

INVESTOR ADVISORY PANEL

July 26, 2024

To: Financial Services Regulatory Authority of Ontario

25 Sheppard Avenue West – Suite 100
Toronto, ON M2N 6S6

Re: Proposed Rule 2024-002 – Total Cost Reporting

On behalf of the Investor Advisory Panel (the “Panel”) of the Ontario Securities Commission (“OSC”), I wish to thank you for this opportunity to comment on the Financial Services Regulatory Authority of Ontario’s (“FSRA”) proposed Rule 2024-002 – Total Cost Reporting (the “Proposed Rule”).

The Panel’s mandate

The Panel is an initiative of the OSC to ensure investor concerns and voices are represented in the OSC’s policy development and rulemaking process. Our mandate is to solicit and articulate the views of investors on regulatory initiatives that have investor protection implications.

The Panel’s comments

The Panel is supportive of the Proposed Rule and its objectives. The Panel believes that transparency on the full cost of products and services is a critical element of ensuring trust and confidence in our financial system. Total cost reporting allows investors to compare products, features, and services based on consistent cost information regardless of the regulatory jurisdiction under which the product or service falls. The Proposed Rule aims to make cost reporting not only comprehensive, but also largely standardized and consistent for both investment funds and segregated funds. By bringing reporting and fee transparency for segregated funds closer to the reporting requirements of CRM2, the Panel believes the Proposed Rule will promote greater clarity and reduce confusion for investors, improving trust in the financial system.

Individual variable insurance contracts (“IVICs”) can be a useful tool for business owners, for succession planning due to tax benefits, and generally for investors who prefer to have a full or partial guarantee on investment amounts. While the Proposed Rule is focused on insurers’ ongoing annual reporting requirements, the Panel strongly believes that total cost reporting and disclosures are critical at the point of sale of an IVIC, given that it is a long-term binding agreement. This would make the practice of fee disclosure consistent across most investment vehicles, benefiting not just investors, but advisors and wealth firms who are responsible for executing a single process.

Furthermore, given the transparency principle of this policy, the Panel advocates that FSRA require firms offering IVICs to explicitly state the cost of the insurance premium (similar to the annual reporting requirements of the Proposed Rule) in fund fact sheets and accompanying information folders at the point of sale. At present we believe this cost (as presented) is embedded in the MER, which makes it difficult for an investor to understand and compare the explicit cost of the IVIC's guarantee.

Regarding the specific consultation questions set out in the Notice of the Proposed Rule, the Panel provides comments as follows:

1) Identify the different circumstances where full compliance with the Proposed Rule would not be in the customer's best interest and in particular, how it would result in costs to customers that would exceed the benefit to the same customers.

The Panel does not believe that the Proposed Rule will result in substantial costs that will eventually be passed on to investors. First, many firms that offer IVICs also offer mutual funds, and as such are already preparing to implement Total Cost Reporting for those products. Where such firms can leverage existing processes, the Panel does not believe that the Proposed Rule, which will require similar disclosures, will add material cost to what is already in flight.

Second, we point to the CSA's recent fee study,¹ which clearly indicates that fees for investors have continued to fall since the implementation of CRM2 – which itself required abundant costs to implement. While CRM2 may not have been the cause of the lower fees, and it is not known whether the cost of implementing the Proposed Rule will be passed on to investors or will ultimately result in lower fees, the Panel believes that, despite the initial costs, the Proposed Rule offers an evident benefit to investors in the form of enhanced disclosure.

In short, the Panel does not believe that the costs of full compliance will outweigh the benefits to investors over time.

2) b): How would full compliance with the Proposed Rule impact different types customers (e.g., customers with only IVICs, customers with both IVIC and mutual funds)?

In the Panel's 2022 comment letter on the CSA/CCIR consultation on Total Cost Reporting, we recommended that four key datapoints be prescribed and prominently displayed on annual statements. Specifically:

- A. The value of the investor's account at the beginning of the year;
- B. The net amount of all of their deposits to and withdrawals from the account (if any) during the year;

¹ <https://www.securities-administrators.ca/wp-content/uploads/2024/04/CRM2-Fees-Report.pdf>

- C. The total of all direct and indirect costs they incurred during the year to buy, sell and hold their financial products, along with all annual costs incurred for administration of their account; and
- D. The value of their account at the end of the year after deduction of the year's costs.

The Panel is pleased to see that these key items are required as part of the minimum display requirements in the Proposed Rule, and greatly appreciates the details around component fees such as the cost of insurance contract and advice fees.

However, we believe that the minimum requirements should also prescribe a further breakout that includes dollar amounts paid for the management of assets (management fees) and amounts paid for distribution and advice (advice fees or trailing commissions) in a comparable format to what is prescribed for the mutual fund industry in the enhanced cost disclosure reporting requirements published April 20, 2023 (the "TCR Enhancements").² With respect to comparability, we note that the IVIC reporting example in Annex I of the TCR Enhancements (p. 68) does *not* have the cost of advice and distribution split out on the same table, nor does it have the same level of detail. The Panel notes that the Proposed Rule does not provide examples of reporting, unlike the TCR Enhancements. Given that the objective of the Proposed Rule is to require Total Cost Reporting (i.e., is more prescriptive), we question whether explicit examples might be beneficial for industry (and investors), to ensure compliance. We believe that the inclusion of advice fees in the same format as required for mutual funds and ETFs would further harmonize the client reporting rules and terminology between insurance product (IVIC) sales channels and investment fund (mutual fund and ETF) sales channels, which in turn would facilitate comparability, such that an investor can make a well-informed decision on not only what product to purchase, but from whom.

Furthermore, the differences in the regulatory regimes for mutual funds and IVICs create a conundrum. Licensed mutual fund dealers, unlike IVIC salespersons, are subject to the Client Focused Reforms, which directly address conflicts of interest. The Panel would like to bring to FSRA's attention the fact that dually licensed advisors (those who can distribute both investment funds and segregated fund products) face their own conflict in that the compensation structure between these two products can differ greatly. Advisors should not be motivated by compensation to recommend one product over another, and the Panel fears that a lack of harmonization will further be used to exploit the two distinct regulatory regimes. For clarity, a dually licensed advisor might be more motivated to sell an insurance product over an investment fund based on the compensation they receive, rather than what is in the client's best interest. Though FSRA may not be able to control the actions of dually licensed advisors, it can require harmonized reporting that will make the differences in fee structures and amounts between investment products easier for investors to understand and consider. Accordingly, reporting for IVICs should include a breakout of what is paid in advice fees, in a similar format to reporting for mutual funds.

² https://www.osc.ca/sites/default/files/2023-04/csa_20220420_31-103_nop-total-cost-reporting.pdf, p. 46, Appendix D, "What we received".

We believe this element of the display is important as it allows the investor to not only understand how much is paid, but to *whom* it is paid. This type of detailed disclosure allows for an investor to appreciate precisely how much they are paying for advice.

In the case where an investor owns both IVICs and investment funds, the lack of a prescribed standard format for Total Cost Reporting does not facilitate comparability. This hampers investors' ability to make educated decisions and ensure continued value and satisfaction from the advice relationship.

Finally, a unique feature of IVICs is a commitment from the investor to hold the contract through to maturity. Drawing parallels to the banking/retail mortgage industry, it would serve investors well to have a prescribed display of the cumulative amount of total fees paid, in addition to yearly fees as stipulated in the Proposed Rule.

2c) What is the anticipated frequency of each circumstance occurring?

The Panel points to industry data showing that at the end of March, more than half of licensed advisors in Canada are licensed to sell both mutual funds and segregated funds.³ The proportion of dual-licensed advisors increases dramatically across the 'Big 6' banks; about 72.4% of advisors within the bank channels can sell both types of products.

The Panel believes that the potential for IVICs to be sold alongside (or in place of) more traditional investment funds is a frequent occurrence. As such, the frequency of having to report total cost for both investment funds and IVICs to retail investors would not be insignificant.

2d) How would full compliance with the Proposed Rule result in outcomes that are not in the best interest of the customer?

Full compliance with the Proposed Rule would be a step in the right direction for current IVIC holders and generally in the best interest of clients.

However, as mentioned in our response to 2b), we believe that harmonization with the TCR Enhancements would facilitate far greater comparability to similar products (i.e. those without insurance wrappers/guarantees). To this end, we encourage FSRA to modify minimum display requirements to ensure comparability with the mutual fund industry across all fee types, and specifically around advice fees. This has the added effect of encouraging, where the investor feels appropriate, more engagement with advisors to ensure that they are deriving value from the advice relationship.

2e) How would an exception be consistent with the fair treatment of customers?

The Panel does not believe that plain, contract-level fee disclosures should be subject to any exceptions.

³ <https://www.investoreconomics.com/reports/retail-brokerage-and-distribution-quarterly-update-spring-2024/>
Page 28, Table 28 "Number of Advisors and Dual Licensed Advisors at Big Six and Other Full-service Brokerage Firms"

We once again graciously thank FSRA for the opportunity to comment on the Proposed Rule. We would be pleased to clarify or elaborate on our comments should the need arise.

Sincerely,

A handwritten signature in blue ink that reads "James Sinclair". The signature is written in a cursive style with a large, stylized initial "J".

James Sinclair

Acting Chair, Investor Advisory Panel