Via email: comments@osc.gov.on.ca; consultation-en-cours@lautorite.qc.ca

April 4, 2013

British Columbia Securities Commission
Alberta Securities Commission
Saskatchewan Financial Services Commission
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
New Brunswick Securities Commission
Registrar of Securities, Prince Edward Island
Nova Scotia Securities Commission
Superintendent of Securities, Newfoundland and Labrador
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Yukon Territory
Superintendent of Securities, Nunavut

Attention:

The Secretary
Ontario Securities Commission
20 Queen Street West
19th Floor, Box 55
Toronto, Ontario M5H 3S8

Me Anne-Marie Beaudoin
Corporate Secretary
Autorité de marchés financiers
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Montréal, Québec H4Z 1G3

Dear Sirs/Mesdames:

Re: CSA Discussion Paper and Request for Comment 81-407 Mutual Fund Fees

This comment letter is being submitted on behalf of the following entities within RBC: RBC Global Asset Management Inc.; RBC Dominion Securities Inc.; Royal Mutual Funds Inc.; RBC Direct Investing Inc.; RBC Phillips, Hager & North Investment Counsel Inc.; and Phillips, Hager & North Investment Funds Ltd. We are writing in response to the Canadian Securities Administrators' ("CSA") request for comment on Discussion Paper 81-407 – *Mutual Fund Fees* published on December 13, 2012 ("Discussion Paper").

We appreciate the CSA's efforts to examine the mutual fund fee structure in Canada, whether there are investor protection or fairness issues, and to determine whether any regulatory responses are needed and appreciate the opportunity to comment.

At RBC, we support the principles of strong investor protection and fairness and believe that mutual funds are an effective investment vehicle for all investors, particularly retail and mass-affluent investors. We also wish to highlight the importance of access to financial advice for investors. Globally, investors have experienced two financial crises between 2000 and 2009. Financial crises cause uncertainty and anxiety for many investors, which can result in investors making poor financial decisions. Advice and guidance can help those investors who seek it to develop a financial plan and stick to it, particularly during periods of market stress. Financial markets and investment outcomes may not be entirely predictable, but investors can succeed by focusing on what they can control. In particular, they can succeed by having a financial plan or strategy in place that matches their objectives, risk tolerance and time horizon, and by managing their expectations, risk exposure and costs, as well as being disciplined about saving, diversification, and periodic rebalancing.

As noted in the Discussion Paper, for Canadians, mutual funds are the most widely-held investment vehicle. They are also among the most highly regulated investment products in Canada. Accordingly, in considering revisions to the current regulatory regime governing mutual funds, we respectfully request that the CSA carefully consider:

- What specific regulatory gaps exist;
- Whether the introduction of new rules for Point of Sale disclosure and the Client Relationship Model will sufficiently address identified regulatory gaps before considering additional proposals;
- Addressing identified regulatory gaps across the full spectrum of financial products that are offered to retail and mass affluent investors, rather than applying additional regulation only to mutual funds or prior to comparable regulation being applied to other financial products. As referenced in the Discussion Paper, the issues identified are not unique to mutual funds; and
- The potential unintended consequences from additional regulation, informed by a review of developments in foreign jurisdictions, such as the implementation of the Retail Distribution Review ("RDR") in the U.K., including the impact of those developments on investors and the industry in those jurisdictions. The U.S. mutual fund industry is the largest in the world, and experience to date suggests that unbundling management fees from fees-for-advice generally reduced access to advice, resulted in higher account turnover and, increased total shareholder costs for lower-wealth investors.[1] In particular, we are concerned that if adviser compensation cannot be included within product fees charged by mutual fund manufacturers, this could have the unintended consequence of removing or limiting an investor's access to advice in certain circumstances, especially with regard to clients that have smaller amounts of investible assets.

Our Fundamental Beliefs

To provide background and context to our comments, our approach has evolved in a manner consistent with the following fundamental beliefs:

- mutual funds are an effective investment vehicle for all investors, particularly retail and mass affluent individuals;
- the total cost to investors of owning mutual funds in Canada is comparable with other developed markets[2];
- access to financial advice is valuable to investors[3];

[1] "The U.S. Mutual Fund Industry: Evolution of Compensation for Financial Advisor Relationships, Strategic Insight

[2] "Monitoring Trends in Mutual Fund Cost of Ownership and Expense Ratios. A Canada – U.S. Perspective", Investor Economics and Strategic Insight, November 2012

[3] "Econometric Models on the Value of Advice of a Financial Advisor", CIRANO Institute, July 2012. Clients with advisors are more likely to start investing earlier, invest regularly, save enough, diversify and have a financial plan. These behavioural activities are core attributes to investing successfully.

- investor choice is important; specifically, investors have the right and the ability to choose whether to seek financial advice or not, and to choose how to pay for that advice and service;
- transparent disclosure of the cost of investing in mutual funds is important, including what investors pay the fund manager and the dealer; and
- a competitive market, where businesses determine what client segments to pursue, what products and services to offer, and what fee options to make available, is the best policy option for clients.

We believe that given sufficient information, access to advice, and choices, investors will choose the model that best suits their needs, and reward market participants based on their ability to deliver value through investment solutions and in the way they do business.

Evolution of Mutual Fund Fees in Canada

The evolution of the current fee model in Canada has resulted in many positive developments. In considering questions about investor protection and fairness, we believe it is important for the CSA to take this into account. It is noted that the Discussion Paper summarizes the evolution of fund fees in Canada and identifies the following four trends, which we have set out below along with our comments on positive elements we believe are associated with these trends:

1. Trend away from transaction-based sales commissions. Over the past two decades, this has contributed to the evolution of, and accessibility to, advice. Advisors have moved away from a transaction orientation that is supported by 'one-time' product sales commissions to an advice-based orientation supported by a fee-based business model in both a "bundled" (trailing fee) and "unbundled" form (separate fee charged directly by the dealer, combined with "F" Series mutual funds with no embedded trailing fee).

2. MERs trending down. This is a positive development for investors. Some portion of the decline may be attributable to changes in asset mix, but the Discussion Paper highlights declines in MERs for both fixed income and equity funds. Part of this trend is driven by lower-MER fund families gaining market share over an extended period. While it is difficult to quantify the exact impact of lower MERs on net sales/market share, this decline offers *prima facie* evidence at least that the market is competitive and that many advisors/investors consider MERs when selecting mutual funds. This trend is reinforced by decisions of certain higher-MER fund companies to lower fees.

3. Advisors increasingly relying on trailing fees as source of revenue. This is consistent with the trend away from transaction-based sales commissions. As transaction-based sales commissions decline, the percentage of advisor compensation earned from trailing fees automatically increases. In our view, this promotes the ongoing provision of advice and service to a greater extent than an "up-front" product commission model. Trailing fees have been a source of revenue that enabled dealers to broaden the services available to clients beyond product research and recommendations. Services may include financial planning, portfolio construction, ongoing monitoring and rebalancing, retirement planning, suitability reviews, client reporting as well as compliance and supervisory functions.

4. Trailing fees generally remaining steady or increasing. Trailing fees are identified as a potential or perceived conflict of interest, which may require enhanced disclosure and/or regulation. The conflict is potentially an unintended consequence of the transition from a transaction-based approach to a trailing fee-based approach. This transition is an ongoing, material, deliberate and, in our view, positive trend. It is important to note that this has resulted in a significant number of positive developments for individual investors over the past 20 years:

- greater access to advice and choice, particularly for retail and mass-affluent investors[4];
- lower costs of investing in mutual funds, including less frequent and lower up-front commissions and fewer investors being restricted by redemption penalties;
- better disclosure of the total costs of investing; and
- a more sustainable and effective long-term business model for dealers than a transaction-based business model, that is aligned with client interests, and that is better able to meet enhanced regulatory compliance as well as client service expectations.

In addition to the positive trends noted above, we believe that the CSA and the investment industry should also consider the following potential unintended consequences of additional regulatory restrictions. In particular:

- We are concerned about how investors and market participants may respond to additional regulations for mutual funds that are not also introduced for other financial products at the same time. In the Discussion Paper, the CSA anticipates that any regulatory options would include consideration of all investment funds and comparable securities. Therefore, we assume it is not the CSA's intention to create a disincentive for investors to invest in mutual funds or for advisers to recommend them, although this could be the result if certain changes identified in the Discussion Paper were implemented;
- We are also concerned about the potential reduced access to advice and choice for retail and mass-affluent investors. The early indication in the U.K. is that firms are focusing on higher net worth investors and that more advice firms are opting for 'restricted' advice status[5] than was originally anticipated. The U.S. experience suggests less access, higher costs, higher account turnover and potentially lower investment returns for lower wealth investors;
- Proposed changes may also potentially result in higher costs for investors. The November 2012 Strategic Insight paper "A Perspective on the Evolution in Structure, Investor Demand, Distribution, Pricing, and Shareholders' Total Costs in the U.S. Mutual Fund Industry" indicates in the U.S., fee for advice charges typically range from 1.00-1.50% of assets invested. In Canada, the embedded trailing fee model has provided some consistency, with the majority of trailing fees reported between 0.50% and 1.00%. It is not evident how individual dealers may choose to charge clients for investment advice and services or what level of fees may be applied. Early indications in the UK suggest there may be large differences across dealers, and that fees will increase for retail and mass affluent investors; and
- Any proposed requirement should include an assessment of potential behavioural changes by investors. We are aware that a number of studies have been conducted in the U.K. to identify the potential implications of the Financial Services Authority's implementation of its RDR. We encourage the CSA to allow sufficient time to assess the potential unintended consequences of these changes, which potentially limit client's access to advice, the investment options available to them, and ultimately investment outcomes (ie actual portfolio performance and actual savings rate). Choices exist for investors in the current competitive environment, and mutual funds are the mostly widely accessible investment option for investors today. We must ensure that advice remains accessible to those investors who choose to pursue it.

We believe it is important and necessary to fully assess the potential implications of any proposed regulatory change that goes beyond a discussion of the perceived merits and also takes into

[4] Today, the market offers investors a choice of how to pay their dealer; embedded within a mutual fund (Series A) or directly (Series F) and have lower cost options available (Series D) through direct channels.

[5] Firms can only declare themselves "independent" if they consider products from all providers and all areas of consumer finance. Firms that do not meet these criteria will be deemed to provide "restricted" advice status.

account the positive elements of the existing structure, as well as any possible unintended consequence of each reform proposal being considered.

Set out below are our comments on the specific regulatory reform proposals in the Discussion Paper:

1. Specifying and providing advisor services in exchange for trailing fees

We support disclosing the level of trailing fee and what services are being provided. Trailing fees are often referred to as the fee for advice. In actual fact, they provide revenue to support a much broader range of activities including the operational elements of distributing mutual funds (transaction processing, custody, issuing account statements, tax reporting, regulatory compliance, etc) and the advice and service provided to clients (financial planning, portfolio construction, ongoing monitoring and rebalancing, retirement planning, tax reduction strategies, etc). Trailing fees also provide funding to improve access to advice and service through phone, internet or mobile devices. This proposal should take into account and be consistent with the introduction of new rules for Point of Sale disclosure and the Client Relationship Model.

2. Creating a standard series or class of securities available for DIY investors

We support the principle of investor choice. A limited number of Mutual Fund Managers offer a series specifically designed for DIY investors. For example, RBC Global Asset Management Inc. currently offers over 100 of its mutual funds through Series D for investors choosing to invest through a direct channel. Series D pays a reduced trailing fee to this channel, which may not provide investment recommendations or advice to clients, but does provide other services including, online and phone access, transaction capability, custody, account statements, tax reporting, and access to investment research. It is ultimately the investors' choice whether to select a Series D fund, and market demand should determine whether fund managers choose to make additional Series D or similar funds available through direct channels. Respectfully, we are of the view that it is not good policy to attempt to direct investors to non-advice channels or to require all fund managers to offer a series for DIY investors, irrespective of whether there is market demand and irrespective of the economics and business considerations of each individual fund manager.

3. Unbundling the trailing fee component from the management fees.

We strongly support the principle of providing transparent and easily-understood cost disclosure in Point of Sale documentation, such as the Fund Facts document, about the level of trailing fees and about the nature of the advisor services that are being provided to investors. We also support treating any such increase in trailing fees as a material change for the relevant fund, thereby triggering the requirement to issue a news release and file an amendment to the simplified prospectus and Fund Facts document, as an option to enhance the effectiveness of this disclosure.

We are not in favour of unbundling the trailing fee component from the management fees and regulating it separately, as it is not clear how this would further enhance disclosure or have a positive impact on the overall cost of investing.

The need for security holder approval is apparent for increases in management fees, but less so for changes in trailing fees. Given the low participation rates for security holder meetings for investment funds, and the lack of clarity on how the security holder is directly impacted by a change of trailing fee, we believe that seeking approval is not an effective means of informing investors of changes to trailing fees.

In so far as such a requirement is considered a possible tool or mechanism to limit increases in the costs of investing, MER's are actually trending down, as noted under "Evolution of the Fee Model in Canada" on page 2.

4. Creating a separate series or class of funds for each purchase option.

We support the principles of disclosure and investor choice. The upfront sales commission is paid by either the investor (front end sales commission) or the fund company (deferred sales commission), not the mutual fund. It is unclear what a separate series for each purchase option would accomplish beyond disclosure, which can be addressed more directly than by requiring separate series.

The Discussion Paper compares the U.S. deferred sales commission ("DSC") model to the Canadian model on pages 54 and 55. Respectfully, in our opinion, there are two additional important considerations to comparing the DSC models in each country. First, the paper indicates that in the U.S., the financing cost of a DSC is borne by the fund in the form of a higher 12b-1 fee. However, a key difference in Canada is that the financing cost of the DSC is borne by the fund manager directly, rather than the fund. This funding cost is partially offset by reducing the trailing fee paid to the dealer firm compared with that paid on a non-DSC series mutual fund. In theory, a 5% commission would be financed over 10 years through a 0.50% reduction in the trailing fee (common for equity funds), and over 20 years through a 0.25% reduction in trailing fee (common for bond funds). Secondly, the prevalent approach in the U.S. is the unbundled fee-for-advice model coupled with the 12b-1 fee. Investors generally pay a direct fee for advice to their dealer in addition to the 12b-1 fee. If the fee is asset-based, it typically ranges between 1.00% and 1.50%. In Canada, the prevalent approach is the bundled trailing fee model and the trailing fee typically ranges between 0.50% and 1.00%.

If the Canadian investor were to bear the financing costs of the DSC model directly, it would most likely result in a higher MER for investors choosing the DSC option and no change for investors choosing the up-front commission option.

Respectfully, we do not believe this proposal enhances investor protection or fairness, and may result in higher costs for investors choosing the deferred sales commission option.

5. Imposing a limit on the proportion of fund assets that would be used to pay trailing fees.

We support the principles of disclosure and transparency. We are concerned about the implications of imposing limits and the risks of unintended consequences related to the regulation of market prices. The example used in the Discussion Paper suggests limits on trailing fees as a percentage of the overall management fee. It is our view that this would potentially have an unintended consequence of rewarding higher cost fund providers, by enabling them to pay higher trailing fees than lower cost fund providers. This would potentially put at risk the long-term trend noted earlier, whereby lower-MER providers, including RBC Global Asset Management Inc., have been gaining market share. Apart from a natural competitive concern with this proposal, we also believe it would be counterproductive to the CSA's objectives for investors.

The Discussion Paper also suggests a cumulative lifetime limit on the amount of sales and trailing fees that are paid by a purchaser of a mutual fund as an additional or alternative cap. Cumulative lifetime limits raise a number of administrative questions that would make this difficult to implement. They also raise concerns about possible fund and/or client turnover when limits are reached. We believe that cumulative limits ultimately would only serve to restrict the availability of investment advice and potentially distort the investment advice provided to investors.

Competitive forces and improved investor awareness have contributed to the trend away from transaction-based sales commissions, which has led to the evolution of, and greater accessibility to, advice over the past two decades. Any proposed policy should consider the potential impact on the accessibility of advice and consumer choice.

6. Introducing additional standards or duties for Investment Advisors.

It is noted that on October 25, 2012 the CSA published "Consultation Paper 33-403 – The Standard of Conduct for Advisors and Dealers: Exploring the Appropriateness of Introducing a Statutory Best Interest Duty When Advice is Provided to Retail Clients". RBC submitted a response letter to this paper dated February 22, 2013.

We provided the following comment in our above-noted response which we reiterate here: "it is anticipated that current industry efforts to implement various regulatory developments would result in increased transparency for investors and incent dealers to enhance their existing practices." And further: "Given that the regulatory objectives of Point of Sale Disclosure and the Client Relationship Model are to "raise the bar on industry professionalism and bolster investor confidence", consideration for adding further layers of regulation should take into account the actual benefits that investors may experience in practice."

7. Eliminating the payment of trailing fees by mutual fund manufacturers.

We support the principle of investor choice and are opposed to the prohibition of a pricing model to address perceived conflicts. The proposal to eliminate trailing fees restricts investor choice by potentially reducing access to or increasing the cost for advice and service, particularly for investors with smaller amounts of investible assets. The trailing fee has supported a number of positive developments for investors including broader access to advice, choice and greater consistency and transparency of the total costs of investing in mutual funds.

We anticipate that retail and mass-affluent households and investors will be significantly disadvantaged by the elimination of trailing fees by mutual fund manufacturers. All dealers would be required to develop and implement a fee-based account platform and establish policies and mechanisms to collect fees directly from client accounts. Currently, fee-based accounts are mainly offered by IIROC dealers. From our experience, this would be an expensive undertaking, which could prove too costly for some independent or smaller MFDA dealers. Fee based advisors may prove to be more expensive, for some investors, than embedded trailing fees, depending on the fee set by dealers. We are also concerned that only offering a direct fee-for-service model will create a disincentive for investors to choose the advice model, whether or not they have sufficient knowledge and experience to invest without advice, and could also lead to a reduction in savings rates over time. The option to invest directly, without advice, with lower fees, is available in the marketplace today. This option includes mutual funds with lower management fees, including over 100 funds offered through Series D by RBC Global Asset Management Inc. The option to separately pay for advice also already exists in the marketplace and RBC Global Asset Management, together with all major fund companies, offers lower-cost "F-series" funds for advisors and investors to use in these accounts.

Conclusion

We encourage the CSA to continue to emphasize greater transparency of both the product solutions offered by asset managers and the advice/services offered by dealers, rather than imposing price regulation and/or restricting choice in a market that in our view is functioning effectively. Investors are well served in an environment that fosters competition, which is enabled by investors having access to sufficient, comparable information to make informed decisions. For example, data shows that investors are increasingly choosing to invest in no load and zero commission front-end load mutual fund series.

In responding to client and advisor demands, market opportunities and our view of regulatory objectives, we have emphasized transparency, value and choice in our approach to the mutual fund industry. In fact, we have consistently supported the CSA's efforts to effectively and efficiently bring greater **transparency** to the market (such as our response to the Fund Facts disclosure document), and have embedded this principle in everything from the development of our products and how they are priced to how we vote our proxies on behalf of unitholders. Our mutual funds (RBC, PH&N and BlueBay, our UK-based fixed income investment manager) offer **value** through some of the lowest MER's in the market, with more than 90% of our funds being below the industry average and, in many cases, significantly below. Over the last several years we have expanded our business from a single fund family, single distribution channel to a multi-segment, multi-channel approach whereby we offer Canadians **choice** in how they access our mutual funds and vary the MER charged accordingly. At the same time, we have supported significant enhancements in the advice-giving capability of our distribution network, including increased availability and access to advice and our approach to Financial Planning and Wealth Management; with such improvements made possible through the trailing fee-based model.

This approach of transparency, value and choice has been critical to RBC Global Asset Management Inc.'s increase in market share of long-term funds in the Canadian mutual fund industry from 6% in 2002, to over 14% in 2012. While a portion of this growth came through the acquisition of Phillips, Hager & North Investment Management Inc. ("PH&N") in 2008 (3% at acquisition date), the majority has come through above–average organic growth of both the RBC and PH&N fund family. It is important to note that, prior to our acquisition of PH&N in 2008, PH&N funds were not effectively available through advice-based channels. By creating new "trailing fee" series of funds with excellent long-term track records and still low MER's, we were able to make these low-cost, high-performing funds available to Canadians who rely on advice-based channels while maintaining and, in fact, increasing access to lower-cost solutions for self-directed investors through series D funds.

It is difficult to accurately quantify the impact of any particular business decision on net sales and market share growth, and we definitely do not take our current success for granted as we face effective competitors - foreign and domestic, bank/insurance-affiliated and independent. However, we do offer this ten-year perspective on our growth in market share as evidence that competition in the mutual fund market exists and that, over time, advisors and consumers respond positively to products that provide transparency, value and choice and that are offered in ways that can be accessed by consumers in the manner they choose. In short, this is very tangible evidence that the mutual fund market is operating competitively in Canada and to the benefit of clients who are "voting with their feet" for transparency, value, and choice in terms of whether to seek advice or not, and how they pay for that advice.

While it is important to consider developments in other countries, the full effects of the ban on trailing fees in the U.K. and Australia will not be known for some time. The impact of these policies should be fully understood on both investors and the industry before deciding to proceed with regulatory changes that could significantly and negatively impact the way Canadians invest. We believe that it is also important for the CSA to take into account the overall success of the

Canadian financial services system relative to these other markets in delivering better outcomes for investors.

Finally, the CSA should fully assess the impact of the pending new rules for Point of Sale disclosure and the Client Relationship Model before considering additional regulatory changes.

Sincerely,

"George Lewis"	*"David McKay"*
George Lewis Group Head, Wealth Management & Insurance	David McKay Group Head, Personal & Commercial Banking

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