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April 12, 2013

VIA E-MAIL

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
Registrar of Securities, Northwest Territories
Superintendent of Securities, Yukon Territory
Registrar of Securities, Nunavut

Attention:
John Stevenson, Secretary
Ontario Securities Commission
20 Queen Street West
19th Floor, Box 55
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comments@osc.gov.on.ca

Me Anne-Marie Beaudoin
Corporate Secretary
Autorité des marchés financiers
800, square Victoria, 22e étage
C.P. 246, tour de la Bourse
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consultation-en-cours@lautorite.qc.ca

Dear Sirs/Mesdames:

Re: Canadian Securities Administrators Discussion Paper and Request for Comment 81-407: *Mutual Fund Fees* (the “Discussion Paper”)

We are writing in respect of the request for comments dated December 13, 2012 regarding the Discussion Paper. We appreciate the opportunity to comment on these important matters.

Invesco Canada Ltd. is a wholly-owned subsidiary of Invesco Ltd. Invesco is a leading independent global investment management company, dedicated to helping people worldwide build their financial security. As of February 28, 2013, Invesco and its operating subsidiaries had assets under management of approximately US$714 billion. Invesco operates in more than 20 countries in North America, Europe and Asia.

Invesco Canada is registered as an Investment Fund Manager, an Adviser and a Dealer in Ontario and certain other provinces. Our investment products are primarily bought by and sold to retail investors. As such, we take a great interest in regulatory discussions that impact those investors.

We have read the Discussion Paper with the utmost interest and have struggled with how to comment. In our view, many portions of the Discussion Paper are inaccurate with unsupportable conclusions. We believe the Discussion Paper portrays the mutual fund industry generally and financial advisors specifically in a very negative and offensive manner. We hope that was not the intended message of the Canadian Securities Administrators ("CSA"), but that is certainly the message conveyed and we are offended by it. In light of that, our comments are divided into the following sections:

1. The context of the mutual fund industry

2. Critique of specific items in the Discussion paper

3. Commentary on the "Topics for Consideration"

I. The Context of the Canadian Mutual Fund Industry

Mutual funds have long been the preferred means of investment for many average Canadians. The reasons for this are not hard to fathom. Most investors do not have the time or knowledge to research various investment options, including direct investments in stocks and bonds, and to build a sound portfolio. They contract that out to professional managers in the form of mutual fund investments. Also, for most small investors, building your own portfolio is simply too expensive, given the transaction costs associated with buying and selling stocks and bonds and the administration of various account types that help an investor maximize after tax returns. By joining with other small investors, these expenses are pooled and, on balance, investment expenses are reduced.

Over the many years it has provided investment management services to Canadians, the mutual fund industry has evolved. Initially a few basic fund types were offered, such as Canadian equity, global equity and fixed income mandates. Based on investor demand for more investment options, the range of fund types expanded to include more specialized mandates, including mutual funds that invest in specific countries or in specific sectors of the economy. Over time, investors became disenchanted with some of these specialty products, they redeemed their investments and many of these mutual funds were terminated. That is, the mutual fund industry has shown it is highly responsive to investor demand and that classic market forces work very well in this industry.

The mutual fund industry has shown great creativity in responding to investor needs caused by restrictions on foreign investment (through RRSP clone funds), a variety of yield products (in response to the current low interest rate environment) and, more recently, with income conversion structures (which the federal government recently decided to disallow). These products have served investors very well enabling them to diversify their portfolios properly in the case of clone funds, generate cash flow when that was otherwise difficult to do in the case of yield products and to enable taxable investors to obtain fixed income exposure without the historical drastic tax consequences of such an investment in the case of income conversion structures. These innovations were necessary because, among other reasons, public retirement programs are widely acknowledged to be inadequate for funding

Canadians in retirement. When Canadians' investments were primarily in the form of registered tax plans, they were forced by law to be overexposed to the Canadian market, which represented only 2-3% of global financial markets during that period. As Canadians realized that to properly fund retirement and other life activities it would be necessary to invest through taxable accounts, mutual funds assisted Canadians in this effort with products that reduced the bite of taxation. Again, this is strong evidence of the responsiveness of this industry to market forces.

As we discuss below in this comment letter, the same market forces have had an effect on fee structures, often to the benefit of Canadians. In the 1980s, common practice was to charge an investor a 9% commission for investing in a mutual fund, in addition to the management fee paid by the fund. Today, 94% of Invesco Canada's sales of front-end load mutual funds are done on a no commission basis. Even with the 1% trailing commission we typically pay, this is undeniably a significant reduction in expense for the investor. Mutual funds also devised deferred sales charges which enabled Canadians to put their full investment amount to work rather than a subset of that after commissions were paid. As Canadians found the redemption charge schedules too onerous, shorter redemption period options were devised. At every turn, the Canadian mutual fund industry has responded to investor desires and demands.

At the same time, the distribution of mutual funds in Canada has evolved often, in our view, to the detriment of investors. Reliance on banks has increased at the expense of independent financial advice. Many Canadians now buy bank-owned mutual funds through an "advisor" in their bank branch. This works because Canadians tend to trust the banks much more than do citizens of other countries. However, banking and investing are not the same. Canadians who invest through their bank branch, for example, do not get independent advice and are recommended only proprietary products. In response to this, independent dealers began to create their own proprietary mutual funds, often with enhanced commissions, and independent mutual fund managers sought distribution alliances, in many cases, buying distributors. Invesco believes this has been a very negative development for investors as it creates inordinate conflicts of interest for advisors who hold themselves out as independent, yet are incented to sell products manufactured by their firms and for managers, who shift their focus away from investment excellence and become more concerned with distribution prowess. The Canadian regulatory community, including the CSA, the Mutual Fund Dealers Association ("MFDA") and the Investment Industry Regulatory Organization of Canada ("IIROC") has had, at best, tepid responses to these issues suggesting that dealer firms apply the same know-your-product standards to approving the sale of these products as they do to third party products. We do not believe such guidance provides any protection to retail investors and merely gives those who engage in this practice a regulatory cover for their actions.

As we discuss further below, Canadian investors have generally been very well served by advisors. Investors who use an advisor typically outperform do-it-yourself investors, have more invested and are less prone to overreact to short-term market swings. This latter point cannot be underestimated as studies have shown that during periods of long-term market performance, some investors underperform because they reacted to a market downswing and ignored the tried and true maxim of buying low and selling high. Good advisors remind their clients of this truism and that leads to better results. For this reason, we have focused our business on serving clients who use financial advisors – we cannot provide personalized advice to an investor the way an advisor can and our business is based on the successful partnership of Invesco Canada with the advisor to best serve the retail client. Any reforms that impact these relationships must be examined and evaluated in that context.

Notwithstanding the foregoing, we regularly see initiatives aimed at further regulating mutual funds, such as the “modernization” of NI 81-102, the Fund Facts Document initiative, and the recently approved amendments to NI 31-103 that seek to bring transparency to the costs of investing but that ignore virtually all other types of investments. This sends an extremely negative message to Canadians and we regularly see the share of investments by Canadians in mutual funds decrease in proportion to market share increases in less regulated products. This is the problem that regulators need to address rather than spending an inordinate amount of time on the mutual fund industry specifically.

We were pleased, therefore, to see in October 2012, the CSA publish Consultation Paper 33-403 (the “Consultation Paper”) regarding the standard of conduct for advisers and dealers. While imperfect, the Consultation Paper sought to address the issue from the perspective of the advice provided to retail investors and how that advice is formulated. That pleasure, however, was eradicated with the publication of the Discussion Paper, which appears to be solely focused on painting a negative picture of advisors, on the mutual fund management industry as tools of advisors, and on fees. We had hoped the CSA would correct the misconceptions on mutual fund fees and were disappointed that, instead, the CSA chose to perpetuate the same old tired myths that have increasingly been taken as received wisdom by those who are interested in gathering information through sound bites and headlines rather than by an in-depth analysis of an issue. For example the Discussion Paper often asserts that mutual fund fees in Canada are the highest in the world and, therefore, outside the norm, whereas a proper study of the cost of ownership, as we cite later in the Discussion Paper, shows the opposite.

We are not suggesting that the mutual fund industry is perfect. There are certainly issues that need to be addressed. But the Discussion Paper ignores the vast majority of those. To that end, we are attaching our comments on the Consultation Paper as an Appendix to this comment letter as the CSA raises the standard of care issue as one of its topics for consideration. Our main points in our comments on the Discussion Paper and our comments on the Consultation Paper can be summarized as follows:

- The volume of regulation is immense but of little effect without a commitment to enforcement of existing regulations;

- The lack of case law in relation to the myriad pages of regulation applicable to mutual funds makes it quite difficult for companies to comply and the CSA needs to bring cases not necessarily with the intent to win but to seek clarification from the Courts (while there is some deference to Staff by the Courts, such deference is not absolute and industry often disagrees with Staff);

- The overriding factor in the fees debate is a lack of transparency and understanding of fees by Canadian investors, a state of affairs that is being addressed by the amendments to NI 31-103 that come into force on June 15, 2013 – as such, the Discussion Paper is premature as currently investors do not have the proper context to understand the fees and costs of investing but they will have it once the amendments fully come into effect;

- Lastly, the United Kingdom and Australia have undertaken significant reforms in this area, including banning commissions altogether, yet there are concerns that small investors will not be able to get adequate advice under these reforms – as such, we recommend that no further reforms be undertaken in Canada until the experience in the U.K. and Australia can be properly assessed.

II. Critique of the Discussion Paper

We believe the title of the Discussion Paper is a misnomer and, in and of itself, it is misleading. The Discussion Paper lacks any real discussion about operating expenses, for example, and appears to take as received wisdom the misinformation consistently peddled to the Canadian public about "excessive mutual fund fees" (we will revert to that point later in this letter). We had hoped the Discussion Paper would address that issue head-on and either provide proper arguments in support of that myth or refute it. Instead, the Discussion Paper does neither.

Rather, the Discussion Paper appears to have as its primary focus sales commissions and trailing commissions. We believe that this is an extremely narrow focus and is unhelpful because the Discussion Paper seeks solutions without establishing that the reason for "excessive fees" is embedded advisor compensation. If the United States is held up as the example then, in our view, the November 2012 paper *Monitoring Trends in Mutual Fund Cost of Ownership and Expense Ratios, A Canada – US Perspective*, by Investor Economics and Strategic Insight (the "CoO Study"), fully refutes the idea that fees in Canada are excessive or that embedded advisor compensation is the problem from a fee perspective (we offer no comment on the notion that embedded compensation leads it insoluble conflicts of interest). The CoO Study is the first of its kind, to our knowledge, that normalizes the differences in how various fees are charged in Canada and the U.S. to form a proper comparison. As such, its significance cannot be overlooked.

As the Discussion Paper has its primary focus on advisor compensation, rather than mutual fund fees as a whole, it is incumbent on regulators proposing reforms to make the case that reform is required. This case is not made in the Discussion Paper. Furthermore, we are compelled to ask, what is the precedent in Canada for regulating fees in any industry? We see this in utilities and health care. Because of the high barriers to entry into utilities-related industries, fee regulation is necessary due to the potential for abusive and unreasonable pricing practices. As for health care, fee regulation (i.e. medicare) is believed necessary to ensure equal access for all to health care which we, as Canadians, view as a basic human right. The same considerations either do not apply to mutual fund investing or no one has ever made the case that they do. Until that case is made, the debate sought to be initiated by the Discussion Paper is premature.

To the contrary, we note that barriers to entry into the mutual fund management industry are quite low. There are over 100 companies that offer mutual funds to retail investors in Canada and many more that offer investment management services to institutional investors and higher net worth investors (assets in excess of $1 million). Every year we see mutual fund managers exit and enter the industry. Similarly, the market for financial advice has as its only significant barrier to entry the costs associated with building a significant compliance infrastructure. Many economists do not view such costs as a true barrier to entry and the experience of the Canadian financial advisory industry supports that view as dealer firms enter and exit the business on a regular basis.

Another feature of industries with regulated fees is that the customers in those industries have virtually no bargaining power. We do not believe the same can properly be said in our industry. At the high end of the wealth spectrum there is much competition for "high net worth" investors, with new entrants into that space on an almost daily basis. This has caused fees charged to these investors to decline over time and virtually every firm in that sector of the market charges a lower rate as assets increase, with some clients paying as low as 0.65% or 0.75%. At the lower end of the wealth spectrum, it is certainly true that clients do not have much bargaining power but it is simply wrong to say that they have none. For example, there are many advisors today who, in recommending mutual fund investments to their clients, charge no upfront commission and receive their compensation through the 1% trailing commission. In fact, at Invesco, 94% of all front-end unit purchases are done on this basis. It was not long ago that virtually all financial advisors charged a 5% up-front commission on these transactions. It is our understanding that the change in the compensation model, to a 0% up-front commission, was initiated by customers who questioned why their financial advisor should get both payments. In what will surely come as a surprise to anyone reading the Discussion Paper, some financial advisors agreed! Market forces have then compelled this model onto the vast majority of the industry.

Another example of bargaining power comes in the form of choice of distribution channel. First, within the advice channel, there are a variety of fee models available to investors. Some dealers still charge an up-front commission and collect a trailing commission. Others do not. Some dealers may provide rebates of trailing commission as a client's assets rise. Some might differentiate on service. These are all market mechanisms that actually work. Second, investors can switch distribution channels and, if they choose, they can invest though a discount brokerage account. The Discussion Paper highlights the fact that the large bank-owned discount brokers only sell the full trail Series A units of third party fund companies (but not their own) on their shelves; but an investor investing through this channel is not restricted to dealing with discount brokerages owned by banks. Rather, they can invest with an independent discount broker, some of whom offer rebates of trailing commissions they receive and some of whom offer the no trail Series F, albeit on a limited basis.

Finally, investors have bargaining power through the ability to invest in products other than mutual funds. Some dealers offer "model portfolios" or "separately managed accounts" that may involve lower fees. As these alternatives become more popular, fee pressure is exerted on fund companies and dealers who deal in mutual funds. In other words, there is a very active and competitive market for fees.

It seems to us that the issue is not that fees are too high, it is that those who question mutual fund fee models seem to think that advisors should provide extensive service to their clients and not get paid for it. We take this position because, as noted above, the highest net worth investors typically pay 0.75% for investment management services. As such, 0.75% can be viewed as a floor, below which the supplier of investment management services is simply not willing to provide the service. (It is trite but worthwhile to observe that one does not have a right to financial advice and one is not compelled to provide financial advice. The industry exists because there is a demand for financial advice borne out of customers' experience with the alternative.) In that context, to the extent a low net worth client pays only 1%, that client is, in our view, getting a good deal. In fact, one might argue that the client is underpaying for the service and that service is subsidized by the higher net worth client. Why do we say this? A client with $50,000 invested in mutual funds does not, 94% of the time, pay the dealer an up-front commission. The trailing commission on that investment is $500 per year. The amount of work that a financial advisor has to do is not necessarily tied into the amount the client invests and we observe that there is virtually no difference in what a dealer does for a $50,000 client than for a $150,000 client (for which they would receive $1,500 per year). It is possible that the advisor does not provide much advice to the client for the $500 paid to the dealer (of which the advisor retains less than $250 typically) but many advisors provide a whole range of financial planning services for that fee. Such advisors typically have a team who assists them and most dealer models require that the advisor pay the salaries of the team members. For full financial planning, the total hours spent among the advisor and the team on the client will be in excess of 20 hours per year. At $250, that works out to an hourly rate of $12.50. Is the CSA seriously at odds with a client paying $12.50 per hour for financial planning advice? Of course not all advisors provide that range of services. This is where the recently enacted amendments to NI 31-103 requiring full disclosure of the dollar amount of compensation paid to the dealer (the "Transparency Initiative") comes into play. The regulatory expectation underlying those reforms – which Invesco Canada fully supports – is that a client seeing that information will initiate a discussion with their financial advisor regarding the latter's value. If the client does not agree that there is proper value, presumably the client will switch advisors. To that end, we believe that the CSA, along with the MFDA and IIROC (collectively the "SROs") should initiate reforms to simplify and expedite account transfers among dealers. There is simply no reason why it should take a maximum of 3 days to process the purchase of an investment product but over a month in many cases to transfer the account.

The other side of this discussion is how Canadians buy mutual funds. The Discussion Paper notes that most mutual funds are bought through financial advisors, but some are bought through discount brokers and others are bought directly from the fund companies. The Discussion Paper notes that very few Canadians deal with direct selling mutual fund companies, despite the lower fees on the products they sell and despite the media attention that they get. Direct selling mutual fund companies are not a new phenomenon in Canada. One of the leaders in the field was Altamira.

Altamira was arguably the most successful direct sale mutual fund company in Canadian history until it was bought by National Bank Financial and direct sales are no longer offered. Scudder Investments, which has been quite successful globally tried to expand into Canada but was unsuccessful. Since then, only Steadyhand Investments has entered the field, in 2007. During its 6 years of operation, it has amassed assets under management of $265 million.

The conclusion we draw from this is that Canadians generally want to invest through financial advisors and receive advice. Other options are available – and have been for a long time – but are seldom pursued. The evidence[1] is that, on average, retail investors stay invested longer[2], invest more[3] and have better results[4] when working with a financial advisor than otherwise. (We acknowledge this is not uniform but the quality of advice and how to deal with "bad" advisors is beyond the scope of the Discussion Paper.) The key to meeting this need, therefore, is to ensure an adequate supply of financial advice. Like any other business, the supply of the product (financial advice) depends on the economics of the industry. While different forms of compensation may raise different issues, it is important that we not lose sight of the big picture and that is that the economics of the financial advice business have deteriorated significantly over the last several years. Our concern is not that dealers and advisors make enough money; rather, our concern is that if they do not make what they perceive to be enough money, they will exit the business and it will be more difficult for investors to obtain good financial advice. If that occurs, we believe the economic impact to Canadians will be devastating as they approach retirement without sufficient savings.

In the remainder of this section of our comments, the sub-headings reflect the headings in the Discussion Paper.

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[1] Investment Funds Institute of Canada, *The Value of Advice Report 2012* ("VA Report")

[2] *Ibid.*, p.9, citing Winchester, Huston and Finke. *Investor Prudence and the Role of Financial Advice*, Journal of Financial Service Professionals, July 2011

[3] *Ibid.*, p.3, citing the *Ipsos Reid Canadian Financial Monitor Study,* p.6, citing Montmarquette, Claude and Nathalie Viennot-Briot, *Econometric Models on the Value of Advice of a Financial Advisor*, CIRANO Institute, July 2012 ("CIRANO") and p.7, citing KPMG Econtech, Value Proposition of Financial Advisory Networks, January 2011.

[4] *Ibid*, p.4, citing Department of Finance Canada, *Statistics on RPP/RRSP Participation and Savings*, March 31, 2010, and p.6 citing CIRANO

I. Introduction

In the fourth paragraph of the Discussion Paper, the CSA states "we anticipate that any regulatory initiative we might undertake would assess whether the same initiative should also apply to other investment funds and **comparable securities products**" (emphasis added). This statement is of particular interest and welcomed by the mutual fund industry. We have long stated that regulatory reforms in Canada disproportionately target mutual funds and we have repeatedly made the case that there are plenty of substitutes for mutual funds, the substitutes are poorly regulated in comparison to regulation of mutual funds, the substitutes engage in practices much worse than anything ever alleged against the mutual fund industry and the client experience is much more opaque. We commend the CSA for implicitly recognizing this fact with the above-quoted statement.

We are concerned, however, that the above-quoted statement is mere puffery. The mutual fund industry has made the argument above repeatedly, especially during the 2007 and 2008 consultations on the Point of Sale ("POS") Initiative. The response received from the regulators on many occasions was that POS was an initiative of the Investment Funds Branch of the Ontario Securities Commission ("OSC") and similar branches/divisions of other CSA members and that, while those who regulate investment funds agreed with the overall argument, they advised us all that those substitutes were outside the regulatory scope of the CSA members who work on investment fund issues and they did not feel it appropriate to impede "regulatory progress" on mutual funds just because of the disparity that they were in the midst of creating. While we are pleased that the CSA appears to have changed its view on this important aspect of regulatory reform we are concerned that, from the OSC in any event, only members of the Investment Funds Branch are listed in the Notice for Comment. (Interestingly, a similar comment can be made about the Consultation Paper, the OSC representatives for which are not from the Investment Funds Branch despite the subject matter being one of the "Topics for Consideration" at the end of the Discussion Paper.) We fear that while the Investment Funds Branch may conclude that the reforms must extend to comparable securities products, perhaps the relevant branches for those products will disagree? We suspect that, in that case, the Investment Funds Branch would proceed with its initiative and the same issues of regulatory and product arbitrage would arise.

II. Background

The CSA notes that published studies have concluded that Canadian mutual fund fees are among the highest in the world. The Canadian mutual fund industry has long challenged these studies on the basis that the structure of advisor compensation through trailing commissions is not reflected in the management expense ratios of other countries. Yet, while the CSA notes this disagreement it does not offer an opinion on the issue. This is unfortunate because this myth seems to lie at the foundation of the Discussion Paper. We note that the CoO Study was not released until after the Discussion Paper. Therefore, we ask the CSA to review the CoO Study and act (or rather, not act) accordingly. If the CSA agrees with the conclusion of the CoO Study, namely that after normalizing the calculation base for expense ratios in the U.S. and Canada the only difference is Canadian taxes, then we believe it is vitally important for the CSA to so state. At present, we suspect that those who perpetrate the excessive fee myth will discount the CoO Study because it was sponsored by the Investment Funds Institute of Canada ("IFIC") which represents many participants in the mutual fund industry. Only the CSA can truly correct this misinformation.

III. Canadian Mutual Fund Industry Participants

We are extremely disappointed with how the CSA has defined “independents”. We make reference to our comment letters on the POS Initiative dated December 23, 2008 and October 17, 2009 for additional detail on the distribution channels in the Canadian mutual fund industry. We cannot understand why the CSA would define independence as whether or not the fund manufacturer also accepts deposits. When financial industry participants use the term “independent”, it means independent of distribution. That is, an independent fund manufacturer focusses on one thing: managing money. It has to do it or it cannot survive. In contrast, a Canadian bank-owned fund manufacturer does not have to worry about fund performance in the same way because of their clients’ loyalty and the inability of clients who buy mutual funds through bank branches to switch to third party mutual funds or even to get reliable advice on their options in that regard.

As we have stated in our previous letters, integration of manufacturing and distribution is the single greatest conflict of interest in the mutual fund industry. This conflict manifests itself in two ways: First, when an independent fund company experiences a period of negative performance, it is closely followed by a period of net redemptions. This provides an excellent incentive for the fund company to ascertain what is wrong on the performance side and to make changes that ought to benefit their retail investor clients. Non-independent fund companies do not suffer the same experience or, to the extent they do, it is quite muted in comparison. There are many incentives for financial advisors who work for non-independent dealers to retain client assets with the investment management affiliate of their dealer (including compensation and licensing sponsorship to name a couple). Therefore, in the face of a decline in fund performance, those fund manufacturers do not typically see the same net redemption activity faced by the independents. As a result, their incentive to improve is less than that of an independent fund company. It is the retail client who suffers.

The second way in which the conflict of interest manifests itself is that dealers who are affiliated with manufacturers place an incentive to sell proprietary funds by virtue of the compensation grid. The Discussion Paper clearly states that the percentage of trailing commission paid on proprietary funds is greater than that paid on third party funds. We note this is clearly illegal under subsection 4.1(1) of National Instrument 81-105. We understand that dealers construct “recommended lists” of mutual fund investments for their clients and sales of recommended list funds generate a higher grid payout than funds not on the list and that third party funds do appear on recommended lists. However, we suspect that all proprietary funds are also on the list and this enables the dealer to legally evade subsection 4.1(1). It appears that the CSA has condoned this practice since it makes the assertion regarding grid payments without commenting on the legality or ethics of the practice. To put it mildly, we are disappointed with the CSA in that regard. We also note that lack of enforcement on that point sends the message to all capital markets participants that, under Ontario securities law and the securities laws of other provinces, it is acceptable to do indirectly what you cannot do directly.

IV. Mutual Fund Fee Structure in Canada

1. Current Mutual Fund Fees

a. Sales Charges

vi. High Net Worth/Institutional

The Discussion Paper states that "[i]nvestors buying under this option typically negotiate their own management fee…as well as an advisory fee that they pay directly to the mutual fund manufacturer." We seriously question the accuracy of this statement which, at best, is misleading. The typical contractual arrangement in this space is a negotiated management fee that the client pays directly to the fund manufacturer. Agreements with individual investors tend to include an authorization from the individual for the manufacturer to redeem from his or her account a sufficient amount of units to pay the management fee when due. Institutional investors are more inclined to pay the manufacturer directly, rather than through a redemption of units.

In most cases, institutional investors do not use advisors and, in those cases, there is no "advisory fee". Some pension plans use consultants and a limited number of consultants seek a fee for their service which is more akin to a referral fee. While the cash flows from the manufacturer to the consultant in those arrangements, the fee is negotiated between the client and the consultant and, like the individual case noted above, the client effectively asks the fund manufacturer to act as a conduit for the payment of this fee.

To characterize these arrangements as an advisory fee paid directly by the fund manufacturer is ludicrous. We note that this is no different from many Series F arrangements where the client advises the fund company of the fee due the advisor and asks the fund company to redeem units with a value equal to the fee owing the advisor and to remit the fee to the dealer on behalf of the client.

b. Ongoing Fund Fees

i. Management fees – trailing commissions

In many places, the CSA refers to 12b-1 fees as being the same as trailing commissions. We disagree, in part, with this characterization. We note that 12b-1 fees range from approximately 0.25% to 1.00%, thus putting them on par with trailing commissions. The first 0.25%, per FINRA rules, is considered a "shareholder servicing" payment and the balance is considered payment for distribution expenses. In addition, many mutual funds in the U.S. pay a sub-accounting or sub-transfer agency fee to the dealer in the amount of 0.25%. As such, 12b-1 fees tell only part of the story and are not directly comparable to trailing commissions. US mutual fund companies also often pay revenue sharing fees. These amounts are not paid by the funds themselves but, rather, from the account of the manager. As that is similar to how trailing commissions are paid, those fees must also be considered. These fees, in the aggregate, provide a better comparison to trailing commissions. Those fees, in the aggregate, are quite similar to trailing commission rates in Canada. This has also been confirmed in the recent CoO Study.

ii. Operating Expenses

We read the CSA comments on fund operating expenses with great interest. We are surprised that a paper called "Mutual Fund Fees" devotes a mere half page to this important aspect of the management expense ratio ("MER") and then ignores the subject the rest of the way. We are pleased that the CSA recognizes that fixed rate administration fees “can also effectively prevent mutual fund expenses from declining as a percentage of assets as the fund grows” and we would observe that such is a rather high price to pay for the “stability and predictability” such fees provide. We believe such fees represent a serious conflict of interest for a mutual fund manager as there is a clear incentive on the manager to reduce service to unitholders in order to increase its profitability. We see no difference between these fees and management fees and view moves to adopt such fees as a backdoor attempt at increasing management fees.

2. *Evolution of Fund Fees*

a. *Sales Charges Trends*

This section of the Discussion Paper shows how the market has evolved over time to lead to reduced fees for investors in mutual funds, demonstrating the evolution of front-end sales charges, deferred sales charges and the low-load option. We think this is important in the context of the Discussion Paper because it demonstrates that market mechanisms have worked to reduce the cost of investing in mutual funds for Canadians over time. We are concerned with regulatory reforms that seek to interfere with proven market mechanisms.

For those who doubt the market works in this space, we note that the top commission rates on front-end units in the 1980s was in the range of 9%, whereas today substantially all (94% in Invesco’s case) of front-end unit sales are done on a no commission basis – rather, the dealer receives a 1% annual trailing commission but not a commission at the time of the transaction. There is no question that this evolution has benefitted investors. The concept of deferred sales charges has also evolved to meet the needs of the investor. While the concept of paying no commission up front and having all of your money invested was the initial appeal of deferred sales charges, investors, advisors and regulators became concerned with the lengthy redemption charge schedule (notwithstanding that it was initially designed to make an investor indifferent between front-end units and redemption charge units). The market reacted with the low load option that has significantly lower redemption charges and a 2 year schedule and the lower load 4 option with a 4 year redemption schedule during which time the redemption charges are also lower than with the original redemption charge option. The evolution to no up-front commission on a front-end unit and shorter redemption schedules with lower redemption charges are clear benefits to investors and they were brought about by a properly functioning competitive market.

If we take that lesson and rationalize it with the remainder of the Discussion Paper, then one must conclude that the purpose of the discussion initiated by the Discussion Paper is to call attention to the perceived problem that the market is not driving fees down fast enough. While we agree that securities regulators have the authority to regulate in this area (see, for example, *Securities Act* (Ontario), s.143(1)31.ix), we do not believe regulators should do so lightly and without clear and convincing evidence of the need to regulate.

We have made the point above that the management fee itself, after deducting distribution fees, is at the appropriate level. Therefore, any attempt to regulate mutual fund fees will seemingly come from the part of the fee from which compensation is paid to the dealer; however, we believe that the history of fee evolution in Canada shows the market can address this issue. If it is a case of the market not moving fast enough for the regulatory community, then the focus should be on what can be done to accelerate market mechanisms. Put simply, the question that should be discussed is what the regulators can do to prod market systems in a particular direction. As we’ve noted in other comment letters, we strongly support the Transparency Initiative under NI 31-103 and we believe that such reform is likely to be the catalyst needed to reduce fees and expenses for investors. As we have said before, it takes time for a regulatory reform to take effect and we are concerned when regulators propose initiatives to address an issue that was supposed to be addressed by a previous initiative without giving that previous initiative time to work.

b. Ongoing Fund Fees Trends

i. MERs Trending Down

We note that the MER table in Figure 8 leads to some interesting conclusions. We believe it is simply incorrect to make conclusions on the line “All Long Term Funds” since load and no load funds operate quite differently in the marketplace. In looking at the load and no load lines separately, one draws some interesting conclusions. The load funds appear to have peaked in MER in 2000 and from then to just prior to the 2008 financial crisis which severely eroded asset levels (especially among non-bank owned firms), MERs declined by over 10%. This is especially interesting when you consider that most load funds faced a significant increase in the MER as a result of the switch from paying 5% GST to paying 11-13% blended HST in 2009/10. This shows the effectiveness that fund managers have had in addressing expense issues for the benefit of investors. It is unfortunate that such successes are simply ignored. The other interesting point to note is the generally flattening of the MER decreases starting in 2007/8. We would suggest that the reason for this flattening is that 2007/8 is the timeframe in which some of Canada’s largest mutual fund managers switched from a cost recovery model of fund operating expenses to fixed rate administration fees. Of course, with fixed rate administration fees, MERs do not naturally decline as may be the case with a cost recovery model. We would be interested to see the “load” line split into 2 so the further savings realized for investors by fund managers who follow a cost recovery model can be examined. We believe such data would support our earlier point about the proper functioning of the market for fund expenses.

Providing MER data on an aggregated basis is, in our view, not terribly helpful, as it masks important differences among business structures. Our concern is that there are many apples-to-oranges comparisons inherent in this data. We do not believe meaningful comparisons can really be made on other than an apples-to-apples basis. Without a meaningful comparison, the conclusion is questionable.

ii. Trailing Commissions Generally Remaining Steady or Increasing

The Discussion Paper asserts that non-bank mutual fund managers are increasing average fund MERs in all stand-alone fund categories by increasing trailing commissions. This is simply wrong. This assertion follows Figure 10 which shows that in all categories other than Fund of Funds, MERs have increased from 2006 to 2011, as have trailing commission. We are troubled by this assertion based on the data provided.

In the years between 2006 and 2011, two major events occurred: the market crash of 2008/9 which severely eroded assets under management, and the imposition of the Harmonized Sales Tax, which applies to management fees and certain operating expenses, thereby adding over 0.3% to the MER. In many cases, as assets decline, MER increases as the expenses that are incurred are not always tied directly to assets under management and, where these can be reduced or eliminated, such can typically only be done in steps, not on a straight-line basis as assets decline. Notwithstanding these impacts, per Figure 10, equity MERs increased only 0.09% during that time and balanced fund MERs increased only 0.02%. This is an amazing result in light of the events cited above.

We struggle, however, to understand how it is that the CSA can conclude that these increases in MER (which includes a 0.19% increase for fixed income funds), which are greater than the amount of HST, came about as a result of increased trailing commissions. Rather, the reason trailing commissions have increased is quite simple: more investors purchased front-end load units (which pay a 1% trailing commission) than deferred sales charge units (which pay 0.5% to 0.75% trailing commissions) in 2011 than in 2006.

We found it interesting that Fund of Fund MERs declined by 0.03% during the same period, as our expectation would have been otherwise. The CSA is certainly aware that there are some Fund of Fund ("FOF") programs that pay trailing commissions of 1.25% and 1.50%, whereas most standalone equity funds pay 1%. There is no economic rationale – beyond providing incentives to dealers – for fund of funds to pay higher trailing commissions. This suggests to us that, notwithstanding the CSA's conclusion later in the Discussion Paper (which we address in that section of this letter), investors are considering cost to a degree and, further, that advisors are not swayed by the higher trailing commissions. Were it the case that advisors are swayed by higher trailing commissions, those of us who pay a 1% trailing commission on fund of fund products would not have a viable business. While we would agree there are some advisors who put their own interests first, we have repeatedly stated that, in our view, there are only a handful of advisors who do so and, as such, this is not a widespread issue worthy of regulatory intervention.

V. Current Issuers Arising From the Mutual Fund Fee Structure in Canada

1. Investor Understanding of Fund Costs and Control of Advisor Compensation

i. Investor Understanding of Fund Costs

While we acknowledge that investors do not have a full understanding of fund costs, we note that this issue is thoroughly addressed in the Transparency Initiative, which comes into force on June 15, 2013. As such, until the effect of those amendments is demonstrated, we do not believe that investor understanding should be a driving force behind any regulatory proposals that may emanate from the Discussion Paper.

At the end of this particular subsection the writers of the Discussion Paper at the CSA level reach certain conclusions. The full context of these conclusions is important to our comment and, therefore, we reproduce the paragraph prior to providing our comment:

> "It also means that these costs do not figure significantly into investor decision-making. The IEF Study found that the cost of buying is a factor for just 2 out of 10 investors and is almost never a decisive factor. Management fees are treated similarly. Costs deter only 1 out of 6 investors from buying. This suggests that very few investors are aware of the impact costs have on net returns. This may mean that investors are not trying to choose lower-cost mutual funds, which could influence their returns."

It appear to us that the CSA has concluded that "very few investors are aware of the impact costs have on net returns" because costs only deter 1 out of 6 investors from buying mutual funds and cost is a factor of just 2 out of 10 investors, per the IEF study. This pre-supposes that cost should be one of the investor's primary factors in decision-making, a point we dispute. We are surprised that the CSA would impose its normative view on such a debatable point.

The above-noted conclusion is simply not supported by the facts. That is, the survey responses say nothing about causality. Instructive is that 20% of investors do consider the costs of investing, yet they do not find it a decisive factor. Perhaps such investors have come to the conclusion that understanding the investment style, discipline and track record of the investment fund is ultimately more important than cost. Our concern stems from the fact that the conclusions drawn from the IEF Study is a clear misuse of statistical information, where two statistical facts are taken and causality then presumed.

It seems to us that the only conclusions that can be drawn from the data presented is that most investors do not care about the costs of investing and those that do care about the costs of investing do not view it as a decisive factor. One can speculate why that is, but such is not the basis for regulation. It would be interesting if the IEF Study asked those same respondents how often they read the financial press or the works of personal finance writers. If readership was high among the survey respondents, then one could better conclude that the respondents to the study were well informed about the impact of fees and costs on returns and chose to ignore them. We question why the CSA has not considered this as a possibility.

The quoted paragraph again leads us to the conclusion that the CSA believes cost should be the primary factor to an investor in making an investment decision. We do not believe that the CSA is qualified to make that assertion and we do not believe it is appropriate for a regulator to mandate how investors make investment decisions. We do not believe this is the CSA's goal, but we are concerned that such is the effect of pronouncements such as this from the CSA or will be the result of regulatory reforms suggested by the Discussion Paper and the Consultation Paper.

ii. Investor Control of Advisor Compensation

Notwithstanding the CSA's assertion that an investor has little control or influence over an advisor's compensation (which on its face is an absurd statement since the investor can choose not to deal with the advisor), we note that advisor compensation for a product is set at product inception. The investor does have a say, therefore, at whatever point they are making the investment decision: they do not have to buy the product.

The CSA then asserts that trailing commission rates can be increased without security holder approval. While this is true, it tells only part of the story. Once a mutual fund has been launched, if the fund manager sought to increase trailing commission rates, significant disclosure obligations would arise, so investors would have notice of the change. When one considers the various notice obligations under Canadian securities law and especially in the regulation of mutual funds, it is clear that the legislative and regulatory view is that notice is provided in lieu of a direct approval and the investor grants or does not grant approval for a material change (as this would surely be) by either continuing to invest or redeeming. Further, it is arguable that, without client consent, an increase in trailing commissions is a criminal offense under the secret commission provisions of section 426 of the *Criminal Code.*

There are obvious legal questions that arise from this section of the *Criminal Code*, but there is certainly an argument that, by not disclosing the increase in commission to the client, all parties involved (fund manager, dealer, advisor) are committing a criminal offense.

2. Potential Conflicts of Interest at the Mutual Fund Manufacturer and Advisor Levels

i. Mutual Fund Manufacturer

We disagree with the CSA's conclusion that having the mutual fund pay trailing commissions is at odds with the manager's statutory duty to act in the best interests of the fund. Trailing commissions have been part of the Canadian mutual fund landscape for almost/over 25 years. Yet, in that time not one single securities regulator, investor advocate or putative plaintiff has asserted that the payment of a trailing commission is contrary to the fund manager's duty to act in the best interests of the fund.

The Discussion Paper supports this assertion on the basis that paying trailing commissions encourages advisors to recommend the mutual fund to their clients which in turn leads to more assets under management for the fund which in turn leads to greater revenue for the mutual fund manager. On that basis, one supposes management fees are also at odds with the mutual fund manager's statutory duty to act in the best interests of the fund. We think the CSA would agree that such reasoning is preposterous. What the Discussion Paper seems to ignore is the fact that scalability of mutual funds is a real issue. One need only look at pre-waiver MERs of small mutual funds to fully understand this point. There are many small mutual funds for which the manager waives some of the management fees or absorbs some of the operating expenses to ensure the MER remains at an acceptable level. Absent such waivers, some of those funds would have an MER well in excess of 5%. We note that there is no legal precedent to require the manager to waive or absorb the foregoing expenses. To avoid this, the manager seeks to increase assets in the fund and trailing commission payments are obviously one way of doing so. To end the inquiry at this point, however, is intellectually dishonest.

The question becomes what advantages accrue to an investor in this system? We answered that question at the beginning of this letter but we will reiterate the highlights here: access to professional management; and a larger fund so that expenses remain reasonable (recalling that individuals who construct their own portfolios of stocks and fixed income investments typically incur higher operating costs per dollar invested than they would inside a mutual fund) through pooling of expenses.

The concept of pooling of expenses is an inherent feature of a mutual fund. As noted on page 21 of this comment letter, there are many expenses that are pooled and paid for by the mutual fund, not all of which accrue to the benefit of every single investor in the fund. In effect, there are many instances of cross-subsidization of investor expenses within a mutual fund, justified by the belief that investors are still better off, expense-wise, in a pooled investment than otherwise. Isolating one particular fee or expense within that pool ignores the underlying concept and threatens to tear down the entire structure.

Examples of Potential Conflicts – Mutual Fund Pricing Model

We note the comment that trailing commissions on fund of fund investments may be the same or higher than for stand-alone equity funds. The CSA states that the advisor has to do less work for their client with these products and implies, therefore, that this is inappropriate. It is unfortunate that the CSA has addressed this question in so one-sided a manner. We would offer a much more benign explanation to explain this phenomenon. We take it as established fact that dealer compliance requirements have increased significantly over the last 10-15 years. Most notably, the paperwork required to be completed by an advisor with respect to client interactions has increased and, further, advisors are now expected to pay their own staff, which was much less common previously. These two changes have significantly increased the advisor's cost structure yet there have been no improvements to their revenue structure. As a result, it is less profitable to be an advisor today than it was 10-15 years ago. We also note that the rate of exit from the industry by advisors has increased and the average age of advisors keeps increasing (which implies that retiring advisors are not being replaced by new advisors). While it may not be possible for advisors to achieve their prior revenue potential, we believe that, to the extent advisors recommend fund of fund products to clients based on their own remuneration, it is not because trailing commissions are higher than for standalone equity funds, but rather, because it simplifies their compliance and administrative burden. Thus, they are able to potentially lower their costs while maintaining the same level of revenue, thereby increasing their own profitability. This enables advisors to service at least the same number of clients as they did 10-15 years ago. As we have shown the benefits of using an advisor earlier in our comments, we believe that enabling advisors to not reduce the number of clients they service is a positive development.

We are aware that there will be critics of the foregoing argument. However, we start from the premise, as stated earlier in this letter, that financial advisors, in most cases, have a positive impact on investors' experience. As noted, data suggests that investors who consult with an advisor invest more and their investment portfolios outperform those who do not use advisors. It is important that Canadians experience positive investment results because they depend on these investments for lifestyle and retirement purposes. If Canadians retire with insufficient wealth, they will ultimately have to be subsidized by the state. Our reading of current economic news suggests that this will lead to a significant deterioration in lifestyle for retirees (with commensurate effects on the economy as a whole, exacerbated by Canada's aging population) and that the state can ill afford to fund the retirement for more Canadians than it does now. If you accept these premises, then the question becomes how do we encourage Canadians to look after themselves? It seems to us that the evidence shows that we need to encourage more and better financial advice, not less.

As in any pursuit, there are some financial advisors that can be described as "rotten apples", but to suggest this is the majority or a significant proportion of advisors is simply not supported by any rational review of the evidence. We agree that regulators should deal with the rotten apples, but not at the expense of throwing out the entire "crop", which we fear is the likely result of many of the reforms proposed generally and in the conclusion of the Discussion Paper. To support this view, we look no further than the *2012 Annual Report of the MFDA*, which discloses 118 enforcement actions for the year ended June 30, 2012, in a universe of over 80,000 Approved Persons. That is, enforcement actions were commenced against less than 0.1475% of Approved Persons, hardly an alarming rate of alleged recalcitrance.

The CSA notes that the FOF trailing commission results in lower net management fees to the manufacturer. We strongly disagree with this statement as it is premised on the mutual fund manager paying a higher trailing commission on FOF investments than on standalone funds. While some have chosen to do this, we do not believe such is the norm. In fact, of the 10 leading FOF providers only 2 (bank-owned) firms pay trailing commissions in excess of 1% on these products.[5] Invesco Canada pays the same rate of trailing commission on FOF investments as on standalone equity mutual funds, as do most of the leading FOF programs in Canada. The CSA goes on to say that mutual fund managers accept the lower net management fees because FOF products generally fuel the growth of the proprietary funds of the manufacturer that underlie the FOF structure and this increases the manager's overall AUM which increases their management fees. To this, we can only say "so what?" The manager is in business as a rational economic actor so it will always seek to maximize its profitability and adding revenue is a well-recognized way to do that. Also, as far as we know, no one double reports assets. That is, if the FOF had net assets of $10 million, of which $5 million was invested in each of two funds, the total net assets reported would still be $10 million. The mutual fund manager is indifferent to where the money is invested. Also, due to the ban on duplication of management fees – which Invesco Canada

[5] Investor Economics, June 30, 2012

fully supports – the fund manager does not derive an added benefit from a FOF investment. To illustrate:

- Fund A and Fund B are underlying Funds of FOF.
- Fund A and B each ordinarily charge a management fee of 2%.
- FOF also charges a management fee of 2%.
- The manager may not charge management fees (in most cases) on the assets of Fund A and Fund B that belong to FOF, so the revenue is the same as if the FOF did not exist and those investments were split between Fund A and Fund B.

Examples of Potential Conflicts - Automatic Conversion Arrangements

In our view, automatic conversion arrangements have become a necessary evil brought about by competition and lax regulatory oversight. When the deferred sales charge ("DSC") model was first established in the late 1980s, it was established with an upfront commission paid by the mutual fund manager and a trailing commission rate that was half the rate paid on front-end load units. There was also an assumption about holding periods that no longer applies today. The reason for the reduced trailing commission was not related to the expected service to be provided by the advisor but to the amortization of the financing costs incurred by the fund manager.

Like with most innovations in the mutual fund industry, once competitors see success, they copy it without fully understanding the underlying theory and structure. We believe that was the case with trailing commissions on DSC units. As such, a competitor came along and, in response to advisor requests, allowed switches from DSC units to front-end units with a higher trailing commission, at the end of the redemption charge schedule ("matured units"). The advisor request was answered because it is not difficult for an advisor to encourage a client to switch investments after 6 or 7 years and, so, the fund manager agreed to this to retain assets. At the time this first occurred, some fund companies that did not want to follow this practice sought regulatory assistance to prevent it and the response was exceptionally weak. The SROs released tepid policy statements that effectively told their members how to do this, rather than suggesting this practice is inconsistent with their duties to their clients. The roadmap provided a client consent form on a per transaction basis. This was necessary not only to meet the advisor's duties to the client, but also to ensure that the increased trailing commission could not be characterized as a "secret commission" under the *Criminal Code.*

Over time, the requirement for client consent each time a "back to front switch" is made was whittled down to blanket authorizations and, for competitive reasons, some fund companies went even further. In fairness, one fund company took a different approach, namely to establish separate series for the purchase options with the DSC series carrying the previous management fee and the front-end load series carrying a lower management fee; trailing commissions for DSC units and front-end load units were unchanged. The CSA approved that company's request to switch clients with matured units to the new front-load series (with the higher) trailing commission without client consent since those clients would benefit from the reduced management fee (although the management fee reduction was less than the increase in trailing commission). For economic reasons, we do not believe that such approach is generally viable for other mutual fund manufacturers.

In our view, the conflict that arises from converting matured units to front-end load units is the type of conflict that simply cannot be addressed by disclosure. The information imbalances between advisor and client are such that it is simply too easy for an advisor to get a client to sign one of these forms without the client truly understanding the issue. Furthermore, because of this process, the possibility of some sort of management fee relief for the client never arises. We mention all this because we think this is an issue separate and apart from fund fees and is a practice that should simply be banned.

We contrast that to the situation that is evolving where increasingly the trailing commission schedule is established with an automatic trailer increase at the end of the redemption charge schedule. We note that the basis for this is to make the advisor indifferent between the options for a true long term investor. By evening out the economic ramifications, we believe this diminishes the conflict to an acceptable level and therefore should be permitted.

This issue arose, however, because the SROs failed to police their own policy prescriptions. This was compounded by the complete silence of the CSA on this issue, which is relevant since one of the parties involved in this arrangement is regulated directly by CSA members and not the SROs. It is only in the draft Companion Policy for the proposed amendments to NI 31-103 published initially on June 22, 2011 that the CSA finally stated that such practice is unacceptable. Unfortunately, once again this was not followed by enforcement. We take this opportunity to reinforce, again, our view that enforcement is vital to effective regulation. When regulations are added frequently but existing regulations are not enforced, this leads one to question the effectiveness of regulation and ultimately impacts confidence in the system both by the regulated and the general public. That is, until enforcement is carried out with the same vigour as new regulatory proposals, we are skeptical that the CSA's goals will be achieved.

ii. Advisor

The CSA notes that the incentive for an advisor to sell a higher commission mutual fund is exacerbated by the compensation grid, which typically offers an advisor a higher payout ratio based on revenue generated for the firm. We agree with this assertion. We note with interest, however, that the Discussion Paper talks extensively about regulating mutual fund fees but we are aware of no regulatory initiative or interest in regulating the compensation grid. If the compensation grid is a cause of significant conflicts as the CSA states (a view with which we tend to agree), we question the CSA's approach in not broaching regulation of the compensation grid.

The CSA goes on to state that "because trailing commissions on equity mutual funds and balanced/asset allocation funds (as discussed above) are typically higher than trailing commissions on fixed income and money market mutual funds, advisors may be incentivized to favour such mutual funds." While we understand the reasoning behind such a statement, it is disappointing that the CSA again makes such a disparaging remark about the motivations of advisors without providing any support. Our read of the evidence contradicts the CSA's assertion. According to the IFIC, the following are the net sales data for the time periods indicated for equity, balanced and bond funds:

Time Period	**Equity Funds**	**Balanced Funds**	**Bond Funds**
February 2013	$558.4 million	$7.13 billion	$249.1 million
January 2013	$272.25 million	$4.10 billion	$1.30 billion
2012	($14.1 billion)	$27.4 billion	$19.0 billion

If the CSA's assertion was true, then one would have expected equity funds' net sales not to trail the other two categories by such significant margins (especially as equity markets were quite positive during these periods). We note the foregoing as a caution that some assertions sound correct in theory, but oftentimes the evidence shows a different result. Our read of the evidence is that advisors typically recommend investments that reflect client desires. Invesco Canada would argue that equity investments should have been preferred during these time periods, but clients remain wary of risk as a result of the 2008 financial crisis and, as such, they are buying balanced funds to mitigate the perceived risk of equity investments. As an investment decision is made by an investor in consultation with the advisor, the foregoing is likely the correct result, notwithstanding our view that equity investments should have been preferred during this time period.

The CSA goes on to remark that it expects sales of front-end units to exceed sales of DSC units because front-end units pay a higher trailing commission. This is one of the more head-scratching assertions in the Discussion Paper for reasons both economic and practical. We will address both.

As we have stated earlier, the Discussion Paper paints advisors in a fairly negative light, suggesting in many instances that advisors are interested, above all else, in lining their pockets. The facts, however, tell a different story. 94% of all front-end load sales of Invesco Canada funds are done on a zero commission basis. We believe that our experience is similar to that of the rest of the industry. If the CSA's portrayal were accurate, that number would be significantly lower. When one considers that every type of deferred sales charge option, whether it be classic DSC, low load or lower load 4, pays an up front commission, the fallacy of the CSA's assertion begins to reveal itself. If one does the math, then the conclusion is fairly obvious. Our mathematical models show that it is extremely rare for an advisor to collect more compensation over the life of an investment in a mutual fund sold on a front-end load basis than any other purchase option. We compared the same investment across the 4 purchase options (assuming zero commission front-end load) measuring what the annual trailing commissions for each option annually for 14 years and found the only time an advisor would receive more compensation under the front-end load option is if the portfolio had an average annual compound return of more than 10%, in which case the front-end compensation would exceed that of the traditional DSC by the end of the 7th year. As the CSA knows or ought to know, average investor holding periods for a particular mutual fund is significantly less than 7 years.

For an investment that is held for 5 years or less, traditional DSC is actually the most lucrative for an advisor as the upfront commission more than compensates for the reduced trailing commission. Yet we find that only 11% of transactions (measured by dollar amount) are into DSC. We also note that our low load option, which subjects the investor to a redemption fee during the first two years, pays a 1% commission and offers the same trailing commission as front-end yet garners slightly more than 10% of the transactions and assets that front-end receives. Obviously, low load is more lucrative for an advisor than front end load since the former pays an upfront commission is addition to the 1% trailing commission. We would expect these statistics come as a surprise to the CSA yet we hope that they will be interpreted as effectively repudiating the misconception that the CSA has of financial advisors. A more reasonable interpretation of the evidence is that the typical advisor puts his or her clients' interests ahead of his or her own, as one would expect them to do, even absent a statutory best interests duty.

From a practical perspective, we note that DSC units have come under heavy fire from investor advocates for several years – Ken Kivenko, for one, advocates banning DSC altogether – primarily because of the exit cost while still on the redemption charge schedule. Mr. Kivenko, for example, routinely castigates the traditional DSC – often with good reason based on the types of investors he typically represents – and advocates that investors who still invest in mutual funds should invest in front-end load and negotiate zero commission. Mr. Kivenko is not alone in this view and it is often echoed in the personal finance media. The extensive attention drawn to the workings of DSC may be another explanation for a greater proportion of front-end load sales.

One of the attractions of DSC historically has been that you get 100% of your capital invested whereas in front-end units, the commission is taken off the top and your investment is between 95% and 99% typically. It is our understanding that some advisors rely on the DSC commission to finance the ability to provide holistic financial planning advice for their clients. (We are not suggesting that all advisors do this but we believe many do.) Where an advisor has genuine expertise and can add value to a client's search for wealth, the reality is that a 1% trailer, of which you keep half and from that portion pay all your business expenses, is insufficient to make a reasonable profit. In those cases, the 5% upfront commission subsidizes the other advice given to the client by the advisor. Has the CSA not considered that there are other reasons for these phenomena? Or is the CSA so convinced that advisors generally are so unscrupulous that they would sell DSC to clients for the reasons cited by the CSA? This is a truly monumental statement and we fear it shows an incredible bias in the CSA against mutual funds and financial advisors. This is simply unacceptable.

The CSA implicitly recognizes the foregoing in the next assertion in the Discussion Paper, namely that new advisors who do not have a large trailer-fee paying book of business may be more incented to sell DSC funds. Again, the CSA provides no basis for this assertion, which has quite obvious implications and overtones. Unfortunately, we do not track the years of experience of advisors in our relevant systems so we are unable to directly refute the CSA's point on this matter.

The Discussion Paper continues its attack on advisors saying that automatic DSC conversions may incent advisors to recommend clients stay in a fund because the advisor is now getting a larger trail. Virtually every mutual fund company permits switches without re-starting commission schedules so if a client is invested in DSC units of a particular fund company, the client could switch to a different fund and the advisor retains the higher trail. If the advisor motives are as unscrupulous as the CSA implies, then the logical move for an advisor with clients who have matured units would be to switch them to a different fund complex altogether so that the advisor can get an upfront commission. As we noted above, virtually any deferred sales charge option pays more compensation over time than does a front-end sale. It is striking that the CSA appears to take the view that all advisors act with a short term view. The most successful advisors do very well financially because they look after their clients, provide good service, and ultimately help their clients succeed. If that means putting a client in a fixed income fund with a lower trail than an equity fund, the good advisors do that. If that means recommending they redeem out of a DSC fund, they do. We believe that most advisors are "good" advisors (and this view is at least partly supported by the MFDA enforcement statistics previously cited) and we think in a society such as ours it is important to proceed with that view unless the evidence is otherwise. If there are a handful of advisors who are in this business for the wrong reasons, that is not enough to change the presumption and that is why we have enforcement mechanisms.

The CSA offers its opinion that the advisor's standard of conduct under securities legislation may not sufficiently mitigate the perceived compensation incentives. We question this opinion as the CSA has never before raised compensation as a standard of conduct issue and, thereby, tested whether its perceptions in this regard are consistent with or contrary to the current standard of care requiring a registrant to act fairly, honestly and in good faith. This is a further example of issues relating to enforcement of securities laws and supports our view that, generally, we do not believe that enforcement of securities laws in Canada within the investment funds industry is sufficient. The lack of enforcement is problematic because it reduces deterrence and because enforcement creates precedent and reduces uncertainty which is essential for structural mechanisms already in place within the industry to operate as they were expected to when designed. It is for this reason that we are dubious of the current debate over the appropriate standards applicable to registrants who deal with retail clients.

3. The Potential for Cross-Subsidization of Commission Costs

The CSA appears to be concerned that some management fees earned on front-end units are used to finance sales commissions paid on back-end units. We agree that this occurs. Unfortunately, the CSA does not explain why this is a problem. Cross-subsidization is an inherent feature of pooled investing.

The list of pooled expenses is quite lengthy, but certain expenses stand out because it is not always clear that all investors in the fund derive a benefit from those particular expenses (and we note that such is not the test for whether an expense is fund chargeable). Some of the pooled expenses cover investor services that allow fund companies to offer RSPs, RESPs, RIFs, LIFs, TFSAs, the Quebec Education Savings Incentive, the Alberta Centennial Education Savings Plan Grant and many others. Most glaring in this list are the two provincial examples, the costs of which are paid by the fund, not just the fund investors from those provinces who use those programs. Similarly, it is widely accepted that funds pay registration fees for LIFs, but we have not heard any complaints from younger investors who are not even eligible for LIFs. We note that automated transactions are less expensive to process than manual transactions, oftentimes by a significant amount, yet there is no call to issue a series for manual transactions and a series for automated transactions. We generally do not issue statements for clients whose accounts are registered in nominee name but we do for clients whose accounts are registered in client name, yet there is no regulatory imperative to separate these into series. The reason for all this is simple. If there were series that had every combination and permutation of services so that cross-subsidization were effectively eliminated, each series would be too small for it to be economically viable and the fund manager would be faced with a plethora of series with MERs greater than 5%. That would force the manager to absorb expenses (which, on that scale, might put it out of business) or close those series (and thereby limit what it can offer clients). Perhaps that is a better model, but that is surely a controversial point. We view the concept of different series for each purchase option similarly. By pooling all of these expenses, even where an investor pays indirectly for a service he or she does not use, he or she pays less than what he or she would have to pay for a fund company to be able to offer series that are more focused in terms of the ancillary services offered.

We think it is naïve of the CSA to think that if the series were separated, the management fees would be different. As explained earlier in this letter, the introduction of the traditional DSC is the classic case in point. DSC would never have been offered in the first place if regulators required the management fee to be reduced by the trailing commission differential. This is so because the option would not have been economically viable. Perhaps DSC is less useful than it once was, but it is a valuable option, especially for a young investor that expects to remain invested with a particular fund complex for the long term.

While the different series do have different management fees in the U.S., the structure of the regulatory and legislative background is quite different from that in Canada.

Under section 15(c) of the *Investment Company Act*, the fund's independent directors are required to negotiate the management fee annually and to conduct certain investigations in connection therewith. In addition, section 36(b) of the *Investment Company Act* specifically provides for a "fiduciary duty with respect to the receipt of compensation for services" paid for by the fund and provides a private right of action. A tremendous volume of case law has developed in the United States over the past 70 years to give meaning to these provisions. Not only is there no statutory equivalent in Canada to these provisions, but there is no case law on this topic and, absent the statutory rights, there is no real prospect of private litigation addressing this issue.

4. Alignment of Advisor Compensation and Services

The CSA asserts that under a dealer's compensation grid, the amount of trailing commission paid to the advisor may vary based on "whether the mutual funds sold are proprietary or third party mutual funds." We were surprised to see this statement without any additional comment because that practice is clearly illegal under NI 81-105, s.4.1. We note we have often commented on the fact that, in our view, existing regulations are sufficient and the issue is one of enforcement and this would seem to be a perfect example of that. If the CSA or the SROs are aware that this is occurring, the CSA or the SROs, as the case may be, must enforce the law and stop this practice immediately. Failing that, we ask the CSA and SROs to put themselves in our shoes and ask themselves what conclusions they should draw from the combination of this assertion, the direct words of NI 81-105 and the inaction of the regulatory community?

5. Low cost options for DIY Investors

The CSA asserts that the discount online/e-series segment is dominated by bank-owned companies and that none of the independent load only companies have similar discounted offerings. We have seen other commentators lay the "blame" for this situation solely on the independent companies. We disagree. We have had discussions with discount brokers to create a low trail series D (25 bps trail to cover the discount broker's legitimate costs) but such has been rejected by the discount brokers. We are fully prepared to allow our Series F funds to be offered by discount brokers; however, discount brokers have historically opposed this (with some exceptions) on the basis that it is uneconomic for them to offer Series F. We repeat ourselves for emphasis, if any online broker is willing to offer Series F for our entire fund range, we will revise our Series F eligibility language at our July prospectus renewal and permit the offering.

VII. Topics for Consideration

In the opening paragraph, the CSA states that the initiatives listed will be monitored to determine, among other things, whether they promote effective competition among financial industry participants. Without commenting on whether that is an appropriate measure, we would appreciate it if the CSA could expand on how exactly they intend to measure effective competition. Our comments on the seven options listed are as follows:

<u>Option 1 – Advisor services to be specified and provided in exchange for trailing commissions</u>: We have several concerns with this option. First, we are skeptical that this is a requirement that could be enforced and, as we have stated elsewhere in our comments, we are opposed to regulation for the sake of regulation where enforcement has not been contemplated or is not possible. Second, if the services are specified, that effectively acts as a cap on the services to be provided, which could be a competitive issue for advisors. Third, the logical extension of this option is to then differentiate the trailing commission paid by the fund company to the dealer based on the services provided by the advisor to the client.

As a result, a fund company could have to pay different trailing commission rates to the dealer for each of its clients. This would be virtually impossible for us to program and trailing commission payments cannot be done manually. Therefore, the costs of implementing this concept would far outweigh the benefits. We note that the cost reporting under the Transparency Initiative is a different method of achieving a similar result in that the disclosure ought to prompt an investor to ask the advisor what they are getting in return for the dollar amount of trailing commission set forth in that report. As such, this option is simply unnecessary. Fourth, we understand that paying different trailing commissions to different dealers for the same product would run afoul the Competition Act (Canada). If the CSA were to promulgate rules requiring differential trailing commissions on the same series of securities, we believe that may raise constitutional issues relating to paramountcy of federal legislation and it would put the mutual fund manufacturers in an untenable legal position.

We believe financial advisors should be clear with their clients about what services are provided and we believe the Transparency Initiative, which will require annual disclosure of the amount of trailing commissions received, in dollars, for each client from each fund company, will provide the means for the investor to evaluate whether they are getting appropriate value for the services. We believe the competitive market will then address this effectively. We base this view on our belief that there are many advisors who offer many services to their clients and some advisors who offer very little. For clients of the latter type of advisor, they can review the annual compensation report that will be required under NI 31-103 and, if they do not believe they are getting value for service, they should switch advisors. To facilitate this, the SROs and the CSA should consider regulations regarding account transfers. Virtually anyone who has ever transferred an account from one dealer to another is confused as to why the process takes so long. We would argue that it takes so long because there are no regulatory requirements around timeliness and basic human nature is such that you are slower to transfer out client money since that directly impacts firm revenue.

<u>Option 2 – A standard class for DIY investors with no or reduced trailing commission</u>: We agree with the proposal that mutual funds offer a standard class for DIY investors that would be made available through discount brokers. In fact, Invesco Canada is prepared to immediately offer Series F securities (no embedded compensation) of each of its mutual funds through discount brokers. Invesco Canada is also prepared to create a lower compensation Series D (reduced trail of 0.20% to 0.25% to fund the legitimate operating expenses of discount brokers) through that same channel. Notwithstanding the CSA's belief in this matter, the bank-owned discount brokers will not agree to this and such broker's dominate the discount channel. From a business perspective, the independent discount brokers simply do not conduct sufficient business for us to make an offering solely through them. Our concern is that we would have to subsidize operating expenses in that case since the size of the series would be too small to bear its operating expenses and deliver a significantly lower MER product to investors. We have recently tried to offer a Series D, with a reduced trailing commission, but, again, the bank-owned discount brokers rejected our overtures. It is up to the CSA to address this issue at that broker level and not at the fund company level. This proposal cannot work unless the bank-owned discount brokers are compelled to offer these series through their platforms.

We strongly disagree with the alternative formulation of this option, namely that fund companies be compelled to offer these series directly to investors. First, as an independent investment fund manager, we feel quite strongly as a matter of principle that investors are always best served by seeking financial advice from professionals and by having their money invested with a company solely concerned with investing. If we are forced into distribution, this will detract from our focus on investing to the detriment of our investing clients. Second, as we have long argued, there are inherent conflicts of interest when manufacturing and distribution are joined. We work hard to avoid conflicts of interest every day and do not wish to be subjected to additional conflicts. Third, engaging in direct distribution would require us to establish an infrastructure to do so, at significant cost (at least several million dollars), and to register with yet another regulator (the MFDA) which also entails significant cost and infrastructure. Because of these costs, we would be forced to charge distribution costs to investors of these securities and even then there is no guarantee that this could be a profitable enterprise. Is the CSA suggesting that investors who seek advice therefore should subsidize investors who do not? Lastly, as a simple philosophical matter, in a capitalist economy, firms are entitled to select the markets in which they wish to compete. Many mutual fund firms have consciously decided to market their products through financial advisors because we believe investors are generally better off when financial advisors are involved. To force us to compete in a different market is unacceptable in the Canadian economic system.

<u>Option 3 – Trailing commission component of management fees to be unbundled and charged/disclosed as a separate asset-based fee</u>: We note that this option already exists in the form of Series F securities, which has had a low rate of adoption. Initially, Series F securities kept mutual fund managers entirely out of the dealer compensation discussion and process. A view developed that perhaps Series F securities suffered from a low rate of adoption because of the difficulty for the dealer to collect the advisory or management fee it charged to the client. Note that if a client did not have cash in his or her account, the dealer would have to ask the client to sell an investment to pay the fee. At the simplest level, this is extra non-revenue producing work for an advisor and human nature dictates alternatives will be sought. As a result of this perceived problem, several fund companies offered an alternative whereby the dealer and client would set the advisory or management fee rate, communicate that rate to the mutual fund manager, and the manager would redeem just enough securities monthly or quarterly (as the case may be) to pay the fee to the dealer on behalf of the client. This option has not increased the adoption rate for Series F.

What we find particularly interesting with this proposal is that there is overwhelming evidence that investors who pay these fees tend to pay more directly to their dealers than they would have paid indirectly through a mutual fund investment with embedded compensation. That is, these fees are typically in the 1.25% to 1.50% range, which compares with the standard 1.00% Series A trailing commission. We note that these arrangements are prevalent in the United States and the fee range is no different there. As a global organization with significant operations in the United States, we regularly interact with dealers and advisors in that country and almost uniformly, they report high advisory fee rates regardless of the amount of assets invested by the client. We also note that, in Canada, many bank-owned firms and integrated manufacturers offer separately managed accounts, which are effectively mutual funds but the securities are owned directly by the client rather than by the fund. These portfolios follow a model and are not typically tailored to the individual. In all cases, account fees in the 1.50% range are charged. As such, while we have no issues with this option, we have no reason to believe that this would reduce fees for investors.

<u>Option 4 – A separate class or series of funds for each purchase option:</u> We oppose the idea of separate classes or series for each purchase option for two reasons: (a) potential lack of scale and (b) disruption of the concept of pooled expenses.

The proliferation of series of mutual fund securities brings with it concerns over scale. Mutual funds have certain fixed expenses and certain variable expenses, both of which factor into a mutual fund's MER. Until a series reaches a particular size, the fixed expenses are paid for by a relatively small pool of assets. When that occurs, MERs tend to get to high levels, well above 3% and often above 5%. Funds with MERs that high tend not to attract subscribers. To make the series more attractive, therefore, the mutual fund manager often will subsidize the expenses of these small series to reduce MERs to acceptable levels, in the range of 2.50% to 3.00%. A perusal of industry management reports of fund performance for Series F and other small series will amply demonstrate the extent of management subsidization of these series. Managers are not required to subsidize these series and as they become more widespread both the incidence and amount of subsidization can be expected to decrease. Ultimately, these costs are borne by investors and, therefore, we submit that requiring series proliferation will cost investors more than the status quo.

We also take issue with this proposal because it seeks to single out one element of cross-subsidization within the mutual fund structure. As we mentioned at the outset of this letter, pooling of expenses is one of the benefits of mutual fund investing. What this means is that all investors in a series or a fund pay for all expenses, even the ones for services they do not use. In return, however, their overall expenses are lower. As expenses are removed from the pool, this balance is disrupted and some investors will pay more than the status quo. Also, this could lead to further series proliferation as series become more tailored to the particular services offered. As we've demonstrated above, this leads to further management subsidization which, over time, should lead to the exit from the business of more investment fund managers as profitability declines. (Let us not lose sight of the fact that in almost all respects, mutual fund managers are profit-seeking enterprises.) This leads to reduced choice for investors and no case has been made that less choice is preferred. Further, because of the economics, investors may find that their preferred series is available for one fund in their portfolio and not others and this will lead to confusion and investment aversion. Simply put, when people are confused, the average person tends to avoid the situation rather than confront it and erase the confusion. We believe this would be a negative outcome for mutual fund investors.

<u>Option 5 – Cap commissions</u>: At a conceptual level, we agree that a cap on commission rates payable by mutual fund manufacturers to dealers would, as we have previously stated, largely mitigate the conflict of interest for a dealer that arises from differential trailing commissions. The difficulty is in establishing an appropriate rate and we would welcome discussion on that point. We are not prepared to suggest a rate at this time, however, we would look to current standards as representing a very good starting point given the familiarity of industry participants with those standards and the fact that it would result in the least amount of short term disruption to the market.

We believe caps on the dollar amounts paid per investor, whether aggregating all sales charges or just trailing commissions, are not viable due to the technological development required. The systems development would be extremely difficult and costly. It would also take much time to develop. We also do not agree that such is fair, especially to the extent the client has a relationship with the advisor and receives ongoing services.

A cap on the rate paid removes the compensation conflict insofar as the advisor recommends mutual funds. Combined with the cost reporting that investors will receive under the Transparency Initiative, investors will be well positioned to discuss compensation with their advisor in a meaningful way. This will either lead to acceptance by investors (fully informed) of current practices, reduction in compensation rates, or abandonment of financial advice. All such outcomes may be appropriate depending on the circumstances.

<u>Option 6 – Implement additional standards or duties for advisors</u>: This proposal is already being addressed by the CSA in the Consultation Paper. We have provided comments on the Consultation Paper, which we attach as Appendix A to this comment letter in case

CSA members who regulate investment funds were not involved in the Consultation Paper, and/or have not read it and the comment letters submitted in respect thereof (which we would view as rather unfortunate).

Option 7 – Discontinue the practice of advisor compensation being set by mutual fund manufacturers: We believe embedded compensation benefits investors for many of the reasons already set forth in this letter. The extent to which our belief is valid will be well tested with the implementation of the Transparency Initiative as investors become very well informed about what compensation they actually pay to dealers, directly and indirectly. Further reforms until the effects of the Transparency Initiative are known simply do not make sense to us at this time. We say that because many opponents of unbundling commissions and banning commissions have raised, in our view, legitimate concerns about the impact of these reforms on the actual investment performance and experience of retail investors. Whether those concerns are valid will be well known within several years as the experience of the Transparency Initiative and the U.K and Australian reforms discussed in the Discussion Paper take root. Only once that it known would it be prudent to consider such reforms.

Thank you for providing us with the opportunity to comment on this important initiative. We would be pleased to discuss our comments further should you so desire.

Yours very truly,

Invesco Canada Ltd.

Eric Adelson
Senior Vice President and Head of Legal – Canada

APPENDIX "A"

INVESCO CANADA COMMENT LETTER ON CANADIAN SECURITIES ADMINISTRATORS CONSULTATION PAPER 33-403: *THE STANDARD OF CONDUCT FOR ADVISERS AND DEALERS: EXPLORING THE APPROPRIATENESS OF INTRODUCING A STATUTORY BEST INTEREST DUTY WHEN ADVICE IS PROVIDED TO RETAIL CLIENTS*

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February 22, 2013

VIA E-MAIL

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
Registrar of Securities, Northwest Territories
Superintendent of Securities, Yukon Territory
Registrar of Securities, Nunavut

Attention:
John Stevenson, Secretary
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20 Queen Street West
19th Floor, Box 55
Toronto, Ontario M5H 3S8
jstevenson@osc.gov.on.ca

Me Anne-Marie Beaudoin
Corporate Secretary
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800, square Victoria, 22e étage
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Montréal (Québec) H4Z 1G3
consultation-en-cours@lautorite.qc.ca

Dear Sirs/Mesdames:

Re: Canadian Securities Administrators Consultation Paper 33-403: *The Standard of Conduct for Advisers and Dealers: Exploring the Appropriateness of Introducing a Statutory Best Interest Duty When Advice is Provided to Retail* Clients (the "Consultation Proposal")

We are writing in respect of the request for comments dated October 25, 2012 regarding the Consultation Proposal. We appreciate the opportunity to comment on these important matters.

Invesco Canada Ltd. is a wholly-owned subsidiary of Invesco, Ltd. Invesco is a leading independent global investment management company, dedicated to helping people worldwide build their financial security. As of January 31, 2013, Invesco and its operating subsidiaries had assets under management of approximately US$713 billion. Invesco operates in 20 countries in North America, Europe and Asia.

Invesco Canada is registered as an Investment Fund Manager, an Adviser and a Dealer in Ontario and certain other provinces. Our investment products are primarily bought by and sold to retail investors. As such, we take a great interest in regulatory discussions that impact those investors.

In this comment letter, we would like to discuss our views generally of the standards of conduct and the possible impacts of regulatory changes in that regard. In Appendix 1 attached to this letter, we have responded to some, but not all of the questions posed in the Consultation Paper. Where we have not responded we either do not have a view at present or we believe the question has been raised prematurely. Our comments are from the perspective of a manager of mutual funds.

Investor protection is, of course, one of the primary purposes of securities regulation. We recognize that every initiative brought forth from the Canadian Securities Administrators ("CSA") is done with this concept in mind. We are concerned, however, that the CSA has initiated many regulatory changes and many concept papers/consultation proposals over the last several years either without an overriding approach in mind or one that has not been well articulated publicly. That is, when one reads the multitude of proposals put forth by the CSA over the years, it is not clear what end state the CSA is seeking. We believe that if the CSA took the time to articulate the desired end state, it and those who provide comments could evaluate its proposals in that context and ensure that regulatory reform remains focused toward a desired outcome. We acknowledge the international context in which the CSA operates and the outside pressures to which it is subject. At this stage, we are not suggesting such is the case with the Consultation Paper which is a welcome procedural step toward reform, but we are concerned that this initiative could be compromised by following other jurisdictions' reforms before an evaluation of those reforms is possible. However, we believe the CSA should not be shy about using other jurisdictions' regulatory reforms as a test laboratory prior to making similar proposals in Canada.

Consistent with the foregoing thoughts, we believe the correct question to initiate the debate over statutory standards of conduct is how will reforms to the standard affect the retail investor. That is, if a statutory best interest duty or fiduciary duty is proposed to apply to the activities of financial advisors/dealer representatives or anyone who provides advice (collectively, hereinafter referred to as "advisors"), how does that, in practice, improve the protections for a retail investor from the status quo? The Consultation Paper does not attempt to answer this question. In fact, it poses this question in several different forms.

The Consultation Paper notes that, in Quebec, registered dealers and advisers are currently subject to a duty of loyalty and a duty of care and must act in the client's best interest. This is interesting in that such formulation is clearly the same as what is often referred to as a fiduciary duty. This is helpful to the questions raised in the Consultation Paper as it provides a real opportunity for the CSA to assess whether, as a result of this difference in standard between Quebec and the rest of Canada, Quebec investors are better protected? The answer to that question ought to inform this entire discussion. It would be helpful if the CSA would address the impact of that difference and assess it in the publication that follows this Consultation Paper.

At this stage of the process, our primary concern lies with the practical meaning of a difference in the wording of the duty of care in that it is not clear what exactly would be expected of an advisor operating to that standard. Our experience is that in the face of this type of uncertainty, advisors became unduly conservative in approach, often to the detriment of their clients' longer term interests. In the Consultation Paper, the CSA describes the proposed standard of care as follows:

> There may be a large number of potentially suitable investment products, but the question is whether the advice to the client must identify a smaller range of products that are, in the advisor's view, in the client's best interest. One consideration in giving that advice would be the relative cost to the client of the product.

Other than the last sentence, we find this formulation helpful in that it implies that the advisor can start with a list of suitable investments and then narrow the list to what is best among those for the client, based on the advisor's professional judgment. This further implies a reasonably safe haven for an advisor who can demonstrate that the process was followed, as it would be unjust to judge whether the standard was met in hindsight, which is the risk when the advisor's performance is assessed only after the performance of the investment is known. (Otherwise, the standard effectively serves as a guarantee.) The reason we dislike the last sentence is it sends the message that cost is the primary consideration. We disagree with that idea because it is an overly limiting factor. We are not suggesting that cost should not be a consideration, but there are high cost investments with superior long term performance (relative and absolute) and a client would not be well served by ignoring these products. If this is all about cost, then the CSA has to consider the impact of regulating with cost as an overriding concern. We think it is wrong for the regulators to focus on cost in a market-driven environment and it leads to unintended outcomes. When cost is the focus, the effect of regulation is typically to drive down participation. In this case, if the goal (whether primary or not) is to reduce cost, it seems likely that will lead to a reduction in the number of advisors servicing clients and we question whether that is a desirable outcome.

In the potential benefits of a new standard, the CSA notes that "this does not mean that there is necessarily only one "best" investment for a client. Nor does it mean that advisors would assume liability for the success of the investment." If a new standard is adopted, while we believe a court would agree with this, we think a lot of time and effort could be saved if a statement to this effect were included within the relevant rules.

The Consultation Paper reviews similar reform efforts in the U.S., U.K. and Australia. The tenor of the questions posed by the CSA indicates a preference for the U.K. and Australian approaches over that of the U.S. The issues raised in the U.S., as discussed in the Consultation Paper, are valid and serious issues. We believe the CSA must address those specifically prior to rejecting the U.S. approach.

We feel compelled to comment on the CSA's expressed view on commissions paid by issuers expressed in the fifth key investor protection concern. The CSA states that commissions paid by issuers to advisors and dealers for recommending the issuer's securities may constitute such a fundamental conflict of interest that regulators should consider how best to mitigate the risk (e.g. prohibiting some or all embedded commissions). This is an overly narrow focus on an element of an issue that may well lead to a perverse result. First, in the context of mutual funds, if all mutual funds paid the same commission, then the conflict would be mitigated, so that is one obvious solution to the perceived conflict. Second, while there are certainly some advisors that make recommendations based on their own compensation, there is no evidence that this is a widespread practice. If compensation was driving recommendations, then presumably one would expect consistent increases in the value of mutual funds held by clients of IIROC dealers. But the evidence is that the market share of mutual funds within the IIROC channel has been in steady decline for years. Second, we do not yet know the effect of banning certain commission practices. It is evident that investors are unclear how much they pay for investment products. However, the CSA has addressed this with the forthcoming amendments to NI 31-103. We do not believe that the U.K. or Australia took this step prior to banning certain commissions. We believe this is an innovative and prudent initiative by the CSA, but time is required to assess its impact. Historically the CSA has addressed conflicts through disclosure requirements before considering similar action in Canada, and therefore, would it not be prudent to see what the impact of cost transparency is in Canada and what the impact on investing is in U.K. and Australia? What would the CSA's position be if, in 2-3 years it became evident that, in those countries, there were fewer financial advisors, fewer retail investors using financial advisors (either doing it themselves or not investing) and overall savings were significantly lower? Surely the CSA would agree that such is a most undesirable outcome. What would be the harm in waiting to assess that? We believe such an outcome is likely because investors in those countries will perceive that, previously, they paid no commissions and now they are required to pay commissions without getting anything in return. At minimum, this could be avoided in Canada through the cost transparency initiative in the NI 31-103 amendments. Once investors realize what they are currently paying for their investments, then a debate on commissions and compensation would be more informed. We know from studies that IFIC has shared with the CSA that investors who have an advisor achieve better results than investors who do not have an advisor and also that those investors save more. In the context of dwindling public and corporate pension plans, is retirement savings not an overriding concern for the CSA?

Conclusion

It is clear that Canadian investors are generally unclear as to the nature of their relationship with their advisor and their advisor's legal obligations. Until investors have this clarity, it is difficult to assess whether the standard of care must change and, if so, to what degree.

Thank you for providing us with the opportunity to comment on this important initiative. We would be pleased to discuss our comments further should you so desire.

Yours very truly,

Invesco Canada Ltd.

Eric Adelson
Senior Vice President and Head of Legal – Canada

Appendix 1
Responses to Specific Questions in the Consultation Paper

Question 1: Do you agree, or disagree, with each of the key investor protection concerns discussed above with the current standards applicable to advisers and dealers in Canada? Please explain and, if you disagree, please provide specific reasons for your position.

We do not agree with the concern that the current regime is not "based on the most principled foundation". Given the range of investment choices available to investors and the simple fact that there is no way to predict the future performance of a product, the suitability standard is based on a solid principle, namely, how can anyone determine what is "best" for anyone, absent the ability to predict the future? For example, most investor advocates have expressed the view that fees are most important and if you have two equity funds with similar objectives, the best one is the lower fee one. We disagree with that assertion because it completely eliminates any consideration of the skill of the portfolio manager. Not all portfolio managers are equal. Some are actually better than others. Given the track record of the manager, the fee differential may be irrelevant when considering long-term results. In our view, a recommendation into such an investment would be quite likely to meet a suitability standard. We are concerned that if a similar investment had slightly lower cost but also slightly lower returns, it may not meet a higher standard of care. This illustrates the effectiveness of the "good faith" requirement in the current standard of care. This is the principle upon which the current standard is based and we believe that is a pretty strong principle. We are unable to comment on Concern 4 "Recommendation of suitable investment versus investments in the client's best interests" because there is no articulation in that concern of what the distinction means. We do note that the courts already recognize a higher standard in situations of vulnerability, such as discretionary accounts.

Question 2: Are there any other key investor protection concerns that have not been identified?

A key investor protection concern that has not been identified is investor apathy. Many Canadians do not have adequate savings. Financial advice has been shown to be the best remedy for this concern. Canadians who seek financial advice typically save more and have better returns than Canadian who do not, including do-it-yourself ("DIY") investors. In this context, we are concerned with any regulatory proposal that may have the effect of driving investors away from seeking financial advice and this potential impact should be considered in the context of the Consultation Paper. That is, would the impact of a statutory best interest standard or a fiduciary duty encourage Canadians to seek financial advice or would it drive those who do invest into the DIY channel. We address this issue further in our response to question 29. Until further data is available from countries who have embarked on the type of reform contemplated by the Consultation Paper, it is simply not possible to determine whether a change in the standard of care will effectively address concerns of investor apathy.

Question 3: Is imposing a statutory best interest standard on advisers and dealers the most effective way of addressing these concerns? If not, would another policy solution (e.g., changes to one or more of the existing statutory standard of conduct requirements) offer a more effective solution?

We do not believe that a statutory best interest standard is the most effective way of addressing the concerns. Fundamentally, a statutory best interest standard is useful only to the extent that it can be privately enforced and the reality is that in most cases it is simply too expensive for investors to engage in private litigation to enforce their rights, when one compares the cost of private enforcement with the amounts at issue. To the extent conflicts of interest are the concern, we believe the CSA has taken too extreme a view over time of the efficacy of disclosure as a cure for conflict. In many cases, the disclosure has the opposite effect. If the CSA believes a practice that gives rise to a conflict is more likely than not to have negative consequences, the CSA ought to examine the range of options available to address the conflict, including banning the practice. We find it interesting that NI 31-103 requires registrants to identify all conflicts of interest, decide how to deal with those conflicts, and provides guidance that sometimes banning the practice is required, yet generally the CSA takes a pass on banning any suspect practices by regulation. The financial services industry is highly competitive and, sometimes, one player in that industry may realize that a conflict practice should be banned but does not do so because it will lose business to its competitors who take a different view. In those cases, the CSA must step in to ban the practice and ensure a level playing field.

Question 4: Do you believe that some or all of these concerns are inapplicable (or less significant) in any CSA jurisdiction as a result of its current standard of conduct for advisers and dealers?

We do not believe there is any difference among CSA jurisdictions in this regard.

Question 6: If such a duty is imposed, are the terms of the best interest duty described above appropriate (for example, should there also be an on-going obligation regarding the suitability of advice previously given or investments held by a client)? What changes, if any, would you suggest to the terms of the best interest duty described above?

Those who advocate for a change in the standard of conduct do so on the basis that the existing suitability standard is ineffective. As such, it is not clear when the suitability standard would apply if a best interest duty or fiduciary duty is a higher standard. The remainder of the “scope” of the duty set out in the Consultation Paper seems reasonable. Without private enforcement rights, we believe this entire exercise will be ineffective.

Question 8: Do you agree, or disagree, with each of the potential benefits and competing considerations of the statutory best interest standard described above? Please explain and, if you disagree, please provide reasons for your position. Are there any other key potential benefits or competing considerations that have not been identified?

We disagree that a principle-based approach is necessarily a positive in this context. A principle-based approach in a regulated environment typically introduces a level of uncertainty precisely because it is not prescriptive and, therefore, it is open to interpretation. In contrast to the uncertainty that would arise in the context of a new standard of care, the suitability standard has been in place for many years and, over time, a level of certainty has developed over precisely what is required to meet the standard. We note that the landscape today includes a suitability standard that is fairly well understood and, where the facts of the situation show investor vulnerability, a fiduciary duty exists. It is not always clear, however, what is required of an advisor when the advisor is subject to a fiduciary duty under current standards. As noted in our response to question 16, to the extent that there are perceived deficiencies with the application of the suitability standard, this could, and perhaps should, be cured by improved enforcement.

Question 9: What are the criteria that should be used to identify an investment that is in a client's best interest?

We do not believe that it is possible to devise a checklist as to whether an investment is in the client’s best interest which, we believe, is the foundation of the suitability standard. We note that some investor advocates have failed to provide criteria, which we find telling. In our view, many of the examples discussed are contrary to the registrant’s current duty to act fairly, honestly and in good faith. One example cited is a churning situation. We ask, simply, how can that meet any standard of good faith? And if a fiduciary duty is imposed, how, practically, is that practice deterred? We would argue that suitability is only one part of the current standard. In a churning situation, the investment to which the client is switched may indeed be suitable (showing the deficiency in that standard) but in the context of the overall advice, the current registrant's duty is likely not met (showing the strength of the current statutory duty).

Question 10: Should breaches of a best interest standard give rise to civil liability at common law?

Yes, breaches of a best interest standard should give rise to civil liability. We also believe that breaches of the current registrant's standard should similarly give rise to civil liability to the extent it is viewed that it does not.

Question 11: If so, is it necessary to state expressly that a best interest duty will give rise to civil liability on the part of the adviser or dealer or is it sufficient if that standard is a statutory duty?

As there appears to be some confusion as to whether being explicit in the regulation is required for civil liability to follow (otherwise, presumably, the question would not be raised) we favour elimination of confusion as an overriding principle. Therefore, to reduce uncertainty, it should be stated.

Question 12: Does the duty of an adviser or dealer to act fairly, honestly and in good faith when dealing with clients, coupled with the existing rules related to suitability and conflicts of interest, already impose a standard of conduct that is functionally equivalent to a fiduciary duty?

We believe that, for the most part, the current regime is functionally equivalent.

Question 13: If so, should it be made clear that investors can enforce that duty as a private law matter?

If there is uncertainty as to private rights of enforcement, then these should be clarified for retail investors.

Question 14: If you believe that the existing standard of conduct for advisers and dealers already imposes a standard of conduct that is functionally equivalent to a fiduciary duty, what impact (if any) would the introduction of a statutory best interest standard have? For example, would it be desirable for investors to have the benefit of a statutory best interest standard that has long been recognized and interpreted under fiduciary duty common law principles?

We are unclear of the benefits. We believe those who propose regulatory changes are obliged to set forth the real benefits of a change.

Question 15: Do you think the investor protection concerns raised in this Consultation Paper could be addressed by issuing guidance about current business conduct requirements, including the duty to deal fairly, honestly and in good faith with clients? Please provide specifics about the type of enhanced guidance that would be most effective.

We believe guidance would be a viable alternative to imposition of a new duty. We are unable to draft guidance for the regulators. As a starting point, we would urge the CSA to publish a list of the primary types of investor complaints and explain for each example how such practice is contrary to the current standard. The CSA must provide this guidance in true collaboration with the MFDA and IIROC, since they bear the brunt of enforcement and, by virtue of their responsibilities, possess better expertise than the CSA on this matter.

Question 16: Do you think that the concerns raised in this paper could be addressed by increased enforcement of current business conduct rules, including fair dealing, suitability and conflict of interest requirements?

We believe most of the concerns can be addressed through increased enforcement. We note that proper enforcement requires both manpower and adequate penalties. Additional regulation without addressing the questions relating to proper enforcement is likely to be ineffective.

Question 18: If yes, given that a fiduciary duty is already owed to a client in certain circumstances, why do you think that clarifying the circumstances in which such a duty is owed will affect ongoing costs of advisers and dealers in Canada?

An increase in certainty means an increase in internal rules for any registrant and an increase in compliance oversight. At minimum, that implies an increase in personnel devoted to this function and an increase in personnel requires such personnel to be paid a salary. Given the economic circumstances faced by many registrants, we would expect to see a shift in personnel from revenue-producing roles to compliance monitoring roles to meet the clarified standards. This leaves fewer people to deal directly with clients and could lead to some of the negative outcomes discussed elsewhere in this letter.

Question 20: We note that cost-benefit and/or market impact analysis has been conducted to varying extents on the proposed reforms in each of the U.S., U.K., Australia and E.U. Do you believe that this international analysis is relevant to the possible introduction of a statutory best interest standard for advisers and dealers in Canada? If so, please explain.

We believe it is necessary for the CSA to engage in its own cost benefit analysis. We remind the CSA that, at least in Ontario, this is a legislative requirement and failure to provide that could render any regulatory reform *ultra vires* the *Securities Act* (Ontario).

Question 22: How should a statutory best interest standard apply to mutual fund dealers, exempt market dealers and scholarship plan dealers?

The response to this question really goes to the heart of our comment in the body of this comment letter, namely, what end state is envisioned by the CSA? The closer one gets to a "pure" fiduciary duty, the less viable are the categories cited in this question.

Question 24: Do you agree with the approach reflected in the Australian Reforms or UK Reforms to accommodate restricted advice and scaled advice, respectively?

We have not reviewed the Australian and U.K. proposals extensively. On its face, we do not understand the principled reason why a lesser amount of investor protection is required to suit the circumstances that give rise to a tailored approach. That is, if someone providing financial advice has to consider the best interests of the client, how can it be possible to ignore an entire range of products? Ultimately, how does that serve the client? For example, we have no information on why a client would select an advisor who is only permitted to speak about scholarship plans when a client is seeking to save for education purposes. Perhaps the client is best served by another type of investment vehicle altogether. Such categorization only works with a suitability standard. Furthermore, we do not believe that under the current system in Canada, retail clients understand the distinction among different types of dealers. Therefore, they would likely not understand that different standards of care may apply.

Question 26: Will the qualifications required to make a best interest standard work in Canada result in retail clients receiving only advice on a narrow range of investment products?

If a true best interest standard is imposed, then by definition the client must receive advice on the widest possible range of products.

Question 28: Do you believe that the statutory best interest duty described above would affect the current compensation practices of advisers and dealers? If so, in what way?

We believe that compensation generally is a separate matter from standard of care. We say generally because, obviously, if an advisor can be shown to be recommending one investment over another because of the compensation to the advisor, that would seem to be a clear breach of a traditional fiduciary duty. However, the question is really the degree to which that compensation erodes the investor's return.

Question 29: Should a best interest duty expressly address adviser and dealer compensation practices? If so, in what way?

Given the forthcoming amendments to NI 31-103 regarding cost and performance reporting, we believe addressing compensation – which we take to mean embedded compensation - is premature. The U.K. and Australia have addressed embedded compensation extensively in their recently effective reforms. Those reforms have been in place for too short a period of time to assess their impact (i.e. a few months). The transparency initiative under NI 31-103 is expected to have some impact. Once that data is in and/or a proper assessment of the U.K. and Australia experiences is possible (i.e. after 2 or 3 years) then it would be appropriate, based on that assessment, to consider a similar reform. Our concern is that at this time, the entire debate around embedded compensation is mere conjecture. However, U.K. and Australia are two real life examples in regulatory systems and cultures not dissimilar to ours. It is rare that such a test opportunity is available and deciding these matters now serves no public purpose.

Question 30: Could volume based payments or embedded commissions continue if the statutory best interest standard described in this paper is introduced? If so, should such compensation structures be specifically prohibited?

For the reasons cited in response to question 29, we decline to answer this question at this time.

Question 32: Should any statutory best interest standard be modified in any way to preserve various compensation structures?

We believe that the subject of compensation is separate from consideration of a statutory best interest standard. The CSA should first determine what compensation structures are appropriate and only then should it deal with the standard of care issue. We say that because any standard of care will have to be defined by the CSA in the regulatory reform process. This provides the opportunity to address compensation structures within that duty. But that can only work if the determination is first made as to what compensation structures are appropriate.

Question 33: If the statutory best interest duty described above is introduced, what areas of guidance would be most useful to advisers and dealers?

Extensive guidance on how an advisor is supposed to apply the standard in everyday practice would be necessary. Regulation that captures unintended behavior or makes "criminals" out of those who are not intended to be is simply bad regulation. The CSA strives for considerably better than that.

Question 36: Are there any advisory relationships between an adviser or dealer and a retail client where a fiduciary duty would not be appropriate?

In a relationship where a dealing representative only provides recommendations and the client is able to reject those recommendations and actually does on occasion, then a fiduciary duty is inappropriate. The client has to be truly vulnerable to the advisor for the duty to exist. Many relationships exist where the advisor provides recommendations and the client decides; in reality, the client typically follows the advice. In that case, we believe vulnerability exists. It is for this reason that we have formulated the first sentence of this response in the manner which we did.

Question 39: Are any existing regulatory rules inconsistent with the best interest standard described above?

There are none of which we are aware.

Question 40: Would the statutory best interest duty described above require revisions to the rules that govern how firms address conflicts of interest with their clients?

We do not believe the rules that govern how firms address conflicts of interest with their clients would change. The registrant's policies in that regard may have to change.

Question 42: Should the CSA consider only imposing a best interest standard in respect of certain requirements, such as conflicts of interest or suitability requirements?

We do not believe that a best interest standard can be partially applied. We also believe that where registrants are under different duties in respect of different functions, there is often confusion and the higher standard often is adopted regardless.

Question 44: Should a best interest standard apply only to advisers and dealers when dealing with "retail clients"?

We do not necessarily agree that the standard should be based on who the client is but on the nature of the relationship. If the advice is tantamount to discretionary management (i.e., with a client rubber stamp) then the standard should apply.

Question 46: Should certain kinds of permitted clients (e.g., municipalities) have the benefit of a statutory best interest standard?

As noted in our response to question 44, the application of the standard ought to be based on the nature of the relationship. The "permitted client" definition illustrates this quite well. Many "permitted clients" are sophisticated institutional investors who are perfectly capable of looking out for their own interests. However, some are significantly less so. For example, it is not uncommon for certain pension funds to be overseen by a board of trustees that have no investment experience. Presumably, those boards place greater reliance on their financial advisors and, in such case, the same standard ought to apply to them as to a retail investor.

Question 47: Are there certain kinds of retail clients that do not require the benefit of a statutory best interest standard?

As noted in our previous responses, we do not agree with the underlying premise of this question. If a retail investor, even one with thorough investment knowledge, places heavy reliance on the advisor, their own sophistication should not be relevant to the standard to which the advisor is or ought to be subject.

Question 48: If the best interest standard described above was introduced, should advisers and dealers be permitted to modify or negate the standard by contract with their clients? If so, what limitations (if any) should be placed on that ability?

Contracting out of or modifying the standard should be permitted. However, it is in this context where we believe that the distinction between retail investors, accredited investors and permitted clients is appropriate. Given the issues of vulnerability, information asymmetry and power that lead to a fiduciary-like duty, we do not believe that contracting out or modifying a standard is appropriate for retail investors. However, accredited investors and permitted clients do not have the same vulnerability or asymmetry and, therefore, should be permitted to contract out. The problem we foresee, however, is that if the standard is not well defined, it is not possible for an accredited investor to make an informed decision in that regard.

Question 49: If a best interest standard is introduced, should the existing duty on advisers and dealers to deal with their clients fairly, honestly and in good faith continue to apply whenever the best interest standard does not?

Yes.

Question 50: Should the best interest duty described above apply when any advice is provided to a retail client or only when personalized advice is provided to a retail client?

We question the distinction between advice and personalized advice. If advice is being given to a retail client that is not personalized, it is foreseeable that the retail client would try to adopt that general advice to their own situation which could lead to rather undesirable results. If the advice is so general that the advisor can appropriately distance himself or herself from the implementation of the advice, then the client will be unlikely to establish that a duty of care was even owed in the circumstances. Most likely, if this distinction is made, both parties to disputes will have to deal with an additional level of argument, namely whether or not the advice was personalized.

To illustrate the foregoing, suppose the non-personalized advice was to invest in global equities. If the client applies this advice by buying Fund A without consulting the advisor, then no duty of care is owed by the advisor relating to that investment, whether the standard of care is the current standard, a best interest standard or a fiduciary duty. If the client applies this advice by buying Fund B in consultation with the advisor, then the advisor would be subject to a suitability standard in relation to the selection of Fund B for the client under current law or, under a modified standard, under such standard. That is, this distinction is implicit in the legal application of any standard of care and, therefore, it does not need to be addressed in a rule or statute.

Question 52: Should it be triggered in the same circumstances in which the suitability requirement arises? Does this include advice to *hold* securities (as opposed to buying or selling securities)?

If a client seeks advice, whether to buy, hold or sell, the same standard ought to apply to the advisor. However, we do not believe it is practical to require, in all cases, an advisor to regularly monitor an account and contact the client when he/she feels it necessary. That said, clients should be able to contract for that service – and one could see tremendous value in such a service – but absent a deliberate agreement between client and advisor, the standard should be restricted to advice-giving.