THE INVESTMENT FUNDS INSTITUTE OF CANADA | L'INSTITUT DES FONDS D'INVESTISSEMENT DU CANADA

# IFIC Submission

## Re: CSA and CCIR Joint Notice and Request for Comment – Proposed Amendments to National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* (NI 31-103) and to Companion Policy 31-103CP *Registration Requirements, Exemptions and Ongoing Registrant Obligations* (31-103CP) and Proposed CCIR Individual Variable Insurance Contract Ongoing Disclosure Guidance – Total Cost Reporting for Investment Funds and Segregated Funds (collectively, Total Cost Reporting)

July 27, 2022

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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
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Dear Sirs and Mesdames:

**RE: CSA and CCIR Joint Notice and Request for Comment – Proposed Amendments to National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* (NI 31-103) and to Companion Policy 31-103CP *Registration Requirements, Exemptions and Ongoing Registrant Obligations* (31-103CP) and Proposed CCIR Individual Variable Insurance Contract Ongoing Disclosure Guidance – Total Cost Reporting for Investment Funds and Segregated Funds (collectively, Total Cost Reporting)**

The Investment Funds Institute of Canada (**IFIC**) appreciates the opportunity to comment on the consultation for Total Cost Reporting. This comment letter will focus specifically on the Canadian Securities Administrators' (**CSA**) proposals for the securities sector (**Proposed Securities Amendments**) in the proposed amendments to NI 31-103 and 31-103CP.

IFIC is the voice of Canada's investment funds industry. IFIC brings together approximately 150 organizations, including fund managers, distributors and industry service organizations to foster a strong, stable investment sector where investors can realize their financial goals. IFIC operates on a governance framework that gathers member input through working committees. The recommendations of the working committees are submitted to the IFIC Board or board-level committees for direction and approval. This process results in a submission that reflects the input and direction of a broad range of IFIC members.

## Summary

IFIC continues to support expanded cost reporting to investors. IFIC initially indicated its support for expanding annual cost reporting to investors in 2017 so that costs related to fund management fees and operating expenses were more visible to investors. This position has since been supported by research findings. While annual fee and performance statements are received and largely read (91% of investors report receiving a statement of either performance or cost of their investments and 69% state that they read all or most of the statements),[1] many investors mistakenly believe that current annual fee summaries show the total cost of investing, and that the vast majority of investors would prefer total cost reporting.[2] IFIC's position on this remains the same as stated in its 2018 MFDA submission[3] and since then in several public communications with the regulators and the media. IFIC has consistently supported enhanced disclosure of embedded costs in relation to expanding the annual report on charges and other compensation (**Annual Report on Charges**).

However, IFIC does not support the type of expanded cost reporting proposed for quarterly (potentially monthly) client account statements (**Account Statements**). Research by Pricewaterhouse Coopers LLP (**PwC**), which examined the Proposed Securities Amendments, concluded in its report (**PwC Report**) that including investment fund fees in account statements, that are not individualized, not in dollar terms, and not in the context of appropriate performance information, risks confusion and sub-optimal investor choices.[4] In **Appendix E**, we provide a copy of the PwC Report. Through the proposed changes to the Annual Report on Charges under the Proposed Securities Amendments, investors will obtain information on investment funds' embedded fees, properly presented in dollars, broken out at the investor level and contextualized. IFIC believes that investors would prefer to receive this more appropriate expanded cost reporting information in annual rather than quarterly reporting. From the PwC Report, we note that a recent US study suggests the majority of investors would prefer annual rather than quarterly fee reporting.[5] The proposed changes to the Account Statements are not consistent with the theme of regulatory burden reduction that has been adopted by the CSA. There are a number of other aspects of the Proposed Securities Amendments that are not consistent with regulatory burden reduction and those aspects are addressed in this submission, as applicable.

This submission sets out the material elements of IFIC's concerns with the Proposed Securities Amendments for Total Cost Reporting. Also, in **Appendix A**, we respond to the CSA's five specific questions regarding the Proposed Securities Amendments either by cross-references to applicable comments in this submission or directly in Appendix A. In **Appendix D** we summarize the challenges with including the TER in the Annual Report on Charges and Account Statements.

Our feedback is focused on the following key points:

- IFIC is supportive of expanded cost disclosure in the Annual Report on Charges;
- IFIC recommends that the Proposed Securities Amendments not include the proposed changes to the Account Statements because they could be misleading, confusing and/or counter productive for investors;

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1 Innovative Research Group, Inc. (2019). *CRM2/POS 3-year tracking study, September 2019 Report*.
2 Behavioural Insights Team. (2021). *Improving Fee Disclosures for Canadian Mutual Fund Investors*.
3 The IFIC submission to the MFDA's consultation on Expanded Cost Reporting is available here. https://www.ific.ca/wp-content/themes/ific-new/util/downloads_new.php?id=20193&lang=en_CA
4 PricewaterhouseCoopers LLP, *Assessment of the Joint Regulators' enhanced fee disclosure proposal*, July 2022, annexed as Appendix E to this letter, p. 32.
5 PricewaterhouseCoopers LLP, *Assessment of the Joint Regulators' enhanced fee disclosure proposal*, July 2022, annexed as Appendix E to this letter, p. 32.

- The CSA's proposed transition period is inadequate and, if not extended, would introduce significant risks for stakeholders;
- IFIC recommends that the CSA provide a minimum of a 3.5 year implementation timeline, being at least the same timeline that was provided for the introduction of CRM2. Accordingly, the final amendments would come into effect in September 2025 instead of September 2024 (assuming a Q2 2023 final publication and ministerial approvals);
- IFIC recommends that investment fund managers should be permitted to provide dealers with cost information derived solely from their most recent public disclosure documents, and dealers should be permitted to rely solely on such information for providing enhanced cost disclosure, and
- IFIC would be pleased to work collaboratively with the CSA to address IFIC's foregoing recommendation regarding the proposed implementation timeline, and operational and other issues.

IFIC's principal concerns with the CSA proposal are the proposed Account Statement requirements and the unrealistic implementation timeline. To understand this argument, it is necessary to describe fund and client account systems and reporting issues in detail. We hope this detailed information demonstrates the importance for investors of getting expanded cost reporting right by allowing a realistic implementation period.

## Quarterly (or monthly) Account Statement Requirements

As stated above, IFIC has consistently indicated its support for expanded cost reporting so that costs related to fund management fees and operating expenses are set out in annual reporting to investors, specifically as enhanced disclosure in the Annual Report on Charges.

The Proposed Securities Amendments would require the fund expense ratio (**FER**), which is the sum of the management expense ratio (**MER**) and the trading expense ratio (**TER**), to be disclosed as a percentage in the Account Statements for each individual investment held in the account.

IFIC's view is that including the FER as a percentage in Account Statements is not desirable or supported by IFIC because, from an investor's perspective, it could be misleading, confusing and/or counter productive. The Proposed Securities Amendments for Account Statements would result in the provision of mismatched data that is difficult to understand and not properly contextualized, all of which could have negative implications for investors, for the following reasons:

- The inclusion of FER would not necessarily be specific to an investor's circumstances and, therefore, could be incorrect. For example, it would not reflect any management fee rebates/discounts that result from tiered fees based on the investor's individual holdings or aggregate household holdings; rather, the FER information would be determined at the fund series/class level. All other information in Account Statements is personalized to investors. In IFIC's view, meaningful investor FER disclosure should reflect an amount specific to the investor after taking into account all management fee rebates/discounts. This will be accomplished by the enhanced Annual Report on Charges under the Proposed Securities Amendments.
- The requirement to include the FER as a percentage would not be easily understood/put in context by investors, considering the book cost and market value disclosures in their Account Statements are in dollars. The measurements of performance (dollars) and cost (percentage) do not align. Investors typically compare the book cost and market value dollar amounts to determine the aggregate performance return, in dollars. Such aggregate performance will be over a time frame that is short, medium, or long term (depending how long the client has had the account

at the reporting registrant). However, the FER is only for one year. Therefore, the performance period and the FER period do not align. Investors cannot be expected to convert each of performance and cost values on the one hand, and the time periods on the other, to draw their own conclusions regarding, for example, the relationship between annual percentage performance and annual cost. Research suggests that when it comes to percentages, investors tend to neglect small amounts and have a tendency to misinterpret percentages when making decisions around fees and returns.[6]

- The inclusion of the FER for a fund series/class without corresponding annual performance information stated as a percentage for that series/class, lacks proper context and could result in investors drawing incorrect conclusions about the FER. It is IFIC's view that it is misleading to investors to provide them with FER information without investors having the opportunity to consider the information in context. More specifically, the absence of relevant annual performance information stated as a percentage does not enable investors to draw any conclusion about the value proposition of each investment fund holding.

- Investors are well served when provided with the full direct and indirect costs of investing and the performance of their investments. Under the Proposed Securities Amendments, this will be achieved by the enhanced Annual Report on Charges. Therefore, it does not serve an investor's interest to provide less meaningful data, such as the FER on a stand-alone basis in their Account Statements, when more complete cost information will be provided in the Annual Report on Charges, delivered together with the annual investment performance report.

- We note that current Account Statements do not contain any full cost information. The inclusion of FER into those statements would, in certain situations, only reflect part of the cost of investment, which would also make such disclosure potentially misleading. By way of example, for Series F securities of funds, the Account Statements as proposed would reflect the FER, but not the account-based fees charged by advisors outside the fund. This may lead investors to believe that they do not pay any fees related to the fund holding other than the FER. The advisors' account-based fee attributable to Series F securities would only be reflected in the Annual Report on Charges disclosure. Another example would be where short-term trading fees are not reflected in the FER. These too would only be reflected in the Annual Report on Charges.

- IFIC is also concerned about the negative investor outcomes that could result if the proposed amendments to the Account Statements proceed. The PwC Report concluded that, while quarterly reminders of the existence of fees would be effective, they could potentially encourage negative investor behaviors. The PwC Report provides that the saliency of presenting fee information (i.e. losses) on its own can negatively skew investors to become overly focused on the costs, leading to loss aversion or fee aversion.[7] A narrow focus on cost could inappropriately affect the comparison of a fund, to other funds, and banking and other products. So, the stand-alone FER cost information, presented without any context (as described above), could cause investors to unduly focus on costs and lead investors to make counter productive decisions to exit certain fund holdings based solely on the FER information. This could have negative consequences for the investors' investment returns and attaining their long-term investment goals.

- The proposed amendments to the Account Statements would entail a significant

[6] PricewaterhouseCoopers LLP, *Assessment of the Joint Regulators' enhanced fee disclosure proposal*, July 2022, annexed as Appendix E to this letter, p. 25.
[7] PricewaterhouseCoopers LLP, *Assessment of the Joint Regulators' enhanced fee disclosure proposal*, July 2022, annexed as Appendix E to this letter, p. 31.

increase in costs and time for system enhancements for fund managers and dealers. Consistent with the theme of regulatory burden reduction, this type of endeavor should only be undertaken where there are clear, significant, and demonstrable benefits to investors. IFIC does not believe this to be the case in relation to the proposed changes to the Account Statements and considers there to be an imbalance between relatively few potential investor benefits and the related cost and time of implementation. According to PwC, no comparable jurisdictions require quarterly fee disclosures.[8] The PwC Report indicates that PwC did not find strong evidence that the proposal for quarterly disclosures would significantly benefit investors above and beyond what would be included in the Annual Report on Charges. The PwC Report provides that this may be the reason that comparable jurisdictions have not adopted quarterly disclosures of the type contemplated by the Proposed Securities Amendments.[9]

- Securities regulatory authorities have succeeded in creating a very robust disclosure regime for investment funds. At point of sale, investors can readily access MER and TER information about any investment fund in Fund Facts and/or ETF Facts documents. An abundance of research has demonstrated that investors make use of mutual fund and ETF documents, including the CSA-sponsored CRM2/Point of Sale Three-Year Investor Tracking Survey. This survey showed that 69% of investors reviewed Fund Facts with their advisors before making a purchase and that investors rated every section of the Fund Facts document as important for making an investment decision with fee importance at 93%.[10] After the point of sale, investors can also access MER and TER information about any investment fund in the investment funds' Management Report of Fund Performance (MRFP). Fund managers are required to have websites to retain Fun Facts and/or ETF Facts, and MRFP documents. So, the MER and TER of any fund is already publicly available, which makes the proposed new Account Statement reporting redundant. IFIC believes that in terms of receiving after point of sale MER and TER fee information, investors would prefer to receive such information in annual rather than quarterly reporting. A recent US study suggests the majority of investors would prefer annual rather than quarterly fee reporting.[11].
- The FER is not a number that appears in continuous disclosure materials. If the FER is included in the Account Statements, there would be an inconsistency between Account Statements and continuous disclosure materials. We also note that quarterly (or potentially monthly) reporting of FERs would be at a different reporting cycle than MER and TER disclosures in the MRFPs. It is unclear as to why this should be the case, given that the current semi-annual continuous disclosure cycle has always been considered to be adequate. These factors are not in keeping with the concept of regulatory burden reduction. The CSA should not overlay the policy principles of the continuous disclosure regime onto investors' personalized Account Statements. If the regulators' policy concerns behind proposing the addition of the same MER and TER information that is already publicly available in many forms is the immediacy, frequency, and investors' ease of access of such information after the point of sale, see our recommendation below for an alternative solution to that proposed in the Proposed Securities Amendments.

**Recommendations:** IFIC recommends that the Proposed Securities Amendments do not include the proposed changes to the Account Statements. Through the proposed changes to the

[8] PricewaterhouseCoopers LLP, *Assessment of the Joint Regulators' enhanced fee disclosure proposal*, July 2022, annexed as Appendix E to this letter, p. 11.
[9] PricewaterhouseCoopers LLP, *Assessment of the Joint Regulators' enhanced fee disclosure proposal*, July 2022, annexed as Appendix E to this letter, p. 32.
[10] Innovative Research Group, Inc. (2019). *CRM2/POS 3-year tracking study, September 2019 Report*, pp. 74-76.
[11] PricewaterhouseCoopers LLP, *Assessment of the Joint Regulators' enhanced fee disclosure proposal*, July 2022, annexed as Appendix E to this letter, p. 32.

Annual Report on Charges under the Proposed Securities Amendments, investors will obtain applicable information on investment funds' embedded fees, presented in dollars, broken out at the investor level and contextualized. The enhanced Annual Report on Charges will more accurately reflect the investors' actual fees (after management fee rebates and/or householding discounts), personalized to investors' actual circumstances, and presented together with the investors' investment performance reporting.

IFIC also recommends that the CSA instead consider whether their intended purposes for this proposed change to the account statement requirements (i.e. assuming the regulators' concern is the immediacy, frequency, and investors' ease of access of such information after the point of sale) can alternatively be achieved through the CSA's access equals delivery model under review for the investment funds industry. For example, if access equals delivery is implemented, all investment funds' continuous disclosure materials will be posted on their fund managers' websites in an easy to find location. After the point-of-sale transactions of investment funds, investors can be provided reminders that they can find the MERs and TERs for their fund holdings by going to the fund managers' websites (i.e. the same locations that would serve for access equals delivery rules). A blanket reminder could be added to the Account Statements by a future amendment to NI 31-103 should access equals delivery for the investments funds industry be implemented. As a related matter, we note that because of the January 2022 amendments to NI 81-106 *Investment Fund Continuous Disclosure*, investments funds must have a designated website on which investment funds intend to post regulatory disclosure. In the notice publishing the amendments, the CSA stated, "*This requirement provides future opportunities for investment funds to leverage their websites to reduce regulatory burden, while also improving investor access to disclosure*."[12] As a related matter, once SEDAR+ is fully implemented, SEDAR will also serve as easily accessible source for investors to find offering and continuous disclosure materials, such as Fund Facts and ETF Facts documents and MRFPs.

## Practical Implementation Timeline Implications

The Proposed Securities Amendments would require registrants to provide investors with the newly required information in the first quarterly account statements for the period ending December 2024 and in the first Annual Report on Charges for the period ending December 2025. This assumes the CSA's final publication of the amendments would occur and ministerial approvals be obtained by Q2 2023 with a September 2024 effective date. In the consultation notice, the CSA states this equates to a proposed transition period of 18 months (1.5 years) from the date of the final published version to the effective date of the Proposed Securities Amendments. In relation to the CSA's proposed expectation to complete delivery of the first Annual Report on Charges for the period ending December 2025, IFIC notes the CSA's transition period contemplates one incremental year from the proposed effective date (i.e. from September 2024 to December 2025) which we assume recognizes the need for registrants to collect, calculate daily, and store one full year's worth of data for each client to fulfill the client's annual reporting for the Annual Report on Charges (i.e. in total, first delivery of newly required annual information to clients occurs a minimum of 2.5 years from the final published rule (Q2 2023 to December 2025)).

IFIC's view is that the proposed transition period of 18 months is neither reasonable nor practical. The investment fund industry's service provider, Fundserv, and its members (i.e. mutual fund dealers and investment fund managers), have delineated a timeline for necessary procedures and processes for effecting system changes to meet these regulatory amendments and this timeline is longer than the proposed transition period. Based on past experience, these procedures and processes are not flexible. See **Appendix B** for the prototype Fundserv timeline. It sets out a detailed breakdown for the CSA's, Fundserv's, dealers' and fund companies' roles

[12] Page 3 of CSA Notice issued October 7, 2021, contained in OSCB publishing the amendments (8 workstreams) that came into force January 6, 2022. https://www.osc.ca/sites/default/files/2021-10/csa_20211007_41-101_reducing-regulatory-burden.pdf

along with steps to implement a dollar-based or percent-based FER in reporting. This implementation timeline is consistent with previous positions IFIC submitted to securities regulators about practical expectations for an implementation timeline.[13] The version set out in Appendix B is an aggressive transition period timeline – it leaves very little margin for error in the Fundserv and industry's system changes and testing and leaves little incremental time to resolve unanticipated and/or particularly difficult issues.

It is critical to understand that neither Fundserv nor dealers and fund managers can start working on any of their respective system changes until after the final version of the amendments to NI 31-103 is published by the CSA. ***Based on the prototype Fundserv timeline, assuming Q2 2023 for the final published amendments, the shortest possible timeline for registrants to be ready to implement the new requirements (regardless of whether for the Account Statements or the Annual Report on Charges) would be a transition period of a minimum of 2.5 years from the date of the final published version to the effective date of the Proposed Securities Amendments, plus one year for collecting and storing one full year's worth of data required for reporting the newly required information in the Annual Report on Charges (i.e. in total, first delivery of newly required information to clients would occur a minimum of 3.5 years from the date of the final published rule (Q2 2023 to December 2026).*** This transition period would not change, regardless of whether the CSA proceeds with the proposed amendments to the Account Statements.

The CSA's proposed transition period is inadequate and, if not extended, would introduce significant risks for stakeholders for the following reasons:

- It is unreasonable and impractical for any stakeholder who will be involved in the project work required to implement the new client reporting requirements for Total Cost Reporting to begin work *before* the publication of the final amendments. Technology builds require final, clear and detailed mapped out business requirements, which cannot realistically be started until the final rule is published. In order to prioritize a technology build relative to other projects, final rules need to be in place. Further, no system costing can begin until after the business requirements are finalized. Expecting registrants to start their operational and technology change process and system coding with proposed (not final) rule amendments presents the risk that some of the proposed amendments are not adopted or changed in the final rule. These types of changes would result in revising the business requirements document and redoing some or all of previously undertaken coding. This could result in taking more time overall to correct course/revise/recode than starting with the final published requirements, which introduces a higher level of potential operational error. It would also significantly escalate costs compared to starting with the final published requirements. Technology builds also require budget approvals that follow typical corporate governance approval processes. Budget estimates for any regulatory change project, including technology system changes, cannot get approved if they are based on requirements that are not final.

- The PwC Report, reflecting its research findings and examination of the Proposed Securities Amendments, supports IFIC's concern. In particular, PwC observes that in its experience, and from what it heard in stakeholder interviews it conducted with industry participants, budgets for detailed development spends do not reach approval stage until regulations are finalized, particularly where cost estimates are expected to be substantial.[14] Based on PwC's interviews with stakeholders, it estimates that dealer costs to be in the hundreds of thousands of dollars for smaller firms and up to several

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[13] For example, see IFIC's 2018 submission to the MFDA provided by the link in footnote 3. Also, in our pre-consultation communications with the Joint CSA and CCIR Committee, both in writing and in Joint Forum meetings, IFIC consistently shared the same information.

[14] PricewaterhouseCoopers LLP, *Assessment of the Joint Regulators' enhanced fee disclosure proposal*, July 2022, annexed as Appendix E to this letter, pp. 39

million dollars for larger firms.[15] The European Securities and Market Authority (**ESMA**) reviewed expanded fee disclosure requirements in Europe. While overall more complex, the costs were thought to be significant and were referred to as "very costly" in ESMA's report.[16]

- Implementing the Proposed Securities Amendments would require providing and storing new daily factor, both MER and TER, data elements that do not currently exist within dealers, fund managers or their third-party service providers (i.e. to determine FER, expressed as a percentage, at the fund series/class level, and FER, expressed in dollars, at the account level). To implement requirements that involve one or both of the MER and TER new daily factor data elements that are not already part of an existing data file will require material system enhancements across various stakeholders. These system enhancements are both time consuming and expensive, and also present significant operational risk relating to the data and client reporting. It is important to understand that the material system enhancements required by the various stakeholders must be carried out sequentially, and cannot be designed, coded, and published simultaneously or in parallel by each of Fundserv, fund managers, dealers, and third-party service providers.

- The following explains why such material system changes can only be sequentially implemented by each of the industry stakeholders, and is illustrated by the prototype Fundserv timeline provided in Appendix B.

    - Fundserv has set timeframes in which it designs, codes, and publishes system changes. These set timeframes are what largely dictate the practical timelines in which dealers and fund companies could reasonably be expected to carry out their respective necessary system changes to implement expanded cost reporting that includes calculating, storing and reporting FER, expressed as a percentage, at the fund series/class level, and FER, expressed in dollars, at the account level.

    - It is not possible to know what the final Fundserv technical solution is until it is published. Based on the CSA's proposed Q2 2023 publication date of the final amendments to NI 31-103, the earliest for Fundserv to have its final published technical solution (V35 BRD) is in October 2024.

    - Only after that, can dealers and fund managers start in November 2024 to plan their project, perform development, and perform internal testing and re-engineering to be ready to begin industry testing via Fundserv in early March 2025 until December 2025. Overall, this means it takes a minimum of one year (i.e. from November 2024 to December 2025) for fund companies and dealers working with Fundserv to carry out project planning and development, testing and re-engineering to implement technical enhancements and new procedures.

    - Fundserv would be ready for production in June 2025 and the new enhancements would become operational by December 31, 2025. With Fundserv's activation by December 31, 2025, the fund managers can begin January 1, 2026, to send daily factors to dealers and dealers can begin to store the data daily until December 31, 2026. This allows for one full year's worth of data for each client for dealers to complete the final calculations necessary for client level reporting in the Annual Report on Charges for the period ending December 31, 2026.

- Providing new FER data is a major undertaking because it does not exist on the fund

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[15] PricewaterhouseCoopers LLP, *Assessment of the Joint Regulators' enhanced fee disclosure proposal*, July 2022, annexed as Appendix E to this letter, p. 38

[16] *ESMA's Final Report* from March 2020, para. 188, https://www.esma.europa.eu/sites/default/files/library/esma35-43-2126_technical_advice_on_inducements_and_costs_and_charges_disclosures.pdf

managers' transfer agency system, and certainly not at the fund level per investor. It can be calculated only at the fund level on fund accounting systems. Fundserv data standards do not have a file for this data point to be transmitted. Fundserv will need to design and code system programing changes to support fund managers' communication of the daily price files to dealer firms. From a dealer perspective, they do not have or store this data, and certainly not at the fund level per investor. Dealers would have to program to receive and store the new file from Fundserv and to calculate at an investor account level the dollar cost of the FER and then aggregate amounts for each investment fund holding. FER requirements for the Annual Report on Charges will entail numerous variations at each fund and series/class level to take into account management fee rebates and/or householding discounts to create thousands upon thousands of daily price files. Further, dealers will need to redo their entire existing Annual Report on Charges statements to build in the newly required information (i.e. a complete redesign of the table) and adding more definitions to assist investors to better understand the reporting.

- For ETF providers and dealers that sell ETFs, the CSA's proposed transition period could be more challenging because there is currently no infrastructure for the required ETF data transmission, such as Fundserv. Currently, there is uncertainty about how ETF fund managers will communicate the necessary information to dealers whose clients hold ETFs and how such dealers will obtain and store the information. The same problems exist for other types of investment funds such as prospectus-exempt funds, scholarship plans, labour-sponsored funds and foreign investment funds. The need for dealers to resolve and program the necessary data transmission and retention solutions further complicates their overall system builds and programming. This could be a factor in considering the breadth of product shelves. Dealers will wish to commence the system builds only when solutions are available for mutual fund, ETF, and all other types of investment funds at the same time. This could further exacerbate the dealers' implementation timing challenges.
- Unlike CRM2, the changes required to meet the Proposed Securities Amendments for Total Cost Reporting requires new FER data to be created. The CRM2 requirements for two new annual reports did not require new data to be created. All the information already existed, meaning no new calculations or formulas needed to be programmed. The trailer fee information provided by fund managers to dealers was already accounted for and totaled monthly, which meant creating one new field for fund managers to communicate through Fundserv to dealers, at most, twelve times per year. Considering that under CRM2 the CSA provided registrants with a total transition period of 3.5 years (for most registrants – see breakdown in footnote[17]) to implement the two new annual report requirements, it is not unreasonable to consider that industry would need no less than that transition period to implement the Proposed Securities Amendments for Total Cost Reporting. In fact, given the greater complexity of

[17]Description of the CRM2 effective date and transition period:

The CRM2 amendments came into effect on July 15, 2013 with a transition period for the two new annual reports requirements to come into effect July 15, 2016.

Although the effective date for the two new annual report requirements, technically, was July 15, 2016, by the CRM2 FAQs, the CSA explained that so long as the date July 15, 2016 falls within the start and end date of the 12-month period of the two new annual reports period, the registrant satisfies the July 15, 2016 effective date.

Overall, the result is that because most firms (not all though) decided to report on a calendar year basis (i.e., its first reports covered the period January 1, 2016 to December 31, 2016), that meant most firms delivered their first reports to clients in January 2017. Considering this, from July 15, 2013 to December 31, 2016 means registrants had **3.5 years** to implement the CRM2 annual report requirements from the published date of final rules (i.e. 2.5 years for system changes/statement design and 1 year to collect the data needed for the reporting). However, there were some firms who decided to have their first reports cover the period from July 15, 2016 to July 14, 2017, and in such cases, those registrants had **4 years** to implement the CRM2 annual report requirements (i.e. July 15, 2013 to July 14, 2017) implementing Total Cost Reporting, the investment funds industry would be accomplishing far more than what was required to implement CRM2 in the same amount of time that was allocated for implementing CRM2 (a minimum of 3.5 years).

- The practical implications when adding new data elements are impacted by the interdependent roles of Fundserv, fund managers, dealers, print vendors and other service providers. They are as follows:
  - <u>Fundserv</u>: Fundserv will need to add new data fields to be able to exchange information between fund managers, dealers and service providers. Upon the CSA's publication of the final amendments, Fundserv starts Fundserv/industry group meetings to complete writing the draft technical requirements, followed by the Fundserv approval process before publishing the draft technical requirements for industry comments. Once the draft technical requirements are agreed, Fundserv currently operates on a one-year implementation schedule where Fundserv enhancements/new system requirements are completed in draft by July, published in draft for industry comment for the month of August, published in a final business requirement document (BRD) in October, and ready for production in the following June each year. For example, to add any new data fields into the June 2024 final production release, Fundserv would need to complete writing the proposed draft technical requirements (based on a final published rule) by June 2023 (one year in advance). In the case of a project with the size of development that the Total Cost Reporting requirements will take, the final development will take longer than the typical October to June period. Accordingly, Fundserv anticipates the activation of the final production will take additional incremental time (from October 2024 until December 31, 2025).
  - <u>Fund Managers</u>: The complexity of the fund manager changes required will depend on the nature of the requirements under the new rules. For example, to provide either basic fund MER or FER data similar to the disclosure contained in the Fund Facts will require a process to populate the data in back-office systems and transmit it to Fundserv. Following the initial change to data files, a process will be required to maintain or update the data as needed.
  - <u>Dealers</u>: Dealer systems will need to be updated to be able to accept, retain, use and periodically update the new data elements. Changes will be required to the data file that contains the inventory of securities available on the dealer's platform with the associated security details (security master). Changes will be required to the dealer's statement files.
  - <u>Print Vendors and Other Service Providers</u>: Print vendors will need to update their systems to be able to accept and use the new data files. Changes will be required to the statement layout and design. Other service providers may need to adapt functionality to accept new data points and provide calculation services, as deemed necessary. Bottlenecks could arise at major third-party service providers that will be undertaking changes for significant portions of the investment funds industry all at once. Since some of these changes will also need to be done sequentially, it will be particularly important that the implementation period provides sufficient time to build and test the enhanced functionality.
- The CSA's proposed effective date of September 2024 could create a significant operational burden for the industry as it could be dealing with implementing two massive operational change projects to be carried out in parallel. The securities industry in Canada has generally indicated it will follow the SEC's proposed change to move the securities settlement cycle from T+2 to T+1. The move to T+1 for the Canadian securities industry is proposed to be effective the Labour Day weekend in September 2024; now substantially coinciding with the same period proposed for the Total Cost Reporting effective date. The announcement of the US's move to T+1 came before the proposed amendments for Total Cost Reporting. The Canadian investment funds industry is only a subset of the entire US and Canadian securities industry and

therefore had little to no influence on the effective date for the move to T+1 initiative**.**

- Dealing with only one, let alone two, very massive operational change projects, requires significant technology system and process changes. This entails ongoing system developments and modifications, all of which is onerous and resource intensive/constrained. This can create significant risk to a successful implementation. This also presents significant elevated reputational, litigation, client-experience and/or operational risk and a potentially undesirable outcome for investors, fund managers, dealers, and securities regulators if inadvertent inaccuracies occur due to an inappropriately compressed implementation period. Should these risks come to fruition, the remediation measures necessary would be inconvenient and confusing for investors and expensive and time consuming for the investment industry.

**Recommendations:** IFIC's view is that the work described above cannot begin until the regulatory requirements are finalized. As a result, IFIC recommends that the CSA provide a transition period that is a minimum of one year more than is currently proposed, such that final amendments would come into effect in September 2025 (assuming a Q2 2023 final publication and ministerial approvals). This would mean the total implementation timeline would be about a minimum of 3.5 years:

- a minimum of 2.5 years following publication of the final rule to develop, test and implement systems required to calculate the ongoing indirect costs, in dollars, at the investor level, of owning an investment fund and make it available to dealers,
- one additional year thereafter, to allow for the collection of data for a full year prior to the first reporting date. See bolded portion of third paragraph in section *Practical Implementation Timeline Implications* above for a detailed explanation of IFIC's proposed transition period timeline. In practical terms, this would mean that investors would receive the first Annual Report on Charges containing the newly required information for the reporting period ending December 31, 2026.

This is a reasonable transition period timeline, which is necessary to provide adequate time to develop the technology plan and implement it, assuming unforeseen circumstances. IFIC would be pleased to work collaboratively with the CSA to address this proposed implementation timeline and operational and other issues, and recommends that discussions among CSA and industry representatives occur to that end.

## Requirement to Include TER

The Proposed Securities Amendments would require combining the TER with the MER for the FER value used in the calculation to derive the total fund expenses, expressed in dollars, disclosed in the Annual Report on Charges, and to disclose the FER, expressed as a percentage, in the Account Statements

IFIC recognizes that including the TER fulfills the purpose of 'total cost reporting' for the enhanced reporting requirements. In **Appendix D** we summarize the challenges with including the TER in the Annual Report on Charges and Account Statements. The most significant challenges with TERs are that they are highly variable, distorted by significant cash flows, and not typically a significant ratio for investors or a material absolute number.

**Recommendations:** IFIC recommends that the CSA re-consider using the MER alone for calculating fund expenses, rather than the aggregate MER and TER, for the purposes of the Annual Report on Charges. If the TER is included, IFIC supports a single FER ratio for the formula calculation into dollars, and does not support the separate reporting of MER and TER ratios.

As indicated above, IFIC does not support including the TER, MER or FER in Account Statements.

## Duty to Provide Information - Investment Fund Managers

Subsection 14.1.1(3) of the Proposed Securities Amendments require, under their duty to provide a dealer/adviser with the newly required information, that if a registered investment fund manager provides an approximation, the approximation must be determined based on information disclosed in an investment fund's most recently disclosed Fund Facts document, ETF Facts document, prospectus or management report of fund performance, making any reasonable assumptions, unless the factors in subsections (a) or (b) exist.

IFIC's concerns with this subsection 14.1.1(3) are the following:

- Subsection 14.1.1(3) of the Proposed Securities Amendments should set out an objective requirement for investment fund managers which is not dependent on subjective determinations (i.e. the provision should not use "**if** a fund manager provides an approximation, the approximation must be determined based on…"). Also, subsection 14.1.1 (3) (b) introduces subjectivity and should be deleted for the same reason. An objective approach that is consistent with the disclosure requirements in NI 81-101 [*Mutual Fund Prospectus* Disclosure] should be utilized. If this approach is acceptable for offering documents, including Fund Facts documents at the point of sale, it should also be acceptable in the context of determining the information for the dealers to include in the enhanced client reporting. This approach would not require off-cycle data calculations. Consistent with regulatory burden reduction, it would substantially streamline the data collection process and, potentially, system requirements, while reducing litigation risk. It would also make disclosure documents and client enhanced reporting more consistent, thereby reducing unnecessary complexity and investor confusion.
- In an investment fund's initial year of operation, there will be no MER or TER information (unless either or both is capped) until the first MRFP is filed. Accordingly, the first FER would not be available until after that time. This means there is an information gap. For example, for a fund with a December 31 year end, its first annual (December 31) FER would typically only be available 90 days after the fund's year-end (or by March 31), which is after the Annual Report on Charges would be produced.

**Recommendations:** IFIC recommends that this subsection 14.1.1(3) (a) and (b) should be amended as follows:

> "For the purposes of subsection (1), and paragraph 14.14(5)(c.1) or 14.14.1(2)(c.1), ~~if a registered investment fund manager provides an approximation, the approximation must be determined based on information disclosed in an investment fund's most recently disclosed fund facts document, ETF facts document, prospectus or management report of fund performance, unless~~ *a registered investment fund manager must provide information that uses information disclosed* in an investment fund's most recently disclosed fund facts document, ETF facts document, prospectus or management report of fund performance, unless: (a) [*insert same wording as proposed amendments*] ~~or (b) the investment fund manager reasonably believes that doing so would cause the information disclosed in the statement or report to be misleading~~. *If the information is unavailable for an investment fund class or series, such as for a period prior to the first filing of the applicable MRFP information, an investment fund manager must use the fund management fee, administrative fee, and any other fund fees quantified and disclosed in the fund's most recent prospectus to determine the FER*."

This issue, described in the second bullet above, also exists for the Account Statements reporting.

## Disclosure to Describe any Approximations or Other Assumptions

The Proposed Securities Amendments would require dealers to disclose a description of any assumptions or approximations used by fund mangers to calculate the FER (subsections 14.14(5)(c.2) [*account statements*] and 14.14.1(2)(c.2) [*additional statements*]) or the total amount of fund expenses in relation to securities investment funds owned by the client and the total amount of direct investment fund charges (subsections 14.17(1)(p) [*report on charges and other compensation*].

IFIC's view is that it is not reasonably possible for dealers to obtain from fund managers all the various types of assumptions or approximations fund managers may use in determining the information they provide for each fund, and to provide customized and up to date disclosure to clients for each series or class of each fund held in a client's account. This could mean multiple versions of disclosure which could take up too much or a disproportionate amount of space on client statements and be too much information for clients to understand and for dealers to accurately obtain, store, and disclose considering it may change quarterly and annually. It would end up being in the tens or hundreds of versions of disclosure considering it may differ for every class or series of a fund. Such detailed disclosure of assumptions and approximations would likely be incomprehensible and overwhelming to investors. A short standardized explanatory note would be far more likely to be understood.

Approximations or assumptions used by investment fund managers would need to be standardized through rules before it would be reasonable for dealers to be able to provide such disclosure to their clients. Investors that hold fund investments from more than one investment fund manager would likely become confused if there are different disclosures about approximations and assumptions in respect of each fund holding. Moreover, there is often limited space on the Account Statements, which makes multiple disclosures untenable and such disclosures would need to be weighed against the need for other types of statement messages that must be included in a particular account statement cycle, such as regulatory notices for example. If standardized approaches are established, a fund manager could provide one standard description for dealers to include in disclosure statements. A standard description would also be easier for dealing representatives to explain to clients should clients question the disclosure, as opposed to more bespoke and differing disclosures across funds in the client's account.

**Recommendations:** IFIC recommends that the CSA remove this disclosure obligation in each of the three subsections where it is proposed under the Proposed Securities Amendments (i.e. those referred to in the first paragraph of this section). Instead, the CSA should substitute a generic *explain/disclaim* disclosure statement for dealers to include in the same or substantially similar language for the Annual Report on Charges. Some suggested wording is the following:

> *"This information uses data provided by the investment fund managers and is calculated using the investment funds' most recently published information. It may not reflect the actual charges you have indirectly incurred but is a required calculation that is intended to be an approximation.*"

As indicated above, IFIC does not support the proposed changes to the Account Statements. In any event, the above suggested wording should also be considered a reasonable approach.

## Unreasonableness of Dealer Expectations Under New Section 14.17.1

The Proposed Securities Amendments add an entirely new section 14.17.1 [*Reporting of fund expenses and direct investment fund charges]* which, under subsection (2) and (3), shift the obligation on dealer firms to obtain on their own the information which fund managers are obligated to provided under section 14.1.1 [*Duty to provide information – investment fund managers*] if the information the fund manager provides is incomplete or relying on it would be misleading to clients. Dealers are expected to obtain such information by relying on the most recent publicly available information disclosed (i.e. Fund Facts, ETF Facts, prospectus, or MRFP) and if there is no publicly available information or it is more than 12 months old, to make reasonable efforts to obtain the information by other means.

IFIC's view is that section 14.17.1 is overly and unnecessarily burdensome on dealers and advisers, who cannot be expected to be responsible for obtaining and assessing the information which belongs to investment fund managers. Furthermore, it places unreasonable liability on dealers to be responsible for reporting data that they did not create or validate, which ultimately may impact the investor if the information is inaccurate. This could also be a factor in considering the breadth of product shelves. Reasons for our concerns include the following:

- Dealers do not have the tools/information to assess whether information provided by fund managers is misleading.
- It is unclear whether, under subsection 14.17.1(2), dealers are expected to complete the calculations which the fund managers are expected to do using the formula in subsection 14.1.1(2) to derive the daily cost per unit or share of the relevant class or series of an investment fund in dollars and, if so, what is required if reliance on the stated documents would result in potentially misleading information.
- The responsibilities for fund managers as presented under section 14.1.1 [*duty to provide information – investment fund manager*] are diminished by this section.
- The timeliness of information provided by fund managers impacts statement production. There is significant client pressure to deliver statements on time. Therefore, dealers will need a reliable and consistent data source and should not be liable for acquiring information by themselves when caught short by a fund manager's failure of its obligations.
- Fund managers should be responsible for providing the FER related data required by dealers.

**Recommendations:** IFIC recommends that both subsections 14.17.1(2) and (3) be deleted entirely. Subsection 14.17.1 (4) should be revised so it also provides that if the registrant has not obtained the information from a registered investment fund manager within a reasonable period of time, the information must be excluded from the applicable calculations and reporting. In the case where dealers would need to rely on a foreign investment fund manager for the required information, the dealers should also be able rely on subsection 14.17.1 (4).

## Report on Charges and Other Compensation Requirements

The Proposed Securities Amendments would require in the Annual Report on Charges, for the account as a whole:

> the aggregate amount of fund expenses, in dollars, for all investment funds held during the year, and
>
> the aggregate amount of any direct investment fund charges (e.g. short-term trading fees or redemption fees), in dollars.

IFIC is supportive of expanded cost disclosure in the Annual Report on Charges. However, IFIC has the following recommendations:

**Recommendations:**

If the TER is included in the calculation, IFIC recommends that the MER and TER be combined to reflect a single dollar amount, the FER (rather than the separate reporting of each ratio).

Deleting the requirement for dealers to disclose individual, non-standard, descriptions of any assumptions or approximations used by fund managers to calculate the total amount of fund expenses in relation to investment fund units or shares owned by clients and the total amount of direct investment fund charges (subsections 14.17(1)(p) [*report on charges and other compensation*]. See our comments about this on page 13 above under *Disclosure to Describe any Approximations or Other Assumptions*. IFIC's recommendation is the same as that provided on page 13 under *Disclosure to Describe any Approximations or Other Assumptions* above; that a generic *explain/disclaim* disclosure statement for dealers be prescribed to include the same or substantially similar language for the Annual Report on Charges. Suggested wording is provided in the same section on page 13 above.

## Other General Comments

### SRO Rules Permitting Combined Account Statements and Annual Reports

MFDA Rule 5.3.5 (Delivery of Report on Charges and Other Compensation and Performance Report) allows for the combining of the account statement, performance report and annual report on charges. Some dealers may be reporting charges and other compensation quarterly, combined with the account statement. Clarity is required as to whether this rule will be retained under the consolidated SRO.

### CSA's Sample Prototype Report (Annex G of the consultation materials)

IFIC is supportive of the CSA not making it mandatory for registrants to use the sample prototype of the Annual Report on Charges provided in Annex G of the consultation materials. There should be flexibility for dealers on the presentation of this material. Dealers will be building on their existing forms of such report, which they previously created and designed under CRM2 and with which clients are already accustomed. It would be more time consuming and costly, and potentially confusing to clients if dealers were required to completely redo the approach and style of their existing reports to conform to a mandatory form. Flexibility is consistent with the fact that firms of various sizes and models have tailored their disclosure to be most helpful to their respective client bases. Also, their registered representatives are familiar with their existing forms and have been trained to discuss them with their clients.

Nevertheless, IFIC has some concerns with the CSA's sample prototype of the Annual Report on Charges. While the information in the tables is correct, the presentation could be misleading. The presentation raises the issue of potential double counting because a client could add the prominently displayed "Your total cost of investing" amount in the "What you paid" table and the "Total we received for advice and services we provided to you" amount in the "Our Compensation" table. This could lead to an incorrect perception that results in a perceived overstatement of the total cost of investing. Specifically, this stems from one over-riding concern, which is using two tables to separate the cost reporting (i.e. Your Cost of Investing, in terms of "What you paid") from the "Our Compensation" (i.e. what the client paid to the dealer) as the inter-relationship between the two tables is unclear. More specifically, it would be unclear to some investors that Fund Expenses includes the trailing commissions and, given that trailing commissions are reported in the "Our Compensation" table, there would likely be some double counting of the trailing commissions. This could lead to negative consequences for investors that act on erroneous beliefs.

See **Appendix C** for IFIC's proposed alternative prototype Annual Report on Charges which is a modified version of the IFIC prototype included in the IFIC 2018 Submission to the MFDA's Discussion Paper on Expanded Cost Reporting [18] This prototype assumes MER alone reporting. It is for illustrative purposes only and could be one of many forms used. It creates a single "Costs and Compensation Report" which breaks down all client costs, both direct and indirect, into two

[18] See footnote 3.

groupings: costs paid indirectly to the investment fund manager(s) and/or the investment fund; and costs or compensation paid directly and indirectly to the dealer. The total of these groupings represents the full cost of investing to the client. It removes the concern of an investor mistakenly overstating the total costs by adding totals from two separate tables together. This approach provides better disclosure by separating the elements of investment management fees, fund operating expenses and miscellaneous costs on the one hand and dealer related costs on the other.

**Costs of the Proposed Amendments**

As the CSA noted in 6.(b) of Annex I in the consultation materials, the anticipated cost of the Proposed Securities Amendments includes "investment fund companies or, possibly, dealers and advisers, may seek to pass implementation costs on to investors by increasing management fees or introducing some kind of new fee".

**Recommendation for Future Complex Rule Implementation**

Rule implementation in the investment funds industry can be an extremely complex undertaking, including complicated technology builds. Proposals like CRM2, the order execution trail ban and total cost reporting highlight the importance of identifying implementation barriers and assessing solutions in a timely way.

IFIC recommends that the CSA establish an implementation standing committee (**ISC**) for complex rule changes. The ISC would not debate the regulatory objectives. Rather it would focus on the technology and operational issues. The ISC would be comprised of CSA and industry experts. Industry expertise would be recruited from the operations and technology groups of investment fund managers and dealers as well as third party service providers that make up the overall technology ecosystem. The role of the ISC would be to expeditiously review the new regulatory proposals to identify the technology constraints, barriers, realistic implementation timelines.

Ultimately the CSA will decide the implementation timeline but only after a careful review by the ISC. In this way the CSA and the industry will less likely be at odds publicly over timelines. Furthermore, the timeline would have the support of those who will have responsibility to actually ensure the regulatory objective as proposed by the CSA is achieved

* * * * *

IFIC appreciates this opportunity to provide our input to the CSA on this important initiative. Please feel free to contact me by email at pbourque@ific.ca or by phone 416-309-2300. I would be pleased to provide further information or answer any questions you may have.

Yours sincerely,

THE INVESTMENT FUNDS INSTITUTE OF CANADA

By: Paul C. Bourque, Q.C, ICD.D
President and CEO

# APPENDIX A

## CSA's Five Specific Questions for Comment for the Securities Sector

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?*

Yes, see IFIC's comments in the submission in the first bullet/middle page 9 and page 14 (in the recommendations) for issues related to foreign investment funds, and in the first bullet/middle page 9 for issues related to ETFs.

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?*

Yes. See IFIC's comments and recommendations on page 11 above in the submission under the section *Requirement to Include TER* and Appendix D.

3. *For the purpose of subsection 14.1.1(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?*

Yes, the use of net asset value is more appropriate to use, for both mutual funds and ETFs.

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

Yes, see all of IFIC comments and recommendations in the submission above.

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

Yes. See IFIC's comments and recommendations on pages 6 – 11 in the submission under the section *Practical Implementation Timeline Implications*.

## APPENDIX B

### Prototype Fundserv Schedule for CSA, Fundserv, and Dealers & Fund Companies to Implement a Dollar-Based or Percent-Based MER in Reporting

| | July 2022 | Q2 2023 | July 2023 | August to Jan 2024 | Feb to April 2024 | June 2024 | July 2024 | August 2024 | Sept 2024 | Oct 2024 | Nov 2024 | March 2025 to Dec 2025 | June 2025 to Dec 2025 | Jan. 1 to Dec. 31 2026 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| CSA | End of 90 Day comment period | Incorporate comments, get royal assent and Publish Final | | | | | | | | | | | | |
| Fundserv | | | Call for Working Group Members | Six months Working Group meetings | Advisory Councils and SSC Review Solution for Fit | Annual SSC Vote on full Scope for V35 June 2025 implementation | Fundserv completes writing technical requirements For V35 | Publish Draft V35 BRD for 30 Day Comment Period | Incorporate feedback and SSC approve revised V35 BRD | Publish Final V35 BRD | V35 Project Planning and Dev begin | Support Industry-wide UAT testing | Fundserv Ready for Production June 2025, and activates by Dec 31 2025 | |
| Dealers & Fund Co's | | Review Final | Join Working Group | Working Group | | | | Members and Service Providers provide feedback | | | V35 Project Planning and Dev and Process Re-engineering begin with vendors begin | V35 UAT Testing and Procedure Process Re-engineering | Implement Technical Enhancements and new procedures | Fund Co's begin to send daily factors. Dealers store and ready for client level reporting for period ending Dec 31st, 2026 |

**Challenge for Dealers and Fund Companies (Fundserv Members):** Technical systems solutioning cannot begin until final amendments are published. Based on CSA's publication of the final amendments sometime in Q2 2023, the dealers and fund companies won't know what the final Fundserv technical solution is until Fundserv publishes it – earliest is October 2024. That means dealers and fund companies can only start their projects in November 2024 to then plan their project, perform development, perform internal UAT and then get ready to begin industry UAT via Fundserv to be ready for Fundserv Production to activate December 31, 2025. Only once Fundserv activation is in place by Dec 31, 2025, fund companies can then begin to send daily factors to dealers and dealers will need to store the data from January 1 to December 31, 2026 to collect data for a full reporting year. Early feedback from members is that this is an extremely large development. The data does not exist on the fund company transfer agency system at the investor fund position level. It is only calculated at the fund level on their fund accounting systems. Fundserv data standards do not have a file for this data point to be transmitted. From a dealer perspective, they do not have or store this data. They would have to program to ingest the new file from Fundserv and then calculate at an investor account level the dollar cost of the MER by summing it from the various fund companies. **Hence, although Fundserv would likely be ready by June 2025 and activates by December 31, 2025, dealers and fund companies would need some incremental time from January 1 to December 31, 2026 to collect data for a full reporting year, implement technical enhancements and procedures, project plan, develop, internally test, and finalize production for client account level reporting requirements.**

## APPENDIX C

### IFIC Prototype Annual Report on Charges and Other Compensation [modified version of the IFIC prototype included in the IFIC 2018 Submission to the MFDA's Discussion Paper on Expanded Cost Reporting]

**Liberty Financial**
**Annual Report on Costs and Compensation**
**For the period ended December 31, 2026**

Jane Q Public
123 Main Street
Chatham, ON
Canada N3T 8A9

**Your RRSP Account 12345678**

**Your Total Costs to invest during 2026: $796.99**
This report provides a breakdown of your total costs to invest during the year. These costs are paid directly and indirectly to us (Liberty Financial) for administrative costs and services, including financial advice, and indirectly, through the investment funds you invest in, to parties such as the investment fund companies that manage the investment funds you own.

| | Cost ($) |
|---|---|
| **Amounts you indirectly paid to Investment Fund Manager(s) and / or Investment Fund(s)** | |
| Investment management fees and expenses ("MER")[1] | $671.78 |
| Less: management fee rebates | $(44.79) |
| Less: trailing commissions paid to Liberty Financial[2] | $(298.57) |
| Net management fees & expenses | $328.42 |
| Short-term trading fees paid on the sale of investments | $20.00 |
| Redemption fees paid on the sale of deferred sales charge investments[3] | $50.00 |
| **Net paid to Investment Fund Manager(s) and/or your Investment Fund(s)** | **$398.42** |
| **Amounts paid to Liberty Financial** | |
| Trailing commissions received from investment fund manager(s) [2] | $298.57 |
| Account administration and operating fees | $60.00 |
| Front-end sales commissions | $25.00 |
| Switch fees | $15.00 |
| **Net paid to Liberty Financial** | **$398.57** |
| **Total costs to invest during 2021** | **$796.99** |

[1] **Fund Expenses:** Fund expenses are made up of the management fee and operating expenses. You don't pay these expenses directly. They are periodically deducted from the value of your investments by the companies that manage and operate those funds. Different funds have different fund expenses. They affect you because they reduce the fund's returns. These expenses add up over time. Fund expenses are expressed as an annual percentage of the total value of the fund. These costs are already reflected in the current values reported for your fund investments.

The number shown here is the total dollar amount you paid in management fees and operating expenses for all the investment funds you owned last year. This amount depends on each of your funds' fund expenses and the amount you invested in each fund. Your account statements show the fund expenses as a percentage for each fund you hold.

[2] **Trailing commissions:** Investment funds pay investment fund companies a fee for managing their funds. Investment fund companies pay us ongoing trailing commissions for the services and advice we provide you. The amount of the trailing commission for each fund depends on the sales charge option you chose when you purchased the fund. You are not directly charged for trailing commissions. They are paid to us by investment fund companies.

[3] **Redemption fees on DSC investments**: You paid this cost because you redeemed your units or shares of a fund purchased under a deferred sales charge option (DSC) before the end of the redemption fee schedule and a redemption fee was payable to the investment fund company. Information about these and other fees can be found in the prospectus or fund facts document for each investment fund. The redemption fee was deducted from the redemption amount you received.

[insert if applicable and included in table above] **Direct investment fund charges:** [insert description of such charges]

*This information uses data provided by the investment fund mangers and is calculated using the investment funds' most recently published information. It may not reflect the actual charges you have indirectly incurred but is a required calculation that is intended to be an approximation.*

## APPENDIX D

### Issues with Reporting TER

i. Unlike MERs, TERs will change when a fund makes changes to its investments for any reason, including to invest net cash inflows, fund net cash outflows and change portfolio holdings. As such, the TER could change daily or frequently, whereas MERs are typically stable year over year. Accordingly, using the most recently published TER is inherently less precise than using the most recently published MER. In any event, calculating TERs at the investor account level would be extremely difficult as it requires tracking daily trading activity of both investors and funds and allocating the TER to each investor based on the most recently published information.

ii. Applying a current TER calculated as at a point in time (e.g. month or quarter end) would lack precision as well. For example, investor A and B purchase securities of a fund on February 1 and March 15, respectively. The fund only trades its portfolio on February 25. The actual TERs for Investor A and B are different at the end of the quarter as there has been no trading in the fund while B has been invested (March15 - March 31) and accordingly B's TER is 0%, whereas investor A's TER will be the full cost of the trade on February 25. While this example is simple as we have assumed two investors and only one trade by the fund over the period, it is far more challenging to calculate a customized TER for thousands of clients and thousands of fund trades, each of which change over time. While it may be possible to take the average TER of the fund over the quarter and report that to investors, that would be inaccurate. As in our example of client B, the client would not pay any trading expenses, but the average TER would result in his or her investment reflecting an inaccurate trading cost.

iii. The TER could be far more influenced by fund flows which can be highly variable than by typical portfolio trading, and therefore, IFIC questions the meaningfulness of the data for the investor.

iv. TERs can be distorted by significant cash flows, such as in a fund's early year(s) of operation, when large cash inflows relative to existing assets are invested or when there are large redemptions relative to existing assets. Therefore, the inclusion of the TER would distort the FER values where a client's holdings are in a fund's early year(s) of operation. In fact, in an investment fund's first year of operation, there would be no historic TER.

v. The required TER data is not available for underlying US and European investment fund holdings, which would be an impediment to calculating top funds' TERs.

vi. TERs are not typically a significant ratio for investors or a material absolute number. Breaking out TERs and MERs separately would likely be confusing to many investors. According to the PwC Report, percentage information is generally poorly understood by investors[19]. Creating additional percentage factors would likely compound this comprehension issue for investors.

vii. The need for potential daily tracking of trading commissions and allocation at the account level could add material complexity and costs to systems development, for little marginal value to investors, particularly given the potential for lack of precision.

[19] PricewaterhouseCoopers LLP, *Assessment of the Joint Regulators' enhanced fee disclosure proposal*, July 2022, annexed as Appendix E to this letter, p. 25.

# Assessment of the Joint Regulators' enhanced fee disclosure proposal

**July 2022**

pwc

Creating leaders, inspiring people and bringing perspectives together to achieve what matters most.

# Contents



# Executive summary

**PwC was engaged to assess the Joint Regulators' enhanced fee disclosure proposal**
On April 28, 2022, the Joint Regulators of the Canadian Securities Administrators (CSA) and the Canadian Council of Insurance Regulators (CCIR) ("the Joint Regulators") issued a notice of proposed amendments to fee disclosure requirements in Canada. This report focuses specifically on the proposals to the securities sector (the "Amendments"), and not the insurance sector.

The regulators are proposing the Amendments in order to address concerns they have identified in the current disclosure requirements. The Amendments are proposed to come into effect in September 2024 and are designed to enhance investor protection by increasing investors' awareness of fees.

The Amendments require adding the following key elements to existing fee disclosures:

- in a quarterly account statement (or additional statement as appropriate), the fund expense ratio (the sum of the management fund expense ratio (MER) and trading expense ratio (TER)), stated as a percentage for each investment fund held by the client; and
- in the annual report on charges and other compensation ("Annual Report") for the account as a whole:
- the aggregate amount of fund expenses, in dollars, for all investment funds held during the year; and
- the aggregate amount of any direct investment fund charges (e.g. short-term trading fees or redemption fees), in dollars.

The Joint Regulators are requesting comment on the Amendments described above. The Investment Funds Institute of Canada (IFIC) has engaged PricewaterhouseCoopers LLC ("PwC," "we," or "us") to conduct research that will inform IFIC's response to the Joint Regulators. Below we present our key findings.

**Behavioural research suggests that investors will benefit from enhanced fee disclosure, especially in annual reporting**
We reviewed available behavioural economics research and surveys to assess how investors may respond to the proposed disclosure enhancements. Overall, the evidence suggests that the Amendments will increase investors' awareness and understanding of fees. In particular, the following factors included in the Amendments will be beneficial for investors:

- clear descriptions of fees and their purpose will help to improve awareness;
- simplified language in explanatory notes are necessary to reduce cognitive costs;
- unpacking embedded investment fees from the total cost will improve transparency and comprehension; and
- In the eyes of investors, dollars feel more concrete than percentages, making them more likely to be factored into investment decisions.

In our view, the Joint Regulators should consider adding the following elements to help better achieve their goals of enhancing investors' understanding of fees:

- cost disclaimers and educational statements about the relationship between fees and returns, which will help direct investors' attention to fee importance; and
- visualization to help facilitate the understanding between fees and other account information such as returns, as well as to make fund net returns comparisons over time.

**We did not identify strong evidence in favour of quarterly fee disclosure**
Quarterly statements would be effective reminders about the existence of fees, but have the potential of encouraging negative investor behaviours. Overall, we did not find strong evidence that the Joint Regulators' proposal for quarterly disclosures would significantly benefit investors above and beyond what would be included in the Annual Reports. We also note that no other country requires quarterly fee disclosures.

# Executive summary

In comparison, fee disclosures in Annual Reports would bring greater benefits to investor comprehension because of the opportunity to contextualize fees. Annual Reports are an ideal medium for fee disclosure due to the presence and completeness of other fund or account-level information that is provided together with client account-level performance reporting, and this helps reduce the likelihood of loss aversion and fee aversion for investors. Investors have also been found to have a preference for annual over quarterly reporting (61% versus 34%). Jurisdictions that currently require annual fee reporting are not requiring such quarterly reporting, which further supports the notion that quarterly reporting is not considered to provide net benefits to investors.

**EU and UK experiences provide insight on the impacts of disclosing investor-level fees and trading fees**
The EU and UK, which are largely governed by the same regulatory framework, are the only markets we identified globally as having similar disclosure requirements to the annual disclosures proposed by the Joint Regulators. In particular, these markets require investor-level disclosures in dollar terms, and disclosure of trading expenses, and can therefore be informative on the potential impacts of the Amendments in Canada. Through our consultation with the EU and UK industry, we found that investor-level disclosure has benefitted investors by creating more fee transparency.

**The Amendments go beyond what is required annually in Australia and the US**
Australia has similar annual disclosure requirements to the Amendments, in that disclosure is required at the investor level in Dollar terms. Furthermore, while it is not a requirement to explicitly disclose trading expenses in Australia at the investor level, the “buy/sell spread” of the product is disclosed as part of the periodic statement requirement for Annual Reports.

Meanwhile, the US currently has no Annual Report requirement for such fee disclosure.

**Investors are sensitive to changes in fees**
In terms of investor-level fee disclosure, industry representatives in the Reviewed Jurisdictions noted that the only significant change in the behaviour of retail investors resulting from this disclosure was a broader sensitivity to fees. According to these representatives this has led to a shift away from higher-fee funds, which may ignore the funds’ performance (net of fees) and its value to investors. We note that this is not a product of the disclosure per se, but wider attitudes toward fees. Industry representatives noted that trading expenses were difficult for investors to interpret, and that they could be misleading when added together with other fees.

**Industry will incur costs in adopting the Amendments**
We held discussions with industry participants to understand how they expect to be impacted by the Amendments. Costs to industry are an important consideration because, ultimately, these costs are often passed onto investors to some degree. Although the MER and TER information required for the new disclosure calculations exists in the Fund Facts and ETF Facts documents, developing the new statements proposed will require significant changes in data processes, particularly for Annual Reports.

These Amendments will affect fund manufacturers, third party providers such as Fundserv, and dealers, as well as the ecosystem of service providers and outsource agents for the industry; however, we found that the majority of the cost and operational impacts will be shouldered by dealers. Dealers expect that the changes will be substantial, and that they will depend on the size of the dealer, the number of products they have and other complexities.

Greater impacts are anticipated for dealers using exchange-traded funds (ETFs) because, unlike mutual funds, a different data process will be required as a result of different intermediary participants and as of yet no clear solution has been proposed to enable the data process.

# Executive summary

Industry members anticipate that the required system changes across the industry from Mutual Fund Manager through to dealer would likely take up to two years when including time for finalizing data protocols, system build, testing, and finalization. This is because no process currently exists and would have to be developed. Additionally, after the system changes have been put in production, the new systems will need to collect a calendar year of data in real time in order to prepare the initial Annual Reports. In total, adopting the Amendments may take approximately three years, and some industry participants expected that the timeline could extend as long as four years following regulations being finalized. As noted above, ETFs face additional complications in adoption and may require more time for implementation timelines as a result.

While no direct comparisons are available for the timelines in implementation of the Amendments, the industry can look at the time taken to implement CRM2 as guidance. According to the Ontario Securities Commission (OSC), the CRM2 Amendments[1] came into force in July 2013, with them coming into effect for the new Annual Report requirements in July 2016.[2] Furthermore, given most firms were reporting on a calendar-year basis, the first time these amendments were passed onto clients was in January 2017 (reflecting the January 1 - December 31, 2016 year). This means that in practical terms, three and a half years passed (for most firms) between the published date of the finalized rules and the implementation of CRM2.[3]

We also note that industry will not be able to begin to implement the transition until the regulatory proposals are finalized. Our experience with regulatory change, as well as what we have heard from our industry interviews, is that budgets for the detailed development spend do not reach approval stage until regulations are finalized and therefore no longer subject to change, particularly where cost estimates are expected to be substantial. As a result, detailed progress on building solutions is only likely to commence after that point.

1 Defined by OSC as “National Instrument 31-103 Registration Requirements, Exemptions and Ongoing Registrant Obligations (NI 31-103) and its Companion Policy (CP) relating to cost disclosure, performance reporting and client statements”.

2 OSC (2014) Planning tips for implementing the “CRM2” amendments to NI 31-103 registration requirements, exemptions and ongoing registrant obligations, Available at: https://www.osc.ca/sites/default/files/2021-11/eb_20140307_crm2-faq-published.pdf

3 OSC (2016) CSA Staff Notice 31-345 - Cost Disclosure, Performance Reporting and Client Statements - Frequently Asked Questions and Additional Guidance, Available at: https://www.osc.ca/en/securities-law/instruments-rules-policies/3/31-345/csa-staff-notice-31-345-cost-disclosure-performance-reporting-and-client-statements-frequently

# Introduction

## Background

On April 28, 2022, the Joint Regulators of the Canadian Securities Administrators (CSA) and the Canadian Council of Insurance Regulators (CCIR) ("the Joint Regulators") issued a notice of proposed amendments to the fee disclosure requirements in Canada. This report will focus specifically on the proposals to the securities sector and not the insurance sector (the "Amendments").

The regulators are proposing the Amendments in order to address concerns they have identified in the current disclosure and performance requirements. Specifically the regulatory notice describes regulators' concerns about the following:

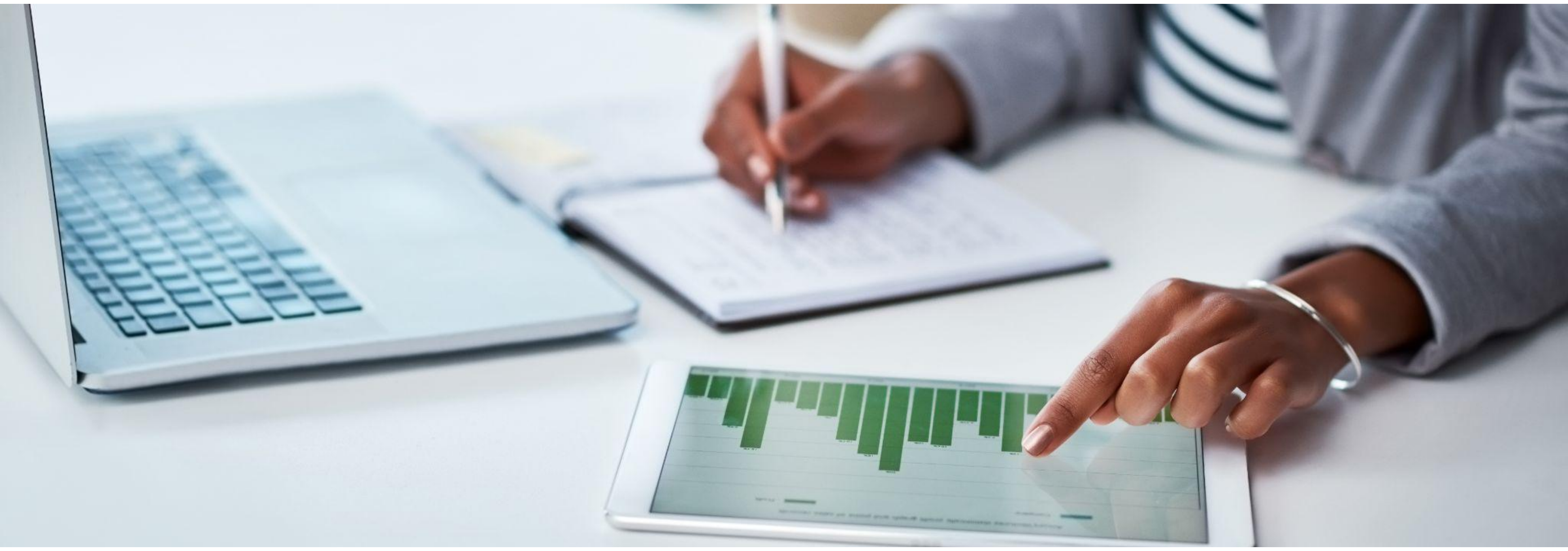
- There are no current requirements for the securities industry to provide ongoing reporting to investors on the costs after the initial sale of the investment product, in a form which is specific to the individual's holdings and easily understandable.
- There are concerns, based on research by the Ontario Securities Commission's (OSC) Investor Office and the Behavioural Insights Team, a social-purpose company part-owned by the U.K. Government, that Canadian investors assume that investment funds' embedded fees are included in the sample Annual Charges and Compensation Report, when this is not the case.[4] This is based on evidence from CRM2 adoption.[5]
- It is also suggested that more cost transparency in the industry may encourage more competition, which would benefit investors.

The Amendments are proposed to come into effect in September 2024 and are designed to enhance investor protection by increasing investors' awareness of fees. The Amendments recommend adding the following key elements to existing fee disclosures:

- in a quarterly account statement (or additional statement as appropriate), the fund expense ratio (FER) (the sum of the management fund expense ratio (MER) and trading expense ratio (TER)), stated as a percentage for each investment fund held by the client; and
- in the annual report on charges and other compensation ("Annual Report") for the account as a whole:
    - the aggregate amount of fund expenses, in dollars, for all investment funds held during the year; and
    - the aggregate amount of any direct investment fund charges (e.g. short-term trading fees or redemption fees), in dollars.

4 According to the OSC report, this sample annual fee report was "included as Appendix D to Companion Policy 31-103CP, Registration Requirements and Exemptions (31-103CP)." The OSC study is available at: https://www.osc.ca/sites/default/files/pdfs/irps/sn_20190819_11-787_improving-fee-disclosure-through-behavioural-insights.pdf

5 CRM2, or Client Relationship Model 2, is a set of rules for Canadian investment dealers and advisors that was implemented in 2017.



# Introduction

## Scope and methodology

The regulators are requesting comment on the Amendments described above. The Investment Funds Institute of Canada (IFIC) has engaged PricewaterhouseCoopers LLC ("PwC," "we," or "us" "our") to conduct research that will inform IFIC's response to the regulators. PwC's scope is divided into three elements. The table below presents the scope and methodology for each element.

**Table 1: Our scope and approach**

| Scope | Our approach |
| --- | --- |
| Jurisdictional review: Compare Canada's current and proposed fee disclosure requirements with major securities markets globally, focusing on the UK, Europe, US, and Australia. | ● Reviewed materials relating to the subject matter.<br>● Performed additional secondary research, to provide a comprehensive picture of requirements in all jurisdictions included.<br>● Undertook interviews with IFIC's counterparts in different jurisdictions and specialists from PwC's international network firms to confirm and augment our understanding of fee disclosure requirements. |
| Impact on investors: Summarize existing research on how the Amendments may impact investors' understanding of fees and behaviour. | ● Reviewed findings on disclosure practices from behavioural science organizations.<br>● Canvassed government reports, industry white papers, and surveys about investors, fees, and disclosures.<br>● Examined peer-reviewed academic journal articles concerning investor behaviour and fee disclosures |
| Impact on industry operations: Assess at a high level the potential impacts of the Amendments on industry operations. | ● Interviewed Fund Managers (i.e. Mutual Fund Managers and ETF Managers), dealers, and service providers to understand potential impacts on industry.<br>● Performed additional secondary research, such as on industry impacts from previous changes in legislation. |

## Limitations

Our findings are subject to the methodology and assumptions described in this report, and the limitations described in Appendix B: Limitations. This report has been prepared solely for the use and benefit of, and pursuant to a client relationship exclusively with IFIC. IFIC may share this report with third parties only in its entirety. No person or entity shall place any reliance upon the accuracy or completeness of the statements made herein. In no event shall PwC have any liability for damages, costs or losses suffered by reason of any reliance upon the contents of this report by IFIC or any other person.

# Jurisdictional review

# Jurisdictional review

## Introduction

As described in the introduction, the Joint Regulators are proposing additional disclosure requirements for retail investors in funds in two documents: Quarterly account statements and Annual Reports. In this section, we compare the current and proposed disclosure requirements in Canada to the disclosure requirements globally. To this end, we reviewed the following jurisdictions: Australia, the European Union (EU), the United Kingdom (UK) and the United States (US), for both quarterly account statements and Annual Reports (referred to in this report as the "Reviewed Jurisdictions"). We complemented this review with a high-level assessment of other global securities markets, but our focus was mainly on the Reviewed Jurisdictions.

In consultation with IFIC, we selected the Reviewed Jurisdictions because they represent countries with developed financial systems, for which reliable sources of information exist.

Our jurisdictional review consisted of interviews with industry specialists from our PwC network in the UK, US, Australia and the EU, as well as IFIC counterparts in the UK (the Investment Association) and the EU (EFAMA). We supplemented this with secondary research.

## Key findings

Currently, no quarterly fee reporting is required in Canada. This is aligned with the Reviewed Jurisdictions: none of these countries require fee disclosure on a more frequent basis than annually, except in situations where fees have changed. Therefore, the Amendments would mean that the Canadian securities market would be the only global market requiring quarterly FER reporting.

For annual fee disclosures, the Amendments would align Canadian requirements to the UK and the EU, where trading expenses are reported on an annual basis at the investor level. Current Canadian requirements go beyond what is required in the US, where there are no requirements to disclose annual fees.

In terms of investor-level fee disclosure, industry representatives in the Reviewed Jurisdictions noted that the only significant change in the behaviour of retail investors resulting from this disclosure was a broader sensitivity to fees. According to these representatives this has led to a shift away from higher-fee funds, which may ignore the funds' performance (net of fees) and its value to investors. We note that this is not a product of the disclosure per se, but wider attitudes towards fees. Industry representatives noted that trading expenses were difficult for investors to interpret, and that they could be misleading when added together with other fees.

## Quarterly statements jurisdictional review

**Current and proposed requirements in Canada**

According to the current legislation, Canadian dealers and advisors are required to send account statements to their clients. This is typically done on a quarterly basis, but can also be monthly. Information should include the: "book cost and current market value of each security in the account and the total book cost and market value of all securities in the account, as well as any cash balance and a notification on any security that might be subject to a deferred sales charge if sold."[6]

6 CSA and CCIR Joint Notice and Request for Comment, Available at: https://www.ccir-ccrra.org/Documents/View/3700

# Jurisdictional review

The Joint Regulators are proposing to require an additional account disclosure of fees to investors on a quarterly basis. The new account disclosures would include Fund Expenses (MER+TER), in percentage terms for each individual investment with embedded fees.

The information required for the new disclosure calculations (MER and TER) exists in Fund Facts documents, which are widely used by consumers. However, while Fund Facts present MER and TER at the fund level as a point of sale document, the Amendments require disclosure on an ongoing basis, and thus aim to use the regular quarterly statement process to achieve this. This is further explored in the Impact on Investor section.

The Figure below shows a sample prototype quarterly statement for the securities sector, from Annex G of the Joint Notice.

**Figure 1: Sample prototype quarterly statement for the securities sector (highlighting shows new information)**

**Dealer ABC Inc.**

Your Account Number: 123-4567

**Holdings in your account**
**On December 31, 2020**

**Portfolio Assets**

| Description | Shares Owned | Book Cost | Market Value | Current gain or loss | Fund Expenses[1] | % of your holdings |
|---|---|---|---|---|---|---|
| **Investment Funds** | | | | | | |
| ABC Management Monthly Income Fund, Series A FE | 250.00 | $17,000.00 | $19,500.00 | $2,500.00 | 1.00% | 41.49% |
| ABC Management Canadian Equity, Series A FE | 450.00 | $19,500.00 | $22,500.00 | $3,000.00 | 2.00% | 47.87% |
| **Equities** | | | | | | |
| Company A N/A | 100.00 | $2,000.00 | $3,000.00 | $1,000.00 | | 6.88% |
| Company B N/A | 50.00 | $1,500.00 | $2,000.00 | $500.00 | | 4.26% |
| **Totals** | | **$40,000.00** | **$47,000.00** | | | **100.00%** |

1. Fund expenses are made up of the management fee, operating expenses and trading costs. You don't pay these expenses directly. They are periodically deducted from the value of your investments by the companies that manage and operate those funds. Different funds have different fund expenses. They affect you because they reduce the fund's returns. These expenses add up over time. Fund expenses are expressed as an annual percentage of the total value of the fund. They correspond to the sum of the fund's management expense ratio (MER) and trading expense ratio (TER). These costs are already reflected in the current values reported for your fund investments.

Source: CSA and CCIR Joint Notice and Request for Comment

# Jurisdictional review

**Comparison of Canada to the Reviewed Jurisdictions**
The table below outlines the differences in the types of fees between Canada's quarterly account disclosure requirements and the Reviewed Jurisdictions.

**Table 2: Quarterly investor-level product fee disclosure requirements by jurisdiction**

| Cost type | Canada (present) | Canada (proposed) | Australia | EU | UK | US |
|---|---|---|---|---|---|---|
| Monthly or quarterly investor-level product fee reporting required? | No | Yes | No | Only following a change in fees | Only following a change in fees | No |

As shown in Table 2, quarterly or monthly fee disclosure is not currently a requirement in any of the Reviewed Jurisdictions. As a result, we are not able to analyze the experience of the Reviewed Jurisdictions with respect to quarterly disclosures.

In the US, which is the world's largest securities market, while investment advisors typically bill for their advice services on a quarterly basis, there is no quarterly requirement to disclose fees for investment products in an investor's portfolio.

**Other global markets**
Globally, based on our review of the Morningstar 2020 Global Investor Experience Study, and other secondary sources, we identified no other examples of quarterly fee disclosure requirements at the investor level.

## Annual Reports jurisdictional review

**Current and proposed requirements in Canada**
Currently, Canadian dealers are required to deliver Annual Reports to each of their clients containing the aggregate amounts (in dollars) paid to them for their services (e.g. trading fees and account operating charges). They are also required to disclose any additional compensation paid to the firm by third parties in relation to the client's account (e.g. trailing commissions paid by Mutual Fund Managers).

The Joint Committee is proposing an expansion of the fee disclosure requirements to retail fund investors.
The additional information required by the Amendments includes:

- Aggregate Fund Expenses (MER+TER), in dollars at the account level (or "investor level");
- other fees (e.g. short-term trading fee or redemption fee), aggregated in dollars; and
- total costs amount at the investor level, which includes the above.

The Figure below shows a sample prototype Annual Report for the securities sector, from Annex G of the Joint Notice.

# Jurisdictional review

**Figure 2: Sample prototype Annual Report for the securities sector (highlighting shows new information).**

**Dealer ABC Inc.**

Your Account Number: 123-4567

**Your Cost of Investing and Our Compensation**

This report shows for 2021

- your cost of investing, including what you paid to us and to investment fund companies
- our compensation

**Your Cost of Investing**

Costs reduce your profits and increase your losses

Your total cost of investing was $815 last year

**What you paid**

| | |
|---|---|
| **Our charges:** Amounts that you paid to us by withdrawals from your account or by other means such as cheques or transfers from your bank. | |
| Account administration and operating fees – you pay these fees to us each year | $100.00 |
| Trading fees – you pay these fees to us when you buy or sell some investments | $20.00 |
| ***Total you paid to us*** | **$120.00** |
| **Investment fund company fees:** Amounts you paid to investment fund companies that operate the investment funds (e.g., mutual funds) in your account. | |
| **Fund Expenses** - See the fund expenses % shown in the holdings section of your account statement[1] | $645.00 |
| Redemption fees on deferred sales charge (DSC) investments[2] | $50.00 |
| ***Amount you paid to investment fund companies*** | **$695.00** |
| **Your total cost of investing** | **$815.00** |

**Our Compensation**

**What we received**

| | |
|---|---|
| Total you paid us, as indicated above | $120.00 |
| Trailing commissions[3] paid to us by investment fund companies | $342.00 |
| ***Total we received for advice and services we provided to you*** | **$462.00** |

1. **Fund expenses.** Fund expenses are made up of the management fee, operating expenses and trading costs. You don't pay these expenses directly. They are periodically deducted from the value of your investments by the companies that manage and operate those funds. Different funds have different fund expenses. They affect you because they reduce the fund's returns. These expenses add up over time. Fund expenses are expressed as an annual percentage of the total value of the fund. They correspond to the sum of the fund's management expense ratio (MER) and trading expense ratio (TER). These costs are already reflected in the current values reported for your fund investments.

   The number shown here is the total dollar amount you paid in management fees, trading fees and operating expenses for all the investment funds you owned last year. This amount depends on each of your funds' fund expenses and the amount you invested in each fund. Your account statements show the fund expenses as a percentage for each fund you hold.

2. **Redemption fees on DSC investments**: You paid this cost because you redeemed your units or shares of a fund purchased under a deferred sales charge option (DSC) before the end of the redemption fee schedule and a redemption fee was payable to the investment fund company. Information about these and other fees can be found in the prospectus or fund facts document for each investment fund. The redemption fee was deducted from the redemption amount you received.

Source: CSA and CCIR Joint Notice and Request for Comment

The table below outlines the differences between Canada currently, the Amendments, and the Reviewed Jurisdictions in terms of requirements for the Annual Report.

**Table 3: Annual investor level fee disclosure requirements by jurisdiction**

| Cost type | Canada (present) | Canada (proposed) | Australia | EU | UK | US |
|---|---|---|---|---|---|---|
| Disclosures required? | Yes[7] | Yes | Yes | Yes | Yes | No |
| Reports Trading Expense Ratio? | No | Yes | No[8] | Yes[9] | Yes[10] | - |
| Fees reported in dollars or percentages? | Dollars | Dollars | Both | Both | Both | - |

7 Under CRM2, fee disclosures at the investor level are required for fees paid directly or indirectly to the dealer

8 While a trading expense ratio is not reported, "Other fees and costs" are required to include the impact of the buy/sell spread for the product.

9 While the EU does report the Trading Expense Ratio, the methodology for calculation differs significantly to the proposed calculations in the Amendments as the EU also includes implicit costs and slippage, i.e. the difference between the expected price of a trade and the price at which the trade is executed.

10 See above footnote.

# Jurisdictional review

**EU and UK**
The EU and UK are governed by a similar regulatory framework, with the main difference being that the UK (along with the Netherlands) has banned embedded, or trailer, commissions.

In the EU and UK, firms are required to comply with three directives:

- Markets in Financial Instruments Directive (MiFID), which governs investor-level disclosures. MiFID II was implemented in 2018 and requires all direct and indirect costs to be disclosed to the client annually. MiFID II disclosures are required to be updated annually unless there is a change to fees.
- Undertakings for the Collective Investment in Transferable Securities (UCITS), which governs fund-level disclosures. UCITS requires firms to produce a Key Investor Information Document (UCITS KIID), which is updated on an annual basis.
- Packaged retail investment and insurance products (PRIIPs), which governs fund-level disclosures. PRIIPs is similar to and overlaps with MiFID II, and also requires the production of a Key Information Document (PRIIPs KID), which is updated annually for each fund and share class.

MiFID II requires annual cost and charges disclosures at the investor level. Based on our review, these requirements are the closest to the Joint Regulators' Amendments, due to inclusion of transaction charges and investor portfolio-specific fee disclosure. See Figure 3 as example Statements of Cost and Charges in the EU. Figure 4 shows an example UK Charge Summary.

# Jurisdictional review

**Figure 3: EU Statement of Costs and Charges and EU Statement of the Cumulative Effect of Costs and Charges on investments**

A Client Esq

Statement of Costs and Charges paid in the period 01 January 2018 to 31 December 2018

Sterling

| Cost and Charge Type | Amount | VAT (where applicable) | Total |
|---|---|---|---|
| **Costs and charges paid to Rathbone Investment Management Ltd** | **3,581.98** | **389.75** | **3,971.73** |
| **Rathbones Management Fees** | **1,948.75** | **389.75** | **2,338.50** |
| Rathbones Management Fee | 1,948.75 | 389.75 | 2,338.50 |
| **Rathbones Transaction Charges** | **1,633.23** | **0.00** | **1,633.23** |
| Dealing Commission | 1,633.23 | 0.00 | 1,633.23 |
| **Other Costs and Charges paid to Third Parties** | **1,795.13** | **0.00** | **1,795.13** |
| **Transaction Costs** | **85.68** | **0.00** | **85.68** |
| HMRC Stamp Duty | 85.68 | 0.00 | 85.68 |
| **Ongoing Third Party Charges (e.g. Unit Trusts)** | **1,709.45** | **0.00** | **1,709.45** |
| Ongoing Fund Charge [1] | 1,709.45 | 0.00 | 1,709.45 |
| **Total** | **5,377.11** | **389.75** | **5,766.86** |
| **Average Value of Portfolio Over the Period** | | | **301,730.60** |
| **Total Costs and Charges as a Percentage of the Average Value of Portfolio Over the Period** | | | **1.91%** |

This statement shows all the costs and charges that are deducted from your fund(s) included in this valuation pack in the past year (or part year where applicable) that relate to the management and administration of your investments. It includes Rathbones' charges as well as charges levied by third parties.

Where we facilitate a payment to a financial adviser on your behalf, or you pay for Rathbones' services other than the management and administration of your investments out of your fund(s), the amount paid is not reflected above and will appear separately in the statement of cash movements.

The average value of portfolio over the period is calculated by reference to the gross portfolio value before any costs and charges.

1 = please see the notes on the previous page for information about using third party investments and ongoing fund charges.

Rathbone Investment Management - Portfolio Valuation

A Client Esq

Statement of the Cumulative Effect of Costs and Charges on your investments in the period 01 January 2018 to 31 December 2018

Sterling

| Fund | Fund Name | Start Date Value | End Date Value | Risk Level | Gross Return % | Net Return % | Cumulative Effect of Cost and Charges on Investment Returns % |
|---|---|---|---|---|---|---|---|
| 111111 | A Client Esq | 118,047 | 116,746 | 4 | 2.11 | -0.97 | -3.02 |
| 222222 | A Client Esq ISA | 173,018 | 196,129 | 4 | 2.50 | 1.31 | -1.16 |

This statement shows the annualised effect of costs and charges on the performance of the individual funds within your portfolio.

Gross return is the return before all costs and charges; net return is the return after deduction of all costs and charges.

We have not included data for accounts opened in the last quarter due to timing differences.

Rathbones management fees are charged quarterly in arrears and are debited after the quarter end date. The calculation shown here is based only on the fees debited in the reporting period.

Where management fees or other charges are transferred to another fund to be paid they will appear in the calculation for the paying fund rather than for the fund in which the charges were incurred.

Rathbone Investment Management - Portfolio Valuation

Source: Rathbone Investment Management

# Jurisdictional review

**Figure 4: Example Charges Summary as seen in UK Cost Disclosure Statements**

**Charges Summary**

| | **Service Costs** | | **Product Costs** | | **Third party payments** | | **Total Costs and Charges** | |
|---|---|---|---|---|---|---|---|---|
| **Charge Type** | **Amount** | **%** | **Amount** | **%** | **Amount** | **%** | **Amount** | **%** |
| One-off charges | £0.00 | 0.00% | £0.00 | 0.00% | £0.00 | 0.00% | £0.00 | 0.00% |
| Ongoing charges | N/A | | £44.20 | 0.70% | N/A | | £44.20 | 0.70% |
| Transaction costs | £10.00 | 0.16% | £2.12 | 0.03% | N/A | | £12.12 | 0.19% |
| Government charges / stock exchange levies | £16.25 | 0.26% | N/A | | N/A | | £16.25 | 0.26% |
| Ancillary services | N/A | | £0.00 | 0.00% | N/A | | £0.00 | 0.00% |
| Incidental costs | N/A | | £0.00 | 0.00% | N/A | | £0.00 | 0.00% |
| **Total costs and charges** | **£26.25** | **0.42%** | **£46.32** | **0.74%** | **£00.00** | **0.00%** | **£72.57** | **1.16%** |

Source: UK Cost Disclosures Statement Example and Help-Sheet, Interactive Investor

**EU and UK: impact on industry and investors**

To understand the requirements of the EU and UK markets, which we have considered to be closest to the Amendments, we conducted interviews with IFIC counterparts in the EU and UK and industry experts across the PwC network. We supplemented this with secondary research.

The introduction of MiFID II in 2018 allowed industry participants to see the “before and after” impact of adding enhanced disclosure requirements. Based on that, there are lessons learned for Canada about how enhanced disclosure may affect industry and investors.

We did not identify research on the impacts of expanded disclosure in annual reporting on investors. Our interviews provided conflicting viewpoints on this issue: some of those interviewed felt that, based on anecdotal evidence, retail investors were generally not factoring cost information into their purchasing decisions even with enhanced fee disclosure, and were more focused on their net gains or losses. On the other hand, in other cases it was noted that retail investors sensitive to fees had shifted to lower-fee passive funds, compared to higher-fee active funds.

Furthermore, those we interviewed noted that professionals selecting funds had also changed their behaviour in response to heightened sensitivity around fees. Industry participants are concerned that in Europe there is too great a focus on fees outside the broader context of returns and the value of advice received. Those selecting funds, aware of the sensitivity towards fees, have a tendency to screen out higher-fee funds, regardless of value, because they are perceived poorly by the overall market. It is important to note that these impacts are largely products of investor and industry attitudes towards fees, and it is difficult to say to what extent the disclosure itself contributes.

Industry participants in Europe and the UK raised the issue of investors’ ability to understand and contextualize trading expenses. They noted that trading expenses are difficult for investors to understand because the size of these costs can be significantly influenced by the fund’s strategy, and so they need to be contextualized by the type of fund purchased and that fund’s performance outcomes. There is a concern that adding all costs together (as the Joint Regulators propose to do) obscures understanding of these issues.

# Jurisdictional review

Participants we spoke with were not able to quantify the impact of complying with new disclosure requirements on the industry; however, they noted that impacts had been "significant" both in terms of setup and ongoing costs, which is also echoed in an ESMA report in March 2020.[11] It is important to note that one significant element of these costs is related to the way that trading expenses are calculated at the fund level, which is not comparable to what the Joint Regulators are proposing in Canada. In the EU and UK, the trading expenses calculation methodology includes bid/ask spreads and estimation of market impact costs as reflected by price before and after a transaction. This methodology is somewhat controversial because, among other issues, it can lead to negative trading expenses. It is also costly to implement in terms of data collection and calculation, and accounts for a substantial share of the overall cost of disclosure. Therefore, it is not possible to infer potential cost impacts for Canadian industry.

**US**

In the US, there is currently no annual or quarterly statement requirement for fee disclosure at the investor level. The disclosure regime includes items such as fund fee ratios in the fund financial statements, trade execution costs on trade confirmations, disclosure that the advisor receives a trailer fee as well as the most recent Form CRS relationship summary document.[12] Despite there being no formal requirements for disclosure along the lines of Canada's proposed Amendments, US research performed by FINRA found that when asked "How clear of an understanding do you have of the fees you pay for your non-retirement investment account(s)?" 62% of those surveyed reported a clear understanding.[13]

**Australia**

Our interviews with industry participants in Australia suggest that its requirements are somewhat comparable to the Amendments and the UK/EU, although they do not require trading expenses to be disclosed. Additionally, product structures and distribution are not fully comparable with the Canadian markets, making direct comparisons somewhat challenging. Fee disclosure statements (FDS), for which the latest requirements were introduced in July 2021, require Annual Reports, in dollar amounts, at the investor level, focused on the cost of advice. Figure 5 shows a sample of an FDS.

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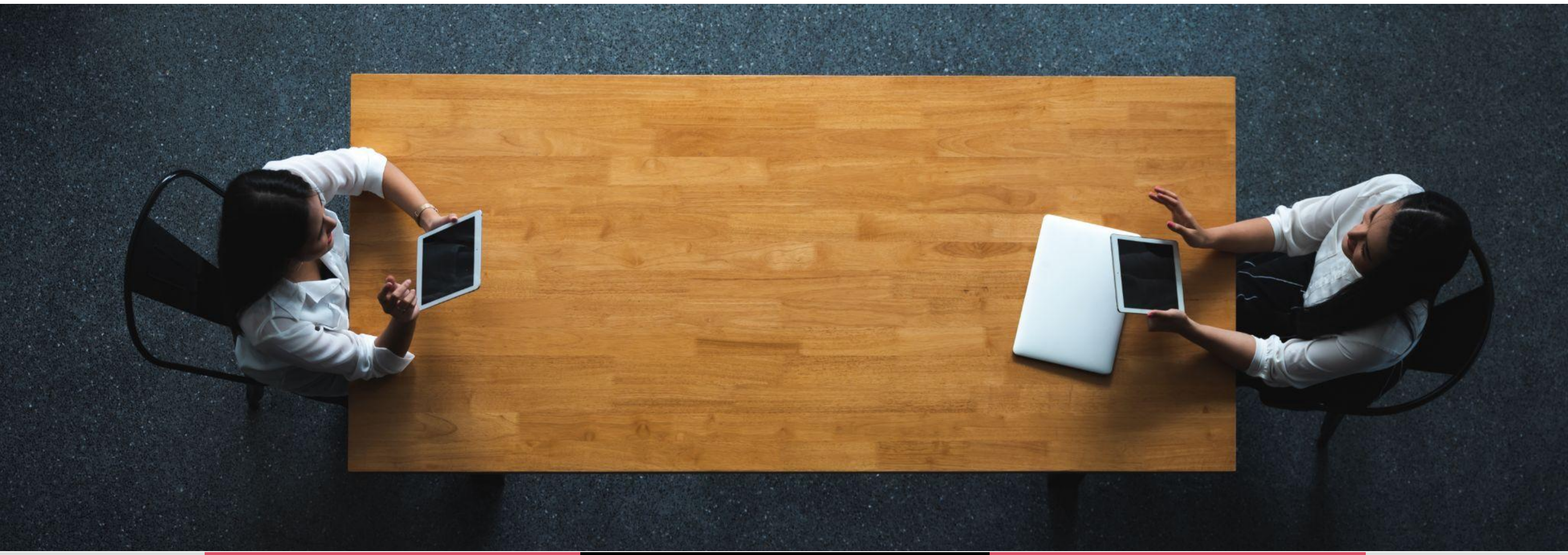
11 See para 188 of ESMA's Final Report from March 2020. Available at: https://www.esma.europa.eu/sites/default/files/library/esma35-43-2126_technical_advice_on_inducements_and_costs_and_charges_disclosures.pdf

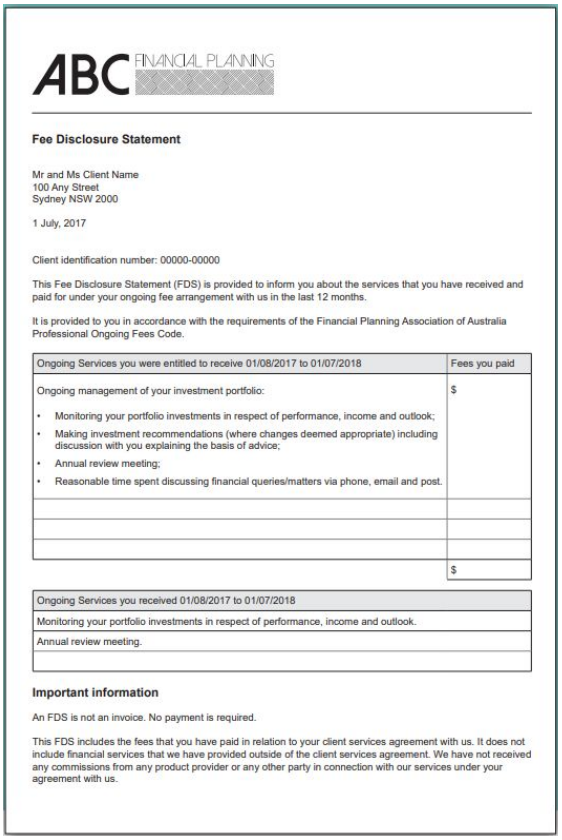
12 SEC (2019) Form CRS Relationship Summary; Amendments to Form ADV, Available at: https://www.sec.gov/info/smallbus/secg/form-crs-relationship-summary

13 FINRA (2016) Investors in the United States 2016, Available at: https://www.usfinancialcapability.org/downloads/NFCS_2015_Inv_Survey_Full_Report.pdf



# Jurisdictional review

**Figure 5: Sample Fee Disclosure (FDS) Statement**[14]



ABC FINANCIAL PLANNING

**Fee Disclosure Statement**

Mr and Ms Client Name
100 Any Street
Sydney NSW 2000

1 July, 2017

Client identification number: 00000-00000

This Fee Disclosure Statement (FDS) is provided to inform you about the services that you have received and paid for under your ongoing fee arrangement with us in the last 12 months.

It is provided to you in accordance with the requirements of the Financial Planning Association of Australia Professional Ongoing Fees Code.

| Ongoing Services you were entitled to receive 01/08/2017 to 01/07/2018 | Fees you paid |
|---|---|
| Ongoing management of your investment portfolio:<br>• Monitoring your portfolio investments in respect of performance, income and outlook;<br>• Making investment recommendations (where changes deemed appropriate) including discussion with you explaining the basis of advice;<br>• Annual review meeting;<br>• Reasonable time spent discussing financial queries/matters via phone, email and post. | $ |
| | |
| | |
| | |
| | $ |

| Ongoing Services you received 01/08/2017 to 01/07/2018 |
|---|
| Monitoring your portfolio investments in respect of performance, income and outlook. |
| Annual review meeting. |
| |

**Important information**

An FDS is not an invoice. No payment is required.

This FDS includes the fees that you have paid in relation to your client services agreement with us. It does not include financial services that we have provided outside of the client services agreement. We have not received any commissions from any product provider or any other party in connection with our services under your agreement with us.

Source: Financial Planning Association of Australia

In addition, Regulatory Guide 97 (RG97) is guidance from the Australian Securities and Investments Commission (ASIC) on how issuers of ("Super")[15] and managed investment products ("non-Super") disclose fees and costs. Specifically, RG97 includes "periodic statement" disclosure requirements for investors, for both Super and non-Super products, which include how fees and costs should be disclosed. In both cases, the periodic statement must include:

- the amount of "Fees deducted directly from your account" and the approximate amount of "Fees and costs deducted from your investment"; and
- the total of all fees and costs disclosed in the periodic statement ("Total fees and costs you paid").[16]

Total fees and costs you paid is thus the summary of both directly paid amounts and indirect amounts. As shown in the below Figures, although trading expenses are not disclosed, the "Other fees and costs (investment options)" category includes the "buy/sell spread" of the product disclosed as part of the periodic statement requirement for both Super and non-Super Annual Reports. Furthermore, the "additional explanation of fees and costs" section of the report for Super products requires detailed disclosure of any advice fees that were incurred by the member during the period, if not already included in another part of the periodic statement.[17]

14 Available at: https://fpa.com.au/wp-content/uploads/2017/04/FPA_Sample-Fee-Disclosure-Statement_factsheet.pdf

15 ATO (2021) Super, Available at: https://www.ato.gov.au/individuals/super/#Whatissuper

16 ASIC (2020) RG97: *Disclosing fees and costs in PDSs and periodic statements*, Available at: https://download.asic.gov.au/media/5801438/rg97-published-28-september-2020.pdf, p31 and p53

17 ASIC (2020) RG97: *Disclosing fees and costs in PDSs and periodic statements*, Available at: https://download.asic.gov.au/media/5801438/rg97-published-28-september-2020.pdf, p36

# Jurisdictional review

**Figure 6: Fees and costs summary in sample Non-Super periodic statement**

Fees and costs summary

| Description | Amount |
|---|---|
| **Fees deducted directly from your account**<br>This amount has been deducted directly from your account (reflected in the transactions listed on this statement). It includes the insurance premiums you paid. | $6438.54 |
| **Fees and costs deducted from your investment**<br>This approximate amount has been deducted from your investment. It covers amounts that have reduced the return on your investment and are not reflected as transactions listed on this statement or in the Additional explanation of fees and costs. This amount is the Transaction Account fee only. This amount does not include the Other Fees and Costs below related to your selected investment options. | $6.11 |
| **Total fees and costs you paid** | **$6,444.65** |
| This approximate amount includes all the fees and costs that affected your investment during the period. | |
| **Other fees and costs (investment options)**<br>This approximate amount has been deducted from the investment options you have chosen and has reduced the return on these investments but is not charged to you directly as a fee.<br>These fees and costs include management fees and costs, performance fees, transaction costs and buy/sell spreads associated with your selected investment options. | $1,285.65 |
| Total fees and costs you paid - with investment options fees and costs<br>This approximate amount includes the total fees and costs you paid and the other fees and costs associated with your selected investment options during the reporting period. | $7,730.30 |

**Additional explanation of fees and costs**

Generally the benefit of any tax deduction to which the Fund is entitled will be passed on to members in the form of reduced fees or costs.

If your account balance is less than $6,000 on 30 June or at time of exit, the fees and costs charged to your superannuation account, excluding **Other fees and costs (Investment Options)** above, are capped at 3% of your account balance. Any amount in excess of that cap will be refunded to your account.

The fees and costs information shown above may not include all the fees and costs in relation to your underlying investments. For more information regarding the fees and costs of the underlying investment options available through the Product, refer to the product disclosure statement or other disclosure document for the relevant investment option, which may be obtained free of charge online by logging in to your account, on request from your adviser (if you have one) or by contacting us.

**Figure 7: Fees and costs summary in sample Super periodic statement**

Fees and costs summary

| Description | Amount |
|---|---|
| **Fees deducted directly from your account**<br>This amount has been deducted directly from your account (reflected in the transactions listed on this statement). It includes the insurance premiums you paid. | $1,493.85 |
| **Fees and costs deducted from your investment**<br>This approximate amount has been deducted from your investment. It covers amounts that have reduced the return on your investment and are not reflected as transactions listed on this statement or in the Additional explanation of fees and costs. This amount is the Transaction Account fee only. This amount does not include the Other Fees and Costs below related to your selected investment options. | $0.00 |
| **Total fees and costs you paid** | **$1,493.85** |
| This approximate amount includes all the fees and costs that affected your investment during the period. | |
| **Other fees and costs (investment options)**<br>This approximate amount has been deducted from the investment options you have chosen and has reduced the return on these investments but is not charged to you directly as a fee.<br>These fees and costs include management fees and costs, performance fees, transaction costs and buy/sell spreads associated with your selected investment options. | $3,301.58 |
| Total fees and costs you paid - with investment options fees and costs<br>This approximate amount includes the total fees and costs you paid and the other fees and costs associated with your selected investment options during the reporting period. | $4,795.43 |

**Additional explanation of fees and costs**

The fees and costs information shown above may not include all the fees and costs in relation to your underlying investments. For more information regarding the fees and costs of the underlying investment options available through the Product, refer to the product disclosure statement or other disclosure document for the relevant investment option, which may be obtained free of charge online by logging in to your account, on request from your adviser (if you have one) or by contacting us.

# Impacts on investors

# Impacts on investors

## Introduction

Through the Amendments, the Joint Regulators aim to enhance investor protection through improving the visibility and explanations of ongoing fees. Our discussion of the Amendments' potential impacts on investors is as follows:

1. Current state of disclosure in Canada and the Amendments
   - We summarize the current requirements for fee disclosure in Canada and the proposed fee disclosure changes for the securities sector.
2. Literature review
   - We provide evidence from academic, government, and industry sources that support aspects of the Amendments: fee definitions and purpose, the merits of including MER, dollar framing, cost breakdowns, contextualizing fee suggestions, and visualizations.
3. The frequency discussion
   - We examine the impacts that quarterly versus annual fee reporting may have on investor protection.

With some exceptions, we find that overall the evidence from past research and surveys corroborates the idea that the Amendments will help improve investors' experience with comprehending and factoring fees into their decisions. We also highlight improvements that could be integrated into disclosure implementation, which, in our view, would improve the prospects of achieving the regulators' goals. Where appropriate, we use external examples and make references to prototypes from the Amendments to support our analysis.[18] A summary framework of the behavioural principles for fee disclosures that informed our analysis are outlined in Appendix C.

## Key findings

The following elements are captured in the Amendments and in our view will benefit investors in any frequency of fee reporting:

- clear descriptions of fees and their purpose will help to improve awareness;
- simplified language in explanatory notes will help to reduce cognitive costs;
- unpacking embedded investment fees from the total cost will help to improve transparency and comprehension; and
- dollars will feel more concrete than percentages, making them more likely to be factored into investment decisions and for investors to more easily derive a meaningful value specific to their investment fund holdings.

We identified two additional opportunities that would support investors' contextualization of the value of fees in their investments:

- cost disclaimers and educational statements about the relationship between fees and returns to help direct investors' attention to fee importance; and
- visualization to help facilitate the understanding between fees and other account information such as returns, as well as to make fund comparisons over time.

[18] CSA and CCIR Joint Notice and Request for Comment, Annexes

# Impacts on investors

Quarterly statements would be effective reminders about the existence of fees, but have the potential of encouraging negative investor behaviours. Overall, we did not find strong evidence that the Joint Regulators' proposal for quarterly disclosures would significantly benefit investors above and beyond what would be achieved by the Annual Reports. This may be the reason that no other country has introduced this requirement. We have not identified studies that assessed the impacts of quarterly or monthly reporting (versus annual); however, broader behavioural research suggests the following:

- since quarterly statements lack other account information, such as performance returns, investors will have challenges with contextualizing the value of fees in their holdings;
- the saliency of presenting fee information (i.e. losses) on its own can negatively skew investors to become overly focused on the costs, leading to loss aversion or fee aversion; and
- as a result, if quarterly fee reporting is introduced, there should be the inclusion of value-based fee framing to better articulate why fees exist and the value they bring to investors; this would be especially pertinent so that investors do not overly focus on costs.

In comparison, fee disclosures in Annual Reports would likely bring greater benefits to investor comprehension because of the opportunity to contextualize fees.

- Annual Reports are an ideal medium for fee disclosure due to the presence and completeness of other account information. This context helps reduce the likelihood of loss aversion and fee aversion for investors.
- Investors have also been noted to have a greater preference for annual over quarterly reporting (61% versus 34%)[19] and several jurisdictions currently require annual but not quarterly reporting, suggesting a greater benefit for investors at the former frequency. 19

## Current state of disclosure in Canada and the Amendments

Currently, fund product costs (MER and TER) are available to investors at the fund level through Fund Facts and ETF Facts documents that are provided when funds are purchased, and can be accessed at any time. However, there are no requirements for the securities industry to provide ongoing reporting to investors on the costs after the initial sale of the investment product, in a form that is specific to an individual's holdings and easily understandable. Canadian dealers and advisors are required to send account statements to clients on either a quarterly or monthly basis, but are not required to provide ongoing fee disclosure at this frequency. Canadian dealers are also required to deliver Annual Reports to clients containing the aggregate amounts paid to them for their services, as well as any additional compensation that is paid to the firm by third parties. For these annual investor-level fee disclosures, fund product costs (both MER and TER) are not currently required and fees are represented in dollar amounts.

The Joint Regulators see opportunity in the current landscape to further improve cost transparency. As noted previously, the proposed fee disclosure changes for the securities sector from the current state include the following:

- in a quarterly account statement (or additional statement as appropriate), the fund expense ratio (the sum of the management fund expense ratios (MER) and trading expense ratios (TER)), stated as a percentage for each investment fund held by the client; and
- in the Annual Report for the account as a whole:
    - the aggregate amount of fund expenses, in dollars, for all investment funds held during the year; and
    - the aggregate amount of any direct investment fund charges (e.g. short-term trading fees or redemption fees), in dollars.

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19 United States Government Accountability Office. (2021). *Many Participants Do Not Understand Fee Information, but DOL Could Take Additional Steps to Help Them.*

# Impacts on investors

This cost transparency is expected by the Joint Regulators to help enhance investor protection through improving investors' ongoing awareness and comprehension of fees, the costs of their holdings, the effects of fees on returns, and the compounding effect over time. In addition, we note that according to economic theory a perfectly competitive market requires perfect information of buyers and sellers. It follows that in a given market, buyers who become more informed will make that market more competitive. Thus if the Amendments would result in more informed investors, they will also enhance the competitiveness of the market.

In the following, we assess the potential impacts of the Amendments on investors by first providing a literature review that has informed our assessment and then providing our assessment as it relates to the requirements for annual and quarterly reporting. We finish with what we believe should be considered in implementing the Amendments.

## Literature review

**Fee definitions and purpose**
A stated goal of the Amendments is to increase investors' awareness of fees, and this begins with improving understanding. According to a Canadian study published in 2021, investors generally have strong knowledge of mutual fund and ETF investing: 85% of mutual fund investors reported that they believed themselves to be somewhat to very knowledgeable about investing in mutual funds, and 86% felt somewhat to very knowledgeable about ETFs. When it comes to fees, 84% of investors have reported that their advisors discuss at least one aspect of fees at some point, but only 64% of investors report discussing the management expense ratio (MER) and only 59% reported having had discussions about fees paid to the firm.[20]

Moreover, research from Broadridge has highlighted that 88% of investors are aware of Fund Facts and ETF facts, and that 86% of investors find them to be helpful when comparing investments, regardless of whether investors own one fund or more than ten funds. However, the findings also highlighted that 34% of investors were not aware of the information contained in management reports of fund performance (MRFPs) and financial statements; yet, when shown, investors found the information about fees, performance, and holdings to be especially important. In particular, 81% of investors found the section about management fees to be very important in MRFPs, but 42% found MRFPs and financial statements difficult to understand.[21]

Finally, in a longitudinal assessment of CRM2 disclosure, a large majority of investors self-reported having a good or an excellent understanding about the information in costs and performance statements, including the overall rate of returns and market value. Specific to fees, 79% of investors reported having a good understanding of the types of fees charged to them, but only 39% reported understanding the impact of fees on investment. In line with the purpose of the Amendments, 82% of investors agreed that having a further improved understanding of different types of fees would help them make more informed investment decisions.[22]

One of the first considerations in ongoing fee disclosures is that investors may not be as aware as they could be of the fact that differences in fees exist, that the expense ratio does not necessarily reflect all fees, that fees implicitly compound over time, or where to find fee information. More specifically, investors have trouble understanding disclosures about fees due to their narrative complexity; this can lead investors to dismiss the importance of fees and the act of contextualization with net returns when assessing funds.

20 Pollara Strategic Insights. (2021). *Canadian Mutual Fund & Exchange Traded Fund Investor Survey*.

21 Broadridge. (2021). *Canada Investor Quantitative Report*.

22 Innovative Research Group, Inc. (2019). *CRM2/POS 3-year tracking study, September 2019 Report - Annual Tracking*.

# Impacts on investors

To mitigate challenges to fee understanding, simplified disclosures have been shown to improve investor awareness and be factored into fund decisions.[23] As human cognitive bandwidth is typically limited, it is important to keep these descriptions short and simple; the more complex information becomes, the more difficult it is to process and understand, and the more likely investors will disengage. Upon reviewing the Joint Regulators' proposed text descriptions, it is evident that there is an explicit endeavour to bring fees and their purposes into visibility. This description makes fund expenses more transparent and would help investors be aware that there are different fees associated with their investments. It is also consolidated in one paragraph for investors and uses short sentences to better hold investors' attention when they are reading about fund expenses.

**Figure 8: Proposed fund expense description**

*"Fund expenses are made up of the management fee, operating expenses and trading costs. You don't pay these expenses directly. They are periodically deducted from the value of your investments by the companies that manage and operate those funds. Different funds have different fund expenses. They affect you because they reduce the fund's returns. These expenses add up over time. Fund expenses are expressed as an annual percentage of the total value of the fund. They correspond to the sum of the fund's management expense ratio (MER) and trading expense ratio (TER). These costs are already reflected in the current values reported for your fund investments"*

Source: CSA and CCIR Joint Notice and Request for Comment, Annex C

Investors often have a poor comprehension of the terms related to fees. This can stem from a failure of disclosures defining the terms in the first place. Even if they are defined, they tend to be described in complex language which increases cognitive costs for investors and this results in investors being unlikely to take investment fees into account.[24] It can be helpful to offer investors a summary document that simplifies the fund and fee information. In a study from the Behavioural Insights Team, investors who self-identify as being less knowledgeable about investing indicated they would not review anything in detail beyond summary-level information. In contrast, 81% of investors reported that they would like to receive cost information that is not currently provided through fee summaries.[25] So, while investors may desire more information to inform their decision-making, it is important for the information itself to be disclosed in an understandable form so that it can be used.

Therefore, simplified terminology is a key avenue to reducing misunderstanding and to promoting the factoring of fees into investment decisions.[26] The Amendments propose explanatory notes (e.g. trailing commissions and redemption fees on DSC investments, shown in Figure 9) to supplement account statements, in addition to an optional call-to-action should the investor be interested in further information. These inclusions will improve investor protection due to enhanced fee visibility and clarity.

23 DeHaan, E., Song, Y., Xie, C., & Zhu, C. (2021). *Obfuscation in mutual funds.* Journal of Accounting and Economics, 72(2-3), 101429.

24 Pontari, B. A., Stanaland, A. J., & Smythe, T. (2009). *Regulating information disclosure in mutual fund advertising in the United States: Will consumers utilize cost information?* Journal of Consumer Policy, 32(4), 333-351.

25 Behavioural Insights Team. (2021). *Improving Fee Disclosures for Canadian Mutual Fund Investors*.

26 Behavioural Insights Team. (2021). *Improving Fee Disclosures for Canadian Mutual Fund Investors*.

# Impacts on investors

**Figure 9: Explanatory notes from sample prototype**

2. **Redemption fees on DSC investments**: You paid this cost because you redeemed your units or shares of a fund purchased under a deferred sales charge option (DSC) before the end of the redemption fee schedule and a redemption fee was payable to the investment fund company. Information about these and other fees can be found in the prospectus or fund facts document for each investment fund. The redemption fee was deducted from the redemption amount you received.

3. **Trailing commissions.** Investment funds pay investment fund companies a fee for managing their funds. Investment fund companies pay us ongoing trailing commissions for the services and advice we provide you. The amount of the trailing commission for each fund depends on the sales charge option you chose when you purchased the fund. You are not directly charged for trailing commissions. They are paid to us by investment fund companies.

***Information about fund expenses, MERs, trading expenses and other investment fund company charges, as well as trailing commissions, is also included in the prospectus or fund facts document for each fund you own.***

Source: CSA and CCIR Joint Notice and Request for Comment, Annex D

**Merits of including MER**

A key outcome of disclosing fee information for investors is the opportunity that they have to better make fund comparisons through the presence of additional information. In the following, we discuss whether it would be beneficial to disclose MER in account statements and additional statements.

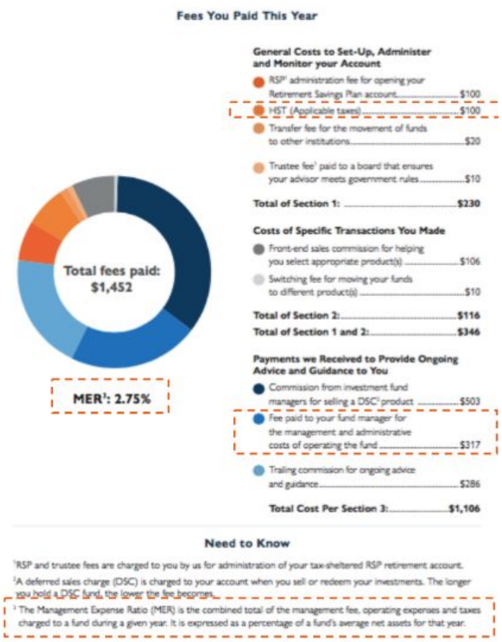
We are of the view that investors would benefit from the inclusion so long as MER is accurately described. When the MER is disclosed in statements, there should be one clear definition or associated explanatory note of its purpose in the context of the investment. Our view is informed by behavioural principles and two studies that touched on this issue.

An unpublished behavioural economics study conducted by BEworks had participants examine a mock account statement that included MER to understand whether the expanded cost disclosure would help investors think about fees. When MER was made salient in the disclosure shown in Figure 10, investors felt less confident about their understanding of the statement.[27] However, this mock Annual Report only described MER in percentage terms and it appeared unclear whether investors may have been distracted by two different mentions of management fees in the lower half of the mock report. Removing information that is not needed and providing fees with accurate explanatory notes would be expected to be more effective; both these considerations are captured in the Amendments prototypes.

27 Beworks. (2019). *Behavioural Economics Applied to Enhance Disclosure Practices and Investor Outcomes*.

# Impacts on investors

**Figure 10: Sample statement of expanded cost disclosure**



**Fees You Paid This Year**

Total fees paid: $1,452

MER[3]: 2.75%

**General Costs to Set-Up, Administer and Monitor your Account**

- RSP[1] administration fee for opening your Retirement Savings Plan account .......... $100
- HST (Applicable taxes) .......... $100
- Transfer fee for the movement of funds to other institutions .......... $20
- Trustee fee[1] paid to a board that ensures your advisor meets government rules .......... $10

**Total of Section 1: .......... $230**

**Costs of Specific Transactions You Made**

- Front-end sales commission for helping you select appropriate product(s) .......... $106
- Switching fee for moving your funds to different product(s) .......... $10

**Total of Section 2: .......... $116**
**Total of Section 1 and 2: .......... $346**

**Payments we Received to Provide Ongoing Advice and Guidance to You**

- Commission from investment fund managers for selling a DSC[2] product .......... $503
- Fee paid to your fund manager for the management and administrative costs of operating the fund .......... $317
- Trailing commission for ongoing advice and guidance .......... $286

**Total Cost Per Section 3: .......... $1,106**

**Need to Know**

[1]RSP and trustee fees are charged to you by us for administration of your tax-sheltered RSP retirement account.

[2]A deferred sales charge (DSC) is charged to your account when you sell or redeem your investments. The longer you hold a DSC fund, the lower the fee becomes.

[3] The Management Expense Ratio (MER) is the combined total of the management fee, operating expenses and taxes charged to a fund during a given year. It is expressed as a percentage of a fund's average net assets for that year.


Source: BEworks

In a contrasting research finding from the Behavioural Insights Team, including the MER in the account holdings section of Annual Reports was found to better help investors with identifying the actions that they should take upon learning about fees.[28] This suggests that including MER in reporting with one clear definition of its purpose can help investors better realize that MER is a key fee that differs across funds. This realization would help investors reconcile the impact of fees, and encourage them to think about the course of investment actions they could take and reevaluate their investments accordingly. However, it is important to note that investors would best understand costs in the context of returns, and that this would be best achieved in Annual Reports.

Therefore, including the listing of MER in account and additional statements would demarcate the presence of the management fees, compared to not having it listed at all. Investors would be able to make use of the additional disclosed fee information, to make fund comparisons. Once again, the benefit to investors would be best realized when there is contextualization of the cost information with other pertinent fund and account information, which would be found in Annual Reports, to facilitate investor understanding of the overall fund's value.

**Dollar framing**

Research suggests that when it comes to percentages, investors tend to neglect small amounts, long-term costs, and the exponential growth of fees' impact over time. This percentage neglect is further amplified by the fact that individuals have a tendency to misinterpret and incorrectly add/subtract percentages when making decisions around fees and returns.[29] This can lead investors to misjudge future gains and losses because the challenge associated with making financial calculations is magnified, hindering their comprehension of what they pay in fees.

28 Behavioural Insights Team. (2021). *Improving Fee Disclosures for Canadian Mutual Fund Investors*.

29 Parker, K. N. (2017). *Numeric Data Frames and Probabilistic Judgments in Complex Real-World Environments* (Doctoral dissertation, UCL (University College London)).

# Impacts on investors

Percentage information is so poorly understood that it may not even be weighted in decision-making: Investors have been found to underreact to fees as if they are only half the size than they actually are.[30] Percentages also do not create the same imagery for investors as dollars do, resulting in an overall devaluation of fees because they feel small.[31] Reframing numbers as dollars helps increase and direct investors' attention to fees, helping them overcome the percentage neglect. Dollars are more likely to be weighted into decisions because they are better understood. In turn, investors would decide more effectively about investments when they consider fees in dollar units and be more likely to factor fee information into decisions because the information is more concrete.[32]

The Amendments propose that for quarterly account statements, fees would be stated as a percentage for each held fund, while for annual reporting, dollars would be used to capture the total fund expenses, aggregated with all other costs. The annual prototypes summarize the total cost of investing using a table, in dollars; this presentation of fees (as further described in the next section about cost breakdowns) and dollar framing is optimal for investor comprehension of fees. The research cited above suggests that this change would help investors better understand fees, again, largely in the context of annual fee reporting. For the quarterly statements, where only percentages are included at the product level, the accompanying fee explanatory note will play a larger role in supporting investors' comprehension.

**Cost breakdowns**

A cost statement that saliently captures the total cost of investing, on top of a cost breakdown table, can effectively facilitate investor awareness and understanding without overwhelming investors with too much information. This is because if the fees are made salient (e.g. listing the fees at the top of the account statement page), investors are more likely to locate these fees amid other statement information, which would improve their comprehension.[33] Thus, the Amendments' focus on expanding cost information in a way that more clearly breaks down what fees are and what they mean for investors will be beneficial. Unnecessary or excess information should be removed to simplify the amount of content in an account statement.

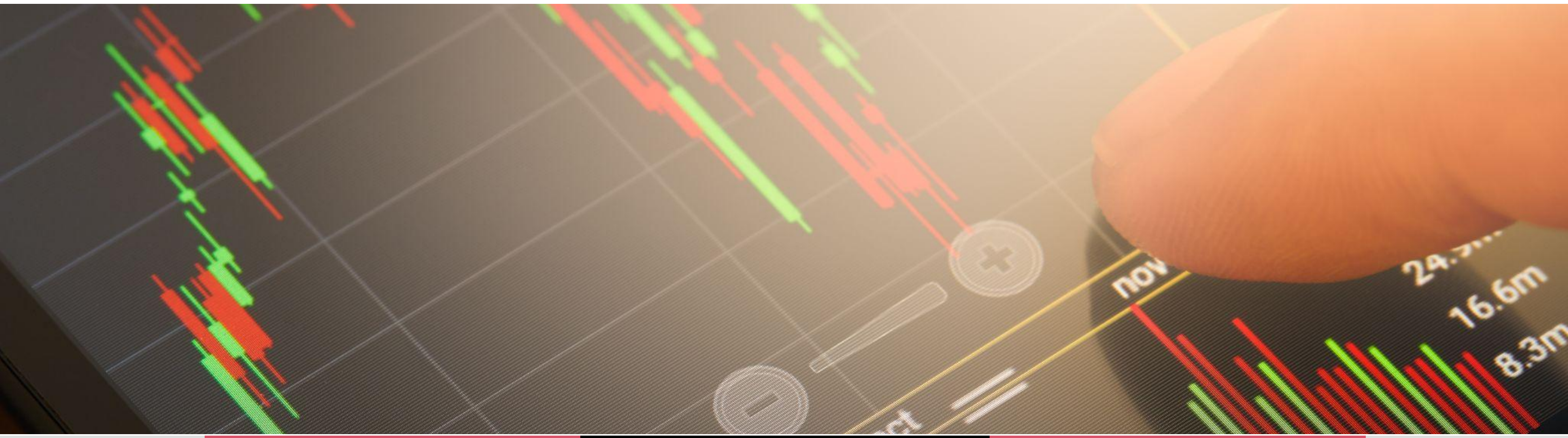
As outlined in the following prototype from the Amendments, embedded fees would be expanded by only including relevant information for each line (i.e. the purpose of each specific fee). The summative total cost statement is bolded, highlighted, and in a large font. The cost breakdown table parses each fee contributing to the total of $815. The presentation, which highlights the main takeaway at the beginning of the statement and then provides a breakdown of each fee by line items, will reduce cognitive barriers to understanding fees paid by the investor. This additional overlay improves transparency to each fee, compared to no overlay, and would support investors' increased comprehension of investment costs. Moreover, the simplified presentation is in line with the best practice of clearly presenting descriptions without unnecessary information.

30 Kim, H. H., & Yang, W. (2022). *Inattention to mutual fund fees and the effect of fee disclosure policies*. Available at SSRN 3230081.

31 Newall, P. W., & Parker, K. N. (2019). *Improved mutual fund investment choice architecture. Journal of Behavioral Finance*, 20(1), 96-106.

32 Newall, P. W., & Love, B. C. (2015). *Nudging investors big and small toward better decisions*. Decision, 2(4), 319.

33 Financial Conduct Authority. (2018). *Now you see it: Drawing attention to charges in the asset management industry*.



# Impacts on investors

**Figure 11: Cost summary table from prototype**

**Your total cost of investing was $815 last year**

**What you paid**

| | |
|---|---|
| **Our charges:** Amounts that you paid to us by withdrawals from your account or by other means such as cheques or transfers from your bank. | |
| Account administration and operating fees – you pay these fees to us each year | $100.00 |
| Trading fees – you pay these fees to us when you buy or sell some investments | $20.00 |
| ***Total you paid to us*** | **$120.00** |
| **Investment fund company fees:** Amounts you paid to investment fund companies that operate the investment funds (e.g., mutual funds) in your account. | |
| **Fund Expenses** - See the fund expenses % shown in the holdings section of your account statement[1] | $645.00 |
| Redemption fees on deferred sales charge (DSC) investments[2] | $50.00 |
| ***Amount you paid to investment fund companies*** | **$695.00** |
| **Your total cost of investing** | **$815.00** |

***Our Compensation***

**What we received**

| | |
|---|---|
| Total you paid us, as indicated above | $120.00 |
| Trailing commissions[3] paid to us by investment fund companies | $342.00 |
| ***Total we received for advice and services we provided to you*** | **$462.00** |

1. **Fund expenses.** Fund expenses are made up of the management fee, operating expenses and trading costs. You don't pay these expenses directly. They are periodically deducted from the value

of your investments by the companies that manage and operate those funds. Different funds have different fund expenses. They affect you because they reduce the fund's returns. These expenses add up over time. Fund expenses are expressed as an annual percentage of the total value of the fund. They correspond to the sum of the fund's management expense ratio (MER) and trading expense ratio (TER). These costs are already reflected in the current values reported for your fund investments.

The number shown here is the total dollar amount you paid in management fees, trading fees and operating expenses for all the investment funds you owned last year. This amount depends on each of your funds' fund expenses and the amount you invested in each fund. Your account statements show the fund expenses as a percentage for each fund you hold.

Source: CSA and CCIR Joint Notice and Request for Comment, Annex D

**Contextualizing fee suggestions**

Direct instructional suggestions can be used to make the relationship between fees and returns more salient and understandable for investors. While investors' neglect of fees is driven by the difficulty of processing percentages, it can also be due to the fact that investors have not been explicitly educated to pay attention to them.[34] For example, a Canada-wide survey of investors found that only 51% of investors say that the fees on their accounts have an impact on their investment returns.[35] This finding demonstrates low comprehension regarding the relationship between fees and returns. The Amendments could consider a statement like the following: "Within investment fund products, you may want to consider the fund's overall fees, as it can have a significant impact on its net return. In other words, you should ask yourself whether the fund you own provides a return that justifies the fees it charges you."

34 Scholl, B., & Fontes, A. (2022). *Mutual fund knowledge assessment for policy and decision problems. Financial Services Review*, 30(1), 31-56.

35 Innovative Research Group, Inc. (2019). *CRM2/POS 3-year tracking study, September 2019 Report - Annual Tracking*.

# Impacts on investors

In the original research study, a version of the above suggestion to the investor has been found to encourage individuals to seek more information about fees because they now believe them to be more important.[36] Fee information was viewed 40% more often among those who were exposed to the suggestion compared to those who were not. Currently, there is no such type of suggestion in the statement prototypes of the Amendments. A suggestion of this type could be integrated at the top of account statements, as shown in Figure 12, or included in the footnotes for "Fund expenses" (see Figure 11), and be made more salient by bolding the text or breaking up the sentences.

**Figure 12: Top of account statement from prototype**

Dealer ABC Inc.

Your Account Number: 123-4567

**Holdings in your account**

**On December 31, 2020**

**Portfolio Assets**

| Description | Shares Owned | Book Cost | Market Value | Current gain or loss | Fund Expenses[1] | % of your holdings |
|---|---|---|---|---|---|---|

Source: CSA and CCIR Joint Notice and Request for Comment, Annex D

Furthermore, financial literacy plays a part in fee comprehension. Highly literate investors are more likely to be aware of investment charges, be able to process large amounts of fund information, and be more sensitive to high-fee funds.[37] Those with lower financial literacy and investment experience are most susceptible to poor fund choices, so fee disclosure is especially valuable for them. For this latter group, disclaimers help draw attention to the specific actions that they need to take to set themselves up for better returns. This is important because this investor group is likely to be relying more on past returns to inform investment holdings. In one experimental research study, investors were assessed on the extent to which fees and returns information drove investment decisions. Investors were asked to choose between one low-fee fund and one high-fee fund across multiple trials. The returns of the two funds were stochastically generated and the fees were different between the funds. The two disclaimers were as follows:[38]

- standard disclaimer: "Past performance does not guarantee future returns"; and
- social disclaimer: "Some people invest based on past performance, but funds with low fees have the highest future results."

The social disclaimer that emphasizes the benefits of considering fees was more effective at motivating investors towards considering fees, especially those with lower financial literacy. A disclaimer like this could also be particularly effective in countering the belief that investors have about higher-fee funds relating to better performance.[39] We note that this experiment does not address the issue of overall fund value, including both fees and returns, and that the design was a single-choice paradigm.

36 Fisch, J. E., & Wilkinson-Ryan, T. (2014). *Why do retail investors make costly mistakes? An experiment on mutual fund choice*. University of Pennsylvania Law Review, 162(3), 605-647.
37 Jiang, J., Liao, L., Wang, Z., & Xiang, H. (2020). *Financial literacy and retail investors' financial welfare: Evidence from mutual fund investment outcomes in China*. Pacific-Basin Finance Journal, 59, 101242.
38 Weiss-Cohen, L., Newall, P. W., & Ayton, P. (2021). *Persistence is futile: Chasing of past performance in repeated investment choices*. Journal of Experimental Psychology: Applied.
39 The Brondesbury Group. (2015). *Mutual Fund Fee Research.*

# Impacts on investors

In the Amendments, a similar disclaimer is suggested for the top of account statements (Figure 13): “Costs reduce your profits and increase your losses.” This statement would be expected to increase fee awareness, and could be further enhanced with a cost qualifier and framing that emphasizes positive outcomes from considering fees: “Lower costs increase your profits and decrease your losses.” However, we note that investors need to understand both fees and value (from returns and advice they receive) rather than fees alone, to make informed decisions. Thus statements need to emphasize the importance of net return in evaluating a fund performance. The importance of this context is discussed in more detail later in this report.

**Figure 13: Disclaimer about costs from prototype**

**Your Cost of Investing and Our Compensation**

This report shows for 2021

- your cost of investing, including what you paid to us and to investment fund companies
- our compensation

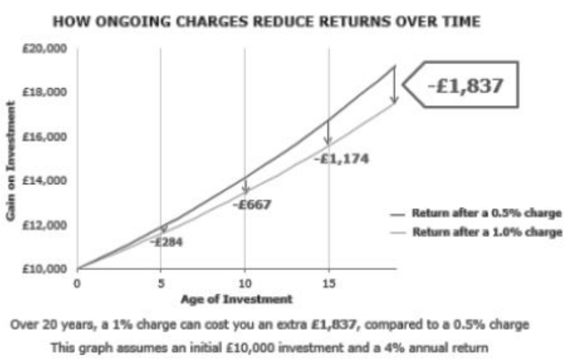
***Your Cost of Investing***

Costs reduce your profits and increase your losses

Source: CSA and CCIR Joint Notice and Request for Comment, Annex D

**Visualizations with text descriptions**
There are several visual design choices that can ease the cognitive barriers to comprehending fee impact and their relation to returns. Simple changes such as including ratings, metrics, and colour coding are helpful for investors when they assess overall fund and account information.[40] Research has also found that visualizing risk with return and fee information in an infographic helps reduce the amount of additional and preventable fees incurred from investments by up to 20%. The authors describe “preventable fees” as the excess fees that investors incur because they face difficulties in comparing the fees of different funds (e.g. a fully rational investor would minimize fees by allocating all wealth to the cheapest fund; again, we note that this behaviour does not properly contextualize the overall value of investment).[41] This is because the visual nature of making costs salient relative to returns elevates the importance that investors place on fee impact; this sensitivity would be expected to translate across all types of fees.

**Figure 14: Sample visualization of fee impact on returns**




Source: Financial Conduct Authority

40 IOSCO. (2019). *The Application of Behavioural Insights to Retail Investor Protection*.

41 Cox, R., de Goeij, P., & Van Campenhout, G. (2018). *Are pictures worth a thousand words? Infographics and investment decision making. Infographics and Investment Decision Making* (November 2, 2018).

# Impacts on investors

Overall, investors consider themselves to have a better understanding of fees and how potential financial returns may be impacted when texts and visualizations are presented together; while we acknowledge that implementing graphical visualizations would be more complex than simpler design changes (e.g. colour coding), the combination with texts should be regarded as a highly effective route to improve comprehension about the temporal relationship between fees and returns.[42] Solely adding infographics of visualized risk, return, and fees without a text description has been found to be insufficient in helping investors compare different funds.[43] Additionally, investors have been found to understand fee information when presented through text descriptions but prefer their actual costs of investing to be outlined in a table,[44] which is captured in the Amendments.

## The frequency discussion

**Quarterly statements**

Investors cannot assess fee trade-offs of funds when fees are hidden; out of sight is out of mind, so an important consideration for fee visibility is when the fee information is provided to investors.[45] Currently, the Fund Facts document provided at the original point of sale is the main means of bringing fees to attention. The Amendments' inclusion of quarterly fee reporting in the account statement could be meaningful if the goal is to keep fees in investors' minds. In this context, the quarterly statements would likely serve as reminders and the likelihood of investors paying attention to them after the initial purchase may be slightly higher if investors actually review the quarterly statement to inform holdings.

Evidence suggests that investors do review Annual Reports received and would want more frequent information (i.e. quarterly) to be available, only if they are described in understandable language. In a 2019 Canadian investor survey, 69% of individuals who recalled receiving account statements about the performance or costs of investments reported that they read all or most of the content.[46] In a sample of American investors surveyed in 2021, 58% reported that they would be likely to obtain and review additional investment documents if they learned that fees could reduce the growth of their savings over time.[47] Finally, 47% of 2,000 self-directed investors surveyed by the Ontario Securities Commission in 2020 reported that they spend less than an hour each month viewing monthly and annual account statements. While we acknowledge that self-directed investors are only a small portion of the overall population of fund investors, 66% of these investors reported spending less than an hour each month reviewing the fees that they are charged (Figure 15).[48]

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42 Kozup, J., Howlett, E., & Pagano, M. (2008). *The effects of summary information on consumer perceptions of mutual fund characteristics. Journal of Consumer Affairs*, 42(1), 37-59.

43 Cox, R., de Goeij, P., & Van Campenhout, G. (2018). *Are pictures worth a thousand words? Infographics and investment decision making. Infographics and Investment Decision Making* (November 2, 2018).

44 United States Government Accountability Office. (2021). *Many Participants Do Not Understand Fee Information, but DOL Could Take Additional Steps to Help Them*.

45 Barber, B. M., Odean, T., & Zheng, L. (2005). *Out of sight, out of mind: The effects of expenses on mutual fund flows*. The Journal of Business, 78(6), 2095-2120.

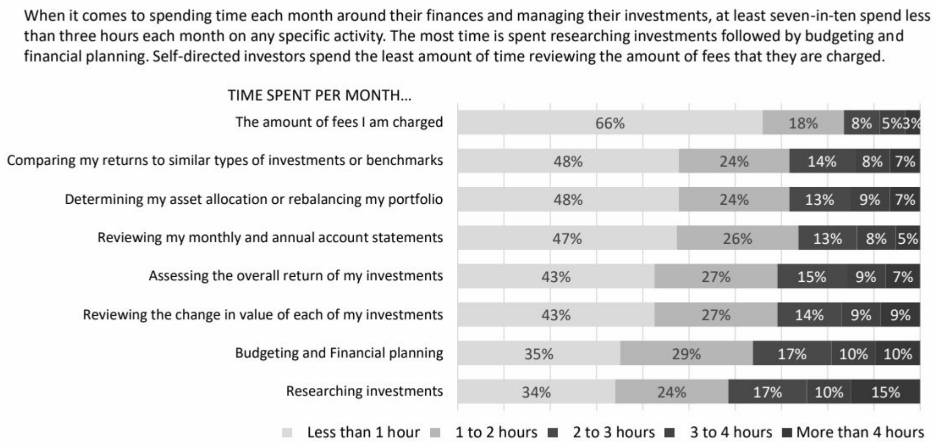
46 Innovative Research Group, Inc. (2019). *CRM2/POS 3-year tracking study, September 2019 Report - Annual Tracking*.

47 United States Government Accountability Office. (2021). *Many Participants Do Not Understand Fee Information, but DOL Could Take Additional Steps to Help Them*.

48 Ontario Securities Commission. (2021). *Self-directed investors: Insights and experiences*.

# Impacts on investors

**Figure 15: Findings from the OSC on self-directed investors**




Source: Ontario Securities Commission

When considering the contextualization of investment costs among other fund information, it is essential to take into account the fact that investors would see their fees alone in quarterly reports. If fees are presented alone, the overall costs to investing may be incorrectly assumed as being very high due to the lack of fund context. For example, an investor may not realize that a higher expense ratio is because of the differences in managing an equity fund compared to a fixed income fund. In another instance, if a fund has the trailer fee bundled in the management fee and this is not explained to the investor, the fund would look more expensive than an unbundled fund. Frequent fee reporting could lead to investors putting too much emphasis on fees because the costs are solely presented, thereby making them especially salient.[49]

Because investors feel losses more strongly than gains (the pain of losing money is psychologically twice as powerful than gaining the same amount),[50] repeating fee information on its own could lead investors becoming highly sensitive to any degree of loss. They may become conservative in their investing such that they are overly focused on lower-fee funds and fail to consider the net value of their holdings. This follows from the fact that individuals pay more attention to and are more affected by negative than positive information.[51] Given that investors would not get visibility into their returns in the quarterly statements, their immediate perception of investment progress could be skewed to the losses (i.e. costs) of investing, which does not demonstrate the values attached to fees, and they could become fee averse (i.e. avoid high-fee funds).

To mitigate the likelihood of investors negatively overweighting fee information due to information repetition, one option can be to omit fee disclosures in quarterly statements. In this case, investors could still obtain information about fund product costs upon request or through other sources such as MRFPs, financial statements, and fund managers' websites. Alternatively, if quarterly fee reporting is introduced, it would be helpful to leverage fee descriptions that positively convey fee purpose, so that investors do not become overly focused on just their costs. In the Amendments, there is the following phrasing: "The managers pay us ongoing trailing commissions for the services and advice we provide you" (p.30). An iteration of this phrasing, specific to MER and TER, could provide more explicit reference to the services that fees help to maintain and be framed with greater investor agency: for example, "The fund expenses that you pay contribute towards the ongoing professional management, operating costs and taxes of the fund that you have invested in." An analogous statement may help reduce the skewness that investors would experience when looking at fees alone in quarterly statements.

49 Rosen, T. (2018). *Should US Companies Adopt Semi-Annual Reporting? An Analysis of Quarterly Reporting Requirements and the Practice of Earnings Guidance (Doctoral dissertation*, Brown University, Providence, Rhode Island).

50 Novemsky, N., & Kahneman, D. (2005). *The boundaries of loss aversion*. Journal of Marketing Research, 42(2), 119-128.

51 Baumeister, R. F., Bratslavsky, E., Finkenauer, C., & Vohs, K. D. (2001). *Bad is stronger than good*. Review of General Psychology, 5(4), 323-370.

# Impacts on investors

**Annual Reports**

When it comes to Annual Reports, research finds that investors are more likely to desire and use Annual Reports if financial information is described in less technical terms.[52] This is already reflected in the Amendments, which is the inclusion of simpler text descriptions and explanatory notes.

In an evaluation of investor preference, the U.S. Government Accountability Office found that 61% of investors reported wanting fee information for comparing investment options annually while only 34% preferred it quarterly.[53] The greater preference for Annual Reports and their completeness in fund information make them more relevant for investors, their comprehension, and their investment-holding decisions.

For the Annual Reports where additional investment information is included, investors would be expected to be comparing the fees—which would be improved through clearer explanatory notes, cost breakdowns and dollar framing—with other fund information. The presence of information about returns and performance (i.e. the net gains) helps reduce the likelihood of loss aversion and fee aversion. Contextualization should then occur more intuitively and there should be a lower risk of investors being overly focused on the costs due to the availability of other fund and account information.

**Suggested considerations for fee reporting frequency**

The risks from ongoing fee disclosure in quarterly statements may be greater than the risks from disclosing them in Annual Reports. Given that quarterly statements would lack the fund information that help contextualize the value that fees bring to investments (e.g. information about returns), this frequency poses an increased risk for loss and fee aversion among investors because of the tendency to overweight negative information. Furthermore, the saliency of fees on their own in quarterly statements can also impact highly financially literate investors, who have been noted to actively avoid high-fee funds, as they become increasingly aware and focused on investment charges. Lastly, as described earlier, none of the Reviewed Jurisdictions require fee disclosure on a more frequent basis than annually, unless fees have changed at the investor level (i.e. EU, UK). This may suggest that there is limited evidence in favour of more recurrent fee disclosure beyond annual reporting.

For Annual Reports, there are two key elements that make them the more ideal medium to deliver fee disclosure. First, Annual Reports will contain other fund information alongside cost information. The availability of these insights helps investors contextualize their funds by reallocating their attention away from just the fees alone and instead, toward a higher-level evaluation of the net value that their holdings bring to them. Second, while captured in only one research survey, it was found that there is a greater number of investors who simply prefer fee information annually rather than quarterly. At minimum, this provides an early indication that fee disclosures in Annual Reports would benefit investors because positive preferences help facilitate action (i.e. investors would be more inclined to review and use the information in Annual Reports).

For these reasons, we suggest that Annual Reports would be the effective method for ongoing fee disclosure, compared to quarterly statements, to enhance investor protection. Annual disclosure should take precedence and quarterly fee reporting could be later considered if an investor knowledge gap is found due to a lack of frequent fee disclosure. The Annual Reports would summarize fees against the backdrop of goals and return over time, which will provide greater benefit to investors by supporting their ability to contextualize costs against gains. Annual fee reporting would also pose a lower risk for investors in terms of the propensity for loss aversion or fee aversion.

52 Epstein, M. J., & Pava, M. L. (1994). *Individual investors perceptions on the summary annual report: A survey approach*. Journal of Applied Business Research (JABR), 10(3), 60-67.

53 United States Government Accountability Office. (2021). *Many Participants Do Not Understand Fee Information, but DOL Could Take Additional Steps to Help Them*.

# Operational impacts for industry

# Operational impacts for industry

## Introduction

This section of the report assesses the efforts (cost and time) that would be incurred by the fund industry in adopting the Amendments. The costs involved are important to understand because they are often passed onto investors to some degree. To assess the expected cost and time, we held discussions with industry members to understand how they expect to be impacted by the Amendments.

While we are able to comment high-level on the industry implications, our scope does not include a detailed assessment of the proposed timelines and costs in complying with the Amendments. We also note that, through our consultations, industry members are reluctant to begin their cost planning until the intricacies on the Amendments are finalized.

## Outline of new process requirements

The Amendments will require changes to the data flows between the Mutual Fund Managers and dealers, and thus will affect each of the entities involved in the process. Currently, MER and TER information is made available to investors at a fund level via the MRFP and Fund Facts documents. Investor-level information is compiled and provided to investors by the dealer in accordance with regulatory requirements, including those related to CRM2.

With the proposed changes, the following updates will be required to the data flow:

**Quarterly statements:** Mutual Fund Managers will compute and transmit MER, TER and fund expense ratio percentages to dealers, potentially through an industry intermediary such as Fundserv, which in turn will transmit the information to the dealers, or potentially through other data distributors such as Fundata. The dealers will then need to combine this information with the relevant fund investment shown in the quarterly statement provided to investors. MER and TER data is updated semi-annually in connection with annual and semi-annual filings of MRFP documents by Mutual Fund Managers for each fund. A process to capture updated information will therefore need to be built into the dealer's quarterly statement production process.

**Annual Reports:** Mutual Fund Managers will be required to compute daily cost factors (at the per unit per series/class level) and transmit these to Fundserv (or other intermediary) as part of their daily data feeds. Fundserv would then transmit this information to the dealers, who in turn would be required to store the daily investor- or unit-level information. For the purpose of annual cost reporting, the dealer will use the cost factors for each series/fund at an investor level to compute the cost based on the investor's units held, taking into account purchases, sales, re-investments, adjustments, etc.

**Special considerations for ETFs:** ETFs will require more significant process changes than mutual funds. Currently, it is not possible for ETF Managers to track investor-level information; therefore, daily cost factors would appear to be the required mechanism. As a result, the burden of tracking, collating and computing the investor-level costs is expected to fall squarely on the dealers. In addition, the processes, tracking and data flows for ETFs differ from those used for mutual funds: for example, the Canadian Depository for Securities (CDS) is involved in the existing process flow rather than Fundserv. As a result, we anticipate the potential for substantial incremental costs in developing a new solution and incorporating such different data flows.

# Operational impacts for industry

**Figure 16: Current data flow process**

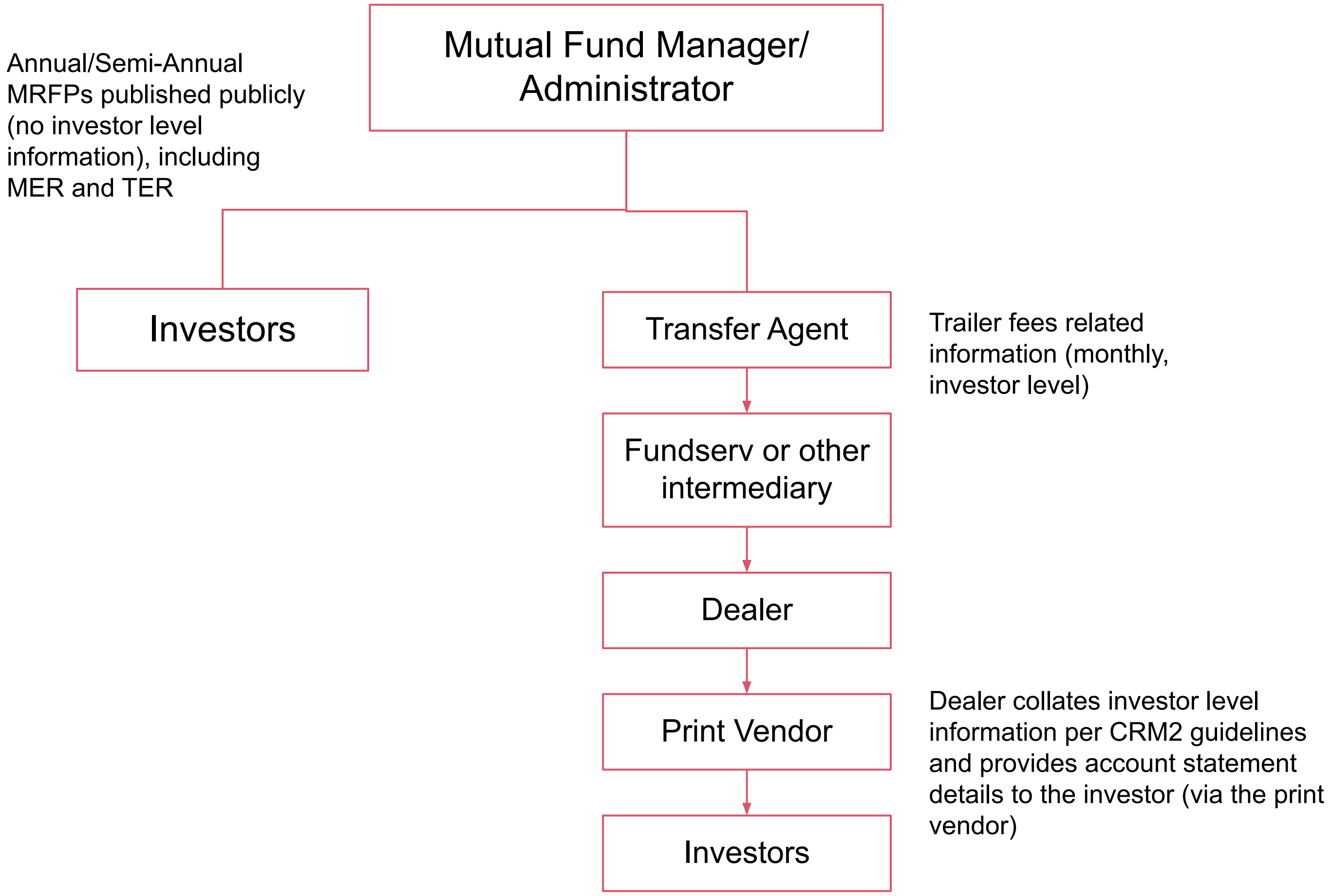
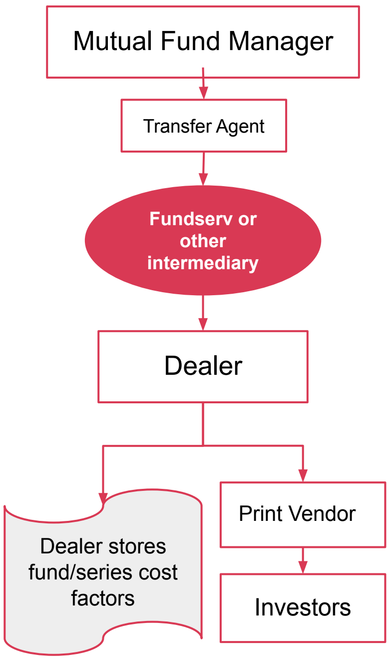



**Figure 17: Data flow process under proposed disclosure requirements**




**Cost Reporting Process under proposed guidelines**

Mutual Fund Managers to compute daily cost factors by series (based on MER and TER).

Fundserv (or other intermediary) to transmit cost factors and MER/TER percentages

Dealer stores fund/series cost factors and calculates total cost annually'

Dealer captures most recent MER and TER data to collate within quarterly statement

# Operational impacts for industry

## Impacts by stakeholder

In the following discussion, we provide a summary of the cost and time impacts of the Amendments on different industry stakeholders. We highlight the changes that are required, and provide a sense, where available, of the potential magnitude of cost. We also comment on the suggested timeframe for implementation.

The organizations we discuss are:

- Fund Managers (i.e. Mutual Fund Managers and ETF Managers)
- Dealers
- Fundserv
- Other key service providers, such as transfer agents and dealer systems providers.

In Canada, the MER and TER numbers, in percentage terms, are already being reported for investors semi-annually through the annual and semi-annual MRFPs and also through the Fund Facts and ETF Facts documents on at least an annual basis and whenever there is a material change. However, filtering these numbers through to the investor level will require some significant changes in the way data is collected and processed by industry participants, including aligning on the architectural approach to be employed.

This is primarily because any data on fund value and related cost per unit would need to be collected daily for every fund in every account to calculate the dollar figure of fees paid. This is a large amount of data to track that isn't currently being collected. The additional data requirement will be a complex process for industry, particularly for firms who have a high number of funds and/or use multiple series for their funds and more involved fee pricing with investors and for dealers with significant numbers of product codes. As is discussed below, the multi-stakeholder involvement and requirement for system development across industry participants is also a critical part of the change process.

In assessing anticipated impact on their operations, industry members often referred to their recent experience transitioning to the CRM2 framework. We have noted later in this section some of the similarities and differences in these two change processes as well as how the timelines and costs might compare.

**Fund Managers**
In order to comply with the quarterly disclosure requirements proposed in the Amendments, Mutual Fund Managers will need to add the MER/TER information to other data they already provide to their transfer agent, who then connects to Fundserv to pass on into the dealer system. This will require a change to data fields in the required file formats, and related programming to ensure the relevant data is properly captured on a timely basis.

For purposes of the annual disclosure requirements, the Joint Regulators propose that in addition to the current duties, investment fund managers will provide daily cost per unit or share of the relevant class or series of an investment fund calculated in dollars.

The suggested formula is (A/365*) x B = C, where:

- A = FER of the fund
- B = Unit price for the day of the fund
- C = Daily dollar cost per unit for the fund

*N.B. Every four years, the formula will require division by 366 days, due to the leap year.

# Operational impacts for industry

While our interviews with industry members indicate that fund managers are expected to be tasked with the calculation and transmission to intermediaries of the daily cost factors and FER, as applicable, as a result of the Amendments, questions remain around how fee complexities will be dealt with, and also whether this is the most efficient process to use, as noted below.

One question relates to timing of availability of current MER and TER data that will make up the FER. Many fund products utilize a calendar year-end, and MER and TER data is published typically between 60 and 90 days after year-end. Thus for the annual cost disclosures, the daily cost factor being transmitted by fund managers for their reporting issuer-regulated funds will be based on the most recently available MER/TER, which will be lagged by up to approximately six months. Industry participants have noted that the calculated aggregate amount of fund expenses incurred by the investor will, as a result, be an estimate rather than an exact amount. Furthermore, in the first year of operations until financial statements are first issued, new funds do not have a published MER or TER, and it has been noted that initial TER calculations are often high and unrepresentative of an expected normal level of operations. Using such an unrepresentative TER, which, due to the previously mentioned time lag, would be applied to an investor's holdings in a period subsequent to the period in which it occurred, would add another potentially inappropriate estimate into the annual cost amount. Solving these types of data challenges are likely to cause additional process costs for fund managers and dealers.

Other considerations for fund managers, and ultimately dealers, include how fees will be calculated with more complex pricing structures in place, such as tiered pricing or account householding, adjustments to expenses on account of fee waivers or over/under accrual of expenses, and nuances for ETF products such as use of net asset value versus closing market value of a fund.

As previously noted, industry participants identified challenges with the prescribed nature of the CSA's suggested process for calculating the formula. In particular, this process determines who calculates the ultimate cost to the investor. For the mutual fund industry, an alternative process could see the transfer agent for the Mutual Fund Manager do the investor-level calculation and transfer that data point through Fundserv on a monthly basis, similar to the current process for trailer-fee costs. However, the current draft proposals do not appear to allow for that as a potential solution.

**Fundserv**
Mutual Fund Managers are expected to provide the required data through Fundserv or another intermediary.[54] Therefore, Fundserv and other intermediaries are expected to be an important part of implementing the Amendments. The largest expected change for Fundserv—which currently deals with over 100,000 fund codes in their system—will be the requirement to create a new file standard or amend existing files to send to the dealer, in order to include the daily cost factor information and MER/TER data for these fund codes. This requires establishing the data protocol with all stakeholders, through an industry working group, for the new or updated files. We corroborated the reasonability of industry members' contention that regulations must be in place before they begin system changes with PwC technology specialists, who see this step as foundational and thus requires very specific guidelines.

The new data requirements will have to be computed by the Mutual Fund Managers within their fund accounting function and initially passed to the transfer agency function (that is in many cases an outsourced function to the Mutual Fund Manager). Transfer agency systems will thus have to be adjusted to support this new data flow. This data will need to be programmed to be included in the new data fields and passed through Fundserv's system to be received and stored by the dealers. The most efficient solution to enable this data transfer will need to be finalized and may ultimately reflect different files being used for the two types of data (the relatively static FER, and the daily cost per unit amounts).

54 We note that some of this information could end up being sent via a data distributor like Fundata or Morningstar. It should be recognized, however, that these entities have varying business models and currently may not serve all participants in the industry.

# Operational impacts for industry

Given the nature of anticipated change and the large number of stakeholders (Mutual Fund Managers and dealers, transfer agents and dealer systems), it is expected to require a multi-year project, similar to previous CRM2 changes (that took over three years from issuance date to the effective date for the two new Annual Report requirements), including build, test and finalization phases plus collection of the initial year of data.

**Dealers**
In complying with the quarterly Amendments, dealers will need to extract the new FER data provided, store it as required, and then build an interface to input it into the investor statements, likely requiring coordination and programming changes with print vendors.

Complying with the Annual Report requirements will be more complex, as under the current proposals, dealers will need to take daily dollar costs for each series of each fund in each account and store this information. This information is not currently being tracked, so would require new systems and processes to be put in place. Industry participants have noted that they maintain thousands and, in some cases, tens of thousands of fund codes, which will significantly impact both complexity and cost to develop and maintain an appropriate storage and calculation process.

Fund codes vary depending on the fund’s product design (reflecting multiple series as well as front-end, DSC or low-load options, etc). If the dealers are required to track significant numbers of these fund codes (which require a NAV x daily fee rate calculation), performed daily for the year and personalized for each client, this is likely to create a significant requirement of data storage and analysis, whether the calculation for each investor is done daily and accumulated, or calculated once at the end of the reporting period. Not all dealers have the databases and storage solutions to deal with these requirements, and the estimated cost to build these additional capabilities is expected to vary by size of dealer and is not currently estimated.

The Joint Regulators also suggest that when disclosing the FER of each fund as well as the total dollar amount of fund expense for an investor, there is a requirement for dealers to include a description of any assumptions or approximations made in the calculations. As more detailed solutions are developed, a greater sense of the likelihood of such assumptions will become apparent. Tracking any assumptions in order to ensure appropriate and sufficient disclosure will be an additional burden both in implementation and on an ongoing basis.

Another concern that was raised by some of the larger institutions, such as banks, was with having multiple distribution channels, which may not necessarily be linked with one another. Since systems vary across distribution channels, the operational challenge has greater complexity in supporting dealer reporting changes through multiple process and system changes.

According to our industry interviews, the dealer-side costs are roughly estimated to be in the hundreds of thousands of dollars for smaller firms and up to several million dollars for larger firms, although many interviewees had not yet started to consider a cost estimate. The main one-time implementation-related cost drivers are expected to be the required system changes, development of a storage solution and programming to capture the data, and the need to reprogram and redesign for both quarterly and Annual Report. Furthermore, as much of the industry is reliant on third party system providers (fund accounting, transfer agency, dealer systems and print vendors), charges from these vendors are currently very difficult to estimate.

While the estimates provided above are indicative only, the dealers are able to use the recent changes to CRM2 as a reference point for expected costs, although in that case the data points collected for investor-level trailer fees, for example, were generally only 12 monthly data points. Dealers we consulted with pointed to the changes in CRM2 as an example of the long “runway” required in implementing these system changes. Dealers will also have to bear additional recurring costs, relating to human resources, data storage and other operational costs.

# Operational impacts for industry

Additionally, potential solutions have not yet been identified to deal with ETFs, a product type that is experiencing significant growth currently, as well as other fund products that may not be settled through the Fundserv platform such as scholarship plans. These will all add incrementally more cost to dealers that sell these products, together with uncertain timeline expectations to achieve compliance.

## ETFs

ETFs provide unique challenges to the industry as, unlike mutual funds, the ETF manufacturers do not have transparency into who the unitholders are, nor is there the similar intermediary infrastructure provided by Fundserv for mutual funds. Nuances also exist for ETF series of mutual funds versus standalone ETF products. Therefore, and as noted above, dealers that sell ETF products will have to build a separate process with other intermediaries and potentially different infrastructure to collect, calculate and distribute the required data to investors.

Currently there is no immediate industry solution to support this data transfer. In addition, CDS, a key intermediary for the ETF industry, has significant projects currently underway related to post-trade modernization as well as the anticipated T+1 settlement change. While the full cost reporting implementation challenges will be felt across the ETF industry, we have heard from participants that it is likely that smaller dealers would be impacted most, which may create adverse consequences for product choice.

## Timelines

The Joint Regulators outlined some potential dates for transition to the new legislation. The key dates proposed were:

- for the reporting period ending December 2024, investors will receive the newly required information in their quarterly account statements; and
- for the reporting period ending December 2025, investors will receive the newly required information in their annual account statements.

Industry members anticipate that the required system changes across the industry from Mutual Fund Manager through to dealer would likely take up to two years when including time for finalizing data protocols, system build, testing and finalization. This is because no process currently exists and would have to be developed. Additionally, after the system changes have been put in production, the new systems will need to collect a calendar year of data in real time in order to prepare the initial Annual Reports. In total, adopting the Amendments may take approximately three years, and some industry participants expected that the timeline could extend to as much as four years following regulations being finalized. As noted above, ETFs face additional complications in adoption and may require more time for implementation timelines as a result.

Furthemore, we note that the industry will not be able to begin to implement the transition until the regulatory proposals are finalized. Our experience with regulatory change, as well as what we have also heard from our industry interviews, is that budgets for the detailed development spend do not reach approval stage until regulations are finalized and therefore no longer subject to change, particularly where cost estimates are expected to be substantial. As a result, detailed progress on building solutions is only likely to commence after that point.

While no direct comparisons are available for the timelines in implementation of the Amendments, we believe that the industry can look at the time taken to implement CRM2 as a benchmark. According to the OSC, the CRM2 Amendments[55] came into force in July 2013, with them coming into effect for the new Annual Report requirements in July 2016.[56]

55 Defined by OSC as "National Instrument 31-103 Registration Requirements, Exemptions and Ongoing Registrant Obligations (NI 31-103) and its Companion Policy (CP) relating to cost disclosure, performance reporting and client statements".

56 OSC (2014) Planning tips for implementing the "CRM2" amendments to NI 31-103 registration requirements, exemptions and ongoing registrant obligations, Available at: https://www.osc.ca/sites/default/files/2021-11/eb_20140307_crm2-faq-published.pdf

# Operational impacts for industry

Furthermore, given most firms were reporting on a calendar-year basis, the first time these amendments were passed onto clients was in January 2017 (reflecting the January 1 - December 31, 2016 year). This means that in practical terms, three and a half years passed (for most firms) between the published date of the finalized rules and the implementation of CRM2.[57]

The following table provides a comparison of the key changes related to CRM2 and the Amendments, and demonstrates that there are similarities in terms of the areas that the changes apply to, notwithstanding that the calculations and method of implementation may be different, particularly given the data requirements from investment fund products like ETFs.

**Table 4: Comparison between impacts of CRM2 and the Amendments**

| Area | CRM2 | The Amendments |
|---|---|---|
| Quarterly statements | Yes - New data fields (position cost, market value, etc.) | Yes - New data field (FER ratio) |
| Annual reporting | Yes<br>● Annual performance report (new)<br>● Annual cost and compensation report (new) | Yes - New data in Annual cost and compensation report |
| Trade confirmations | Yes - Additional disclosures | N/A |

57 OSC (2016) CSA Staff Notice 31-345 - Cost Disclosure, Performance Reporting and Client Statements - Frequently Asked Questions and Additional Guidance, Available at: https://www.osc.ca/en/securities-law/instruments-rules-policies/3/31-345/csa-staff-notice-31-345-cost-disclosure-performance-reporting-and-client-statements-frequently

# Appendix A: Acronyms and other abbreviations

| Term used in report | Definition |
|---|---|
| The Amendments | Proposed changes to the securities sector |
| Annual Report | The annual report on charges and other compensation |
| ASIC | Australian Securities and Investments Commission |
| CSA | Canadian Securities Administrators |
| CCIR | Canadian Council of Insurance Regulators |
| CDS | Canadian Depository for Securities |
| CRM2 | Client Relationship Model 2 |
| EFT | Exchange-traded fund |
| EU | The European Union |
| FDS | Fee disclosure statement |
| FER | Fund expense ratio |
| IFIC | The Investment Funds Institute of Canada |
| The Joint Regulators | The Joint Regulators of the Canadian Securities Administrators and the Canadian Council of Insurance Regulators |
| KIID | Key Investor Information Document |
| MER | Management expense ratio |
| MiFID | Markets in Financial Instruments Directive |
| Non-Super | Australian-managed investment products |
| OSC | Ontario Securities Commission |
| PRIIPs | Packaged retail investment and insurance products |
| PwC | PricewaterhouseCoopers LLC |
| Reviewed Jurisdictions | Australia, the US, the EU and the UK |
| Super | Australian superannuation products |
| TER | Trading expense ratio |
| UCITS | Undertakings for the Collective Investment in Transferable Securities |
| UK | The United Kingdom |
| US | The United States |

# Appendix B: Limitations

Our Services were performed and this Report was developed in accordance with our engagement letter dated May 25, 2022 and are subject to the terms and conditions included therein. Our role is advisory only. IFIC is responsible for all management functions and decisions relating to this engagement, including establishing and maintaining internal controls, evaluating and accepting the adequacy of the scope of the Services in addressing IFIC's needs and making decisions regarding whether to proceed with recommendations. IFIC is also responsible for the results achieved from using the Services or deliverables.

**Receipt of new information:** PwC reserves the right at its discretion to withdraw or revise this report should we receive additional information or be made aware of facts existing at the date of the report that were not known to us when we prepared this report. The findings are as of June, 2022 and PwC is under no obligation to advise any person of any change or matter brought to its attention after such date, which would affect our findings.

**Reliance on third party data/information**: We relied upon the completeness, accuracy and fair presentation of all the information, data, advice, opinion or representations obtained from third parties, public sources and IFIC, which are detailed under the references section (collectively, the "Information"). We have not conducted any audit or review of the Information, nor have we sought external verification of the Information. We accept no responsibility or liability for any losses occasioned by any party as a result of our reliance on the financial and non-financial information that was provided to us or found in the public domain.

**Use limitations:** This report has been prepared solely for the use and benefit of, and pursuant to a client relationship exclusively with IFIC. We understand that IFIC may share our report with third parties. IFIC can release this report to third parties only in its entirety and any commentary or interpretation in relation to this report that IFIC intends to release to the public either requires PwC's written consent or has to be clearly identified as IFIC's own interpretation of the report or IFIC is required to add a link to the full report. PwC accepts no duty of care, obligation or liability, if any, suffered by IFIC or any third party as a result of an interpretation made by IFIC of this report.

Further, no other person or entity shall place any reliance upon the accuracy or completeness of the statements made herein. In no event shall PwC have any liability for damages, costs or losses suffered by reason of any reliance upon the contents of this report by any person other than IFIC.

**This report and related analysis must be considered as a whole:** Selecting only portions of the analysis or the factors considered by us, without considering all factors and analysis together, could create a misleading view of our findings. The preparation of our analysis is a complex process and is not necessarily susceptible to partial analysis or summary description. Any attempt to do so could lead to undue emphasis on any particular factor or analysis. We note that significant deviations from the above listed major assumptions may result in a significant change to our analysis.

# Appendix C: Behavioural principles for fee disclosure

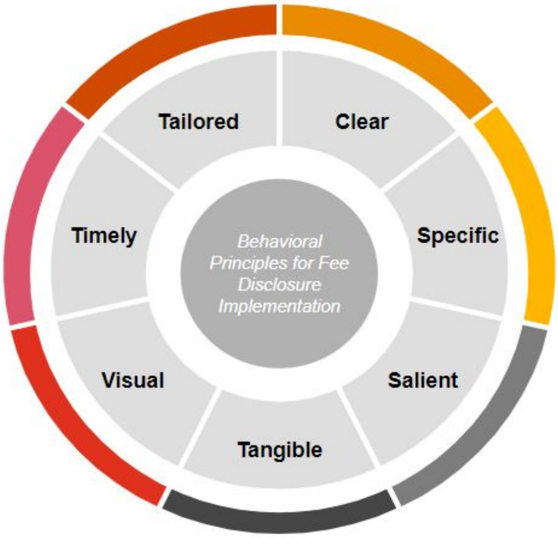
This appendix aggregates the key findings from the behavioural economics literature and research surveys into key principles that should be incorporated in fee disclosure to improve investors' understanding and decision-making.

The way fee disclosures are currently written in Canada makes them difficult for investors to interpret, and they are particularly bad at explaining and contextualizing fees:

- Investors have trouble understanding fees because disclosures use complex terms and jargon that are not accessible to most retail investors.
- The specific costs associated with fees are not clearly detailed in most disclosures, and investors lack supporting tools (e.g. summary tables) that would help them understand embedded fees.
- Many investors struggle to judge the magnitude of fees when presented as a percentage.
- Compared to other fund information, fees are not made salient and it can be difficult to contextualize all the information together in a way that still communicates fee value.
- The lack of visual tools to compare funds' fees and returns exacerbate contextualization difficulties.
- Overly repeating information that is solely about costs can negatively impact investor behaviour.

To overcome these barriers and enhance investor protection through the awareness of investment fees, seven behavioural principles are important for Regulators to embed in fee disclosure design and implementation. The principles will help facilitate transparency and investors are expected to have greater trust in the investment space.[58]

**Figure 18: Behavioural design principles for fee disclosure implementation**




58 Kanagaretnam, K., Mestelman, S., Nainar, S. K., & Shehata, M. (2010). *Trust and reciprocity with transparency and repeated interactions*. Journal of Business Research, 63(3), 241-247.

# Appendix C: Behavioural principles for fee disclosure

| Principle | Consideration for disclosure |
|---|---|
| Clear | Text descriptions will use simple terminology and active voice. All types of fees should be articulated using non-expert terms so that investors can comprehend and contextualize them. |
| Specific | Text descriptions will be concise. Where appropriate, direct callouts to fees should be made so that investors pay attention to them in the context of other statement information. |
| Salient | Highlighting, bolding, and information positioning (i.e. at the top of the statement) will be leveraged to increase fee visibility. Return information can be made salient with the fees. |
| Tangible | Dollar units will be used to represent fees, especially when paired with information about returns. This framing of fees is better suited than percentages for investor comprehension. |
| Visual | Infographics, charts, and tables should be applied to consolidate and summarize fee structures and their relation to returns. Fee disclosure should be visually and temporally represented by highlighting the impact of fees on returns so that investors can better understand the relationship. |
| Timely | Statements with fee disclosure should be delivered to investors at opportune times when they may be more interested and receptive to acting on the information. Since Annual Reports facilitate contextualization, this frequency likely brings more benefit to investors than quarterly statements. |
| Tailored | Statements should capture the true cost that investors have paid in fees for their investments (e.g. investor-level expense). Incorporating the investor's actual investment costs and invested amount reinforces the ability to comprehend the value of fees in their investments. |

- Act with integrity
- Make a difference
- Care
- Work together
- Reimagine the possible

## Who we are

At PwC Canada, our more than 7,300 partners and staff in offices across the country are committed to delivering quality in assurance, tax, consulting and deals services. PwC Canada is a member of the PwC network of firms with more than 295,000 people in 156 countries.

Find out more by visiting us at: www.pwc.com/ca.

## Our purpose, vision and values

At PwC Canada our culture is built upon two important building blocks: our purpose and our vision.

Our purpose is to build trust in society and solve important problems. Our purpose is what guides our decisions and shapes our conversations.

Our vision is ‘creating leaders, inspiring people and bringing perspectives together to achieve what matters most’. Our vision reflects who we are and what we want to be.

To deliver on our purpose and realize our vision, we’re guided by our values which are: Act with integrity, Make a difference, Care, Work together, and Reimagine the possible. Our values are what we have in common and define how we behave and work with our clients, communities and each other.

We are a community of solvers coming together in unexpected ways, trusted by clients and the world over. See how The New Equation can solve for you, visit: https://www.pwc.com/ca/en/the-new-equation.html