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April 12, 2013

British Columbia Securities Commission  
Alberta Securities Commission  
Saskatchewan Financial Services Commission  
Manitoba Securities Commission  
Ontario Securities Commission  
Autorité des marchés financiers  
New Brunswick Securities Commission  
Superintendent 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

John Stevenson  
Secretary  
Ontario Securities Commission  
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Toronto, ON M5H 3S8

Me Anne-Marie Beaudoin  
Corporate Secretary  
Autorité des marchés financiers  
800, square Victoria, 22e étage  
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Montréal (Québec) H4Z 1G3

**Re: CSA Consultation Paper 81-407**

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We are writing to provide comments with respect to the CSA Consultation Paper 81-407: *Mutual Fund Fees*.

Quadrus Investment Services Ltd. ("Quadrus") is one of the largest mutual fund dealers in Canada with more than 3770 registered investment representatives. It is the exclusive mutual fund dealer for London Life Insurance Company and preferred mutual fund dealer for the Gold Key investment representatives of The Great-West Life Assurance Company.

We thank the CSA for its overview of Canadian mutual fund fees in this paper. We concur that mutual funds have become the retirement and savings investment vehicle of choice for average Canadians since the introduction of the deferred sales charge in 1987. This fee structure provided the average Canadian small investor with access to the services of a financial advisor to assist them directly, and to professional fund asset management and diversification without an up-front charge.



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However, there remains considerable concern that Canadians have not invested enough for the future; whether for education, retirement, emergency funds or other potential needs. If there is one thing that unites federal and provincial governments, financial industry experts, unions and the media together, it is a concern that most Canadians are not saving enough. Although the Paper doesn't specifically comment on this, it is our view that mutual funds generally and the access to advice from financial advisors that deferred sales charges provide to the average Canadian specifically, have played major roles to date in ensuring that the nation's savings gap is not even wider.

The Paper raises a number of potential conflicts of interest at the advisor level. We believe that despite these potential conflicts (which arise in every product and service sales situation) there is a fundamental alignment between the interests of Canadians and their financial advisors. We believe that it is in the best interest of all Canadians to save sufficient amounts for their future needs. Similarly, it is in the best interests of advisors to help Canadians do this. We see this as a strong alignment of interests; Canadians need to save money for the future and the work that advisors do in helping Canadians engage in goal setting, identifying risk tolerances, actually investing, investing more, rebalancing and staying invested during challenging times help them to accomplish this. The job of an advisor is not an easy one, but it is without question a necessary one for the long term health of our society. The paper overlooks that the significant ongoing servicing requirements that an advisor must perform in order to retain the mutual fund assets of a client. The servicing of mutual fund business by advisors requires a major investment of time and includes regular ongoing communication with clients in order to understand changes to a client's situation, educate clients, answer questions and transact changes to a client's portfolio. It is our opinion that this work more than justifies the trailing commissions associated with a mutual fund fee. The inherent congruency between the need of an advisor to service a client in order to maintain a client's mutual fund assets should be noted.

We think strong client/financial advisor relationships are for the public good and benefit all Canadians. We are of the view that Canadians who choose not to invest for their future, invest insufficiently, delay investing or invest inappropriately are doing harm to themselves and financial advisors can help them avoid these mistakes. It is our perspective view that most people prefer spending today over putting money away for the future. Left to their own devices, people generally will consume rather than invest. The idea of saving for retirement is a concept most Canadians agree with in principle but when it comes right down to it they find it difficult to actually make strides in this area. When understood from a human dynamics perspective, it is startling that Canadians have put away as much as they have into mutual funds.

The paper notes that over 90% of mutual fund assets have been amassed through financial advisors. We believe that without advisors meeting with Canadians face to face, year after year, decade after decade convincing them of their need to put money away, convincing them to make a commitment to a financial plan and encouraging them along the way to stick with it, Canadians' savings rates would be much worse. We suggest that if advisors had not been in a position to offer such investment options to Canadians, collective savings rates would be significantly lower. Instead of \$800 billion saved today it is likely that this figure would be much closer to the \$40 billion saved by Canadians who invested without an advisor; the paper notes that only 4.7% of all mutual fund assets were purchased directly by Canadians without the use of an advisor. We believe that this makes sense, as it is a minority of Canadians who will do the research and take the steps necessary to invest on their own without the aid of a financial advisor.



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The do-it-yourself segment of Canadians is aided by the Internet and is well served through various competing online discount brokerages. The CSA considers under possible changes **ii) A standard class for DIY investors with no or reduced trailing commission.** Under this scenario, every mutual fund would have a low cost 'execution only' series or class of securities available for direct purchase by investors. The principle here is that investors who choose to invest without the services of a financial advisor should not pay an MER that includes charges for commissions. To the extent that these proposed series are only available to DIY investors, we are not opposed to the concept. However we do believe that fund manufacturers should be entitled to determine how they offer their services, and forcing them to offer DIY series funds to all investors regardless of a minimum investment level would have an impact on administration costs.

We do not support any requirement to make such DIY series funds available by financial advisors however, as doing so may require them to do significant work without any compensation. We are concerned that such a scenario will have the unintended consequence of lessening an advisor's willingness to spend the time and effort to convince average Canadians to save for their future. The advisor has two tasks when working with clients: first, to convince them of the benefits of saving for their future, and second, to recommend appropriate investments. If the client has the option of investing through a DIY series, even though he or she has had the benefit of an advisor's services, the majority of clients will choose the lower cost option. This begs the question as to why an advisor would go through this trouble for no compensation. Going forward under such a scenario, would see Canadians save far less money than today. This is not in the best interests of Canadians. Quadrus is strongly opposed to option ii) if it is intended to go beyond application to DIY investors only.

The Paper also raises option **vii) Discontinue the practice of advisor compensation being set by mutual fund manufacturers.** We believe that such an approach could be very detrimental to average Canadians. In general, we strongly recommend that Canadians start investing early to take advantage of the known benefits of compounding over time. Those who start to invest early usually have little or no assets. Presently, mutual fund manufacturers act in a mutually beneficial way for all parties in such situations through the use of a deferred sales charge. The deferred sales charge ensures alignment between the advisor and the client. A client with few or no assets has little ability to pay an advisor directly for their help in investing for their future. It is not appropriate to expect the advisor to not be paid for the value they provide. This is where the mutual fund company bridges the gap. By financing a deferred sales charge paid by the mutual fund manufacturer the fund manager ensures that the advisor can be compensated. All parties are improved through the facility of the deferred sales charge. Discontinuing the use of deferred sales charges will greatly limit the ability of small Canadian investors to obtain access to the education and benefits that financial advisors provide. As noted earlier, it is no coincidence that the greatest increase in mutual fund investments by average Canadians occurred following the inception of the deferred sales charge. Such clients simply could not afford a fee for service structure. In the interests of securing a better future for Canadians, Quadrus is opposed to the implementation of option vii).

We note that some jurisdictions have implemented restrictions on trailing commissions recently. We believe that prudence requires that Canada observe the outcomes of these experiments rather than follow their lead. There is a great deal of room for negative unintended consequences when making such radical changes – particularly to the average Canadian saver.



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The Paper did not address the implications of client name administration versus nominee name administration on client costs. The majority of mutual fund assets held by Mutual Fund Dealers Association member firms is done on a “client name” basis. There are a number of pros and cons for how mutual funds should be held by Canadians, whether in a client name or nominee account. Regardless of one’s preference, it is helpful to note that nominee accounts are more costly for dealers to administer. For this reason, many mutual fund dealers do not provide nominee accounts and for those that do there are often account fees charged to the client and minimum account requirements. Some of the options set out in the Paper suggest that there may be a benefit to having certain specified service fees negotiated between the client and the advisor. We note that full flexibility in the negotiation of a client’s fees with an advisor is really only available if the client account is held on a nominee basis. If the CSA were to require that all advisor compensation must be negotiated between the advisor and the client we fear that all business would need to be conducted on a nominee basis. Although we are not opposed to Canadians individually negotiating how much they will pay for the services that they want, we are not sure that small investors are well served in a world where they must also pay a nominee account fee. For example, a small investor with \$5,000 having to pay an additional \$100 per year on top of what they have negotiated with the advisor would effectively be paying the equivalent of a 200bps MER over and above mutual fund costs. Changes of this nature will have unforeseen negative consequences, and we believe it will be the smaller client most likely to feel them. Mandating negotiation of services provided in return for ongoing trailing commissions will, in our view, lead to negotiation of fees which will require nominee account charges as noted above. For this reason we are hesitant about CSA option **iii) Trailing commission component of management fees to be unbundled and charged/disclosed as a separate asset based fee or i) Advisor services to be specified and provided in exchange for trailing commissions.**

For the small investor, the pooling benefit of mutual funds is paramount. Through a mutual fund, an investor with \$1,000 or less to invest is able to receive the same diversification benefits and portfolio management advice as a large investor with \$1 million dollars. Most people view this pooling aspect of mutual funds as a positive. In **option iv) A separate series or class of funds for each purchase option** the Paper seems to reframe the fundamental pooling nature of mutual funds as a negative by referring to it as the “cross-subsidization” of investors. This “cross-subsidization” is really a core aspect of pooling and is integral to the nature of mutual funds. Small mutual fund investors are subsidized by larger investors to the extent that the larger investors increase the size of the pool and lower the average participation costs. We believe that this is a good thing for society. In absolute dollar costs a small investor pays less than what they would normally and hence benefits from the pooling structure of the fund. Quadrus is not opposed to the creation of separate series for each available purchase option. However, we think that such a decision should not be imposed but should be determined by the fund manufacturer. Critical size plays an important role in assessing whether a separate unit value series can be supported for each of front end, DSC, low load and no load series. What the paper seems to suggest would essentially mandate that a mutual fund be split into 4 separate “funds” with separate expense structures. This dilutes the benefits of pooling as small investors are more likely to be limited to the load purchase options while those with larger assets will have greater access to series with minimum participation requirements. This has the inherent possibility that the small investor will pay higher MER’s because there are fewer assets in their series over which to share costs. We doubt this is the intended outcome, and do not believe that it is in the best interests of many Canadians. We believe that the marketplace should dictate when it makes sense to split series by purchase option. Many mutual fund companies already provide separate pricing by purchase options and this decision is one that is made strategically firm by firm based on cost constraints and marketing factors.



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Intervening in this area will force mutual fund companies to consider restricting the number of purchase options available. We aren't certain that a restriction in choice is in the best interests of Canadians. Imposing additional series within a mutual fund has the effect of magnifying the size of scale disadvantage that is inherent within the Canadian marketplace vis a vis the U.S. market. This is because doing so would increase overall unitholder costs without increasing the base over which those costs are spread.

The costs of mutual funds have been a source of public debate recently. Some take the position that the fees charged by Canadian mutual funds are high relative to other countries. Others point out that a fair comparison requires significant and detailed analysis as the situations in each country differ materially. We think it may be helpful to step back and consider some important facts which are not the subject of debate.

- Canada is one of the few jurisdictions in the world where sales tax applies to mutual fund fees.
- The Canadian mutual fund industry is the smallest of the countries analyzed by the CSA.
- The average Canadian mutual fund is 7 times smaller than the average American fund.
- The cost of almost everything that Canadians buy, from gasoline to milk to books to automobiles to music and even air travel, is recognized as being higher in Canada as opposed to the United States.

There is no doubt that each of these facts would lead *a priori*, to the belief that mutual fund fees in Canada would normally be considerably higher than in the United States. There are a number of other factors that must be taken into consideration when comparing Canadian fees to comparable fund categories in the United States. We understand that the Investment Funds Institute of Canada has done such a comprehensive study and the conclusions clarify that Canadian fees are not materially higher when assessed on a level playing field.

Commentators who believe that Canadian mutual fund fees are unreasonably higher than those in the United States must, based on the above factors alone, concede that fees in Canada should reasonably be higher – it then becomes a question of “how much higher”. We see this as a difficult question for any regulator to answer as even in the area of commodities such as gasoline, milk, automobiles, milk, music and air travel there is no general consensus on why or what is an appropriate level of pricing differential between the two countries. Generally, market forces are expected to lead to an appropriate level. We feel the analysis of the mutual fund field is fraught with even more complexity.

If, as we believe, the “level playing field” assessment of fee differences between Canadian and American mutual fund investors is small or non-existent, then option **v) Cap commissions** would seem to be unnecessary. In such a scenario the natural competition inherent within the Canadian mutual fund industry would be sufficient to more than compensate for the fact that the Canadian mutual fund market is much smaller and more heavily taxed when compared to our neighbours to the South. The total cost is the key comparative and if Canadian investors have been well served with these costs compared to American investors, then we believe that we have succeeded.

In summary, we don't feel that the amount of commissions should be subjected to regulation unless it can be demonstrated that the overall costs to the client are excessive. We do not believe this to be the case.

We have no specific comments to make on **option vi) Implement additional standards or duties for advisors** as we provided these in an earlier letter dated February 22, 2012 in response to CSA Consultation Paper 33-403.



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In closing we thank the CSA for the opportunity to provide feedback on this Paper. The changes mentioned in the Paper are significant and far reaching, with the potential to seriously harm small Canadian investors inadvertently. Large investors will always have access to financial advice and the market. Smaller investors, who make up the bulk of Canadian society, do not have that luxury and any change that has the potential to weaken their abilities to invest for their futures should be subject to the most intense scrutiny and analysis. We look forward to continuing the discussion at a future roundtable or technical conference.

Yours truly,

A handwritten signature in cursive script that reads "Michael Stanley".

Michael Stanley  
President and Chief Executive Officer  
Quadrus Investment Services Ltd.