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

Dear Sir or Madam:

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

We are writing in respect of the CSA Discussion Paper and Request for Comment 81-407 *Mutual Fund Fees*, dated December 13, 2012, regarding the mutual fund fee structure in Canada (the "Discussion Paper"). We appreciate the opportunity to comment on this important issue.

Russell Investments Canada Limited is registered in all provinces and territories of Canada as an investment fund manager, portfolio manager and exempt market dealer. Russell Investments Canada Limited and its affiliates carry on business collectively as "Russell Investments". Russell Investments is a global asset manager that offers actively managed, multi-asset portfolios and services that include advice, investments and implementation. As of March 31, 2013, Russell Investments had approximately CDN $176.3 billion in assets under management.

Given the very preliminary stage of this process and the broad nature of the questions raised by the Discussion Paper, in Part I we make some general comments in order to frame the discussion. In Part II, we respond to the topics for consideration found in Section VII - 2 of the Discussion Paper.

Part I - General Comments

Advice Provided by Financial Advisors has Value

The discussion regarding mutual fund fees is largely a discussion about how the advice provided to retail investors in connection with purchases of mutual fund securities is to be paid for. Retail

investors are generally not able to purchase mutual fund securities except through a registered dealer. Except in the case of discount dealers, there is a financial advisor whose job it is to advise the purchaser with respect to the purchase, holding and ultimate disposition of the mutual fund security. We all agree that this financial advice is valuable to clients. But in order for this advice to be provided, the recipient of the advice must fairly pay for the service, whether that payment is made by way of up-front sales commission, an asset based fee, a trailing commission or something else, and whether the payment is made directly or indirectly.

The challenge is to find an appropriate level of regulation that provides reasonable assurance that the advice is fairly and competently delivered, without unduly intervening in the marketplace and impeding the efficiency of commercial transactions in personal financial services.

Consumer Choice & Competition

In an open economy such as ours, we allow participants to make choices. We limit those choices only where necessary to prevent substantial harm to individuals and society, e.g. in situations that give rise to fraud or abusive practices. However, we begin from the premise that absent a good reason, investors should be able to choose from among the broadest possible range of options.

Competition is about allowing consumers to choose the products and services they prefer. Competition drives innovation, efficiency and economic growth. In the investment world, competition and choice allow capital to be allocated to its most efficient use. Russell Investments submits therefore that regulation should enhance and be consistent with allowing more choice to investors, not restricting it. If there is a risk that regulation will inhibit choice, such regulation must be examined carefully before implementation.

Choice in Products and Services Must Leave Room for Individual Preferences

There are many individuals who, even where they have the ability, simply do not have the inclination to spend time reading disclosure documents or carefully monitoring their financial affairs. They would rather do other things with their time and energy. While this may mean returns to them are lower than if they had taken a more active role in managing their own finances, they are happy to pay someone else to monitor performance, rebalance assets, and respond to changes in economic and market conditions. Products and services should be able to accommodate people who choose not to take an active interest in their own financial affairs, even if such products appear to be "high cost" compared with alternatives available to investors who choose a deeper level of participation in their investing process.

There should be and continue to be a variety of delivery mechanisms for advice and for payment for that advice, in order to suit different investor needs and encourage innovation in product delivery. Regulations which make adequate advisor compensation impractical from a cost perspective, or risky from a compliance or liability perspective, will tend to inhibit this choice of delivery mechanisms.

It is important to note the fact that once in a while an advisor or an investor makes what a reasonable person may consider to be a poor choice, or a choice that may in hindsight not provide the optimal performance. This, however, is not evidence of regulatory failure. It is

merely the consequence of there being robust choice and different preferences among individuals as to how to value potential investments.

The Role of Regulation

We submit that in order to achieve the purpose of, as securities legislation states, protecting investors from "unfair, improper or fraudulent practices", the role of the regulator is to ensure that the participants in the markets are acting in a fair and proper manner and not to ensure that investors achieve a specific result or that revenue is distributed in a specific proportion among capital markets participants. The focus is on practices and process, as opposed to outcome.

It is not the role of the regulator to determine what is a "fair" price for mutual funds or for financial advice. In fact, we would submit that there is no logical way to stipulate what is or would be a "fair" price. We would also submit that comparing prices in Canada to rates that prevail in other countries is of limited use in determining whether prices are fair or appropriate. Differences in market structure, economies of scale, the regulatory regime and historical accident are among the many factors which may account for differences in fund fees across jurisdictions. So long as the participants have full disclosure and are not subject to misrepresentations and abusive tactics, it is not for regulators to determine whether fund fees are "too high".

We submit that the regulators have not yet made the case for how the proposals in the Discussion Paper would foster more fair and efficient capital markets.

Fairness to Investors and Regulatory Restraint

All stakeholders want retail investors to be informed. Therefore, a key question is how we can better promote investors making informed choices.

Regulators may look for ways to support advisor education and training. Mandatory continuing education for advisors is one way to do this. Also, the initiative to encourage and foster investors' financial literacy is to be applauded. It represents an excellent counterweight to the "information asymmetry" that regulators are concerned with.

At the end of the day, however, regulation cannot and should not guarantee success for all investors. Regulation that restricts choice should extend only so far as to limit the possibility of unfair, improper or fraudulent practices in the marketplace and must equally consider the legislated objective of fostering "fair and efficient" capital markets

The Importance of a Level Playing Field

Any changes to the current regulatory regime as it affects fees and compensation structures should apply equally across all distribution channels as well as across similar product lines. Every effort should be made to minimize differences in rules applicable to funds distributed through multiple channels, including full-service brokers and dealers, fee-only financial advisors, discount brokers (execution only as well as advised), or separately managed accounts. Furthermore, products which are broadly similar to mutual funds or that may be seen as alternatives to mutual funds should, to the extent possible be subject to the same fees and compensation standards and rules as for mutual funds.

We are concerned that open-end mutual funds will become subject to greater restrictions in terms of fees and methods for compensating distributors, or more onerous disclosure requirements, compared to other financial products which compete for the retail investor's attention (such as the direct purchase of shares or bonds). If intermediaries are required to do substantially more work and assume greater compliance or regulatory risk in order to sell open-end mutual funds, they may decide to favour another product such as variable annuities for reasons which have very little to do with investment merit. Adding regulatory burden can make a product expensive for an intermediary to distribute, since the incremental cost of compliance cannot be immediately or even ultimately offset by additional revenue. In examining the topic of fees, regulators should be concerned that they are not inadvertently introducing undesirable distortions into the marketplace and thereby detrimentally affecting investors.

In addition, changes to rules around fees and compensation may have disproportionate impacts to different fund providers and their distribution channels. The fund companies who depend entirely on arms-length third parties for distribution face significantly different challenges than fund companies with affiliated or captive distribution. As stated at the commencement of this submission, any discussion of fund fees is inseparable from a discussion about compensation of the participants in the distribution channel. An improper execution of these changes or rushed transition from the current industry model may result in substantial unnecessary costs or competitive disadvantages being imposed upon certain stakeholders in the industry.

One risk embedded in several of the possible changes discussed is the potential negative consequence to investors if the changes result in advisors bearing higher costs in their provision of financial advice. The logical outcome of this will likely be (a) advisors exiting the market, resulting in fewer advisors to service the same number of clients, and (b) reduced incentive for advisors to provide services to lower net worth investors. Each of these outcomes has as its effect reduced choice for investors, lower competition in the industry and higher investor costs to mutual fund investing. This is a poor outcome for both investors and capital markets efficiency.

Part II - Topics for Consideration

We are pleased to contribute to the discussion by providing you with our views on the possible changes discussed by the CSA.

Advisor Services to be Specified for Trailing Commissions

Russell Investments agrees with the principle of defining and disclosing the purpose of trailing commissions to investors. However, the CSA additionally proposes that an advisor would be "prohibited from collecting a trailing commission if it was determined that the services were not being delivered...advisors and their dealer firms would have to record and monitor the nature, extent and frequency of the services provided to mutual fund investors".

This proposal would represent undue interference in the business relationship between the dealer firm and the individual advisor. For instance, the trailing commission, like all commission payments, is paid to and received by the dealing firm. Depending on the business model, the individual advisor may receive some proportion of the gross trailing commission. The amount received by the advisor may vary from zero, in the case of advisors who work on salary only, or

almost the entire amount, after deducting a flat fee charge. Trailing commission can even be rebated back to a client's account.

We believe that this range of options serves the Canadian investing public. Although the data indicates that trailing commission is poorly understood by many retail investors, it is by no means hidden or deliberately obscured. Many investors can and do read the materials provided to them and learn about trailing commission, which is what our current system of continuous disclosure is all about. The bottom line is that to the extent that trailing commissions are not clear, better pre-sale disclosure is a more efficient response than attempting to add unnecessary complexity and restrictions to the payment scheme between dealers and their advisors.

Standard Class for DIY Investors

Russell Investments believes that investors should have a choice, and that a wide range of investment options should be available to DIY investors. There is some merit to the principle that every mutual fund should offer a low-cost, "execution-only" option with no or nominal trailing commission, aimed at DIY investors who purchase without the involvement of an investment advisor.

However, Russell Investments questions the concept of regulators adding complexity to fund offerings by, in effect, forcing fund companies to maintain an additional class or series, which (among other things) would need its own Fund Facts document, add to the continuous disclosure obligations, have regulatory filing fees, and possibly have the ability to vote as a separate class or series with respect to certain unitholder matters. This would ultimately add unnecessary costs to offering the fund and decrease efficiencies at the fund level. We point out that this "execution-only" option exists today, insofar as dealers can rebate commission back to DIY investors in discount brokerage accounts. As such, we do not believe that this is a productive change to implement.

Unbundling Trailing Commissions and Charging/Disclosing as a Separate Fee

Enhanced transparency is in principle a desirable result. However, it is questionable whether unbundling trailing commissions by charging a separate asset-based fee, similar to the US 12b-1 model, would in fact materially increase transparency and reduce complexity. We would caution against steps being taken based upon an unverified assumption that this is the case.

We would also caution against a wholesale application of the US 12b-1 regime. As you are aware, 12b-1 fees in the US are undergoing examination, and potential revision or even repeal. Moreover, the underlying legal framework of US investment companies differs in important ways from Canadian mutual funds and the 12b-1 fee concept may not be easily applicable here.

Trailing commission is an issue not because value is not delivered, but because it is poorly understood. We believe that a remedy is for the industry as well as regulators to better explain the reason for the trailing commission. As the CSA recognizes, the trail is not a "fee for an advisor keeping a client in the fund." The fee is paid to enable the advisor to properly service the client on an ongoing basis. Rather than concentrate on whether the fee is embedded or unbundled, the focus should be on better disclosure and investor education.

Separate Series or Class for each Purchase Option

Please see our comments above on "Standard Class for DIY Investors".

Cap on Commissions

Please see our comments above on "Advisor Services to be Specified for Trailing Commissions", and other comments made herein.

To reiterate, Russell Investments does not believe that investor protection requires regulatory intervention to set or restrict specific pricing outcomes. Regulation is called for to ensure that the process by which prices are established is fair, transparent and free from fraud. Regulation should not dictate actual outcomes.

Fiduciary / Enhanced Duties for Advisors

Russell Investments supports a statutory "best interests" standard of conduct for dealers and financial advisors. A properly formulated and practically applied "best interest" standard can be beneficial to investors, dealers, investment fund managers and other stakeholders in the investment industry. However, we believe that the success of a "best interests" standard is entirely dependent on a careful formulation of the standard as one that better protects investors while clarifying practical rules that investment advisors and dealers can feasibly follow. Russell Investments suggests that close examination of the impact of the qualified best interest/fiduciary standard in other jurisdictions is warranted before Canadian rules are finalized.

Discontinue Advisor Compensation being set by Mutual Fund Manufacturers

Russell Investments believes that enhanced transparency is a desirable result. We suggest that a better option than prohibiting advisor commissions is to improve disclosure of trailing commissions so that the concept is better understood by investors, who can then make informed choices in a marketplace that has not been distorted by well-meaning but potentially unproductive regulatory restrictions.

Russell Investments notes that the consequences of similar initiatives to prohibit advisor commissions by mutual fund manufacturers in other jurisdictions have yet to be determined. It is possible that the long-term effects of such a change could be to reduce access by investors, particularly smaller investors, to valuable investment services provided by advisors, due to the increased direct costs of providing this advice. In addition, the costs to industry participants of implementing such a change are high, and sufficient evidence does not yet exist that benefits to investors exist warranting the imposition of such costs. Russell Investments suggests that the empirical long-term consequences of similar initiatives in other jurisdictions need to be studied carefully before this change is considered for the Canadian marketplace.

Concluding Comments

Thank you for the opportunity to respond to the Discussion Paper. We commend the CSA for its openness and desire to engage in dialogue. We support improved transparency through additional disclosure, and enhanced investor education efforts, as the best solutions to the issues raised in the Discussion Paper. We would like to reiterate the general point that while all

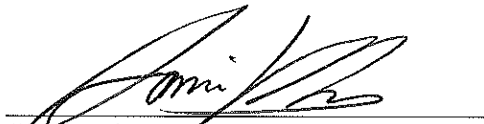
stakeholders in the investment fund industry ultimately benefit from sufficient investor protection, all stakeholders also benefit from protecting and enhancing capital markets efficiencies. That is why securities legislation generally has as its purposes both the protection of investors, and the fostering of fair and efficient capital markets that bolster confidence and attract capital. We submit that the CSA should endeavour to identify and support the industry structure that best preserves both these purposes and does not favor one purpose over another.

If we can clarify or expand on any of the submissions made in this letter, please do not hesitate to contact the undersigned.

Yours truly,

Russell Investments Canada Limited

David Feather
Chief Executive Officer and President



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