INDUSTRIAL ALLIANCE
INSURANCE AND FINANCIAL SERVICES INC.

BY ELECTRONIC MAIL: comments@osc.gov.on.ca
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April 12, 2013

British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
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
Superintendent of Securities, Nunavut

Attention:

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

Me Anne-Marie Beaudoin
Corporate Secretary
Autorité des marchés financiers
800, square Victoria, 22e étage
C.P. 246, tour de la Bourse
Montréal, Québec H4Z 1G3

Dear Sirs / Madames:

Re: CSA Discussion Paper 81-407: Mutual Fund Fees

On behalf of the Wealth Management subsidiaries of Industrial Alliance Insurance and Financial Services Inc., ("IA"), comprised of IA Clarington Investments Inc., FundEX Investments Inc., Investia Financial Services Inc., and Industrial Alliance Securities Inc., we are writing to provide comments with respect to the Canadians Securities Administrators' ("CSA") Discussion Paper 81-407 – Mutual Fund Fees (the "Discussion Paper"), published on December 13, 2012. Collectively our wealth management operations administer or manage approximately $38 billion in assets on behalf of more than 500,000 Canadian investors.

While we are members of, and played a role in helping to shape the comments provided by the Investment Funds Institute of Canada, ("IFIC"), we felt compelled to provide additional points of emphasis concerning some of the CSA's proposed items for consideration. We appreciate the opportunity to participate in this discussion.

The critical role of advice for Canadians

IA believes strongly in the critical role that advice plays in the financial health of Canadians. The volatility present within today's financial markets has exacerbated the behavioral pitfalls investors are prone to making. The role of the financial advisor in helping investors make the right choices to ensure they maximize their wealth and reach their financial goals has never been as critical as it is now. Unfortunately, what defines advice is frequently distorted by the media, to the point where the 'value' discussion is often presented by solely focussing on the costs associated with investing.

We believe that all advice platforms should support and promote transparency and education for investors. In order for investors to make appropriate decisions, they must have access to all necessary information, presented in a manner that is clear, and straightforward. Mutual fund manufacturers and the financial advisory community should endeavour to support this need to the best of their abilities.

We feel that the current system in Canada, while perhaps not perfect, is working well for investors. In a February 2013 study by Advisor Impact, it was concluded that of the roughly 1000 investors that were polled: 77% said their advisor adds value above and beyond market performance, 63% said they receive high value relative to fees paid, and 88% said they are likely to continue working with their advisor.[1] In addition, the Point of Sale and newly adopted Client Relationship Management disclosure requirements will serve to enhance the level of transparency further.

A variety of options

We are firmly of the view that investors benefit from the informed perspective and discipline of receiving ongoing advice. Providing effective financial advice is based on the idea that each client situation is unique. Consequently, a system that provides a range of compensation models consistent with this idea, in a manner that promotes transparency and competitive market forces, is aligned with the interests of investors.

Fee structures have continually evolved to align with the needs of investors, while efficiently providing compensation to advisors for giving ongoing advice to their clients. Many options exist, including fee for service arrangements. The fund industry has consistently responded by providing a range of investment solutions to support a wide range of fee models. We believe that financial advisors should clearly articulate to investors the services they provide, potential conflicts that could exist, and the costs associated with being a client.

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[1] Advisor Impact, *The Rules of Engagement*, " *An Industry report card based on Advisor Impact's Economic of Loyalty Research*", February 2013

While perhaps not ideal for every investor, a fee structure based on embedded compensation enables advice to be accessed in an efficient and affordable manner, and allows the cost of advice to be amortized over a longer-term period. In addition, an embedded advice fee provides an investor with access to ongoing advice as their needs evolve and change. For the majority of Canadians, these factors are critically important. The evidence from other jurisdictions, most notably the U.K, should suggest that any proposed reform that could negatively impact the likelihood of investors being able to receive advice, needs careful consideration.[2]

Fees and costs are determined by market forces

We believe that market competition is working well. Over the past five years the asset weighted MER's (the net cost to our clients inclusive of advisor compensation) of our top 5 selling funds at IA Clarington have fallen by 11.6%.

In your discussion paper, the CSA raises the potential concern that a higher trailing commission may incent advisors to sell a particular mutual fund over another comparable mutual fund with a lower commission. A review of the marketplace indicates that there is a fair degree of standardization in terms of the rate of commission. As of 2011, Investor economics cites that for the very few Canadian equity funds charging a trailing commission higher that 1%,[3] the variance is minor and is unlikely to incent an advisor to make an alternate decision.

We see little to no evidence that suggests a positive correlation between the few products within our own fund complex that pay a higher than average trailing commission, and corresponding sales levels. In fact, we often see that products with above market trailing commissions are marginal sellers. Further, we believe our industry has diligently ensured that the integrity of our product solutions meet the needs of investors. As an example related specifically to the topic of your discussion paper, IA Clarington recently reduced trailing commissions and fees on the Target Click funds to better ensure the achievement of the funds longer term objectives.

In their comments, IFIC identifies that mutual funds are not the only financial product held by Canadian households where the cost of distribution is embedded in the product price. We believe that examining this issue in isolation as it relates to the embedded nature of trailing commissions unfairly signals to investors that any potential problems that may exist, are somehow unique to mutual funds. By solely focussing discussions and potential changes to mutual fund products, investors may be inadvertently directed towards higher-priced substitute products, with different disclosure requirements of limitations on compensation practices.

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[2] Andrew Clare, Professor of Asset Management, Cass Consulting, Cass Business School for Fidelity Worldwide Investment, "The Guidance Gap-An investigation of the UK's post-RDR savings and investment landscape", January 2013.

[3] Investor Economics, Trailer data was gathered in 2011.

What's in the Fee?

After accounting for differences in the cost of advice and taxation, mutual fund fees in Canada are similar to those in the United States, the world's largest mutual fund market.[4]

Over the past decades, however, there has been an important shift in how fees are paid by investors for the advice they receive. According to a September 2012 study from Investor Economics for the Investment Funds Institute of Canada, a diminutive minority of mutual fund assets attracted upfront charges or incurred disposition charges in 2011, compared to the period of the 1990's where it is estimated that 75%-85% of all fund sales were made up of back-end load units.[5] In other words, although embedded compensation has remained over this longer time period, the transactional costs faced by investors have largely been eliminated. The shift towards embedded compensation in exchange for ongoing advice does not equate to investors paying higher total costs to their financial advisors.

The market has gravitated to paying for the distribution and advice associated with mutual funds through embedded fees because it is a better model for the various stakeholders: for the investor they provide access to advisory services in a format that is aligned with their objectives and not motivated to create short term trading, for the dealers they provide a simple and efficient way of collecting the advice fee, and for advisors they provide stable revenues in exchange for the ongoing service received by their clients.

Proposing refinements within our industry to support transparency and investor education make sense. However, we feel that it is important to be mindful of the potential to introduce unintended elements of complexity, confusion, and additional costs to investors that would likely not be commensurate with the desired benefits. Between the other regulatory initiatives aimed at improving transparency, and the current system which helps achieve the same effect through disclosure and investor education, we feel that investors are well served by the current framework.

Specific Comments on Possible Regulatory Changes

Advisor services to be specified and provided in exchange for trailing commissions

Client needs can change dramatically. We believe strongly in the need for clients to understand what services and ongoing advice they can expect to receive on an ongoing basis. With that said, it may prove problematic and be potentially impractical to prescribe a minimum standard given the differentiated service offerings within the marketplace. The requirement to monitor and enforce a relatively subjective measure such as this could create an administrative burden, the impact being ultimately borne by investors beyond the commensurate benefits. We believe that the issue is best addressed through greater transparency between investors and those providing advice. Financial advice providers

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[4] Investor Economics and Strategic Insight, *"Monitoring Trends in Mutual Fund Cost of Ownership and Expense Ratios, A Canada-U.S. Perspective"*, November 2012.
[5] Investor Economics for The Investment Funds Institute of Canada, *"Mutual Fund MERs and Cost to Customer in Canada: Measurement, Trends and Changing Perspectives"*, September 2012.

should clearly articulate to investors the services they provide, potential conflicts that could exist, and the costs associated with being a client.

A standard class for DIY investors with no or reduced trailing commission

Investors who choose to go it alone are a small subset of the overall investing public, as few possess the interest and time required to do the job on their own behalf, and even fewer have the necessary technical skill set. Complicating the matter further from a decision making perspective are the natural behavioral pitfalls investors are prone to making. It is for these reasons that IA believes strongly in supporting advice platforms. However, investors should fully understand the costs associated with investing whether they seek advice or not. Those who use transactional services should pay a fee commensurate with the level of service they receive from their discount brokerage.

Alternative pricing structures do exist within the industry, in most instances because a specific need has resulted in the creation of a specific solution. The rise in fee for service business models for example has led to the availability, use, and adoption of F class units. We feel that mandating the creation and maintenance of an additional, special class of units for non-advice channels could be unsustainable and uneconomical as a potential solution, generating additional expenses to be borne by investors. We believe that the answer should lie in improved disclosure to investors relating to the provision (or lack thereof) of ongoing investment and financial planning advice for the fees that they pay.

Trailing commission component of management fees to be unbundled and charged/disclosed as a separate asset-based fee

We support the provision of effective and informative disclosures. We are of the view that the current industry practice of separately disclosing the trailing commission serves investors well. Mutual fund manufacturers cannot alter management fees without shareholder approval, and to increase trailing commissions in an effort to potentially incent sales from financial advisors would come at the expense of reducing manufacturer profitability. Consequently, we view the relationship between trailing commission levels and fund manufacturer profitability as a natural check and balance mechanism.

Secondly, and as previously stated, the Point of Sale and newly adopted Client Relationship Management disclosure requirements will serve to enhance the level of transparency further.

Finally, we support IFIC's comments pertaining to the potential for investors to be burdened with unfavorable tax consequences should regulations require trailing commissions to be unbundled.

A separate series of class or funds for each purchase option

We concur with IFIC's position on the matter that mandating the creation of a separate series for different purchase options would cause an administrative burden and potentially increase costs to the investor without commensurate benefits.

An element of unequal cost sharing is inherent in any collective investment structure. As long as this unequal cost sharing is reasonable, as is the case with most mutual funds, the shared efficiencies resulting from economies of scale outweighs the concern over 'cross-subsidization.' The proposal to create a separate series for different purchase options could potentially reduce shared efficiency.

Cap commissions

We concur with the comments brought forth by IFIC on the issue, and feel that the evidence supports the effectiveness of the current system. For all cases filed with MFDA's Enforcement Department during 2012, only 7.4% were related to commissions and fees. IA's experience is consistent with the broad industry; for all complaints filed with Investia during 2012, including internal investigations, only 7.8% were related to commissions and fees.

Investor fee level awareness has also been increasing. According to a 2012 study by Pollara for IFIC, it was cited that in 2012, 63% of investors reported that their advisor discussed fees with them the last time they purchased a mutual fund, up from 58% in 2009.[6] We believe that low complaint levels related to fees, coupled with an upward trend in overall fee awareness is consistent with a system that is providing effective disclosure to investors.

Implement additional standards or duties for advisors

We concur with the IFIC observation that the idea of creating and implementing a fiduciary standard for advisors is indeed a complex issue. We would caution against the impact of a 'one size fits all' approach, as it could have some unintended consequences, including significant effects on the cost and availability of advice for Canadian investors.

Discontinue the practice of advisor compensation being set by mutual fund manufacturers

We believe that the current market-based system is functioning and serving investors well. Multiple pricing options exist for investors within the Canadian marketplace, and there is strong evidence given the significant shifts in consumer preference that investors are utilizing these available choices.

We do not feel that it is in the best interest of investors to prevent the sale of products that have predetermined compensation for advice from being available to the investing public. As stated earlier, the embedding of trailing commissions in the pricing of financial products offers greater access and affordability for advice, in part by allowing this cost to be amortized over the longer-term. As stated previously, the evidence from other jurisdictions, most notably the U.K, should suggest that any proposed reform that could negatively impact the likelihood of investors being able to receive advice, needs careful consideration.[7] IPSOS Reid research that shows lower income households in Canada who work with a financial advisor experience the largest net benefit versus those who don't, when compared to every other income segment.[8]

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[6] Pollara for The Investment Funds Institute of Canada, *"Canadian Investors' perceptions of mutual funds and the mutual fund industry", 2012.*
[7] Clare *op. cit.*
[8] Ipsos Reid, "Canadian Financial Monitor", 2009

Finally, in light of the body of research concerning low levels of financial literacy amongst investors, we would strongly oppose a proposal that could result in altering the landscape for investors in a manner that would prevent them from seeking or gaining advice.[9]

Conclusion

Thank you for providing us with an opportunity to comment on the issues. We look forward to being a part of any further public consultation on this topic and would be pleased to discuss our input in greater detail with you. Should you have any questions or wish to discuss these comments, please contact me directly at david.scandiffio@iaclarington.com.

Regards,

David Scandiffio, President, IA Clarington Investments
Chair of the IA Wealth Management Planning Committee

On behalf of:
David Chapman, President, FundEX Investments Inc.
Louis DeConinck, President, Investia Financial Services Inc.
Richard Legault, President, Industrial Alliance Securities Inc.

[9] Lusardi and Mitchell, "*Financial Literacy and Retirement Planning in the United States*", 2011