Kenmar Associates
The Voice of the retail Investor

Via email April 25, 2017

CSA CONSULTATION PAPER 81-408 – CONSULTATION ON THE OPTION OF DISCONTINUING EMBEDDED COMMISSIONS
http://www.osc.gov.on.ca/documents/en/Securities-Category8/sn_20170110_81-408_consultation-discontinuing-embedded-commissions.pdf

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Kenmar is an Ontario- based privately-funded organization focused on investment fund investor education via on-line research papers hosted at www.canadianfundwatch.com. Kenmar also publishes *the Fund OBSERVER* on a bi-weekly basis discussing investor protection issues primarily for investment fund investors. An affiliate, Kenmar Portfolio

Analytics, assists, on a no-charge basis, abused investors and/or their counsel in filing investor complaints and restitution claims.

We would be disingenuous if we said we were pleased to once again provide comments on this topic. Quite frankly, we are frustrated and disillusioned by the endless rounds of consultation. While our spirit is not broken, our determination and stamina is being tested to the limit. Nevertheless, Kenmar Associates is providing an input on this Consultation paper.

This CSA Consultation Paper pulls back the curtain to reveal the extent to which embedded commissions and industry structure impedes dealing representatives and others from being able to act in the best interests of their clients. We congratulate the CSA on the detail, statistics, commentary, research references and depth of the background data provided. The plain language exposition and adroit use of charts/tables may encourage more retail investor participation in this important Consultation.

Definition of trailing commission
According to our research there is no widely accepted definition of trailing commission in securities law. We believe that the Commissions and SRO's should agree on a common definition. The definition provided in Appendix B to the CSA Notice and Request for Comments on Proposed Amendments to NI 31-103 published on June 14, 2012 was as follows:
""trailing commission" means any ongoing payment to a registered firm in respect of a security purchased for a client that is paid out of a management fee or other charge to the investment." This makes it clear that the money is coming out of the investment which is key and that the dealer received such commissions directly as a result of sales to the investor. A trailer is just another form of compensation for sales. We take the definition of ***embedded commission*** to be the remuneration of dealers and their representatives for investment fund sales through commissions, including sales and trailing commissions, paid by investment fund managers .There is no reference to advice or services in this definition nor is there a definition of regulated advice. There is certainly not any disclosure of the services that dealers/advisors are to provide in exchange for the trailing commission.

Stated Rationale for consultation : The CSA's paper notes that embedded commissions incentivize dealers and reps to sell funds that pay higher trailers, such as "higher-risk actively- managed funds"; prevent investors from assessing the value they receive from their dealers; and "the cost of the advice and service provided may exceed its benefit to investors," among other things. These compensation structures also encourage fund management firms and fund managers to rely on payments to dealers to gather assets rather than investment performance. "This incentive can, in turn, lead to underperformance and drive up retail prices for investment products due to a competition between investment fund managers to offer attractive commissions to secure distribution." There is no question embedded commissions cause harm to clients.

The CSA has concluded that because these conflicts are both pervasive and difficult to manage, "a change to a different compensation model must be considered. Investors should be provided with a compensation model that empowers them and that better aligns the interests of investment fund managers, dealers and representatives with those of investors. The CSA's consultation paper also indicates that a ban on embedded commissions could also lead to increased price competition; lower fund management costs; a shift to lower-cost products, including passively-managed products; and, further innovation, among other effects, in addition to addressing concerns about conflicts-of-interest. The CSA wants direct payment for advice/service. Under direct pay arrangements, dealers and representatives could adopt various compensation arrangements, including upfront commissions, an hourly fee, a flat fee, a fee-based arrangement, or another suitable compensation arrangement, as long as the compensation is not embedded within the product and is paid exclusively by the investor.

In a 2014 survey of CFA Institute members representing a broad cross-section of investment professionals, Canadian CFA Institute members cited "misaligned incentives of investment management services" and "mis-selling by financial advisers" as the two most serious ethical issues facing the Canadian market in 2015. https://www.cfainstitute.org/Survey/gmss_2015_detailed_results.pdf

In NI81-408 there is no proposed rule or definitive plan of action. The CSA have stated that "what we are considering is eliminating embedded compensation on any "investment fund" under securities legislation, which would include mutual funds (MF), ETFs, closed end funds, pooled funds and structured notes. This would include any of these products, whether sold to retail investors under a prospectus or Fund Fact document, or whether sold on an exempt basis".

At 2012, 39% of all households that owned investment funds were small investors (mass market households), 49% were midmarket households and the remaining 12% of fund owning households were affluent households.

Executive Summary

- Kenmar agree with the CSA on the harm a conflicted "advice" structure like embedded commissions cause retail investors. Any ffinancial incentives, including embedded commissions, that pay advisors/ dealers more to recommend one product rather than another compromise the quality, integrity and independence of advice. The advice gap that must be closed is the one between independent and compromised advice.The objective of breaking the link between conflicted investment advice and product ownership by discontinuing embedded commissions is a huge positive. We disagree however that co-operative marketing (funded by fund assets) should continue as it creates/maintains an unhealthy relationship between advice givers and product suppliers. We can see no rationale for retaining referral arrangements either as explained later in our detailed response.

- While we believe there will not be an expanded investment advice gap for small investors (defined by the CSA as mass market -less than $100k of investable assets) , the advice available may not be in the form that some small investors might prefer and it will still be subject to other conflicts-of-interest and product and service shelf limitations.
- DIY investors using discount brokers should benefit by paying a small transaction fee instead of an embedded commission ranging from 0.25% - I.25% for advice that is never provided.
- Mutual fund investors who do not engage with an advisor will benefit from a commission ban because they will no longer be involuntarily paying for advice they do not want, need or receive.
- Isolating the cost of advice from the product cost is a positive step but our anecdotal experience indicates a not insignificant segment of small investors is not uncomfortable with a tied-advice model and prefer it. A number feel that simply including the notional "advice" cost on monthly account statements as a footnote would satisfy their information needs. We believe a combination of convenience, complacency, detachment, a lack of understanding of the impact of conflict-of-interest on recommendations and unbridled trust in their advisor contribute to this attitude. It is about framing....how the deduction, the payment is framed and presented to clients.
- Small investors will be able to comparison shop but given the limited leverage, may not be able to negotiate advisory/account fees to a significant degree.
- The advice provided will still be subject to conflicts-of-interest, the suitability standard (where product cost is not an explicit factor), weak risk profiling and dealing representative proficiency shortcomings unless other regulatory reforms in CSA Consultation Paper 33-404 *Proposals to Enhance the Obligations of Advisers, Dealers, and Representatives Toward Their Clients* are simultaneously introduced. We agree with the CSA that discontinuing embedded commissions is complementary to CP 33-404.
- Integrated firms will be the big winners as the market share of independent fundcos without a dedicated distribution network could be adversely impacted with the elimination of embedded commissions. This leads us to the conclusion that (a) the percentage and number of non -proprietary funds available to retail investors will decline (b) a bias towards actively-managed mutual funds and closed-end funds will be maintained and (c) the migration to low-cost passive investing products such as Index funds and ETF's will continue to be very slow among small investors.
- Advice fees would be unconstrained subject of course to market competition forces. Fee-based accounts could lead to higher fees but with the potential of lower product costs. Investor-abusing reverse churning, now in progress, will accelerate in the absence of a statutory Best interest advice standard and robust supervision/ compliance and regulatory enforcement. Basic elements of a best-interest process standard, include a clear definition of advice scope, advisor competency, a defined investment process, avoiding or controlling conflicts-of-interest; providing full, clear, meaningful and timely disclosure; interpreting laws and agreements in

manners favourable to clients' interests where conflicting interpretations arise; acting "with care", clear cost and performance reporting and a fair, responsive complaint handling system.

- Regulatory arbitrage with insurance products and some banking products will occur but will be limited assuming regulators make cooperation arrangements with their regulatory counterparts.
- The impact on portfolio managers' behaviour and fund performance is expected to be a positive for investors but we have no hard facts, research or evidence to make such a projection other than logic. (except for the obvious performance improvement resulting from removing embedded trailer costs from fund overheads)
- *NI81-105 Mutual Fund Sales Practices* needs an overhaul and expanded scope beyond mutual funds.
- Digital and online advice will be provided a positive environment for development and growth.
- In Ontario, new laws on financial planning, investment advice and title usage may amplify and accelerate the benefits of embedded commission prohibition in Ontario.
- Improved complaint handling rules and an OBSI with binding powers would be a powerful adjunct to this proposed rule.
- Robust and timely regulatory enforcement is a critical success factor. We cannot overemphasize the importance of enforcement by CSA members and especially the SRO'S. 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.

Introduction

We treat this consultation on a stand-alone basis because there is no assurance that the CSA will move forward with targeted reforms or a Best interests standard. Indeed, without a clear idea of the CSA vision for the regulation of the Canadian investment advice industry, it is difficult to make robust commentary.

The consultation paper is not considering eliminating embedded commissions on any other products. Segregated funds, an insurance industry product, would be immunized from the prohibition but the CSA says it is working with insurance regulators to harmonize requirements where possible.

We would also recommend that the CSA task the MFDA and IIROC with forming partnerships with provincial insurance regulators as IIROC has done with the Ontario FSCO [Under the Memorandum of Understanding (MOU) agreed by IIROC and FSCO, the two regulators will share the decisions and sanctions of their respective disciplinary processes. Disciplinary decisions or actions taken by one regulator will trigger a review

of the sanctioned individual's activities by the other regulator, including consideration of the suitability of the individual for approval, licensing or registration. This may result in an investigation or other appropriate disciplinary action. According to the MOU, IIROC and FSCO will also, where appropriate, conduct joint investigations and share relevant records and documents when both regulators are investigating the same individuals http://www.iiroc.ca/Documents/2016/5a43d68b-9b33-41b6-b426-87752566ae2b_en.pdf
We urge the CSA to consider this a major issue and take concrete steps to mitigate the risks of such regulatory arbitrage.

Regulatory failures of the past have impaired the retirement income security of Canadians. If regulators had acted on the 1995 and 1998 Stromberg reports on the mutual fund industry, we wouldn't have the mess we have today. If the Fair Dealing Model proposed by the OSC in 2004 had been accepted by the CSA, Canadians would by now have a world class advice - based system. CSA characteristics include slow policy making, never-ending consultations and talking and continued "monitoring".

The Dec.15, 2016 announcements from the CSA, MFDA and IIROC portray a comprehensive system of incentives and inducements whose basic intent is to thwart the fundamental principle that registrants are required to deal fairly, honestly and in good faith with clients. That they have been allowed to exist is a reflection on the failure of regulators to protect investors.

Even as we prepare to respond to this consultation, we remain acutely aware that the CSA is a house divided on the Best interests standard for advice, even its definition. The portfolio construction, planning and management process (irrespective of its sophistication) and related financial planning should be conducted solely in the client's best interests. One hundred percent loyalty/focus should be dedicated to this objective. The dealing representative ("advisor ") should be responsible for the process and while the exchange, the point at which the client accepts the recommendation, in advisory relationships, remains the client's responsibility, this responsibility depends wholly on the integrity of the advisor's process. No conflict-of- interest should be allowed to impair the process. Canadian securities regulators remain stubbornly anchored around the transaction so the regulation of financial advice is sub-optimal.

If the pattern of the past is repeated, the new CMRA could be established and this initiative along with Best interests will die stillborn. We urge the CSA to make some firm decisions without undue delay.

Fees/Fee structures and their impact on advice and investors

With the evolution of the investment markets, technological change, an aging population, complex structured products, record high personal debt the key "RRSP rollover" decision point and increased longevity, investor risks and vulnerabilities are much greater than ever before. Canadian investors are highly vulnerable due to low financial literacy, information asymmetry vs. dealers/dealing Reps ("advisors"), investor overconfidence in their investing skills, blind trust in advice givers and a desperate search for yield in a low interest environment. Therefore, fee structures that exploit this vulnerability should be eliminated to the greatest extent practicable.

Based on the CSA review of current actively- managed fee-based (series F) fund offerings and their five year alphas, the data suggests that 87% of investment fund managers offering actively-managed funds today have some funds with negative alphas which could be at risk of redemption if embedded commissions were discontinued and these managers were not able to adjust their fees or improve performance. For active investment fund managers that manage funds with negative alphas, the proportion of assets at risk or redemption could be on average 53% of firm assets. This is truly a startling statistic given that "advisors" are the ones recommending these funds.

Independent academic research resoundingly supports the contention that mutual fund fees in Canada are among the highest in the world. A June 2015 **Morningstar report *Global Fund Investor Experience Study*** https://corporate.morningstar.com/US/documents/2015%20Global%20Fund%20Investor%20Experience.pdf shows that for Fees and Expenses, the highest-scoring country (that is, the country with the lowest costs) is the U.S., a position held since the start of this study in 2009 and reflective of the scale of this market and, as discussed later, sales practices. Australia and the Netherlands join the U.S. with an A grade. Among the lowest-scoring markets are Canada and China, which, while not the most expensive in all categories, do not have any category where fees are at an average or better level. Canada received a D- grade. This has a dramatic adverse impact on the savings and retirement income security for Canadians.

The CSA cited research has shown that mutual fund investors tend not to review disclosure documents for cost information and instead primarily rely on advisors to tell them about costs .Further research indicates that many advisors do not tell their clients about costs although this information gap may be partially closed by CRM2 reporting. While CRM2 reporting reforms are beneficial, they omit product costs, the TER and any DSC early redemption penalty payments. We therefore do not feel this reporting will get at the root of the problem .Further, most small retail clients will not be in any position to negotiate fees and perhaps most importantly, account/product cost(s) will not be an explicit factor in suitability assessments.

We therefore recommend that account and product cost(s) be made an explicit element of a suitability determination consistent with the targeted reforms.

We need to stand back and look at what we are actually paying for. If this is purely a transaction with the fee coming for the advice on the transaction, then in a competitive market place you should be able to buy mutual funds without the load and without the embedded trailer if an investor does not need or want the transaction advice. That is unfortunately not the prevailing model and therein lies the core of the issue [we are aware that a few online brokers may rebate trailers for a modest fee].

As independent research clearly shows, fees are the primary cause of sub-benchmark fund performance for A series units**.** RE Morningstar research: **How Expense Ratios and Star Ratings Predict Suc*cess*** The report states **"***If there's anything in the whole world of mutual funds that you can take to the bank, it's that expense ratios help you make a better [purchase] decision. In every single time period and data point tested, low-cost funds beat high-cost funds.*" http://factualfin.com/blog/blog2.php/how-expense-ratios-and-star-ratings-pred To the extent that the breakdown of fund fee (and services) components are isolable, it is to that extent that investors will be better able to assess value for money for the advice and fund management components.

Embedded commissions are, in our view, primarily designed as a financial inducement for dealers to sell product (rather than advice), thereby increasing fee-attracting fund assets.

Embedded commissions constitute a fundamental conflict-of-interest. The conflict exists because it is the fund manufacturer that is paying the dealer conditional on a transaction taking place. In the first CSA consultation paper on fund fees (81-407, published Dec. 13, 2012) the CSA stated that using fund assets to pay for distribution gives rise to a conflict-of-interest for the investment fund manager. More specifically, the investment fund manager's use of fund assets (which are ultimately investor money) to pay for distribution and increase assets under management can benefit the investment fund manager by increasing their management fee revenue, but may not yield any benefit for the investor. The CSA are of the view that to the extent the investment fund manager would be the primary beneficiary of such a practice, and no corresponding benefit is passed on to investors, the investment fund manager may be at odds with their statutory duty to act in the best interests of the mutual fund and its investors. We agree with this assessment.

And of course trailers create a conflict for advisors in that funds with trailers may be more lucrative than other products and funds with higher trailers may skew recommendations even further. Embedded commissions can lead to mis-selling, thus reducing returns. e.g. use of high cost products, account churning, defective asset allocation and excessive leveraging. Excessive leveraging for example, creates a larger asset base which generates a larger trailer commission cash flow but dramatically increases investor risk exposure. It should be noted however that this same risk can occur in a fee-based account in the absence of a Best interests standard and robust compliance/enforcement.

The CSA also note there's no evidence to substantiate that investors can expect an increase in services and advice if their fund's trailer commissions rise. Trailer commissions paid are very loosely correlated with level of effort received if at all. Because of pooling of assets, large investors (affluent investors per CSA) subsidize smaller investors. With regards to affluent investors (more than $500k of investable assets), the CSA expect that they will be the least affected by the discontinuance of embedded commissions and would likely benefit from the expected decrease in fund management costs and the change in the habits of dealers.

The CSA state (pgs. 52/53)" Based on an analysis of low-cost fund product provider pricing in other markets, while taking into account pricing practices specific to Canada (e.g. tax differences such as the HST etc.), the estimates suggest that management expense ratios (MER) for index funds offered by these new entrants could be up to 40 bps lower than average index fund costs today. Also, MERs for actively- managed funds offered by these new entrants could be up to 75 bps lower than average actively-managed fund costs today. "If these numbers can be believed, such a reduction in A series fees would have a dramatic positive impact on the retirement income security of Canadians.

However, we must examine these claims since the details for making them are not revealed. Actively- managed funds, in their simplest form are offered as Series A and F. Series A is typically 2% and Series F is 1%. From the fundco perspective, 2% is 1% since fundcos are giving up 1% off the top, which is why F is 1%. So the paper seems to be saying the effect of these new entrants could be to reduce Series F management fees on equity funds to as low as 25 bps. That seems to be very ambitious. It is our understanding that even institutional investors don't pay that low on most strategies. And an institutional manager has much lower costs. We leave it to industry participants, fund analysts and others to assess this claim. In any event, we do expect product costs to continue to decline due to competition, the potential arrival of a Best interests standard, relentless media attention on fund costs and increased use of passively-managed products / actively- managed ETF's.

Embedded commissions are one among several causes of abusive salesperson behaviour, although lack of proficiency is also a major factor in the provision of bad advice (the UK RDR review came to a similar conclusion). In fact, Kenmar have been successful in a significant number of complaint cases against dealers/Reps based on incorrect advice on RRSP loan interest deductibility , misunderstanding ROC funds, mis-selling of leveraged ETF's, incorrect interpretation of TFSA rules and undifferentiated advice on RRSP's.

These examples are well delineated in MFDA and IIROC hearing panel decisions, media reports and in our quarterly *INVESTOR PROTECTION in Canada* reports going back over 5 years. **We therefore recommend that dealing representative proficiency be improved as integral to any decision prohibiting embedded commissions.**

There is surprisingly little statutory regulation of the financial advisor industry. Beyond the basic requirements arising from securities legislation across Canada, a wide range of *industry-based* rules and principles guide financial advisors. To achieve the desired outcomes sought by investors, we think the CSA constituents really have to amend the Securities Act(s) or set up a financial conduct or retail financial services regulator dedicated to regulating financial advice to retail investors. The targeted reforms appear to be an uncomfortable patch on a system really focussed on securities distribution not trusted investment advice.

Advisors and Advice

When we consult the rules, regulations and Bulletins of the CSA and the MFDA/IIROC we do not find regulations defining "advice" or the parameters in which that advice should be delivered, monitored and reported. Regulations relate mainly to issuance of securities and the rules and regulations governing their transactions and the rules and regulations governing the disclosure, sale and purchase of securities for individuals.

The CSA state "The term "advisor", as used in this Consultation Paper, is not indicative of an individual's category of registration with Canadian securities regulators, but is rather a plain language term that is commonly used by the public, including fund industry participants and investors, to refer to a representative" .In fact, it is a made up title that has deceived investors into believing that registrants have a best interests duty.

It is interesting to note that the CSA refer to a Dealing Representative, the official registration category, as a "salesperson " http://www.securities-administrators.ca/uploadedFiles/General/pdfs/UnderstandingRegistration_EN.pdf The ASC is more graphic: Persons who are registered under the Securities Act (Alberta) as Dealing Representatives (for example) are generally licensed to sell you products sold by the investment firm they work for, and are obligated to provide you with advice on the suitability of those products for your circumstances. In that sense, it's not unlike purchasing a car from a dealership. If you walk into a Volvo dealership, and explain your needs (four-door, certain horsepower) the person working there will suggest the most suitable Volvo for your needs. While they might have a small selection of other makes and models in their inventory, they are not required to know about, or recommend, any make or model that is not in their inventory that might meet your needs as well, or better. This is true no matter what job title they use, be that "personal banking associate," "investment representative," "investment specialist" or any other title. http://www.albertasecurities.com/investor/investor-resources/you-ascd-blog/Lists/Posts/Post.aspx?ID=63 These regulatory descriptions of dealing Representatives as salespersons are quite different than the descriptions portrayed by industry marketing materials to investors. See SIPA Report *Financial Advisor Fiduciary Illusion* http://www.sipa.ca/library/SIPAsubmissions/500%20SIPA%20REPORT%20-%20Financial%20Advisor%20Fiduciary%20Illusion%2020150502.pdf

Registrants are expected to recommend "suitable" investments per KYC / risk profiling and recommend "suitable" asset allocations. There does not appear to be any legal or other obligation to assist in budget/ debt management, provide lowest cost portfolio solutions, prepare an IPS, monitor the portfolio after the transaction or prepare a meaningful financial plan. Any advice relevant to income tax matters appears to be tilted to promote investment (e.g. RRSP loans) rather than providing a professional, well informed knowledge of tax laws. Marketing literature however suggests that such services may be provided but the real world is something else altogether.

Investors who unknowingly rely on conflicted salespersons as if they were trusted advisors can suffer real financial harm as such salespersons do not owe a fiduciary duty to investors. The cost on an individual basis, in the form of lost retirement savings, can amount to tens or even hundreds of thousands of dollars over a lifetime of investing, money that retirees struggling to make ends meet can ill afford to do without. In addition to paying higher costs, investors who rely on conflicted sales recommendations as if it were unbiased advice can end up facing unnecessary risks or receiving substandard returns as a result of numerous incentives that pervade the compensation system for "advisors". A major problem is that the CSA /IIROC/MFDA have allowed Approved Persons to hold themselves out as "advisors" and "financial planners" when there is no statutory obligation to act in the client's best interest- this is inherently misleading to financial consumers. **We recommend that the CSA take action that will address title misrepresentation.**

The mutual fund industry employs an arsenal of sophisticated techniques to market and sell mutual funds so it is understandable, in the absence of enforced protective regulations, that Canadians are paying a premium price for mutual funds. The bottom line is that the so-called "Wealth management "industry is not providing a robust or economic path for Canadians to accumulate wealth for retirement. Regulatory reforms are required and have been required for many years since the Stromberg Reports identified the key mis-selling issues in the late nineteen nineties.

It should also be noted that while embedded commissions are one cause of mutual fund under-performance, other so-called optional fees are not immaterial-sales loads, early redemption penalty fees, switch fees, currency conversion fees (in some registered accounts) and account transfer charges also take a nasty bite out of retail investor nest eggs.These fees are not regulated and could be increased to mitigate the loss of trailers.

But embedded commissions amount to about half the cost of owning an actively-managed equity mutual fund so rightfully draw the most attention. Across all mutual fund classes, prior CSA research found mutual fund management fees totaled $13.4-billion in 2011, with trailer commissions accounting for $4.6-billion or 34 % of the cost. At the end of 2011, the mutual fund industry managed $762 billion in assets on behalf of an estimated 12 million Canadians. The CSA now inform us that trailing commission paying fund series make up the bulk of mutual fund assets in Canada. At the end of 2015, trailing commission paying purchase options – back-end, low load, front end, and retail no load – made up 67% of assets and increased by 58% over the five years ending 2015. At 2016 the AUM figure has exploded to $1.3 trillion with an increase in trailers. Fundco trailer commissions provide a significant income stream to dealers for distribution of the funds to the retail market. Separating out the cost of "advice" should prompt attentive investors to assess the value of the "advice" obtained .This transparency would help explain some of the fierce industry opposition to a ban on embedded commissions.

As we shall demonstrate, Kenmar do not believe that a prohibition on trailers alone will put investors in a materially safer place. We support a statutory " Best interests " regime but suspect it is probably years away from reality given the lukewarm CSA support (except for the OSC and NBSC) and intense industry lobbying to prevent, delay or water down implementation. Continued use of the lowly suitability standard, prevailing dealer compensation practices and lax enforcement pretty well guarantees sub-optimal investor outcomes even if trailers are prohibited.

"Should you find yourself in a chronically leaking boat, energy devoted to changing vessels is likely to be more productive than energy devoted to patching leaks"-- Warren Buffett

It is our conviction that conflicts-of-interest are so fundamentally harmful that they should be dealt with now by regulators. Even with heightened investor awareness, the limited financial literacy and numeracy of Canadian mutual fund investors, information/knowledge asymmetry and perfected advisor sales pitches will keep ordinary Canadians vulnerable to mis-selling.

The Canadian experience and studies elsewhere in the world such as in the U.K. and Australia provide clear and convincing evidence that the standards for advice giving need to be upgraded**. We recommend that the CSA take action to enhance dealer rep proficiency per *CSA CP 33-404.***

In view of all the issues facing the fund industry the CSA is now , to our dismay, proposing to add alternative funds to the brew .Kenmar argues that no part of the CSA's Alt proposal should be allowed to proceed until salesperson proficiency, KYC tools , risk profiling and conduct standards in the industry are raised: The present securities regulatory framework does not provide adequate investor protection for mainstream products such as mutual funds, let alone complex products such as alternative funds. That being said, Kenmar do not oppose the introduction of Alt funds if they can help improve the risk-adjusted returns of clients. But first, the advice process needs to be more robust in order to recommend them to unsophisticated retail clients.

The Ontario Expert Committee's FINAL report
http://www.fin.gov.on.ca/en/consultations/fpfa/fpfa-final-report.pdf
describes the scheme of the recommendations as a "tripartite approach." Its three main pillars include: a new, harmonized regulatory framework for those who work in the industry; imposition of a duty to act in the best interests of clients; and upgraded and simplified titles and credentials for advisors based on heightened proficiency requirements. We feel the Ontario initiative on financial planning and advice and associated planner/ advisor registration could pay dividends for Ontarions. We urge the Ontario government to follow through as it would bring financial planning under regulation (as in Quebec) and have a common standard for insurance and investment advisors. It would improve investor protection and serve as a beacon for change for the other CSA members.

An Australian study ***Characteristics of trust in Personal financial planning***
https://www.griffith.edu.au/__data/assets/pdf_file/0004/868081/FPRJ-V2-ISS1-pp12-35-characteristics-of-trust-in-personal-financial-planning.pdf
utilises quantitative and qualitative research planning. The authors define trust in financial planning as "the expectation that the advisor (trustee) can be relied on to act

honestly, competently and in the best interests of the client (trustor) and thereby reduce the trustor's risk of loss" (Cull, 2015, p. 10). The paper identified seven primary characteristics of trust that were found to be essential to the client-advisor relationship in personal financial planning. Affective characteristics of trust were found to be essential to the client-advisor relationship. Increased legislation and specific behavioural and technical competencies of advisors were also found to build consumer trust in financial advice. The study's results provide guidance to financial advisors [and regulators] with regards to the skills and factors that build and maintain trust with clients.

This is why we argue that when advice is provided it must be free of conflicts –of-interest and be in the Best interests of the client. Trust in the financial advice process ultimately impacts on public confidence in Canadian capital markets and participation in the economy which assists in meeting broader economic and social objectives.

The CSA must deal with the conflicts issue holistically and not piece-meal. Trailers are the tip of the iceberg of a far larger problem in the wealth management industry. That is why we continue to insist on a statutory Best interests duty to clients and nothing less.

Until advice is actually regulated in some shape or form, financial advice standards are raised and financial advisors have a real professional body to define the proficiency, rules and regulations governing the provision of advice and to discipline and punish those who ignore them, the retail investor will need to be responsible for policing his/her own financial position- a Caveat Emptor environment.

The Canadian Retail Fund Investor Profile

The Canadian Securities Administrators' (CSA) 2016 edition of its investor education survey found that a growing number of Canadians are relying on advisors, with 56% reporting that they utilize an advisor, up from 43% in 2006 when the CSA first carried out the survey.

Moreover, investors cited advisors as their primary source of investing information and credited their advisors as the reason for reassessing their risk tolerance in the past year. The CSA survey found that 61% reviewed their level of risk tolerance during the year, up from 49% in 2012.

Retail mutual fund investors do not understand the adverse impact of fees over time i.e. the de- compounding of returns [studies show that the majority of series A mutual funds do not meet their benchmark over 10 or even 5 years]. This results in clients losing a significant amount of market returns over a 30-40 year investment horizon due to fees.

The 2012 OSC IEF study (pg. 28) found that 51% of investors had no view as to whether there was a conflict- of-interest or not. Among this group, the majority (29% not aware, 22% aware) indicated that they were not aware of all these sales commissions prior to the survey. Others said they were aware, but hadn't formed an opinion. Among the half of investors with an opinion on conflict -of-interest, an astonishing 73 % [36/49] believed that their advisor would look out for their best interest regardless of how the advisor was paid. This should be a BIG Red flag for regulators.

The study concluded "..Two-thirds of investors know little about their advisor when they enter into a relationship with that advisor. Only one-third gets to an advisor through a referral. The most common way to get an advisor is to have one assigned by a bank or financial institution. Investors trust this assigned advisor, because they trust their financial institution to do what is best for them..."

The sad fact is that most "advisors" are executing as salespersons with no regulatory requirement to provide financial planning, tax advice or indeed, any particular advisory service other than ensuring investment recommendations are "suitable".

At the end of 2012 just 37% of Canadian households held investment funds while the balance did not. In other words, two thirds of households would not be impacted in any way by a prohibition of embedded commissions. Further, at the end of 2012, just 22% of small investors (mass market) households held investment funds. These households will typically hold more conservative financial products instead such as cash GICs etc. Thus nearly four out of 5 small investors would be invariant to a ban on embedded commissions.

It should also be noted that mass market households are less likely to purchase their funds through an independent/ other fund distributor. At the end of 2012 only 14% of mass market households purchased their funds through an independent/ other fund distributor compared to 18% of households overall and 21% of affluent households. Mass market households were also much more likely to be solely purchasing their funds through a deposit taker/insurer owned dealer (83%) then were households with higher level of investable assets (i.e. 76% and 75% respectively for mid market and affluent households) .

As regards fees, a BCSC study confirms investors need to learn more about fees .The first phase of the research, which Innovative Research Group conducted on behalf of the BCSC, found that 28% of survey participants don't know how their advisors are paid while 36% are not familiar with the types of fees they pay. The survey also found that 51% of investors say they know what they paid in direct fees over the year, but just 34% know the impact of indirect fees on their investments. Furthermore, the research reveals that only 44% of survey participants understand that paying 1% more, or less, in fees will impact their returns.
http://www.bcsc.bc.ca/News/News_Releases/2017/06_BCSC_study_confirms_investors_need_to_learn_more_about_fees/ **This suggests that securities regulators need to do more targeted investor education on the de- compounding effect of fees on long -term returns**. An advantage of isolating the cost of advice from the product cost would in principle help engaged retail investors get a handle on their investing costs and the value of the advice provided.

The TD bank scandal reveals a lot about corporate culture

A recent CBC report about TD bank employees pressured to meet high sales quotas has touched off a strong reaction from clients, investor advocates and TD employees.

Hundreds of current and former TD Bank Group employees wrote to CBC's Go Public describing a pressure cooker environment they say is "poisoned," "stress inducing," "insane" and has "zero focus on ethics." Some employees admitted they broke the law, claiming they were desperate to earn points towards sales goals they have to reach every three months or risk being fired.

Employees unilaterally increased lines of credit, increased overdraft protection and increased VISA card limits in order to meet sales quotas. One financial advisor admits she acted in her own interest rather than that of her clients after being put on a Performance Improvement Plan - a program that involves coaching and could result in termination of employment - because she wasn't meeting her sales targets. "I have invested clients' savings into funds which were not suitable, because of the SR [sales revenue] pressure" she said. "That's very difficult to admit. I didn't do this lightly." A former TD financial advisor in Calgary says he would downplay the risk of products that gave him a big boost towards his quarterly goal. This is a major systemic issue akin to the Wells Fargo disaster in the U.S.

It will be very interesting to see how banking and securities regulators deal with this mess. Heads should roll, large fines imposed and all victims made whole. NOTES (1) Take a look at this 2013 IE article on TD's planned approach to compensation*. **Lower-producing advisors under fire*** http://www.investmentexecutive.com/-/lower-producing-advisors-under-fire?redirect=%2Fsearch Was this a predictor of the nasty things we see today?; (2) In Nov. 2014, three subsidiaries of Toronto-Dominion Bank agreed to repay at least $13.5-million to clients (10,000 accounts) who were overcharged on fees over the **past 14 years** and paid $650,000 to the OSC in a settlement deal over the wrongdoing and (3) TD Bank was one of the two banks who abandoned independent OBSI as soon as the Minister of Finance provided the opportunity for them to choose their own dispute resolution service.

And yet here we are reading this CSA consultation report on embedded commissions saying deposit –taker (bank) "advisors" work on a salary and are not compensated by trailer commissions. For us this tells us that while trailers are one important conflict of-interest, the real issue is a cultural one. Simply banning trailers will resolve little if there are multiple other sources of advice-skewing incentives backed up by disincentives supported by threats of termination at a branch.

Deposit- taker and insurer owned fund dealers dominate fund distribution in Canada. At the end of 2012, of the 37% of Canadian households that owned investment funds, 87% purchase their funds through a deposit taker/ insurer owned distributor while only 18% purchased their funds to an independent /other fund distributor (a small percentage of households purchase funds from both dealer groups).

To the extent the CSA believes bank branch "advisors" would make up any supposed "advice gap" caused by an embedded commission ban, it is to that extent we urge extreme caution.

Kenmar Response to Specific Consultation Questions

1. *Do you agree with the issues described in this Part? Why or why not?*
Yes, we agree with the embedded commission issues and their importance. CSA and independent research shows that conflicted advice harms investors. If an investor were to invest exclusively in mutual funds, we believe it would make sense to pay a fee if competent ongoing monitoring of the portfolio occurs. The broker or dealer would earn a clear fee as a result of that service. Prohibiting trailers will deal with this issue and will help bring clarity to the advice provided. Some investors may lose access to mutual funds that "advisors" sell with some of the highest fees in the world but will gain access to robo advisors or other direct fee payment methods with higher integrity advice. A recent poll from CARP found that 79% of its members opposed embedded fees with 40% strongly opposed. http://www.carp.ca/2017/04/20/new-poll-older-canadians-want-government-action-protect-life-savings/ When the advice fee is stated as a percentage it should be accompanied with a cost per $1000 metric. For consistency in nomenclature, the charge should be labelled "Service and advice fee" and recorded in dollars and cents on account statements.

We also concur that there is generally no linear or other relationship between the level of embedded trailer commissions set and paid by the investment fund manager to the dealer and the level (and/or quality) of services and advice the dealer and the representative provide to investors in exchange for such compensation .

In **Retail Financial Advice: Does One Size Fit All?** By Stephen Foerster, Juhani T. Linnainmaa, Brian T. Melzer, Alessandro Previtero NBER Working Paper No. 20712 November 2014 the authors conclude:
Using unique data on Canadian households, we assess the impact of financial advisors on their clients' portfolios. We find that advisors induce their clients to take more risk, thereby raising expected returns. On the other hand, we find limited evidence of customization: advisors direct clients into similar portfolios independent of their clients' risk preferences and stage in the life cycle. An advisor's own portfolio is a good predictor of the client's portfolio even after controlling for the client's characteristics. This one-size-fits-all advice does not come cheap. The average client pays more than 2.7% each year in fees and thus gives up all of the equity premium gained through increased risk-taking.
http://fbe.usc.edu/seminars/papers/F_10-3-14_LINNAINMAA.pdf 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.

In the case of mutual funds, Fund Facts (FF) adds to the problem. If the CSA had listened to investor advocates, trailer commissions would be a distinct highly visible line item in Fund Facts, not subsumed in the MER - the cost of distribution would have made trailer payouts more visible. If regulators would have not mandated FF wording that the trailing commission involves the provision of "service and advice" we wouldn't now have to talk about the amount or quality of the recommendations. - the Simplified Prospectus merely said the manufacturer made a payment to the dealer without asserting it was for advice.

The CSA has also allowed meaningless disclosure of trailer commissions. As an example, the TD Balanced Growth fund Fund Facts document, says the trailing commission of this fund is 0-1%, not exactly a very informative fee disclosure for making an informed investment decision.
https://www.tdassetmanagement.com/Fund-Document/pdf/Fund-Facts/TD-Mutual-Funds/TDB970E.pdf The actual trailing commission (in effect the advertised cost of "advice") is a material fact that must be revealed in absolute terms not a range .It should tie in with the MER value in Fund Facts. A wide range of values is in fact not a disclosure at all. It is all well and fine to provide a consolidated number in dollars and cents via CRM2 once a year cost disclosure but the real need of the trailer commission disclosure is at the time of the investment decision. **We recommend Fund Facts reveal the actual trailer commission rate associated to the disclosed MER.**

We wish to point out that the CSA Fund Facts (FF) document does not contain a strong cautionary warning re conflict-of-interest as is the case in the equivalent SEC Summary Prospectus document.

Disclosure has noticeable drawbacks according to a recent study titled, "Consumer Decision-Making in Retail Investment Services: A Behavioural Economics Perspective[1]" (European Commission, 2010
http://ec.europa.eu/consumers/archive/strategy/docs/final_report_en.pdf
suggested that: "Our experimental results **raise doubts that disclosure can always be relied upon to help consumers understand that the advice that they are receiving may not necessarily reflect a choice that is solely in their own best interests..**

First, we find that the impact of disclosing conflicts-of-interest is context-dependent. **Online subjects hardly responded at all to disclosure of advisor remuneration**....Only those subjects who took more time over their decisions reacted appropriately **and even then only when the disclosure was flagged in a bold red font,** for the simplest of decisions.
In contrast, laboratory subjects, with more time and fewer distractions, exhibited a strong reaction to the disclosure of biased incentives, showing evident mistrust of advice.
Second, we find that full and transparent disclosure and/or a health warning may be necessary for people to properly understand the implications of the information being disclosed to them. Online subjects, who were only told that their advisor was paid a commission, did not react to this disclosure unless it was accompanied by a health warning. **Laboratory subjects who were told the exact details of their advisor's remuneration structure responded to disclosure without such a warning**. Thus, the effectiveness of conflict-of-interest disclosure as a policy lever crucially depends on the precise form and content of that disclosure. **People do not appear to naturally recognise conflicts- of- interest and respond appropriately unless the implications are clearly spelled out to them in some fashion**.
Third, we find that disclosing conflicts-of- interest sometimes simply elicits a kneejerk reaction that can be harmful as well as helpful. Subjects in the laboratory exhibited contrarian behaviour in their investment choices when biased incentives were disclosed, investing significantly less in the recommended alternative."

Accordingly, we suggest something like the SEC disclosure: "*Payments to Broker-Dealers and Other Financial Intermediaries:* ***If you purchase the Fund through a broker-dealer or other financial intermediary (such as a bank), the Fund and its related companies may pay the intermediary for the sale of Fund shares and related services. These payments may create a conflict of interest by influencing the broker-dealer or other intermediary and your salesperson to recommend the Fund over another investment. Ask your salesperson or visit your financial intermediary's Web site for more information. Also see Distribution and Shareholder Servicing Plans in the prospectus and Distribution Agreement, Distribution Plan and Shareholder Servicing Plan and Additional Marketing and Support Payments in the Statement of Additional Information."***
We are well aware of the limitations of disclosure but feel a more powerful conflict-of-interest disclosure may have value. **Kenmar recommend the FF warning be significantly tightened up whether or not trailers are prohibited.**

Are Canadians receiving unbiased advice? It is interesting to note that at the end of 2015, just 1.5% of total mutual fund assets (excluding ETFs) were held in passively-managed lower cost funds. Despite all the available performance data and other virtues of indexing, the Index fund market share (advised accounts) has remained essentially unchanged over the last 10 years. However, among Discount/DIY fund series (non-advised), index funds made up a much larger share of assets (16% or $2 billion) that has been growing steadily over time. Why is this?

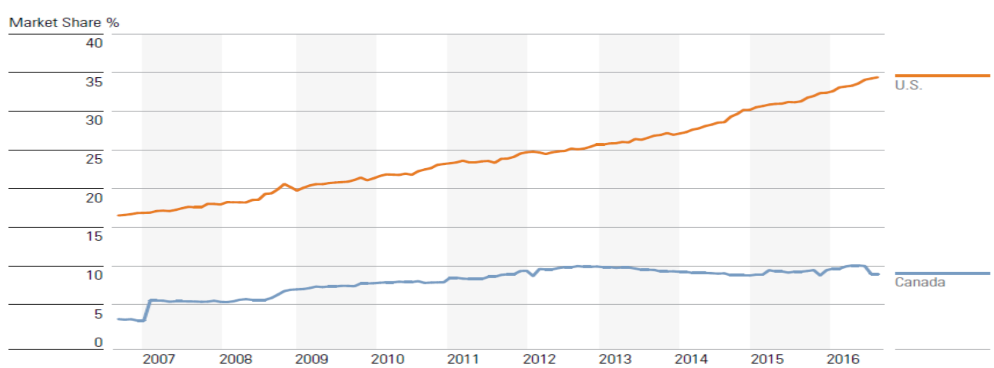
In **Why hasn't indexing taken root in Canada?** Morningstar Canada's Christopher Davis provides an aswer "...It's the incentives, stupid The same fund companies that have little incentive to offer index funds have given advisors little reason to use them. Paying advisors far larger commissions to sell clients active funds tilts the field against index funds. The commissions, which are built into the management-expense ratio (MER) and are commonly known as trailer fees, generally add another percentage point to the management fees paid to active stock funds but add half that amount (or less) to the price tag of index funds. (Commission-based series from ETF providers like iShares, PowerShares and Purpose Investments, which have 1% trailer fees, are an exception.) The commission-based business model is on the decline, but historically fund companies have paid advisors to sell costlier funds, and they've gotten their wish...." http://cawidgets.morningstar.ca/ArticleTemplate/ArticleGL.aspx?culture=en-CA&id=781441

After the United Kingdom banned trailing commissions in 2012, the trickle into passive funds turned into a flood. As Morningstar equity analyst Michael Wong noted in October 2015, passively managed UK assets increased approximately 140% from 2011 to June 2015, and market share significantly increased from about 7.4% to over 12%.

Why are low cost ETF's so small a fraction of Canadian portfolios? The main reason is that, with a few minor exceptions, they don't pay trailers. Another reason is that MFDA dealers aren't set up to sell them. That takes about 83,000 salespersons out of the picture. Quite amazingly, more than 25 years after the world's first listed ETF launched in Toronto, a better part of the country's dealer Reps still can't touch them. https://ca.finance.yahoo.com/news/why-hasnt-indexing-taken-root-100000240.html

The embedded commission and regulatory structures are key reasons passive investing isn't making traction in Canada. See this chart for the material difference in adoption rates:

Exhibit 1 Passive Market Share, Canada vs. United States



Source: Morningstar, Inc. Data as of 9/30/2016.

http://video.morningstar.com/ca/MstarObserver17Q1.pdf?utm_source=tr.im&utm_medium=no_referer&utm_campaign=tr.im%2F1mqZF&utm_content=direct_inputhttp://video.morningstar.com/ca/MstarObserver17Q1.pdf?utm_source=tr.im&utm_medium=no_referer&utm_campaign=tr.im%2F1mqZF&utm_content=direct_input See also
Active vs. Passive Investing in US and Canada Markets | Equities.com
Mystifying statistics –it appears Canadian advisors really love active management and/ or trailer commissions. https://www.equities.com/news/active-vs-passive-investing-in-us-and-canada-markets
2. *Are there other significant issues or harms related to embedded commissions? Please provide data to support your argument where possible.*

Given that most academic studies have found that the best predictor of a fund's return is its expense ratio, (i.e. funds with higher fees tend to underperform their competitors), and given the relatively low interest rate /return environment that is likely to persist, we fail to see how the advisors and dealers can claim to be acting in the client's best interests when profiting from third party payments which create compensation incentives to place consumers in high cost funds /funds-of-funds loaded with high cost proprietary actively-managed mutual funds. FofF funds take much of the load off the advisor so residual benefits of advice, if any, are primarily intangible. According to the consultation (pg 125), for the six years ending December 2015, funds-of-funds net sales totaled $191 billion versus $32 billion for traditional stand-alone funds. They have become the dominant product in the Canadian fund industry.

In some cases, the drive for trailer-commission sales leads to NAAF adulteration, signature forgery or asking clients to sign blank forms. The "signature falsification" (aka forgery) issue has become so bad that the MFDA were compelled to issue a Bulletin http://mfda.ca/notice/msn-0066/
to dealers on the subject. And this is the sales culture which is entrusted with advising on the retirement savings of millions of Canadians.

We provide anecdotal evidence from our friends in the industry concerning business practices that are currently in use or just recently implemented that can harm investors. These are not directly related to trailers and would survive even if trailers were banned. We have not been able to verify but we expect the CSA will want to follow through.

Ba**nk A**

- A branch received a transfer-in of an account that held a Bank B fund, which was one of the best performing funds in the account. The branch manager told the investment and retirement planner (IRP) to write a one page essay for the file on why he or she should keep the Bank B fund in the account. The Rep stated that he did not have the time and ended up selling the Bank B fund for one of Bank A's funds.

- On the dealer side, branch managers encourage their representatives to sell Bank A's funds. This is because the branch manager may get compensated higher if the representative sells proprietary products.

Bank B

- Branch managers promote the use of internal separately managed account (SMA) and unified managed account (UMA) platforms. Advisors charge higher fees and receive higher compensation for selling funds through these platforms as opposed to selling ISC funds.
- Bank B is now paying advisors less (as a percentage) of their mutual fund trailers than they are for their internal products and/or fee- based business. Bank B is considering both its internal platform fee based solutions, but the reality is Bank B is fund-of-funds (and fund of SMAs).
- The SMA platform has highly restricted fund offerings with an outsized number of solutions from the bank's own high fee products.
- Clients are often sold the SMA program with the discussion about the tax deductibility of fees. This is only smoke and mirrors as mutual funds deduct from the gross return as opposed to allowing clients to deduct their taxes on their own.

Bank C

- Bank C's investment advice channel's bonus structure is based on the percentage of Bank C's proprietary products held.
- Trailers are higher on the sales of the bank's managed mutual funds vs. its single fund solutions.

- If a client comes in to a branch with between $100K and $500K, the client will be referred to an FP, who can sell any mutual fund. However, Rep's are encouraged to sell the bank's own funds (80/20 rule). Once the Rep hits a certain amount of revenue, the FP will qualify for a trail (usually between 25 and 35 bps). Reps are encouraged to maintain an average trail of 95 bps, which is one reason why they are more apt to sell a managed fund than a single fund solution.
- If a Rep wants to sell a third party fund, the FP will need to justify to management the reason for doing so.

Bank D

- One wholesaler said that the bank is encouraging its Rep's to use its personal portfolio services program. Rep's get compensated by salary, bonus and other incentives (i.e. achievers' trips).

Bank E

- On the dealer side, advisors make more money from selling its multi-manager fund-of-funds. Performance is mediocre. Lower MER, but higher trailer.
- A branch Rep received a higher bonus because he was able to cross-sell a car loan and a premium credit card.

Dealer A

- Strong incentives in place for advisors to sell proprietary funds.

- If a client has a minimum amount invested in proprietary funds, the dealer will waive the annual account fee ($175). The account fee waiver also applies to TFSA and non-registered accounts.
- A Rep was offered a premium price for his customer book upon his retirement dependent on the amount and percentage of proprietary funds.

Dealer B

- Points program in place with a fund company and a number of other fund companies. For FundCo B's funds, advisors receive 4 points for every $10K invested. Points can be converted to FundCo B's shares or other incentives like trips, conference credits, travel and accommodation to Dealer C's conferences.
- Reps have a quota to sell FundCo B's funds. Once the quota is hit, advisors can sell third party funds.
- Advisors are incented to use managed solutions that are on their recommended list

Dealer C

- Advisors can qualify to buy into shares of FundCo C if a certain amount is invested in FundCo C's funds annually. Advisors can also win cruises.
- Advisors receive additional support through their total client experience. Total client experience includes practice management specialists and marketing tools (preferential treatment to guide their business).

Dealer D

- Advisors are incented to sell dealer funds. Advisors get a $5K bonus if they have $7M to $8M invested in its own funds.

3. *Are there significant benefits to embedded commissions such as access to advice, efficiency and cost effectiveness of business models, and heightened competition that may outweigh the issues or harms of embedded commissions in some or all circumstances? Please provide data to support your argument where possible.*

Trailers do provide access to conflicted "advice" , such as it is, for small accounts because they leverage cross-subsidization .The nature of the "advice" however is such that investors are sold actively- managed mutual funds that in most cases fail to match the performance of a portfolio of passive index funds AND are NOT sold lower cost products. As a result of conflicted advice, the retail investor return is significantly impaired over the long term.

In a very real sense, advice <u>not provided</u> is also harmful, yet investors are led to believe that representatives using a variety of misleading titles are acting in their best interests. One example we see far too often occurs when a Rep does not recommend that a client exploit the 50-100% contribution match provided by employee's company RSP plans. Another prime example occurs when we see chronic high balances of 18%+ credit card balances even as the Rep promotes increased monthly mutual fund purchases. This is what is passing for advice.

The conclusions of a 2015 Research paper **Is conflicted advice better than no advice?** can be summarized as follows:
ABSTRACT The answer depends on how broker clients would have invested in the absence of broker recommendations. To identify counterfactual retirement portfolios, we exploit time-series variation in access to brokers by new plan participants. When brokers are available, they are chosen by new participants who value recommendations on asset allocation and fund selection because they are less financially experienced. When brokers are no longer available, demand for Target-date funds (TDFs) increases differentially among participants with the highest predicted demand for brokers. Broker client portfolios earn significantly lower risk-adjusted returns and Sharpe ratios than matched portfolios based on TDFs—due in part to broker fees that average 0.90% per year—but offer similar levels of risk. More generally, the portfolios of participants with high predicted demand for brokers who lack access to brokers compares favorably to the portfolios of similar participants who had access to brokers when they joined. Exploiting across-fund variation in the level of broker fees, we find that broker clients allocate more dollars to higher fee funds. This finding increases our confidence that actual broker client portfolios reflect broker recommendations, and it highlights an agency conflict that can be eliminated when TDFs replace brokers.

Notwithstanding the conflicts, some dealing reps do assist clients with good general advice on saving, using TFSA accounts and diversification. We're not so sure about income tax advice, an unlicensed service. As regards tax advice for example, RRSPs are a terrible investment for low-modest income Canadians nearing retirement because most of the proceeds will be lost to taxes and clawbacks, according to a study by the C.D. Howe Institute. Study author Richard Shillington calls the situation "perverse" and urges financial advisors to stop spreading the myth that RRSPs are good for everyone. Many small retail investors are urged to set up an RRSP (using actively- managed mutual funds), without any differentiation or consideration of income tested benefits they might lose in retirement. See **New Poverty Traps: Means-Testing and Modest-Income Seniors**
https://www.cdhowe.org/sites/default/files/attachments/research_papers/mixed/backgrounder_65.pdf . A Best interests standard coupled with increased dealing Rep proficiency would alleviate such bad advice /mis-selling.

We witness, with some notable exceptions, relatively little in professional personalized investment advice. Guidance is provided: "Buy-and-Hold: "Dollar cost averaging is the Best way to reduce risk", and the like but that guidance is only provided if an actively-managed mutual fund, often a proprietary one, is purchased and held. Some guidance is however clearly self-serving -"Invest in your RRSP", "Borrow to Invest" and "Active management is superior to indexing". Tied advice has a number of significant disadvantages for clients as we have articulated in this Comment letter. Cutting credit card debt or paying down the mortgage is rarely seen, at least in our interactions with unsophisticated retail fund investors over the past 15 years. Having client's pay directly for advice would at least in principle (a) provide clients with less biased advice and (b), prompt engaged investors to assess the services provided and results obtained vs the costs incurred. This is because a direct pay system makes the cost of advice more impactful compared to the disclosure of trailers in Fund Facts.

The alleged benefits of conflicted advice are intangible and in our opinion, supported by research, more than offset by the use of high cost products, unsuitable investments, early redemption penalties and the risks associated with undue leveraging. (in addition, the sales driven culture and slack enforcement motivates some dealing Reps to sell risky Off book products, engage in personal financial dealings and even effect outright fraud).

We have not been able to find convincing independent research to demonstrate that "advisors" actually contain bad investor behaviours as often cited by industry participants. In fact, a number of independent research papers suggest the opposite effect:

In their study, "Assessing the Costs and Benefits of Brokers in the Mutual Fund Industry," Daniel Bergstresser (Harvard Business School), John Chalmers (University of Oregon), and Peter Tufano (Harvard Business School) analyze a database of U.S. mutual funds from 1996 to 2004. Their objective was to compare the performance of investors who bought funds through broker-dealers to investors who purchased funds directly. They found that investors with broker-sold mutual funds experienced "lower risk-adjusted returns, even before subtracting distribution costs." They also found that investors purchasing broker-sold funds were directed into funds with "substantially higher fees" and failed to show superior asset allocation. And as for helping investors avoid behavioral biases, "regrettably, the advisers generally demonstrated all the same biases that the rest of us have."

According to Do financial advisors improve portfolio performance?, a study of German investors at Vox by university professors Andreas Hackethal, Michalis Haliassos and Tullio Jappelli. says they don't. The reason is the old bugaboo - costs and fees.Advisors add value but ... "*Even if advisors add value to the account, they collect more in fees and commissions than they contribute.*" Apparently the authors found that richer, older people tend to use advisors more which accounts for a preliminary gross conclusion that "*Investors who delegate portfolio management to a financial advisor achieve on average greater returns, lower risk, lower probabilities of losses and of substantial losses, and greater diversification through investments in mutual funds.*" They note that the financial industry would love to grab that statement for publicity. However, the net truth is completely opposite: "*Once we control for different characteristics of investors using financial advisors, we discover that advisors actually tend to lower returns, raise portfolio risk, increase the probabilities of losses, and increase trading frequency and portfolio turnover relative to what account owners of given characteristics tend to achieve on their own.*"

The estimated 6-7 year average hold period for mutual funds in Canada is an indicator of sorts that investor behaviour is not being contained by "advisors, one of the asserted benefits of "advice". We have seen accounts churned, funds exchanged upon maturation of the DSC hold period, fund portfolios dramatically altered when a new advisor takes over an account etc. The bottom line is that retail investor accounts are not really behaving as long term investments. To be fair, these malpractices are due as much to regulatory failure as the presence of trailer commissions.

4. *For each of the following investment products, whether sold under a prospectus or in the exempt market under a prospectus exemption:*
- mutual fund
- *non-redeemable investment fund*
- *structured note*

should the product be subject to the discontinuation of embedded commissions? If not:
a. What would be the policy rationale for excluding it?
b. What would be the risk of regulatory arbitrage occurring in the exempt market if embedded commissions were discontinued for the product only when sold under prospectus?
Regulatory arbitrage is a material threat to the success of banning embedded commissions. Segregated funds in particular can be sold to unsuspecting investors by dual licensed "advisors" They can be portrayed as mutual funds to a novice investor. The problem is that fees are higher, disclosure is weaker, conduct rules are looser, enforcement is lighter and sanctions are lower.

Another important form of regulatory arbitrage occurs now when a complaint involves an investment portfolio containing a Segregated fund. The current system requires the complainant to file two complaints: one to OBSI and the other to OLHI for the Seg portion. This is abusive and likely will lead to a faulty conclusion. The CSA has to act on Recommendation 6 of the Independent Assessor: *That the OBSI and Ombudsman for Life & Health Insurance chief executives develop a joint approach to identifying and quantifying losses associated with segregated funds.* Source:
https://www.obsi.ca/en/download/fm/539/filename/2016-Independent-Evaluation-Investment-Mandate-1465218315-e9fa5.pdf
Securities regulators need to take an aggressive pro-active stance to prevent regulatory failure.
5. *Are there specific types of mutual funds, non -redeemable investment funds or structured notes that should not be subject to the discontinuation of embedded commissions? Why?*

We are not aware of any. Some PPN’s issued by banks may have embedded commissions but they are not considered securities and do not assert they have any advice component. In any event, such products are protected via regulatory arbitrage since they are outside the mandate of the CSA

6. *Are there other types of investment products that should be subject to the discontinuation of embedded commissions? Why?*

We do not know .Perhaps it is time for a Segregated fund to be classified as a security under the Securities Act.

7. *Do you agree with the discontinuation of all payments made by persons or companies other than the investor in connection with the purchase or continued ownership of an investment fund security or structured note? Why or why not?*

We agree because it will not be possible to do away with commissions in Canada unless you can break the very strong link between product distribution and the investor, and "advisors" have fiduciary type responsibilities towards their clients. You pay for a service, and you pay for advice, and until you are actually paying for accountable and regulated advice and not the transaction, moving to a fee-only industry cannot happen effectively

We agree because we feel that it removes one significant, but far from exclusive, source of conflicts-of-interest. But, unless all conflicts –of-interest are removed, mis-selling will continue unabated. With trailers removed, at least Fund Facts disclosure will be greatly simplified allowing the document more real estate to better articulate investment strategy and properly disclose fund risks.

8. *Are there other fees or payments that we should consider discontinuing in connection with the purchase or continued ownership of an investment fund security or structured note, including: a. the payment of money and the provision of non-monetary benefits by investment fund managers to dealers and representatives in connection with marketing and educational practices under Part 5 of NI 81-105; b. referral fees; and c. underwriting commissions.*
Why? What is the risk and magnitude of regulatory arbitrage through these types of fees and commissions?

First off, all the compensation conflicts identified in the Dec. 15th, 2016 CSA/IIROC/MFDA announcements must be eliminated as they are designed to thwart the basic law that dealers must deal fairly, honestly and in good faith with clients. The CSA announcement identified a whopping 18 advice- skewing compensation schemes.

We believe NI81-105 needs a complete update and should be expanded to at least cover all the securities mentioned in this consultation. It is not clear to us why its provisions are not applied to all sales recommendations regardless of product.

Kenmar are of the view that if dealers want to be considered as trusted wealth managers, they should not participate in co-operative marketing programs with suppliers. We see no rationale for fund assets to be used for sales pitches by suppliers. Any "educational" seminars should be presented solely as a wealth manager.

We have a strong view on referral fees. Referral arrangements create an environment where dealer representatives are incented to sell products /loans/services to clients whether they need them or not. *As the CSA paper observes "In the case of related party* *referral arrangements, it may encourage representatives to send their clients to another arm of their firm, even when third party product and/or service options may be more suitable. It may also encourage representatives to shift clients to more profitable business lines within the firm with little or no benefit to the client."* By not addressing referral fees , it just seems to us that regulators have provided dealers with a back-door way to achieve what they have been achieving through the front door. The CSA state "We acknowledge that the above types of payments may give rise to conflicts of interest that may continue to incent registrant behavior that does not favour investor interests". So why in the world would referral fees be allowed to continue? A quick look at the BNS referral disclosure document http://www.scotiabank.com/ca/common/pdf/scotiamcleod/Referral-Disclosures-82014612_eng_0211.pdf presents so many bear traps for the unsuspecting retail investor it is hard to imagine he/she would escape unscathed. People are looking for trusted investment advice on their life savings and it is the duty of regulators to provide them a safe environment for doing so.

If there is one referral fee that should be banned it would be the referral that supports leveraging. It is our understanding that one bank, noted for leveraged lending, counts 27,000 advisors among its clientele. According to the consultation paper, dealers may receive a referral fee from the financial institution in connection with their client's loan in addition to the 5% upfront commission (plus the ongoing trailing commission) they may receive from the investment fund manager on the purchase transaction- this encourages undue and risky leveraging recommendations.

This bank offers a 3 for 1 investment loan (!) and loans for RRSP's. Visit https://b2bbank.com/sn_uploads/forms/0817-07-203E_B2B_BANK_Investment_Loan_Application.pdf for details. It is hard to see how such loans could ever be in the retail investors' Best interests. Allowing referral fees for such loans just perpetuates the bad culture that permeates Bay Street. **We therefore recommend (a) that referral fees for investment loans be prohibited and (b) account fees in fee-based accounts should be based on net assets as has been implemented by Australian regulators.**

As for underwriting commissions for closed-end funds, it seems to us that such commissions are clearly for distribution and as such reasonable investor protection can be achieved via quality disclosure and suitability criteria. A problem can arise when an IPO is sold within a fee-based account – we leave it to regulators to decide on such cases. In a closed-end fund, the underwriting is pretty basic yet it still seems to attract a similar fee as for a corporate issuer IPO. That just doesn't make sense. Yet, under the prevailing suitability standard such a transaction would be perfectly acceptable. Under a Best interests standard, we doubt such transactions would pass muster.

Investors today are having a difficult time using and employing the CSA aretheyregistered web site. SIPA have documented the many issues in their report http://www.sipa.ca/library/SIPAsubmissions/500_SIPA_REPORT_REGISTRATION-Above-

the-Law_201611.pdf Should embedded commissions be banned, we would expect an exponential increase in use of the site. In any event, **it is imperative that the CSA repair work begin now**. These points are especially important:
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- The CSA should ensure that Reg check makes it crystal clear when a person is dually registered.
- Reg check should also be kept up to date in near real time*.
- The CSA should issue an investor ALERT regarding dual registration including potential risks.
- Dealers should be required to inform clients in writing if a registrant is dually registered.
- Regulators should examine all rules to see if provisions are adequate to enforce cases where investment assets are redeemed to purchase Seg funds (or life insurance/ annuities).
- Regulators should have a clear privacy policy that the KYC information can only be used to effect actions regarding securities unless client consent has been obtained to use the information for another purpose.
- Finally, regulators might tighten the criteria for approval of a dual-occupation registrant that would include provisions that mitigate regulatory arbitrage.

* There are major holes in the database's records. As of May 26, 2016, the NRD is missing penalty information for at least 51 people disciplined by IIROC and the MFDA between January 1, 2013 and December 31, 2015—including permanent bans. That's 18% of all reps who faced discipline during that period. http://www.advisor.ca/news/industry-news/hidden-in-plain-sight-how-banned-iiroc-and-mfda-advisors-can-still-sell-insurance-207496

9. *If payments and non-monetary benefits to dealers and representatives for marketing and educational practices under Part 5 of NI 81-105 are maintained further to the discontinuation of embedded commissions, should we change the scope of those payments and benefits in any way? If so, why?*

We believe such payments and benefits can only lead to trouble and should be prohibited. There should never be financial/non-financial direct relationship of a supplier with staff of an advisory firm. We are told by trusted industry participants that before the Sentry case there had never been any enforcement of this Instrument since its release in 1998. [As we read the April 5, 2017 Sentry Securities Inc. Settlement Agreement http://www.osc.gov.on.ca/en/Proceedings_enr_20170405_sentry.htm our eyes glaze over. The "conference", which was held in September 2015, included a party for advisors at a mansion in Beverly Hills that cost the firm more than US$1,000 per guest; gifts of Dom Perignon champagne and jewelry from Tiffany & Co., along with golf outings, a wine tasting and movie studio tour provided at the firm's expense. In total, the conference cost Sentry $2 million. The OSC settlement agreement also indicates that Sentry spent excessively on gifts for reps, exceeding $4,000 a year for some reps, on items such as tickets to concerts, hockey, baseball and basketball games, along with other gifts. Furthermore, the OSC alleged that Driscoll provided a rep with tickets to the Montreal Grand Prix in 2015 and 2016, which also violated the rules.]

In OSC STAFF NOTICE 33-743 GUIDANCE ON SALES PRACTICES, EXPENSE ALLOCATION AND OTHER RELEVANT AREAS DEVELOPED FROM THE RESULTS OF THE TARGETED REVIEW OF LARGE INVESTMENT FUND MANAGERS http://www.westlawecarswell.com/oscb/on3725/on3725-1.htm the OSC looked closely at certain aspects of sales practices including cooperative marketing practices, mutual fund sales conferences and fund manager participation in the sponsoring of dealer events. What investment fund managers can and cannot do is spelled out in *National Instrument 81-105 Mutual Fund Sales Practices*, which has been around since 1998. Its purpose was to discourage sales practices and compensation arrangements that raised the question as to whether the clients' interests rather than those of the sellers were being addressed. Fund managers can pay a portion of the costs of an investor conference or seminar that a dealer puts on for investors. However, the Staff Notice says there was a 25% incidence rate where "cooperative marketing practices did not meet the primary purpose of promoting or providing educational information concerning a mutual fund, a mutual fund family or mutual funds generally in order to be eligible for support. "Staff also had concerns regarding mutual fund sponsored conferences. Fund managers are prohibited from paying travel and accommodations expenses of sales representatives, yet there was a 50% incidence rate of this occurring. Similarly, non-monetary benefits such as meals and entertainment were deemed excessive.

The CSA is well aware that so-called "Free lunch" educational seminars co-sponsored by fundcos are thinly disguised sales pitches. These seminars may be invitation-only or they may be advertised in local papers or on the internet." Free lunch "seminars are often held at hotels or restaurants and may offer enticements such as free meals, books, or trips for attendees. In effect, they are perceived as "recommendations" by clients. Such Co-operative marketing ventures have been shown to have little real value for investors and in fact have led to several problems. Dealers ("wealth managers") should not receive payments from product suppliers especially using fund assets. See **Free Lunch Seminar Report**: AARP 2009
http://www.aarp.org/work/retirement-planning/info-11-2009/freelunch.html

We expect that if the OSC had performed a compliance sweep on NI81-105 compensation practice provisions, the results would have been jaw-dropping.

10. *With respect to internal transfer payments:*
a. How effective is NI 81-105 in regulating payments within integrated financial service providers such that there is a level playing field for proprietary funds and third party funds?
Regulation and enforcement of these payments via the 1998 version of NI81-105 would appear to be ineffective based on observed results.

Per a 2013 Invesco Comment letter "*We understand that some 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*

some 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) of NI81-105. 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…"
http://www.osc.gov.on.ca/documents/en/Securities-Category8-Comments/com_20130412_81-407_adelsone.pdf

We recommend that dealing representatives from integrated firms exclusively selling proprietary products be given a descriptive label (e.g. "salesperson") that distinguishes them from true independent advisors/wealth managers so that investors know the limitations and constraints of the "advice" provided.

A major finding of the Cumming report was that "Funds that sell more through affiliated dealers tend to perform worse…funds which receive higher levels of affiliated dealer flows experience lower future alpha on average." (page 9). i.e. the research indicates that mutual fund sales through affiliated dealers appear to have weaker connections to past performance, which is associated with weaker future returns.

This suggests that conflicts-of-interest are at play, which lowers incentives to generate flow via improvement in performance (page 63). This appears to demonstrate that when dealer representatives can only sell proprietary products or are incented to sell the product of the manufacturer that the advisor's dealer is affiliated with, the retail investor is worse off. This is not surprising because the Rep, say at a bank-owned dealer (branch), is restricted in the products that he or she can recommend.
b. *Should internal transfer payments to dealers within integrated financial service providers that are tied to an investor's purchase or continued ownership of an investment fund security or structured note be discontinued? Why or why not? To what extent do integrated financial service providers directly or indirectly provide internal transfer payments to their affiliated dealers and their representatives to incent the distribution of their products?*

We do not have clear visibility on the nature of these transfers but we can say that they effectively transform advice-skewing trailers to dealers into respectable salary plus bonus payments to dealing Reps. Such payouts may not be related to specific transactions but they must surely in aggregate be closely related to the dollar value of the transactions effected by the Rep. They certainly drive the rules, policies and motivations of the affiliated dealer. The CSA should be constructively critical of these internal transfers and the basis upon which they are made. If internal transfer are allowed, then it seems to us that the incentives continue but in a different, more sophisticated form.

c. *Are there types of internal transfer payments that are not tied to an investor's purchase or continued ownership of an investment fund security or structured note that should be discontinued?*
We do not have sufficient information on which to comment.
11. *If we were to discontinue embedded commissions, please comment on whether we should allow investment fund managers or structured note issuers to facilitate investors' payment of dealer compensation by collecting it from the investor's investment and remitting it to the dealer on the investor's behalf.*

Continuing to allow payments between affiliated dealers and manufacturers is controversial and shows that regulators need to probe much deeper into these arrangements. Such a system defeats the whole purpose of separating advice from transactions (using fund assets to finance distribution), thereby not empowering the retail investor.

We should mention an Invesco approach to deal with this issue We have been informed that a few years ago they introduced something called Flexible F or an Investment Advisory Fee (IAF). In these arrangements, the dealer and client "negotiate" a fee (to the same extent as for a fee-based account) and sign an agreement with them and Invesco collect the IAF from the investor on behalf of the dealer. So the investor knows they are paying because (a) they agreed to it in a contract, (b) the contract is very simple and short (c) it shows up on their monthly or quarterly statement, as the case may be. Invesco have no participation in the amount of the fee. On the upside, however, Invesco will not honour the IAF – and they say so in the prospectus and otherwise – if the fee exceeds 1.5%. It appears that a client would have to sign an IAF for each fund family of interest which may place a paper burden on clients and dealers. The CSA may wish to examine this approach and assess the issues associated with it.

12. *Based on a consideration of the data and evidence provided in this Part, would a proposal to discontinue embedded commissions address the three key investor protection and market efficiency issues discussed in Part 2?*
They would address the primary issues <u>but only if the proposed CSA targeted reforms/BI are implemented and meaningful and timely regulatory enforcement is applied</u>.
13. *Are there other ways in which the CSA could address these issues that could be introduced in conjunction with, or separate from, the discontinuation of embedded commissions?*
We are unable to provide a better alternative.
14. *Are there other conflicts-of-interest that could emerge following a transition to direct pay arrangements that would not be addressed in the current securities regulation framework?*
It's not that other conflicts-of-interest will emerge, they exist in plain sight today. The report from the Canadian Securities Administrators (CSA), the Investment Industry Regulatory Organization of Canada (IIROC) and the Mutual Fund Dealers Association of Canada (MFDA) examined the various compensation arrangements in the retail investment business and the conflicts they can create, including a bias for proprietary

products and incentives to sell products that may violate suitability standards. The long list of advice- skewing incentives and inducements was in our view, quite shocking. Even more shocking was the matter of fact lack of reaction and concern by regulators. These arrangements go well beyond the embedded commission issue and cry out for firm, prompt and decisive regulatory action, not more monitoring. One has to question why there has been so little enforcement.

A glance at the IG Simplified Prospects, pages 31 and 32 shows a large number of non-trailer influencers that could skew the advice provided https://www.investorsgroup.com/en/documents/corp/regulatory/prospectus-guides/c2994.pdf . viz "We may also pay prize awards and performance bonuses to your Investors Group Consultant, or provide credits that may be paid in cash or used towards a variety of business, benefit and education-related expenses, based on the dollar amount of the various products and investments distributed or serviced by the Investors Group Consultant during the year, as well as bonuses for career achievements such as obtaining an educational designation, or licence or for program completion. Some prizes and bonuses paid for Investors Group Funds may be higher than those paid for other products. Also, your Investors Group Consultant may own, directly or indirectly, shares of IGM Financial Inc."

A 2016 IIROC report commented on dealer control over compensation related conflicts It stated: "...However, when it came to compensation-related conflicts, most firms sampled lacked a meaningful process to identify, deal with, monitor and supervise compensation-related conflicts. For example, most firms did not have mechanisms in place to identify advisors who recommend products that yield higher fees and bonuses, when there are other suitable but less expensive alternatives available. They also did not have a process in place for implementing additional monitoring of advisors approaching compensation thresholds based on the amount of revenue generated. Furthermore, we found that there was confusion among some firms regarding the best interest standard as set out in our conflicts of interest rule and guidance. Although most Dealer Members responded that they always put clients' best interests first, we found little supporting documentation as far as compensation-related conflicts were concerned. .." http://www.iiroc.ca/Documents/2016/F58C9465-AFC5-42F3-A5D1-6C5BFDF19CF3_en.pdf Without a defined process for managing advisor compensation-related conflicts actions and inactions, we fail to see how robust advice can be provided. The best solution is to avoid such conflicts to the greatest extent practicable.

The Brondesbury Group Report, "Mutual Fund Fees Research", Spring 2015, https://www.securitiesadministrators.ca/uploadedFiles/General/pdfs/Brondesbury%20Mutual%20Fund%20Fee%20Research%20Report_e ngwr.pdf was quite clear in one respect: the literature shows trailers generate conflicts but there is insufficient research on conflicts in fee-based accounts, so we really don't know what the conflicts are. Brondesbury had cautioned against shifting to that model without studying the conflicts. To our knowledge no one has done so. We have repeatedly identified two conflicts: higher fees for advice; reverse churning.

According to the Brondesbury report "All forms of compensation affect advice and outcomes". But not all forms of compensation are equal. For instance, advice delivered under a suitability standard and paid for by trailers is likely to have a worse investor outcome than advice delivered under a direct-pay Best interest standard. Advice from a bank branch dealer collecting trailers would on average be expected to be worse than advice coming from a dealer with a suite of competitive non-proprietary products. Advice provided by a direct pay compensation method is more likely than not to lead to better long-term client outcomes because the client will have a better capability to measure results vs. advisory fees and take timely remedial actions.

15. *What effect do you think the removal of embedded commissions will have on investor experience and outcomes? In particular:*

• *Will investors receive advice and financial services that are more aligned with the fees they pay?*

In theory they might if a documented fee and service schedule is provided and clients are alert. Informed clients could then assess whether the services provided are worth the money. They could at least in principle, comparison shop but we do not expect small retail clients to have much leverage in negotiating fees. NOTE: Since a multitude of other conflicts-of-interest will be omnipresent, we remain constructively critical that many unsophisticated retail investors will be able to assess the quality and integrity of the advice provided.

Kenmar is of the view that advisors also have a potential conflict-of-interest due to the possibility of higher trailing commissions from increased sales of a particular category of fund. For example, since trailing commissions on equity mutual funds are typically higher than those on fixed income or money market funds, advisors may have an incentive to favour such equity mutual funds in portfolio allocations. The resulting unbalanced portfolio would not correlate well with the client risk profile, itself based on a flawed process in the majority of cases. The removal of trailers should have a positive impact on investor experience and outcomes with the provisos surrounding fee-based accounts.

• *What effect will the proposal have on the growth of automated advice? Is this likely to be beneficial to investors?*

We believe automated investment advice will see an increase in interest once the true cost of investment advice and the services actually provided become clear to investors. This could be beneficial for small investors because of lower costs and avoidance of abusive dealer/advisor sales practices.

• *Is discretionary advice likely to increase in Canada as we have seen in the other markets that have transitioned away from embedded commissions and, if so, would this shift be positive or negative for investors?*

Reversion to discretionary is potentially a real issue. What happens is IIROC-licensed reps end up providing discretionary advice, like a PM would. The wording of the proficiency standard is similar but not quite and leaves the potential for abuse. Discretionary could be positive, but it could also be a negative outcome, depending on fees (and clarity on fiduciary duty). There is also the issue of competency. A PM for a fundco spends almost all of his/her time monitoring the portfolio and researching investments. The discretionary advisor at a dealer does not. They don't have the infrastructure really to do those activities -they tend to rely on dealer research, and have no real investment style. We have a hard time believing clients are better off using discretionary. One should contrast that with Private Investment Counsel shops who do the same things as fundco PMs and who are very open and upfront with potential clients about the investment approach, expectations and fees. The problem is cost – they won't take on accounts under $1 million typically.

• *What effect will the proposal have on the growth of the online/discount brokerage channel and cost of fund products offered in this channel? Is this likely to be beneficial to investors?*
From early feedback, we believe that a not insignificant number of people will explore the use of discount brokers as a result of CRM2 sticker shock and unrelenting media reports of advisor wrongdoing. Some will come as orphans as IIROC dealers trim their client base to focus on larger accounts. We believe banning trailers will cause the smaller account clients to consider going DIY with all or at least a portion of their investments. This could be beneficial for investors as long as IIROC does not curtail the many innovative features, guidance and tools these firms have created. A concern: With trailers banned, at what price will discount brokers sell mutual funds?

We are encouraged to see the OSC announcement of its LaunchPad program to help new tech firms develop their business models in a compliant fashion. It appears that the OSC will try to be flexible on regulations, allowing time-limited registrations or exemptions for companies to test new models. Kenmar support this initiative to support the development of online advice, robos and discount brokers. This can only benefit investors.
• *What effect will the proposal have on the cost and scope of advice provided to specific investor segments?*
This is very difficult for us to project.

We suspect a number of questionable products may be dropped. For example, BMO, the country's second-largest ETF provider, wraps its moderately priced ETFs in high-priced mutual funds before selling them at bank branches. Removal of the trailer may assist in reducing the number of such products from the market BUT they might end up in a 1.5 % SMA or fee-based account unless a Best interests standard also comes into force. This is why we keep saying that banning trailers on a stand a-lone basis will not be effective and could have adverse consequences.

It is not unreasonable to expect removal of embedded commissions will spur innovation, cost reduction, more use of automated advice and mobile platforms, especially for millennials. We fully expect Canadian industry creativity to be as creative as those in other jurisdictions. If the uptake of robos in the U.S. is any indication, it should prosper here given our higher mutual fund costs.

Advice Fees may rise but we do not see a corresponding change in the scope of advice provided for small investors. It is anticipated that any increase in fees will be more than offset by use of lower cost products but this should not be taken for granted. That is why we continue to demand a statutory BI standard be implemented.

At first there will be some consternation of the change especially since investors have been told “advice” is free. It will take some time for the system to settle down, perhaps as long as 6 -9 months or even longer. The CSA will have a role is providing investor education. Some fraction of small investors may decide they don’t want or need investment advice at the prices on offer. We continue to make the point that investors with say $25,000 or less to invest may not need much in the way of investment advice. For them paying down debt, cutting household expenses, investing with an indexing firm like Tangerine or a robo may be more than an adequate solution until their investable cash increases and/or their financial situation becomes more complex. We would also expect that the Money Coaches sector would be given a boost if trailers are banned.

A comprehensive CSA communications program will be needed to support the transition period.

While we are cool to financial literacy initiatives we are excited about financial capability. It is our opinion that Canadians need as much support or more for holistic financial planning than advice on investments. In this regard **we recommend that the CSA formally partner with the FCAC to develop easy to use plain language tools, calculators, checklists related to the most common financial issues that will assist Canadians with modest savings to take control of their own financial destiny.**

16. *What types of payment arrangements are likely to result if this proposal is adopted? In particular:*
• *Would the payment arrangements offered by dealers to investors differ based on investor segment? If so, how and why?*
We don’t know but the industry is creative. We expect they will find a solution for each segment and channel. A huge concern of course is that people, especially seniors, will be herded into fee-based or other types of accounts that are not suitable for their needs. It will be up to the regulators to ensure that creativity doesn’t make the situation worse than it is now. We point out that front-end load payments are in use now and will continue to be permitted according to this consultation.
17. *Do you think this proposal will lead to an advice gap? In particular:*
•*Which segments of the market are likely to be affected?*
Please consider segmentation by wealth, geography (size and location of community e.g. remote, small, medium, large), age, technological sophistication, the level of fund ownership across households, etc.

There has long been an "advice gap" in the industry, where full-service advice is much more likely to be available for large accounts and not small accounts. That reflects the economic reality that getting lots of good quality advice is expensive and not everyone can afford to pay for much of it. There is a gap between what advice investors are actually receiving vs. what they expect (professional unbiased advice). There is a gap between what advice clients are receiving and what they really need (a simple financial plan, low cost simple products). For many, there is a gap between what they are paying for advice and the level of effort applied to their situation.

According to the J.D. Power 2016 Canadian Full Service Investor Satisfaction Study, SM despite Canada's wealth management industry promoting a goals-based approach to advice, nearly half of full service Canadian investors say their advisors fail to deliver on even the first stage of that process, which helps them set goals that reflect their risk tolerance. The study identifies three broad stages of goals-based investing: setting personal goals; implementing a strategy to achieve those goals; and monitoring progress. Only slightly more than half (54%) of investors indicate their advisor helped set goals and discussed risk. **Barely one-third (34%) say their advisor effectively delivered on all three stages.** Additionally, despite all the attention on transparency around fees with CRM2, just 27% of investors say they "completely" understand their fees, down from 30% in 2012 http://canada.jdpower.com/press-releases/jd-power-2016-canadian-full-service-investor-satisfaction-study

Respected fund industry observer Dan Hallett states in **Advice gap exists now** http://www.investmentexecutive.com/-/advice-gap-exists-now?redirect=%2Fsearch :"...Most advisors segment their client roster. This results in larger accounts getting a lot more attention than smaller ones, who are lucky to get one face-to-face meeting each year. (These assumptions are based on IE's surveys.) I know of advisors with 500 or more clients. Yet, practice and relationship-management experts suggest a maximum of 75 to 125 client relationships per advisor.As a result, clients with smaller accounts get little or no ongoing advice because the economic realities force advisors to focus on giving more service to larger accounts. So, there probably is an advice gap problem for smaller accounts already. They technically are "on the books" of an advisor. And even if we assume that they receive good advice up front, economics equate to little or no ongoing interactions and follow-up...." This situation matches our experiences. The "advice gap" is a theoretical construct developed by industry participants wanting to retain embedded commissions.

It's been suggested that in an environment without trailers, some small (say less than $50,000 in investable assets) investors may not get any service whatsoever. A case in point would be the investor who invests $50,000 (per IFIC the average MFDA account in 2014 was $44,000), in an equity mutual fund. The trailer on that would be 1% or $500, of which the salesperson might get half depending on his or her arrangement with the dealer. What kind of service is a client with a $50,000 account getting for $250? We've seen many situations where the level of service has ranged from a short meeting at RRSP season, abysmal to NIL. Recognize however we are talking very basic investment guidance like mutual fund selection, asset allocation and maybe some elementary tax suggestions. It is extremely rare to see a real financial plan in small accounts.

We expect that such small investors would be forced to utilize robos, bank branches (with proprietary mutual funds as the only choice), discount brokers (DIY) or financial priorities might shift to reducing household debt or paying down the mortgage. Clients with amounts to invest as low as $10,000 can access the markets via a direct-to-client firm like MFDA licensed dealer Steadyhand that offers its own proprietary high performance mutual funds, provides basic advice and does not pay trailers. The firm also offers fee reductions based on tenure and amount invested.

As account size grows investors can move up the advice depth ladder. They might also be seduced by a dual licensed Rep to purchase a Segregated fund and obtain the conflicted "advice" associated with that "insurance" product (Seg funds will continue to pay trailers , so "advice" of sorts will still be available to small investors after trailer prohibition in securities products).

There is an advice gap now because the advice provided is based on incorrect information. One has to question the "advice" being dispensed when the client risk profiling process rests on a foundation of Jell-O. The real advice gap is that core advice processes are not functioning. Assessing risk need, tolerance and capacity is fundamental before making investment recommendations ("advice"). Yet an independent research report by PlanPlus Current **practices for risk profiling in Canada** http://www.osc.gov.on.ca/documents/en/Investors/iap_20151112_risk-profiling-report.pdf found that while risk questionnaires are widely used in the mutual fund dealer channel, the vast majority (83.3%) of these questionnaires "are not fit for purpose." The report found that these surveys have too few questions, use poorly worded or confusing questions and involve arbitrary or poorly conceived scoring methodologies. More than half (55%) of risk questionnaires have no mechanism to identify highly risk-averse clients who should be invested solely in cash. The report identifies best practices in other jurisdictions and provides recommendations for regulators, the industry and the academic community. For example, it calls for a "clear regulatory framework that includes all aspects of risk in its definition." It recommends that regulators define the components of risk that they expect advisors to review with their clients in order to establish a client's risk profile.

- *Do you agree with our definition of an advice gap?*

If the "advice gap" is defined as the group of investors who cannot obtain the amount of [**investment**] advice they desire at the price they are willing to pay we would agree realizing however that in many cases a product-based proposition is masquerading as a trusted service- based proposition. The "advice gap" is no different than the "legal gap", or the "dental gap" in that there are individuals desiring specialized services who cannot afford them. That's life in a capitalistic society. Access to affordable investment advice, while desirable, is not a fundamental citizen right at this time.

The investment "advice" clients are receiving today from dealing representatives/ salespersons (self-identified as "advisors") is based on the low suitability standard in addition to being conflicted, thereby leading to non-optimum investor returns. Based on empirical data, a fair number of clients are receiving nothing more than a sales pitch with a recommendation to purchase, sell or borrow money to invest. As we see it, the kind of advice really needed for these small retail clients actually involves many actions that would result in using disposable cash to pay down high interest debt, secure adequate life and disability insurance, pay off the mortgage, budgeting better, spending less on frivolity, and setting up an emergency fund rather than investing in high fee products. Based on our experience, "Advisors" dependent on fundco trailers are unlikely to recommend such actions or take on such high maintenance /low margin accounts if trailers are banned (fee-only advisors would recommend actions beyond investing).

As far as tax advice goes, we do not see a big need for small accounts. Such accounts are pretty basic tax-wise. Besides , it is not clear to us that MFDA Approved persons have the qualifications necessary to provide accountable advice on tax matters .Today's widely-used interactive tax software provides more than adequate guidance on how to arrange tax affairs for small investors. Should a complex tax situation arise, we expect individuals would engage a professional accountant rather than an MFDA approved person.

Financial (other than investment advice) advice regarding debt counseling, income tax support, insurance and estate planning and will preparation would still be available from traditional sources at prevailing rates. For those requiring mortgage advice, mortgage brokers and bank branch staff can satisfy the needs. These important financial advice services will not be impacted by a ban on embedded commissions. So, where is the "advice gap"?

Notwithstanding our views and those of the CSA such an important issue deserves objective evidence .We therefore recommend that the provincial and territorial regulators, in cooperation with the MFDA/IIROC, retain an independent research firm to interview a representatively large number of investment fund investors to determine what level of service, if any, they get from their advisors in return for the trailers. This would include looking at the specific services the dealers provide their clients on an ongoing basis for the service fee/ trailer commission and relate those services to the dollar value of those charges. We expect there will be some services whose value may be difficult to quantify.

• *Should we differentiate between an advice gap for face-to -face advice and an advice gap generally?*

There is no doubt that some investors do feel more comfortable with face to face meetings. A differentiation is appropriate.

• *What types of advice or services currently provided today would be most affected by the proposal?*

• *Are there any potential interactions between this proposal, existing reforms such as CRM2 and other potential reforms such as CSA CP 33-404 that may affect the size of any potential advice gap?*

The existing advice gap would be reduced if embedded commissions and CSP 33-404 were implemented.

•How could a potential advice gap, face –to -face advice gap or financial service gap be mitigated?
• Do you think that online advice could mitigate an advice gap? If so, how?
We believe online advice will be attractive to many and will help close the postulated investment advice gap. For investors with less than $100,000, robo-advisors have already made the investment situation better. While investment solutions are still basic, low-cost diversification, coupled with automatic deposit, flexible reporting, and auto rebalancing provide an excellent starter kit for the small retail investor. Robos continue to expand their capabilities. For example WealthBar, regularly communicates through its website, emails and hosts webinar sessions to help further client confidence and build trust. They also use a wide range of investment classes to help reduce volatility for investors. Wealthsimple has full-time registered portfolio managers available for clients to talk to on the phone, over email or video chat. The company is also able to use its technology to identify and respond to investor concerns. If a nervous client is constantly logging into their account on a day when markets are tanking, Wealthsimple can contact them even if they haven't reached out to the company. Basic financial and tax planning tools are not far behind. Based on this we feel confident that small retail investors will be well served if trailers are banned.

Robo-advisors are fiduciaries so the quality of investment advice will actually be enhanced. Still, some segment of small investors want face to face interaction -it is here we believe the banks are best positioned to be able to provide investment "advice" at a competitive price. Bank-owned dealers have clients that line up to come see them at the bank branch. They have access to client's banking, mortgage, car loan and credit card information so they can operate on a high volume, low margin business model where they can keep their "advisors" on base salaries and some incentives. They have standardized advice and their costs are so far embedded and inter-twined that they don't have to show any "commissions". Bank salespersons have numerous opportunities for cross-selling, giving them a strategic competitive advantage over those firms with a more constrained service offering.

Discount broker capabilities are impressive but we remain concerned that recent IIROC proposals will reduce their benefits for the DIY investor if approved. We urge the CSA to challenge IIROC as its actions could adversely impact financial market health, decrease access, decrease competition and increase the postulated advice gap by unduly constraining discount broker capabilities.
• Do you think that the significant market share of deposit -taker owned and insurer -owned dealers in fund distribution in Canada will affect the size or likelihood of an advice gap to develop?
The Consultation Paper notes, that 55% of mass-market investors are already unadvised and those who purchase investment fund products tend to do so via integrated deposit-takers or insurers. We believe that the mass market dominance of deposit-taker (bank) and insurer-owned dealers will blunt the industry-postulated advice gap.

In a July 2016 column Vanguard Canada observed that its colleagues in the U.K. reported that the advisors who weathered the commission ban best were those who proactively decided to adjust their practices to thrive and not just survive. Many shifted to a fee-based compensation structure, as Vanguard has advocated in their advisor's alpha framework. "In Our own recent global survey of advisors found this view was shared by a majority, with 76% of Canadian advisors surveyed indicating a fee-based model was better for their clients than a commission-based model. *Is this the end of the line for trailer fees?* " https://vanguardcanada.ca/advisors/articles/research-commentary/vanguard-voices/is-this-the-end-of-the-line-for-trailer.htm The key assumption here is that regulators would take steps to ensure that fee-based accounts are suitable for clients (and that clients will have a choice as to the type of account).

18. *Given some of the changes we have seen in the industry over the past few years (fee reductions, introduction of DIY series, streamlining of fund series, automatic fee reductions increasing access to fee-based options etc.), what is the likelihood that the fund industry will transition away from embedded commissions without regulatory action? In particular:*

• *Will the industry continue to transition away from embedded commissions if the CSA does not move forward with the proposal?*

Some of the elaborate campaigns opposing a ban are well funded and comprehensive, comparable to a declaration of war. Given the defiant public stance of Advocis, IFIC, and others we think it is a pipedream that the MFDA channel will voluntarily transition away from embedded commissions. The infrastructure costs of such a change in business model may be prohibitive. Dual-licensed mutual fund Reps may in fact transition clients into trailer paying Segregated funds unless the CSA is able to develop an effective counter-measure.

We see these changes disproportionally affecting small-to-medium independent mutual fund dealers relative to full service *Investment Industry Regulatory Organization of Canada* (IIROC) member dealers as they rely more heavily on embedded commissions (27% of fee revenue compared to 16%).Representatives of vertically integrated deposit-takers and insurers appear to be already largely insulated from the short-term impacts of the proposed changes.

Although we see strong evidence of fund fee reductions, we do not feel there is a good chance that embedded commissions will gradually be reduced without regulatory intervention.

19. *How accurate is Figure 8 regarding the purchase options available to fund investors by channel, account size and firm type? In particular:*

• *Do you see payment options and business models evolving at present?*

• *How are they likely to change over time if the CSA were to choose not to move forward with the proposal?*

We do not have the capability to make such projections.

20. *We note that the distribution of fee-based series is still relatively limited in Canada versus other markets. Are there obstacles (structural, operational, regulatory, investor demand, etc.) specific to Canada limiting the use of fee-based series by dealers?*

From our limited sources we have seen a huge conversion to fee-based over the last two years in the IIROC channel. We have not yet seen a similar movement to fee-based in the MFDA channel. There may be structural/ system issues in the MFDA channel -that affects about 83,000 dealing representatives.

Potential impact on competition and market structure

21. *Please describe how discontinuing embedded commissions will affect competition and market structure and whether you agree with the analysis set out in Part 4? In particular:*
• *Do you think the proposal will have an impact on the level of industry consolidation or integration? What about with respect to the concentration of mass-market investor assets held in investment products managed by deposit-taker owned firms?*
We think the dominance of banks will increase.
• *What are the likely impacts on investor outcomes and market efficiency of any potential consolidation?*
• *What opportunities and what challenges do you think the proposal would introduce for specific industry stakeholder groups?*
• *Independent dealers?*
• *Independent fund manufacturers?*
The CSA provides one clue:" *For active investment fund managers with little or no access to related party distribution, on average 59% of assets at these firms may experience redemption pressure over time assuming once again these managers were not able to adjust their fees or improve performance*." We have no basis for agreeing or disagreeing with this statistic.
• *Integrated financial service providers?*
A wonderful growth opportunity.
• *Mutual fund dealers?*
We see huge challenges for MFDA dealers.
• *IIROC dealers?*
• *Online/discount brokers?*
• *What is the likelihood and magnitude of regulatory arbitrage across similar financial products such as segregated funds and deposit-taker products?*
Very hard to estimate but given the high percentage of dual-registered MFDA Reps, it would be naive to believe that the risk of arbitrage is anything less than significant.
• *What would be the impact on dually-licensed mutual fund dealers and insurance agents?*
Some will exploit regulatory arbitrage, others may exit the business.
• *Will the proposal lead new, lower-cost entrants to the market? Why and how?*
We do not see this happening. New mutual fund entrants would have to compete with the banks/ IG, outperform Fidelity and set up a distribution system for a relatively small market that faces increased regulation. Even powerhouse Vanguard entered Canada with ETF's rather than actively-managed mutual funds.

• Does the interaction between this proposal and the proposals set out in CSA CP 33-404 change your responses to the questions above and, if so, how?
• Will a transition away from embedded commissions reduce fund series and fee complexity, as we have contemplated?
Yes but it may give rise to a new fee structure related to the components of advice e.g. a fee for a financial plan, a fee for specialized reports, a fee for an IPS ….
• Do integrated financial service providers have an advantage in terms of their ability to cross-sell and cross-subsidize across business lines? If so, how?
Integrated financial service providers have a distinct competitive advantage in terms of their ability to cross-sell and cross-subsidize across business lines because they can offer convenient one stop shopping. Multiple accounts can be checked online and money transfers between accounts are simple with integrated firms. Although tied selling is prohibited, bundled cross-business pricing is not. Industry concentration will further increase in favour of the banks and insurance company –owned dealers and fundcos. Independent fundcos would be severely challenged without a dedicated distribution network. The introduction of performance fees might be one way the independent fundco might counter .Reduced competition is clearly not a positive in favour of a prohibition on embedded commissions.
• What are the potential effects on competition of the rise in online advice? Are these effects likely to be large and positive?
Online investment advice will be a positive. Over time, we believe many low cost services will be offered. Digital advice should drive human advisors to increase productivity, examine fees and sharpen their value proposition. The rise of AI could be a real game changer for the advice industry. *See Canada's financial services sector "moving fast" on AI* - Investment Executive
http://www.investmentexecutive.com/-/canada-s-financial-services-sector-moving-fast-on-ai

22. What impact will the proposal have on back office service processes at the investment fund manager or at the fund dealer? In particular:
• Is there any specific operational or technological impact that we should take into consideration?
We cannot comment except to note that mobile solutions are being demanded by younger investors and even some seniors.
23. The payment of embedded commissions requires the dealer and the investment fund manager to implement controls and oversight (with associated compliance costs) in order to mitigate the inherent conflicts of interest today.
• Would the transition to direct pay arrangements alleviate the need for some of these controls and oversight?

We are not aware of prevailing oversight or controls between the fund manager and distributors other than commission payment terms and conditions. If there really were effective controls, discount brokers would not be selling A class funds to online investors and collecting trailers for services not provided. Kenmar suggest that fund governance may also be a factor that should be reviewed as a possible reason for the high mutual fund fees in Canada. While other leading jurisdictions have a board of directors (and independent directors), Canada did not adopt that model and instead adopted the concept of the Independent Review Committee, which Kenmar does not believe provides sufficient oversight. We do not suggest that the CSA delay in implementing the recommendations herein while examining this issue, but it should be pursued.

• *To what extent, if any, does the use of direct pay arrangements by representatives today (e.g. when a representative provides services under a fee-based arrangement) alleviate the need for some of these controls and oversight?*

Under the lowly suitability standard, nearly anything is suitable. We fully expect all the usual well identified problems related to fee-based accounts – double dipping, aggressive asset increase initiatives, reverse churning, fee rates higher than 1% for small investors, abusive or no price breakpoints, leveraging etc. Tougher enforcement would help alleviate the abuse to an extent. A Best interests advice standard would also help alleviate the need for some of these controls and oversight.

24. *Embedded commissions, especially trailing commissions, provide a steady source of revenue for dealers and their representatives. If embedded commissions were discontinued, would dealers be able to compensate for the loss of this revenue with direct pay arrangements?*

We believe they would, say, via fee-based accounts with fees at 1 % or higher. Of course fee-based accounts can be and have been, abused, so regulators would need to be alert. The Cumming study found that an increase in trailer fees corresponds to a decrease in performance. There is negative drift in fund performance when other factors, such as trailers, influence fund sales. However, the study found a different story for mutual fund sales through fee-based purchase options. In these cases, fund sales are highly influenced by past performance and this has a positive impact on future performance suggesting that the greater transparency of fee-based accounts can potentially improve investor outcomes. We use the word "potentially" because we don't know if the fees in a fee-based account will be fair and reasonable or if it will be appropriate. If they exceed 1%, investors might be worse off.

One of the alternative payment methods is the fee-based account. In theory such an account might be an improvement over embedded commissions. In practice we have seen how the industry has exploited this account type in the double dipping scandals. Of course there are many other ways such accounts are harming investors. For example, clients nudged into such accounts might pay a 1% or more fee to hold cash, GIC's, index funds or Bond funds. This would be worse than the current level of exploitation. Another example we are seeing is that seniors (low portfolio turnover accounts) are inappropriately being nudged or forced into fee-based accounts simply to generate a steady flow of fees i.e. reverse churned .See our blogs on **Fee-based accounts** http://www.canadianfundwatch.com/2014/12/alert-trouble-with-fee-based-accounts.html and **Are you a Reverse churning victim?**

http://www.canadianfundwatch.com/2015/10/are-you-reverse-churning-victim.html Regulators need specific rules to address the many threats posed by-fee-based accounts.

As for direct pay, it would depend on the fee level and the method of payment. In principle, dealers should be able to compensate for the loss of trailers by charging a 1% annual fee (typical for equity mutual funds) or more. If it were all upfront, investor resistance would be high. Our concern is that dealers could charge more than 1% which might make the situation worse for small investors.

According to a JD Power study aimed simply to help U.S. wealth companies assess the relative attrition risk they face depending on how they change their products and pricing in response to the DOL rule the findings were illuminating: Responding to a question about their willingness to switch to fees, only 8% of commission-paying investors favour the switch, and another 33% say they probably will. Forty percent are leaning toward disagreement, while 19% are adamant in refusing. Among HNW investors, 25% said they would definitely not switch from commissions to paying 1% in fees on AUM; when the suggested fee rate rises to 2%, the objectors increase to 52%. As for commission-paying validators, 35% say they probably would not switch and 26% definitely would not. This could have implications for Canadian regulators but more research is needed***.***
Commission Clients Don't Favor Switch to Fees: *J.D. Power* http://www.thinkadvisor.com/2017/03/16/commission-clients-dont-favor-switch-to-fees-jd-po Since the CSA is permitting commissions as direct pay, this should not be a huge issue in Canada. However, the up-front sales commission arrangement would need to be covered by a service/engagement agreement that requires the dealer to provide ongoing advice. Again, this advice should be under a Best interests standard not a suitability standard.

25. *Aside from commission grids and salaries, what other approaches to representative compensation might dealers use if we were to discontinue embedded commissions? How are these approaches likely to change over time?*

The Dec. 15, 2016 Canadian Securities Regulators NOTICE Review of Practices Firms Use to Compensate and Provide Incentives to their Representatives identified a host of compensation methods that are used by dealers to skew advice https://www.securities-administrators.ca/aboutcsa.aspx?id=1540 . The survey found that firms use a wide range of practices to compensate their representatives, including direct tools such as commissions, performance reviews and sales targets, as well as indirect tools such as promotions and valuation of representatives' books of business for various purposes (for example, retirement and awards). The systems are all based primarily on sales production.

We are surprised that a consultation paper on embedded commissions/conflicts-of-interest ignores an important aspect of the management expense ratio ("MER"). Fixed rate administration fees (include but are not limited to, registrar and transfer agency costs, audit fees, legal fees and custodial fees) can effectively prevent mutual fund expenses from declining as a percentage of assets as the fund grows We are of the view 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. The Fixed admin fee model also disconnects fee disclosure from actual cost incurred so subsidization (or not) can take place without detection or reporting by auditors.* 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.

See also our response to Q14.

26. *What impact will the proposal have on representatives in the industry? In particular, what impact will the proposal have on the:*

- *career path;*
- *attractiveness of the job;*
- *typical profile of individuals attracted to the career;*
- *recruitment; and*
- *relative attractiveness of careers in competing financial service business lines?*

We cannot respond to this question but can say that it is inevitable that proficiency and ethical standards must be raised and that could cause some Reps to depart the industry or retire early. Conversely, if the transition to a Best interests standard occurs, we could see many professional people attracted to the advice business.

27. How practicable are the mitigation measures discussed and how effective would these measures be at assuring:

- *access to advice for investors,*

We think the measures are adequate. As for the issue of low financial literacy potentially hindering investors' ability to assess the value of advisory services or to negotiate fair fees for such services, the CSA plan of continuing to work on investor literacy initiatives to increase investors' awareness of investing costs and empower them to confidently engage in the negotiation of fees with their representative will need to be dramatically beefed up. This would include more explicit examples of the effects of fee de-compounding, risks and benefits of working with dual licensed persons, how to assess dealer complaint responses and selected topics like reverse churning ,using videos, simulators, plain language brochures, even games. As noted previously, we do not anticipate small investors having the leverage to negotiate fees even if they possessed the requisite negotiating skills. Right now we are seeing small investors being shunned or minimum investment amounts being increased.

- *choice of payment arrangements for all investor segments, and*
- *a level playing field amongst competing investment products?*

We feel that the measures proposed will help mitigate the main effects of a trailer ban between competing investment products.

We would not expect that POS and CRM2 reforms will dramatically improve investors' awareness and understanding of fund and dealer compensation costs in the lead up to any potential rule proposal discontinuing embedded commissions. After all, Fund Facts does not delineate the actual trailer rate (only a range is provided) and annual CRM2 reporting omits about half the cost of investing (only dealer costs are included) with product costs excluded. We would not expect this quasi disclosure to sufficiently improve investor awareness and understanding that would provide a retail investor with an initial point of reference from which to gauge the appropriateness of advisory fees under direct pay arrangements.

The proclamation: "*We would expect representatives to fully inform their clients of the types of accounts available, and the differences between those accounts, both in terms of service and cost. Our expectation is that investors would have more choice in how they may pay for advisory services further to the discontinuation of embedded commissions, not less* "should be validated.

The first sentence is rather naïve given that dealers who offer fee-based do not distinguish fee rate based on service. The only distinction is level of assets. Again, dealers are free to say we offer our services for X% and if you don't want all the services, you are still paying X% if you wish to deal with us. After all, the dealer is not obligated to take on any business; no one has a right to force the business to offer its product or service on a basis that it chooses not to. This is the essence of capitalism. In fact it is happening now to clients who are moved into fee- based accounts (or asked to move their account elsewhere).

Based on history we would have zero confidence that the CCIR will take steps to neutralize regulatory arbitrage. The power of the insurance lobby is well known. The CSA plan to continue to liaise with other regulators to discuss the risk of dealers and representatives prioritizing their compensation interests over the interests of their clients by inappropriately shifting their clients' assets to other investment products with embedded fees is inadequate investor protection. We suggest that Seg funds in particular be defined as a security and that creative rules that would help mitigate arbitrage be introduced by the CSA/IIROC/MFDA.

If the definition of advice is advice on investments (as opposed to financial advice) we feel the number of available options should be adequate. This is hard to predict precisely but we feel that the risks are low that access will be denied to those truly seeking trustworthy investment advice and willing to pay a fair price. See our WHITE Paper **Small investors will not be disenfranchised by a prohibition on trailers**
https://drive.google.com/open?id=0ByxIhlsExjE3Rk05VHBpd285VFk

We remind the CSA that the "advice" provided today is conflicted, not achieving regulatory objectives and in many cases causing investor harm. The CSA Consultation Paper on Best Interests http://www.osc.gov.on.ca/en/SecuritiesLaw_csa_20160428_33-404_proposals-enhance-obligations-advisers-dealers-representatives.htm stated "***Clients are not getting outcomes that the regulatory system is designed to give them:*** *There are a number of potential causes of this concern, including opaqueness in the* *suitability assessment, existing requirements that require more clarity to assist in effective enforcement, barriers to obtaining redress for a registrant breach, and lack of effective compliance and enforcement in certain cases."* Also *"The self-regulatory and industry organization investor complaint experience shows there is consistent and ongoing non-compliance with many of the current key regulatory requirements, with the unsuitability of investment recommendations being the primary basis for complaints to OBSI for the past five years, case assessment files for IIROC for the past three years and allegations in MFDA enforcement cases for the past three years". Source:* http://www.osc.gov.on.ca/en/SecuritiesLaw_csa_20160428_33-404_proposals-enhance-obligations-advisers-dealers-representatives.htm Our comments on CP 33-404 can be found at http://www.osc.gov.on.ca/documents/en/Securities-Category3-Comments/com_20160711_33-404_kenmar.pdf and are incorporated herein by reference.

We believe financial advisors should be clear with their clients about what services are provided and we believe CRM2, which require annual disclosure of the amount of trailing commissions received, in dollars, could at least in principle ,provide the means for the retail investor to evaluate whether they are getting appropriate value for the services. Kenmar believe that with a clear delineation of services, the competitive market should then address this effectively. We base this view on our belief that there are some advisors who offer many services to their clients and many advisors who offer very little.

For clients of the latter type of advisor, they can review the annual compensation report and, if they do not believe they are getting value for service, they should switch dealers/advisors. Virtually anyone who has ever transferred an account from one dealer to another is aggravated as to why the process takes so long. We would argue that it takes so long because there are no enforced regulatory requirements around maximum timeliness and basic corporate behaviour is such that a dealer is slow to transfer out client money since that directly impacts firm revenue. **To facilitate this, the MFDA, IIROC and the CSA should consider regulations regarding account transfers including maximum transfer times as integral to this consultation**.

28. *What other measures should the CSA consider to mitigate the above unintended consequences?*
We have provided numerous recommendations throughout this document to help mitigate unintended consequences. The CSA should learn from the experiences of jurisdictions that have banned commissions.
29. *Other than the potential impacts we have identified in Part 4, what other potential unintended consequences, including operational impacts and tax consequences, may arise for fund industry stakeholders and investors further to the discontinuation of embedded commissions? In particular:*
• *Would there be a negative tax impact to investors associated with their payment of dealer compensation under direct pay arrangements? In particular, would the investor's*

payment of dealer compensation through periodic fund redemptions facilitated by the investment fund manager attract tax consequences? Please explain.
In a non-registered account, such redemption could have adverse tax consequences and create a record keeping nightmare for investors.
• *To the extent a transition to direct pay arrangements results in the rationalization of fund series, could this rationalization attract negative tax consequences for investors?*
• *What, if any, measures, regulatory or otherwise, could assist in mitigating potential operational and tax impacts?*

We are unable to provide useful input in response to this question.

30. *With respect to the loss of a form of cross-subsidy from high net worth investors to lower-wealth investors in a fund further to a transition to direct pay arrangements,*
• *to what extent (please quantify where possible) would the loss of this cross-subsidy increase the cost of providing advice and services to lower-wealth fund investors under direct pay arrangements?;*
We leave this to industry participants for response.
• *does the existence of this form of cross-subsidy suggest that high net worth fund investors may be indirectly paying fees that are not aligned with the services they are receiving (i.e. do the fees they pay exceed the actual cost of the services and advice they receive?); and*
• *what measures may mitigate the potential effects on dealers, representatives and investors from the loss of the cross-subsidy?*

Based on previously submitted industry Comment letters, cross-subsidization allows dealers to service smaller accounts .Large investors are the source of funds that permit this to occur. If actual cost was charged, the price for advice might be too high for small investors unless the dealer decided it a sound business decision to subsidize small accounts until they grew to an economic size.

[Another form of cross-subsidization can occur across fund families .In *Favoritism in Mutual Fund Families? Evidence on Strategic Cross-Fund Subsidization* by Jose-Miguel Gaspar, Massimo Massa, Pedro P. Matos https://papers.ssrn.com/sol3/papers.cfm?abstract_id=557078 the researchers investigated whether mutual fund families strategically allocate performance across their member funds favoring those more likely to generate higher fee income or future inflows. The researchers found evidence of strategic cross-fund subsidization of 'high family value' funds (i.e. high fees or high past performers) at the expense of 'low value' funds in the order of 6 to 28 basis points of extra net-of-style performance per month, depending on the criteria. This overperformance is above the one that would exist between similar funds not part of the same fund family. The authors further document how this family strategy takes place by looking at preferential allocation of IPO deals and at the amount of opposite trades among 'high' and 'low value' funds belonging to the same fund complex (a practice that can encompass 'cross-trading'). Such subsidization practices are clearly more available to integrated firms like the deposit-taking firms (banks).]

Under certain fee structures used in Canada, all investors in a particular mutual fund (or series) pay the same management fee. However, the proportion of that fee paid out as a trailing commission may differ depending on the type of sales charge paid by each investor at the initiation of their investment (higher trailing commissions are generally paid for funds (or series) sold on a front-end basis). Thus, two investors buying the same mutual fund may face different upfront charges and different proportions of the management expense fees may be paid out in commissions to their advisors. As a result, investors with lower trailing commission ratios subsidize those with higher commission ratios through the management expense fee. This diversion of resources causes affluent (HNW) clients to pay more than they should. We would be glad to see this unfair practice end as it has no place in a contemporary advice-based system.

In our view, mitigation measures could include

- The subsidization of smaller accounts by larger ones could also be addressed through firms creating a fee schedule that entails some subsidization of smaller accounts. By taking a long term view of the relationship, and a long term business plan approach, smaller investors can continue to be served profitably under a fee-based model. Firms will benefit over time as such clients grow their assets.
- Independent fundcos may need to acquire a distribution channel to mitigate the loss of the subsidy (or abandon the market).
- Transitioning product line to actively-managed ETF's. Canada already has the highest percentage of actively- managed ETFs in the G7, with this type of fund representing 13.7 % of total ETF assets, compared with just 1 % in the U.S. market, as of Dec. 31, 2015 according to data compiled by National Bank Financial https://beta.theglobeandmail.com/globe-investor/funds-and-etfs/etfs/active-etfs-finding-fertile-ground-in-canada/article28495210/?ref=http://www.theglobeandmail.com& Per CETFA, the amount would be approximately $22.7 billion vs aggregate industry AUM of $123 billion or 18% as of end of Q1, 2017.
- Superior fund performance /effective marketing to attract clients.
- Investors should be offered lower MER fund series as would be reflected in attractive fund breakpoints and household rate packages.
- Investors could be offered loyalty discounts based on the number of years invested with the fund family
- Confident portfolio managers might be willing to implement performance fees as a means to increase revenue to offset the loss of the cross-subsidy provided to smaller investors.
- MFDA dealers could start selling ETF's in order to broaden their market coverage.

A positive by-product of a prohibition would be that the value (or not) of active management of a fund could be compared to a benchmark without the constant need to account for the embedded commission.
31. What measures could fund industry participants proactively take to mitigate the unintended consequences that may stem from the discontinuation of embedded commissions?

We have no comment except to note that a different corporate culture is required from the leadership. They should be taking steps now to address the known consequences of a changing consumer base, fintech and regulatory environment.
32. *For each transition option, please tell us how your business (investment fund manager or dealer) would have to operationally change or restructure in terms of systems and processes and the related cost implications. Where possible, please provide data on the estimated costs.*

We have no comment except to make the observation that it is the primary obligation of regulators to protect investors, not encapsulate costly and abusive business models.
• Are there unique costs or challenges to specific businesses?
• What transition period would be appropriate?
• Should existing redemption schedules for DSC and low-load purchase options be maintained until the redemption schedule is completed, or discontinued at the Transition Date?

We believe they are part of a "deal' and so should be allowed to play out. It would be a constructive gesture if the industry voluntarily waived some early redemption penalties say for hardship cases or when evidence of mis-selling becomes apparent.
NOTE: On page 47 of the consultation we're told "Fund investors with little to invest are the most likely to be offered DSC purchase options and some firms primarily offer their clients DSC options. Also "The dealer will typically choose which purchase options to make available and if multiple options are made available, the representative will choose which of these options are presented to the client depending on their needs and the representative's revenue requirements." **It seems to us such undifferentiated "advice" is likely mis-selling, calling out for regulatory enforcement.**

33. *Which transition option would you prefer? Why? Are there alternative transition options that we should consider?*

As investor advocates we prefer the transition with the shortest cycle time. The CSA say they understand that it will be imperative to provide sufficient time to all affected parties to ensure a successful transition. The CSA believe that a Transition Date of 36 months after the Effective Date could provide sufficient time to complete all required transition steps. If that happens, it will be 2021, 26 years after the first of the Stromberg reports on investor protection! Kenmar appreciate the disruption that a ban on embedded commissions will have but expect that at least some progressive industry participants will move faster and be rewarded by increased sales.

34. *As discussed in Appendix B, the CSA did not retain the option of capping embedded commissions, either as a stand-alone solution to the key issues discussed in Part 2 or as an interim step toward an eventual discontinuation of embedded commissions. Should the CSA further consider using a fee cap as a transition measure? Why?*

The industry argument is that capping commissions eliminates one of the main conflicts in the Cumming report - increased trails resulted in increased sales to that fund company with less correlation to performance. The other big conflict was that the sale of proprietary products bears no relationship to performance of those products - but the paper does not deal with that in any way - in fact it sends the modest investor to the banks. Several fundcos posit that a fee cap allows the small investor to purchase the fund at a stated price without having to explicitly pay for the "advice "- advice they may perceive that they can't afford. The affordability of course comes about by subsidizing the real costs by overcharging larger fund investors. Per the CSA, Investment fund managers could facilitate investors direct payment of dealer compensation through payments taken from the investor's investment (for example deductions from purchase amount or periodic redemptions from the investors account).

In Jan.2016, Credential Credit Union announced a fee -based payment system for mutual fund investors. According to the News Release "The OnPoint Fee-Based Account solution is best suited to investors with a minimum of $100,000 to invest who are seeking to build a strong relationship with an advisor who can provide personalized advice and long-term investment solutions. " http://www.credential.com/about-us/news/press-releases/2016/01/26/credential-financial-introduces-mfda-fee-based-account-for-credit-union-members We expect such a payment system will be expanded with lower minimum thresh-holds.

We argue that the idea of small investors negotiating fees is wishful thinking. The CSA want to prompt an explicit negotiation, but we don't think most small retail investors are equipped to negotiate because a lack of negotiating leverage, poor negotiating skills or information asymmetry. However, as investable assets increase, lower rates should apply in a competitive market.

Capping fees would not eliminate the potential for conflict created by the fund manager paying the client’s agent, but it would, according to industry participants, address the financial incentive to behave badly and, in their view, largely reduce the harm created by the conflict. It is also asserted that trailers are fairly consistent within classes, so in a sense this would regularize what is already happening in practice and would eliminate the outliers in the MFDA channel. An embedded commission rate cap is of minimal value in the IIROC channel because of the large number of competing non-fund securities and SMA’s available to such dealers/Reps.

The CSA’s main objection seems to be that capping commissions wouldn’t eliminate embedded commissions/ conflicts. But using a fee- based account also doesn't eliminate all conflicts either so there is little or no net gain by banning trailers unless a statutory Best interest advice standard is adopted.

On the other hand, investor advocates argue that maintaining trailers (even at a 1% cap) does absolutely nothing to get advisors to look at product merit as the primary determinant of what they recommend to clients. Industry participants seem to think that the only options advisors have for clients are actively-managed mutual funds .As a general rule, ETFs (and Index funds) outperform active MFs over the long term, but by "advisor" recommendation, far more money goes to MFs… simply because of the bias-inducing trailers that they pay. See **Why Indexing Works** by J.B. Heaton, Nick Polson, Jan Hendrik Witte: SSRN
https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2673262

On balance, we thought the CSA arguments against a fee cap were reasonably sound so cannot think of a reason to reconsider If the CSA vision is to isolate the costs of advice, the connection between fund manufacturers and dealers/advisors must be severed but in a way that will not harm investors.
35. Please explain whether you think each of the initiatives discussed above will, either alone or in combination:
• *address the three investor protection and market efficiency issues and their sub-issues identified in Part 2; and*
• *address or not address any additional harms or issues that you have identified.*

As we have explained, the prohibition of embedded commissions is complementary to the other CSA initiatives -- targeted reforms and regulatory Best interests. If these other reforms are not implemented, we believe the investor protection gains will be marginal and could significantly increase the market share of bank-owned dealers with proprietary products, which we regard as negative. If the other initiatives are introduced, then we believe the identified issues will be addressed.

When embedded trailers are banned, fund dealers will likely respond by going fee-based like the investment dealers, consolidate or disappear as control of remuneration passes from the fund companies to the dealer's hands.

What the Cumming's report does not emphasize was that dealer compensation on mutual funds is largely uniform (A 2015 report by Investor Economics found that 86 % of equity and balanced funds sold in Canada paid trailer commissions of 1 % for front-end and no load options. An additional 9 % of the funds paid fees above 1%). At dealers, fee schedules may be opaquely disclosed and may be complicated for retail investors to compare. Regulators will not be able to regulate dealer/advisor fee schedules. The CSA assumption seems to be that a competitive market will prevail. Perhaps it will. Will small retail investors really be able to negotiate fees? We doubt it, so they will be nudged into robos, bank branches, DIY investing or simple index investing like that offered by Tangerine. Not necessarily bad outcomes while they wait until their account size grows to the point where more fulsome advice can be obtained.

36. Are there alternative options or measures, whether regulatory or market-led, that could successfully address the three investor protection and market efficiency issues and their sub-issues identified in Part 2. If so, please explain.

The principle of separating advice from transactions is so fundamental that any other identified option is not consistent with that goal. That being said, we would listen to industry proposals.

Summation

In aggregate, the CSA estimate that 44% of actively-managed fund assets may experience redemption and reallocation pressure to competitor investment fund managers over time if embedded commissions were discontinued and these managers were unwilling or unable to adjust their fees or improve performance .For active investment fund managers with little or no access to related party distribution , on average 59% of assets at these firms may experience redemption pressure over time assuming once again these managers were not able to adjust their fees or improve performance. Assuming the CSA analysis is accurate, what does this say about the prevailing Canadian mutual fund industry and its distribution network.

Freeing the "advisor" from trailer commission constraints could be a potential Win-Win for retail investors and those who advise them. Of course there is still the risk of unsuitable investment recommendations, undue leveraging, churning, personal financial dealing, inappropriate pension commutation under foggy suitability criteria and even risky/ fraudulent Off - book transactions. Robust compliance and regulatory enforcement is key to protecting retail investors.

While we accept as fact that trailer commissions skew “advisor” recommendations and reduce fund performance, Kenmar believe many other factors are at play .We support a discontinuance of embedded commissions as a complement to the CP 33-404 regulatory reforms. [See APPENDIX I for a Summary for possible failure mechanisms related to a discontinuance of embedded commissions. See APPENDIX II for a listing of issues related to the prohibition of trailers/embedded commissions. See APPENDIX III for Referenced Documents used in the preparation of this submission.]

We hope this Comment letter proves useful to the CSA in its policy setting deliberations.

Trusted advice is a Canadian socio- economic issue well beyond the bounds of securities regulation. We had better be careful we don't squander this opportunity to protect trusting financial consumers.There will be a huge social and economic cost if we do.

We thank the CSA for the opportunity to provide these comments. We would be happy to address any questions you may have or to meet with you to discuss these and related issues in greater detail. We appreciate the time you are taking to consider our points of view. Do not hesitate to contact us if there are any questions regarding our Comment letter.

Kenmar Associates
The Voice of the retail Investor

Permission is granted for public posting.

Sincerely,

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APPENDIX I: Possible Failure mechanisms resulting from prohibition of trailers

We focus on three of the CSA's main concerns about conflicts of interest: that embedded commissions raise conflicts of interest that misalign the interests of investment fund managers, dealers and representatives with those of investors; that they limit investor awareness, understanding, and control of dealer compensation costs; and that "[e]embedded commissions paid generally do not align with the services provided to investors."

Sounds pretty enticing. Our intuition was always to support prohibition. Yet as fact-based commenters we explored various scenarios to see if banning embedded commissions alone will deal with the stated concerns AND not give rise to unintended failure mechanisms.

Based on our analysis the following failure mechanisms will exist:

1. Dual licensed reps will flog Seg funds and other "investment" products not under the domain of the CSA. The life insurance industry which regulates Seg funds is lightly regulated compared to the CSA regime and Seg fund fees are higher than mutual funds. If not addressed, such regulatory arbitrage could cause harm to retail investors.

2. Integrated firms like the banks will continue to offer only proprietary products. Investors at bank branches will thus be receiving "advice" that is not only conflicted but sub- optimal. This is consistent with the findings of the Cumming report. Even that report did not consider that banks , just like insurers , also have " investment " products like PPN's and Index linked GIC's that could substitute for mutual funds . Such products are not considered to be low- cost products and contain provisions that limit the upside potential of the investment. The CSA has no mandate to regulate the sale of such products so mis-selling could increase.

3. Independent fundcos without a dedicated distribution channel could be disadvantaged by prohibition relative to the integrated firms with an internal distribution network. The end result could be reduced competition for the banks. It could be argued that the increased bank market share will ultimately work to the detriment of the retail investor.

4. Trailing commissions from the fund manufacturers will be replaced by dealer fees (incentives, inducements and non-financial rewards). These fees could very well be higher than the traditional 1% trailer on mutfunds. The Dec 15, 2016 CSA/IIROC/MFDA announcements listed a host of conflicts-of-interest that made our eyes glaze over. This revelation actually is an admission of massive regulatory failure *re enforcement of the basic requirement for registrants to act fairly, honestly and in good faith*.

If embedded commissions are banned they will simply be replaced by these advice-skewing incentives unless they are specifically banned and the rules (a new, more comprehensive version of NI81-105) vigorously enforced. Sales targets cannot co-exist with trust-based advisory relationships...they override the equations that frame the integrity of the deliverable service- trustworthy advice.

We urge the CSA act promptly to address these investor abusing conflicts-of-interest.

5. Conversion of clients to fee- based accounts is in motion now by IIROC dealers. The fees will apply to cash, bonds, bond funds, GIC's, mutual funds etc. so that it is quite possible, even likely, that overall client investing costs will rise. Such fees would not be regulated and could exceed the nominal fund industry standard of 1% for actively-managed equity funds. This could be compensated for if dealing Reps select lower cost products, but will they in the absence of a Best interests standard?

6. Reverse churning could occur (is currently occurring) that could see Buy and hold investors unduly paying more in fees. Regulatory enforcement will be even more critical as many more Canadians, especially seniors, will hold fee-based accounts. Will regulators step up to the plate?

7. The continuance of referral fees could subtract from any potential prohibition gains. Similarly, the continued use of cooperative marketing (using fund assets) could undermine the ban by continuing to allow fundcos to influence dealers. A recent OSC settlement with Sentry Securities Inc. followed a multi-year investigation into sales practices at the Toronto-based independent mutual fund company. OSC commissioner Philip Anisman, who approved the settlement, said this was the first proceeding by the OSC that addressed "prohibited payments and gifts" made by an investment fund manager and the "systemic supervisory failures" that permitted them.(the rule regarding prohibited payments came into effect in 1998 so enforcement has been rather shallow over the past 18+ years). Investment fund managers ("IFMs") are prohibited from making a payment of money or providing a non-monetary benefit to a dealing representative ("DR") in connection with the distribution of securities, except in certain permitted circumstances under Parts 3 and 5 of National Instrument 81-105 Mutual Fund Sales Practices ("NI 81-105"). All payments made to Reps from fundcos should be prohibited as they just add to problems with no benefit for clients.
http://www.osc.gov.on.ca/en/Proceedings_enr_20170405_sentry.htm

8. Small investors who desire human facing advice may be confined to bank branches (and proprietary products/funds) assuming banks develop a new fee structure. The reason the system hobbles along now is that larger investors are subsidizing smaller investors. The result is that dealers use the subsidy to deal with smaller investors. Of course it has been proven by research that the "advice" provided under the trailer regime results in conflicts- of- interest that harm investors. In some cases the "advice" can be doubly dangerous because of churning and leveraging. Regulators and investor advocates have questioned the level of advice relative to fees paid, the quality of advice provided or even if advice is provided at all. Whether small investors receive much trusted support other than fund selection. / asset allocation recommendations is an open question. More information is needed on exactly what "advice" dealing reps provide to small accounts.

9. Smaller clients may be unable or unwilling to pay directly for conflicted advice. Some may decide to become do- it- yourself investors or use robo -advisors or invest with reputable direct to client fund companies that offer guidance but not recommendations. The decision not to engage an advisor could be based on unaffordability, anger at being told in the past that advice was free or simply not feeling the advice is worth the cost. According to industry lobbyist IFIC, just 37% of mutual fund investors seek direct payment for advice. Kenmar believe a combination of convenience/simplicity, complacency, detachment, a lack of understanding of the impact of conflict-of-interest on recommendations and unbridled trust in their advisor contribute to this attitude.

10. Industry participants argue that even small accounts need personalized investment advice while some investor advocates argue that such small investors could buy a low-cost balanced fund or ETF or just pay down debt or their mortgage. Will these postulated small account advice orphans materially suffer as a result of prohibition? We believe not but it is still a risk that should be assessed.

11. Account and product cost are not currently explicit components of a "suitability" assessment. Given that fees reduce returns to investors, and numerous studies have demonstrated the negative relationship between fees and returns. Fees are an important consideration in evaluating the suitability of otherwise-similar investment funds or other investments. Cost was an element of the targeted reforms but it is far from clear that the CSA will make cost an explicit component of suitability. If it does not, investor protection will remain compromised.

12. Since the consultation is non-committal on the future of Best interests and the targeted reforms, the prevailing low suitability standard will continue, leaving a gaping hole for bad advice to continue to be dispensed with near impunity.

13. Continued lax enforcement, wrist slap penalties and a focus on individuals rather than root causes (like supervision, compliance and compensation practices) could undermine the prohibition initiative. Unless regulators apply timely and effective deterrence, rules are meaningless. The recent scandals involving double dipping

occurring over a decade is an example of massive dealer compliance and regulatory failures. Another example would be the lack of NI81-105 enforcement. Yet another would be discount brokers improperly collecting advisory fees.

An objective assessment of the cumulative impact of these failure mechanisms leads to the conclusion that the anticipated benefits of embedded commission prohibition will be less than hoped for. In the worst case, it could make the situation even worse for retail investors.

APPENDIX II: Related Issues not covered by the Questions

There are other issues we wish to draw the CSA’s attention to. These include but are not limited to:

A. After embedded fees are banned, will investor's pay for investment advice?
Given the scope, nature and quality of the “advice” actually being provided, the question is -will retail investors of modest means be willing to pay for such advice when the true dealer costs are made visible via CRM2 and other means and embedded commissions banned ?

There is a range of possibilities why they would continue to pay for personalized investment advice even under the suitability standard:

- They are happy with the results obtained
- They are too busy to spend time on investing matters
- They lack confidence in their own investing abilities
- They do not have access to friends or family that are willing and able to assist them
- They feel their representative adds net value after fees
- They trust their representative even though they may not trust the financial services industry generally
- They appreciate and value advice beyond investing such as on tax matters , better saving habits , comfort during market extremes
- They are not aware of the inherent conflicts of interest and/ or how that may adversely be impacting their portfolio performance
- They believe conflicted advice is better than no advice
- They are unable to determine if the fees/ costs are unreasonable/ competitive
- They underestimate the de-compounding effect of fees on long term returns and hence are fee -insensitive

It is also quite possible they would not pay for personalized investment advice once the masking effects of embedded sales commissions are banned:

- They will discover that mutual funds are a very expensive product that does not provide superior returns over longer timelines

- They will decide the fees are too expensive or they can't afford to pay
- On tax matters. they will leverage their tax preparer (or software)
- On insurance matters, they will use an insurance broker
- They will , on principle, refuse to pay because they had previously been told advice is free
- They will discover the de-compounding impact of fees on long term performance
- They will self-educate via courses , books, investment newsletters
- They will conclude they don't need or want personalized advice
- They will be upset that they have been exploited and/or may hear about well-publicized cases of investor abuse by dealers/advisors (like the double dipping cases)
- They will conclude that they should divert cash towards paying down high interest debt instead of paying fees for investing advice
- They will discover that DIY isn't as intimidating as they thought
- They will discover other lower cost options such robo- investing, debt counsellors, investment clubs or financial coaches
- They will revert to being GIC investors and buy GIC's , Govt. Bonds , PPN's and Index linked GIC's or even Segregated funds
- They will invest in some creative version of a Life Cycle Fund

In the United Kingdom, studies seeking to understand financial consumers' decision-making behaviour conclude that they are most reluctant to pay upfront for advice [June 2006; Andrew Clare, "The Guidance Gap" (Cass Business School, January 2013) http://www.cassknowledge.com/sites/default/files/article-attachments/the-guidance-gap.pdf]

A 2010 study involving retail investors from eight European countries found that between 20 to 30 per cent of respondents were unwilling to pay upfront for advice *Consumer Decision-Making in Retail Investment Services: A Behavioural Economics Perspective* http://ec.europa.eu/consumers/financial_services/reference_studies_documents/docs/consumer_decision-making_in_retail_investment_services_-_final_report_en.pdf .
Like Canada, it is quite possible they did not realize they were always paying for "advice" via hidden fees.

In 2013, the **CFA Institute & Edelman Investor Trust Study** polled investors across the US, UK, Hong Kong, Canada and Australia. The study was based on the feedback received by 1,604 retail and 500 institutional investors. When asked what was most important when making a decision to hire an investment manager, investors ranked "trusted to act in my best interest" as most important (35%). Another 17% stated that commitment to ethical conduct mattered most to them. If you combine these two factors of trust and ethics, you will see that it is the most important thing to more than half of the respondents. The ability to achieve high returns was most important to just 17%, while, surprisingly, the least rated was the amount/structure of fees (7%). http://www.morningstar.in/posts/28966/are-investors-willing-to-pay-for-financial-advice.aspx This suggests to us that while some investors might be unwilling to pay for conflicted advice they would certainly be open to paying for professional advice they could trust.

Even amid today's strong markets, investors are happy to pay for expert advice on their investments. Those were the findings from a recent study performed between January and September 2016 by Cerulli Associates, a Boston-based research and consulting firm. Half of the approximately 5,500 participants agreed with the statement, "I am willing to pay for advice regarding my financial investments." Fully, 79 percent of households aged 30 to 39 either agreed or strongly agreed with the statement, "I am willing to pay for advice." Additionally, 73 percent of households under age 30 felt the same way. While this study applies to U.S. investors, we can find no reasons not to expect similar results in Canada.

Research by behavioural economist Dan Ariely on the "pain of paying" suggests that certain methods of payment will be more successful than others in getting the retail investor to pay directly for advice. Pain is never a good motivator to encourage consumption of a desired product or service. See *The Pain of Paying* http://danariely.com/2013/02/05/the-pain-of-paying/ and also *What is the Pain of Paying?* https://www.ezonomics.com/whatis/the_pain_of_paying/ There could be initial resistance to paying for advice especially since it was previously understood to be free.

Industry lobbyist IFIC sponsored Pollara research found that just over half (54%) would prefer to compensate their advisor through tied-advice (bundled) fees, while 37% would prefer to pay a direct fee. https://www.ific.ca/wp-content/uploads/2016/09/IFIC-Pollara-Investor-Survey-September-2016.pdf/15057/ It is quite possible that when these mutual fund investors become aware of the true cost ,nature , robustness (or not) of the advice provided, the numbers would change significantly. It remains to be seen if CRM2 reporting will have a significant change in investor decision making.

We would expect a certain segment of Canadian investors, also might resist paying upfront fees for financial advice because they do not understand what working with a financial advisor entails and they are unable to discern the benefits, which can be intangible, delayed in time and with an uncertain outcome. They may however be willing to pay for advice if it can be demonstrated that (a) total costs will be equal or lower than prior costs (b) that billing could be spread over a year as was the case with embedded commissions and (c) the integrity of the advice can be relied upon.

The CSA will need to invest in a comprehensive public information campaign to explain the changes in order to stimulate consideration of direct pay advice (or not). Associated Govt. policy alternatives may include optional CPP, a free basic Govt. advice service (as in the UK), a tax deduction for advice fees and investor education courses/books.

B .DIY investor abuse by discount brokers

Discount brokers shouldn't be collecting trailer commissions intended to provide advice.If we examine tables 13 and 15 of the CSA consultation document we find that only $12 Billion of the $30 billion in mutual funds are D class which means that $18 billion is invested in trailer commission paying funds. Since discount brokers cannot and do not provide investment advice, clients are being robbed of returns. Clients are not being treated fairly, honestly and in good faith as required by securities laws. We've been asking Regulators for years to enforce the law; we're still waiting for an answer. At 1% trailing commission that amounts to $180,000,000 each year that isn't going towards the nest eggs of Canadians! **The IIROC/CSA should take immediate steps to eliminate this massive violation of the requirement to deal fairly, honestly and in good faith with clients and the IIROC's claim that its rules equate to a Best interests standard.** There is no need to wait for a decision on embedded commissions.

[The consultation paper discusses this issue in a roundabout way and, to our surprise, seems to say that regulators may not have ability to tell discount brokers firms to stop collecting trailer commissions. (see Appendix B iii Require a standard class for DIY investors with no or reduced trailing commission). It says the CSA understand that "any nominal trailing commission paid would cover the costs of administrative, compliance and technological services provided by the dealer or manufacturer"." It may not be feasible or possible for the CSA to compel investment fund managers to create a new "execution only" series and/or compel dealers to distribute this type of series".] That is not the real issue. We are not talking about such a series (D?) **– we are asking that IIROC enforce the law (and it's own rules) requiring its members including discount brokers to act fairly, honestly and in good faith with clients and to provide the advice said to be provided per the Fund Facts disclosure given to clients in advance of purchase. We are also asking the CSA to examine fund governance – why is the fund making payments from investor assets to dealers to provide advice services they know will definitely not be provided?**

C. A defective KYC leads to inappropriate advice to investors
The Small Investor Protection Association www.sipa.ca has issued a Report *The Know Your Client Process Needs an Overhaul* http://sipa.ca/library/SIPAsubmissions/500%20SIPA%20REPORT%20-%20KYC%20Process%20Needs%20Overhaul%20-%20201607.pdf which provides constructive suggestions for improvement. We strongly encourage the CSA to review this report and unpublished IIROC research and take the necessary corrective actions.The discretion, the complexity of the processes and the asymmetry of knowledge and experience place the dealing representative and the firm in a position of great responsibility and the elderly investor in a vulnerable position. KYC information should formally be updated at least once per year. Unless the core KYC process is improved, merely changing the method of payment will not in itself lead to improved investor protection or better investor outcomes. The basic foundations for robust advice giving must be in place.

We further remind the CSA of the OSC Investor Advisory Panel sponsored award-winning paper on risk profiling by PlanPlus. The paper https://www.osc.gov.on.ca/documents/en/Investors/iap_20151112_risk-profiling-report.pdf The IAP's research found that most (83%) risk-profiling questionnaires are not "fit for purpose" and that many of these tools use arbitrary weightings, have poorly worded questions and aren't capable of identifying risk-averse investors. Despite these flaws, these tools are widely used in the investment industry. Almost half of the firms reported that risk questionnaires were developed in-house and another 36% said that advisors could choose their own risk profiling methodology. Only 11% of firms could confirm that their questionnaires were 'validated' in some way. What this means is that the "advice" being provided today is based on a very shaky foundation .So again, simply banning trailers will not lead to better advice. Key supporting advisory processes must be repaired or overhauled in parallel.

D. Make dealers accountable for the actions of their representatives
It's well known that regulators collect only a tiny fraction of the fines imposed on dealer Reps. whom they hold responsible for investor abuse. We therefore argue that the deterrence value is NIL. We further argue that the advisory contract is with the dealer NOT the individual Rep. Imagine if aircraft manufacturer Boeing practiced this way. An aircraft maintenance technician would be held responsible by the FAA- Boeing would be off the hook even if the plane went down. Our view is that the dealer recruits "advisors", trains them, incents them to meet sales quotas, provides the systems, policies and practices under which they operate and supervises them plus assigns a compliance officer to quality control the whole process.

The dealer gains from the active selling but when the person at the bottom of the food chain gets caught, the firm walks away. This is an attack on natural justice that ends up leaving trusting clients on their own. Dealers like it this way because they are immunized from wrongdoing and Reps like it because they know IIROC/MFDA can't collect the fines. The only loser is Main Street. Note that OBSI, with rare exceptions, rightly holds the dealer accountable for wrongdoing by "advisors" .The dealers" Trust us" marketing materials hold out the promise of integrity and fairness. It is the dealer who makes declarative statements and places marketing ads re trustworthiness and it is the dealer that should be held accountable for the actions of its representatives. In the vast majority of cases the root cause of problems lies with management and the sales culture it has created. **We therefore recommend that regulators adopt the default position that the root cause of rule breaches attribute to the dealer and that any fines levied should be to the account of the dealer.**

E. **The time for the Deferred sales charge option has past**
Kenmar have not found a good reason for investors to be sold funds on the basis of the DSC option (*The DSC sold Mutual Fund under the Microscope* http://www.canadianfundwatch.com/2015/09/the-dsc-sold-mutual-fund-under.html) . Retail investors hate to pay the DSC early redemption fee .So, rather than creating investing discipline, it keeps investors glued to their advisors with no consideration for the level of service provided.
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The CSA says that dealers promote the use of a particular purchase option, such as the deferred sales charge (DSC) option, that pays higher upfront embedded commissions, regardless of the availability of other purchase options that may better suit the investor's needs and objectives. When being sold fund investments under the DSC option (aka "back end load" option), the investor does not directly pay a sales commission to their dealer or representative at the time of purchase .While the upfront fee paid to the dealer will show up in CRM2 cost reporting, any subsequent early redemption penalties incurred by the investor will not.

We're told that data from Investor Economics, as at December 2015, 20% of Canadian fund assets totaling $234 billion were held in the DSC option. It is also typical for trailing commission rates to double at the expiration of a DSC redemption schedule (5 to 7 years) - a trailing commission rate of 0.50% for an investment held in an equity fund under the DSC option may increase to 1.00% at the expiration of the redemption schedule. Surely, the amount of "advice" needed (or supplied) does not double simply by this administrative change. The Canadian fund market is unique in its relative reliance on DSC and low load options. While making up 20% of mutual fund assets in Canada today, these options make up less than 1% of mutual fund assets in the United States and Europe which suggests to us some form of mis-selling is taking place.

In fact a MFDA compliance review completed in Dec. 2015 uncovered instances of the inappropriate use of the DSC option including clients over age 70 that were sold funds under DSC arrangements; clients who were sold funds with DSC redemption schedules that are longer than their investment time horizon; and evidence of poor disclosure of the redemption fees at certain firms and poor suitability assessment and supervision of sales under the DSC option. In a Dec. 15, 2016 MFDA Review of Compensation, Incentives and Conflicts of Interests, the MFDA identified compensation and incentive practices that increased the risk of mis-selling funds under the DSC option. It provided a couple of examples: One firm paid some representatives as little as 10% of trailer commission on client accounts. But new sales commissions on DSC funds were paid out to the rep at rates between 40% and 75%. Another example was of a firm that paid 10% commission bonuses on sales in excess of $500,000 on DSC or low-load funds, and additional production bonuses for each $1 million of sales of DSC or low-load funds.

The DSC option makes no sense to us especially in a period of near zero front-end load (FEL). The CSA notes that although DSC options have been falling in terms of market share, assets in these series continue to grow. In total, $241 billion was held in DSC options at the end of 2015, and these options grew 19% over the last five years (largely due to the growth of low load fund series assets which grew 101% over the last five years versus 3% for traditional back-end load series). While making up 20% of mutual fund assets in Canada today, these options make up less than 1% of mutual fund assets in the United States and Europe- the question is why? Based on our experience fund investors with nominal amounts to invest are the most likely to be offered DSC purchase thus disadvantaging them along several dimensions. We note that Investors Group will be abandoning the DSC option which Morningstar estimates will impact 25% of total assets held in the DSC option. At the end of March, Dynamic Funds announced that as of

June 30, 2017 the DSC purchase option will be closed to new investments. It looks like the DSC is self-extinguishing- a positive sign.

The CSA further note that "Further analysis of MFDA enforcement files show that the DSC option can attract dealers/representatives promoting unsuitable leverage strategies on their clients or churning the client accounts .Recommendations that clients borrow to invest in funds on a DSC basis enable the dealer and their representative to increase the total compensation they can earn from the investment. Specifically, they may receive a referral fee from the financial institution in connection with their client's loan in addition to the 5% upfront commission (plus the ongoing trailing commission) they may receive from the investment fund manager on the purchase transaction." **We urge the CSA to (a) prohibit referral fees and (b) constrain fees on leveraged money as ASIC has done i.e. account fees only on net assets.**

In our interaction with complainants we see some salespersons recommend drawing out the 10 per cent "free" funds from a particular fund. This is a potentially positive thing, in that it reduces the potential DSC fees for the client. If the advisor moves those units of the fund to the same fund but a different class (for example, XYZ Canadian Equity fund DSC switched to XYZ Canadian Equity front-end load with no commission), that is a good thing for the client. But when the fund salesperson regularly moves those 10% "free" funds into a new fund or fund company on a DSC basis, they are simply getting another 5% upfront payment and extending the time the client is trapped in their investment. This abusive practice is not being flagged by compliance. We recommend that the SRO's immediately put dealers on notice that this practice must cease.

Another tactic we have seen is that the mutual fund salesperson coincidentally decides it is time for a change in direction. They sell the fund and put the client into a new DSC fund, starting the redemption clock all over again for the investor, and receiving a new 5 per cent upfront payment from the mutual fund company. **We recommend that the SRO's immediately put dealers on notice that this practice must cease.**

DSC in RRIF's can be a killer for seniors because of minimum annual withdrawal requirement [early redemption penalties run into the tens of millions of dollars annually].Based on our experience, lucrative trailers are the motivation for the sale of DSC funds in RRIF's and RRSP's. Note that DSC penalties cannot be offset against capital gains in registered accounts. Such irrecoverable penalties impair account returns for retirees and pensioners. **We recommend that the CSA should act immediately to phase out the DSC option regardless of any decision on embedded commissions.** [the CSA expect a decline of 15-25 bps based on the pricing practices of investment funds that separate these purchase options into unique series (as DSC purchase options typically tend to be more costly to administer than front-end or no load options].

Issues also arise when there is a fundamental change in the nature of the fund. If DSC survives, we recommend that requirements be developed to provide unitholders with an opportunity to redeem securities without penalty in the case of fundamental changes to a fund.

Mutual fund sellers claim that these fees are supposed to encourage people to "buy and hold" for a longer time. However, if somebody is not getting the level of return they expect (or the quality of service they desire), this just traps people to stay with the same fund company. Investors might be interested in "buying and holding" but with a different fund; the DSC fee effectively prevents this. **Notwithstanding any changes to embedded commissions, we urge the CSA to declare that DSC sold funds are harming investors and should be wound down**. They do not meet the requirement of dealing, fairly, honestly and in good faith with clients.

F. Fair complaint handling is essential

Fair complaint handling is particularly important for all investors, particularly seniors. In our view, investment complaint handling in Canada is exploitive. Too many valid complaints are rejected by the mere issuance of a form letter claiming the dealer is not at fault. The very public attack on the Ombudsman for Banking Services and Investments (OBSI) is symptomatic of adversarial behaviour by the financial services industry. Regulators need to meaningfully enforce the requirement that complaints be handled fairly and in a timely manner. Regulatory rules need to include requirements for detecting and promptly dealing with systemic issues. What is ultimately necessary is a clear path to financial restitution which doesn't exist now except through the difficult and expensive civil litigation process See *IIROC complaint handling rule needs an update* http://www.canadianfundwatch.com/2016/01/iiroc-complaint-handling-rule-needs.html The ineffective IIROC complaint handling rule needs an overhaul without undue delay.

OBSI only provides a *recommendation* for restitution. Due to industry intransigence, OBSI has been forced to issue "Name & Shame" News Releases which appear to have had little effect on an apparently shameless dealers.] Conclusion? OBSI recommendations should be binding on dealers. See the Independent Reviewer's complete set of recommendations at https://www.obsi.ca/en/download/fm/539/filename/2016-Independent-Evaluation-Investment-Mandate-1465218315-e9fa5.pdf The OBSI Board has already recommended that OBSI be granted binding recommendation authority. Each day that passes without such authority exposes Canadians, especially vulnerable investors, to exploitation via unjust compensation denials and low ball settlements. **The CSA must grant OBSI binding recommendation authority and agree with the strategic purpose of OBSI without further delay.**

G. IIROC OEO guidance may curtail Consumer Choice

One of the issues that will arise if mutual fund trailers are prohibited is what choices will be available to the retail investor. Clearly, direct to client firms like Steadyhand noted for being investor-friendly and which have never paid trailers, might see an uptick in business as would robo-advisors. Another viable channel might be online brokers , disparagingly referred to by IIROC as Order Execution Only dealers .IIROC are currently contemplating reining in the scope of activities permitted by what we refer to as ebrokers. They intend to redefine the meaning of *recommendation* and *advice* and thereby limit the tools and services available to the DIY investor, a category that could swell after investors confront CRM2 reports for the first time.

If IIROC institute a much more nuanced interpretation of recommendation it will reverberate back through the rules and will impact compliance at the broker level. We think this is a bigger deal than most people are making out. As the consultation is depicted as Guidance, the CSA may not need to approve the IIROC anti-competitive initiative.

Allowing Canadians to control their own financial destiny is a stated Government objective and DIY investing fits that bill very well for basic needs. It seems to us that the CSA should examine the proposed IIROC Guidance in light of all the regulatory initiatives underway, particularly this one. Clearly there is a need for services that help investor structure portfolios and it may well be that use of these services would fall under higher accountability standards. But there is nothing stopping the implementation component, the core discount brokerage, from remaining as is and separate. We see no reason for adding regulation to the transaction engine at all.

And what of course is the value and cost of allocation components and how can we get the investor to accept the risks and returns of those components. Additionally, if the discount side does develop more tools that mirror a lower cost way of getting advice as opposed to implementation, then yes, it may attract more and more investors who are not as capable of making their own investment decisions, people who do not understand the tools or what they really mean. Could this lead to investor protection issues? In our experience we have not seen any valid investor protection concerns or an influx of client complaints related to "advice" in this channel.

Canadian investors are being squeezed by the proposed OEO guidance.....required to take responsibility for advice presented as merely guidance by regulators and not allowed to take responsibility for their own decisions when deciding to do so....nowhere to run, nowhere to hide.

We expect to see pricing for structure and advice start to develop in the open, separate from products/transactions, which would be a good thing. But of course we have to be wary of the fact that many firms may well attempt to use the discount brokerage side as a way of dumping small clients in an increasing tech world (or alternatively for larger account sizes ,improperly reverse churn them in fee-based accounts). What we are really concerned about here is preventing the development of services that could compete with the current full service (conflicted and much higher cost) business model. It is unfortunate that these issues are being addressed within a significant universal constraint and that constraint is a system which does not properly regulate advice and which is product distribution focused. In an alternate universe the same consultation would be focusing positively on how we could develop the evolution and accessibility of advice for ordinary Canadians. **We urge the CSA to require IIROC to stay its plan to constrain discount brokers.**

H. Canadian fund risk-adjusted performance re impact of trailers
The CSA postulate that fund managers may be aware their funds will continue to have new inflows of cash when there are relatively high trailer commissions so may have less motivation to perform well / take risks to ensure clients remain invested. The CSA state that the research that they have gathered and reviewed suggests that this inherent conflict-of-interest diminishes the investment fund manager's focus on risk-adjusted outperformance, thus impairing investor returns. There is no doubt that an embedded commission creates a conflict-of-interest.

Portfolio managers are supposed to be fiduciaries so we expect that fund governance protocols do not permit this conflict-of-interest to exist. If it does, the CSA should commence enforcement actions. For example, paying full trailers to discount brokers does It is clear that extracting fund assets to compensate distributors impairs fund returns.

The fact that dealers promote higher margin products seems to play out in that direct-to -client fundcos with solid performance have difficulty attracting clients and index products are rarely sold despite their positive advantages for the small investor. The latest SPIVA report demonstrates that the majority of Canadian actively-managed mutual funds do not beat their passive benchmark over longer time periods. The comparison is not totally valid however because the index is costless and frictionless and does not include the cost of distribution (aka "advice"). **We would need to see a deeper analysis to conclude that competitive market forces (based on after -fee performance) are insufficient to overcome the implied conflict-of-interest created by distribution channel access achieved by trailers.** There may be other forces at work.

A G&M article *Canadian mutual funds are the world leader in closet indexing* http://www.vandermeerwealth.com/pdf/Canadian_mutual_funds_are_the_world_leader_in_closet-indexers.pdf suggests that sub-par performance may be deliberate, not necessarily due to the influence of trailer commissions. In their paper, **Indexing and Active Fund Management: International Evidence,**" four professors of finance – Martijn Cremers of Notre Dame, Miguel Ferreira of the Nova School of Business and Economics, Pedro Matos of the University of Virginia and Laura Starks of the University of Texas at Austin – estimate that about 37 per cent of the assets in equity mutual funds sold in Canada are in closet indexers. The implication here is that Canadians are paying for active management but are not receiving it. Depending on the magnitude of the shortfall, the impact on returns could be more significant than the effect of trailers.

See for example TD Canadian Equity A (MER=2.18 %, Assets $ 4.9 billion

We eagerly await the results of the CSA investigation into closet indexing.

The Cumming report results can also at least be partially explained by forces in addition to trailer commissions. For instance, it can be argued that the bank branch network is so convenient for most time- pressed Canadians that investable cash does not necessarily flow to top performing funds but rather to "OK" proprietary funds readily available at bank branches. At the end of 2015, 69 % of assets in the MFDA channel were held at dealers that focussed primarily on proprietary funds. This may be why independent fundcos like Fidelity and Invesco have to have superior returns to attract assets from a smaller segment of the investing population that actually pay attention to fees, performance, risks and taxes.

In our view, it is the structure of the Canadian fund distribution channels that is the dominant factor in influencing fund flows even after considering the not insignificant impact of trailers. Eliminating trailers without implementing other reforms may have the unintended effect of concentrating fund assets even further with bank and insurance owned dealers [Deposit –taker and insurer owned fund dealers dominate fund distribution in Canada. At the end of 2012, of the 37% of households that owned investment funds, 87% purchased their funds through a deposit-taker/insurer owned distributor while only 18% purchased their funds through an Independent/other fund distributor; according to Morningstar data, the banks' combined share rose from 39% at the end of 2011 to 48% by September 2016.] .This growing dominance may not be unacceptable to regulators but at least it should be a factor in restructuring / redesigning the "advice" ("wealth management") business in Canada.

I. Rules without Enforcement are just words

According to the 2013 CFA Institute Global Market Sentiment Survey, financial firms have themselves to blame for the lack of public trust in the industry. The survey found that over half of the respondents outside of Canada (56%) believed that the lack of an ethical culture within financial firms was the biggest factor contributing to the current distrust of the financial industry. In Canada that number was slightly higher at 58%.According to the survey participants, one way to regain the public's trust is through the improved enforcement of existing laws and regulations. Globally, 24% of CFA members agreed with this approach. Of the CFA members surveyed in Canada, 27% felt this was one of the best ways to improve investor trust and market integrity. Source: http://www.cfainstitute.org/about/research/surveys/Pages/global_market_sentiment_survey_2013.aspx We have been advocating this since 2005.

As we have pointed out many times before, that without robust enforcement, the rules don't matter much. We have for years illustrated how few investor complaints are actually investigated by SRO's and Commissions. When we review Hearing Panel decisions we find the bulk of actions are against individuals rather than the root cause of most issues, the dealers. When the dealers are investigated we find that mitigating factors overwhelm aggravating factors, sanctions are modest and root causes are not resolved. More recently, we have seen how the regulators have handled the so-called double dipping scandals. A major aspect of the scandals revolved around fee-based accounts and A class mutual funds paying trailers commissions. In effect, the dealers were collecting fees twice over long periods of time.

Steadyhand president Tom Bradley summed up investor displeasure at the regulatory settlements in these words". *"Then there were four. Four banks have now disclosed to the Ontario Securities Commission that they were overcharging their wealth management clients. BMO is the latest to self-report that they were double charging their clients (following in TD, Scotia and CIBC's footsteps). In a no-contest settlement last week, the bank agreed to compensate 60,000 clients to the tune of $50 million. The BMO case is interesting because the overbilling was not just isolated to BMO Nesbitt Burns, the brokerage arm. It was endemic, with clients also being overcharged in BMO Private Investment Counsel, BMO Investments (bank branches) and BMO InvestorLine (discount broker). .. In my view, these four institutions are getting off way too easy, as are the advisors and branch managers involved. Fee-based accounts, which caused most of the problems here, are not complicated, so the overcharging can't be blamed on a systems error. I can assure you that in investment firms, inputs or factors that impact compensation are never overlooked (30 years of managing investment professionals allows me to say that). The banks' systems may be inadequate, but they are not the reason for this betrayal of client trust. They also got off easy because all four announcements were reported one day and forgotten the next. And the fines paid to the OSC were token. The big amounts (i.e. $50 million for BMO and $73 million for CIBC) simply involved returning the clients' own money to them (with 5% interest)."* 50 million more reasons for CRM2 - Episode 4 - by Tom Bradley https://www.steadyhand.com/industry/2016/12/21/fifty_million_more_reasons_for_crm2/

Investment Fee Overcharging Summary: PIAC

Institution	Reimbursement to Clients	Number of Accounts Affected	Duration of overcharging	Contribution to Investor Protection Initiatives	Date of Settlement
BOM	$49.9 Million	60,393	2008-2016	$2.1 Million	December 2016
CIBC	$73.2 Million	81,575	2002	$3 Million	October 2016
Bank of Nova Scotia	$20 Million	45,703	2008 to 2015	$800,000	July 2016
TD	$13.5 Million	10,480*	2000 to 2014	$600,000	November 2014
Quadrus Investment Services Ltd.	$8 Million	3,329	2011	$250,000	November 2015
CI Investments Inc.	$156.1 Million	360,000	2009 to 2015	$8 Million	February 2016
Totals	**$320.7 Million**	**515,777**		**$14.75 Million**	

*This was one category of violation where the number of affected accounts was not listed.

Another example of lax enforcement:
This is a very puzzling comment from the CSA Footnote 62, page 41

Advisor class units that are offered by some ETF providers are designed for advised investors and are meant to be purchased through an advisor. The only difference between this class of units and the common class units is the trailing commission component (or alternatively denoted the "service fee" component) embedded in the management fee of the Advisor class. We do not know if these holdings of Advisor class units in the online/discount brokerage channel are a consequence of previously advised assets transferring in or are due to investor error. However, we note that some discount brokerages do make Advisor class units available for trade on their platforms.

Given this knowledge, how can the CSA / IIROC possibly justify non-intervention? The mere offering of Advisor Class in these instances is wrong, contrary to the duty to act fairly, honestly and in good faith and basic morality. This is nothing more than a money grab. When the CSA makes findings like this, they have to publicize and name names. Should the public not know which discount brokers do this? It provides a signal as to ethics. In CP 33-404, the CSA makes a big deal out of information asymmetry yet when it is in a position to even out the information imbalance it appears quite reluctant to do so. **Kenmar are of the firm conviction that this lack of meaningful and timely enforcement of existing rules is a major cause for so many negative retail investor outcomes.**

APPENDIX III: Research Reports and materials we considered

The documents listed below paint a clear picture. The takeaway message is that the mutual fund industry has evolved into a sales and marketing culture. Sales incentives like trailers support this culture .Any financial advice provided is incidental, undefined and ad hoc and unregulated. Fund industry lobbyists have been successful in blunting reforms in the $1.3 trillion Canadian mutual fund industry. This has however resulted in needed investor reforms being delayed or derailed.

There have been periodic attempts to break the embedded commission model and give DIY discount investors what they want: the stock-picking prowess of portfolio managers but without advice. In 2004, E-Trade Canada announced it would sell the F class funds of Invesco Trimark Investments and Elliott & Page. Self-directed investors cheered but both firms soon reversed themselves after the rest of the industry made known its deep displeasure. Today Questrade Inc. has its Mutual Fund Maximizer program, which rebates trailers on most big broker-sold funds. A few fund companies offer F series, so Maximizer broadens the range of funds from which to choose. But some discount brokers that offer trailer rebates have been told to stop the practice for their funds. In 2013, a major bank-owned discount broker cut top performing Steadyhand funds out of its lineup because it does not pay trailers. It varies from dealer to dealer, and it changes from time to time. Some don't charge anything - Qtrade, iTrade and BMO Investorline. The others mostly charge a fee for either the purchase or sale, but not both- fees vary considerably.

We are informed that at least one bank-owned dealer has removed Steadyhand, Mawer and Leith Wheeler from their platform because they don't pay a trailer. If trailers are banned, we'll probably see more pricing uniformity. Our preference would be that DIY investors get charged the same commission they get on ETF trades - i.e. $9.95 or less. [Industry talks about investor choice but discount brokers are distorting the market by keeping these low cost funds away from DIY investors See *Purchasing Steadyhand through Discount Brokers - Clearing the Air - Steadyhand Investment Funds* (2013) https://www.steadyhand.com/industry/2013/03/27/purchasing_steadyhand_through_discount_brokers_clearing_the_air/]

If the industry was client-focused , fund manufacturers would reduce price breakpoints, introduce more D Series funds and eliminate DSC money market funds .It seems odd that investor advocates, bloggers and personal finance journalists promote TD's low cost eFunds more than TD does. TD distributes moderately priced index options to its online brokerage customers but none through bank branches. This is an industry that treats dealers/"advisors" better than customers. That's why **we would recommend the CSA to introduce competition and investor choice via access to U.S. Mutual funds as is already the case for ETF's.**

The commission-based system corrupts dealer and "advisers" Back in 2005, the MFDA said it was aware that a number of MFDA members had entered into referral arrangements with Portus, a controversial and troubled fund, regarding managed accounts involving BancNote Trust Series investments. It said "MFDA members in the affected jurisdictions must immediately cease referring clients to Portus during the period covered by the temporary order and any subsequent orders," the MFDA says. The regulator also directed dealer to "take appropriate steps" to determine if any of their Reps have entered into referral arrangements directly with Portus and if so, to cease such activity immediately. It reminded dealers and Reps that securities-related referrals cannot be entered into by Reps either directly or indirectly through another entity, such as an insurance agency or a personal service corporation, these sorts of referrals can only be made through an MFDA member. Over 20 % of Portus assets were acquired by referral arrangements that paid outsized sales commissions. A key fact about which there is clarity is that Portus paid exorbitant fees to advisors who referred their clients to Portus and provided them with sales incentives that would be banned if the investments their clients were making were in conventional mutual funds. It is also clear that the dealers/advisors who referred their clients to Portus did not look beyond the dollar signs and sales incentives in determining the suitability of the Portus investments for their clients. Nor did they seem to understand or appreciate the need for due diligence inquiries respecting the nature, structure and governance of these investments, or the nature and validity of the principal-protection arrangements. The arguments that the dealers/advisors were relying on Portus to do this points out serious weaknesses in the securities regulatory system.

Canadian Fund Industry Overview

Recently CSA sponsored research (2016) on mutual fund commissions' influence on fund flows led by Douglas Cumming, finance professor at the Schulich School of Business at York University in Toronto - and the related Frequently Asked Questions document - has triggered passionate responses. The research found that commissions and "related dealers" (those affiliated with fund manufacturers) result in higher fund flows regardless of portfolio performance. The fund industry - and financial advice providers - downplayed the report, urging regulators to do more analysis before making any policy changes. The industry's automatic "no" response to virtually every investor-friendly proposal risked bringing on the very commission ban the industry now faces. Each time such an idea surfaces, the industry seemingly puts up roadblocks rather than making constructive suggestions to move proposals forward.

How to Lose Market Share [a warning message to the complacent Canadian mutual fund industry]
http://www.investmentexecutive.com/-/comment-how-to-lose-market-share?redirect=%2Fsearch

Change and opportunity ahead for Canada's financial advice industry: Vanguard Global AdvisorTrends report
"Financial advisors play a fundamental role in providing Canadians with valuable financial advice. But their business model is changing with many advisors shifting towards fee-based business models driven in part by the implementation of Client Relationship Model reforms," said Jason McIntyre, head of distribution for Vanguard Investments Canada Inc. "Advisors see this as a positive development that can lead to greater client trust, fee transparency and an opportunity to communicate value."
https://www.vanguardcanada.ca/advisors/articles/vanguard-news/news-from-vanguard/gat-press-release.htm

CSA reveals damning evidence of impact of embedded commissions
http://www.moneysense.ca/save/investing/embedded-commissions-hurt-investors/

Mind the Gap: Active Versus Passive Edition Morningstar
Key Take-Aways
1) The biggest costs investors tend to incur don't show up on a fact sheet but are a product of their own bad behavior.
2) Investors in passive funds have tended to pay smaller bills for their conduct over time.
3) Index fund investors' reasonable expectations, or as Bogle has referred to it, index funds' "relative predictability," go some way toward explaining their exemplary behavior.
4) Channel-specific considerations have also played a part. 401(k) plans are a pipeline for legions of disciplined investors.
http://ibd.morningstar.com/article/article.asp?id=755644&CN=brf295,http://ibd.morningstar.com/archive/archive.asp?inputs=days=14;frmtId=12,%20brf295

Two ways mutual fund investors get burned; First they get scorched by fees, then behavioural silliness compounds the problem: They chase funds with strong track records
The typical Canadian ETF beats its actively managed counterpart by almost 2 per cent a year, after fees. If Canadian investors behave as poorly as those in the United States, those in actively managed funds would give up a further 1 per cent a year by chasing past returns. On the flipside (as mentioned above), Morningstar says index-fund investors outperformed their funds by 0.58 per cent annually during the same time period ended Dec. 31, 2015.If that were true in Canada, those who invest in index funds might beat those who invest in actively-managed funds by more than 3.4 per cent a year. You can make a lot more money if you can avoid getting burned.
http://www.globeinvestor.com/servlet/ArticleNews/story/GAM/20170203/RBGISTRATLABHALLAM

The Market for Conflicted Advice by Briana Chang, Martin Szydlowski: SSRN
Abstract: We study decentralized markets in which advisers have conflicts of interest and compete for customers via information provision. We show that competition partially disciplines conflicted advisers. The equilibrium features information dispersion and sorting of heterogeneous customers and advisers: advisers with expertise in more information sensitive assets attract less informed customers, provide worse information, and earn higher profits. We further apply our framework to the market for financial advice and establish new insights: it is the underlying distribution of financial literacy that determines the consumers' welfare. When advisers are scarce, the fee structure of advisers is irrelevant for the welfare of consumers.
http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2843050

Banks misleading clients on mutual funds - Canada - CBC News
http://www.cbc.ca/news/canada/banks-misleading-clients-on-mutual-funds-1.1415027
Research: Top 10 Issues Facing the Canadian Asset Management Industry
http://www.pwc.com/ca/en/investment-management/publications/top-10-issues-facing-canadian-industry-2010-09-en.pdf Mutual fund companies today face the challenge of differentiating themselves in the industry. As a result, fund companies are increasingly looking to their business models to acquire and retain assets. To succeed, fund managers will not only need to develop a robust distribution model, but focus on delivering knowledgeable, quality advice. Indeed, the advice channel in Canada is gaining importance amongst investors, which could be attributed to the complexity of funds, especially given the myriad of offerings and providers that investors can choose from and the positive experiences when using an advisor. In addition to mutual funds, investors are faced with numerous investment choices like exchange-traded funds (ETFs), wrap accounts, principal-protected notes, segregated and hedge funds. To better understand these products and how they fit in their portfolio, investors are looking for trusted professional advisors.

Regulators point out anomalies in fund sales and accounting practices | Steven G. Kelman | Fund Investing | Morningstar
http://cawidgets.morningstar.ca/ArticleTemplate/ArticleGL.aspx?id=655104&culture=en-CA

Financial Advisor or Investment Salesperson? Consumers Federation
http://consumerfed.org/wp-content/uploads/2017/01/1-18-17-Advisor-or-Salesperson_Report.pdf

Reshaping retail fund distribution: PWC June 2015
https://www.pwc.lu/en/asset-management/docs/pwc-am-reshaping-retail-fund-distribution.pdf

Morningstar Manager Research Observer Jan. 2017 http://video.morningstar.com/ca/MstarObserver17Q1.pdf?utm_source=tr.im&utm_medium=no_referer&utm_campaign=tr.im%2F1mqZF&utm_content=direct_input

Margin of error: Why advisors shouldn't be off-book loan distributors - Investment Executive
"Interestingly, B2B Bank doesn't consider its clients to be the people who borrow from it. In its own corporate profile, B2B says its "client communities" are advisors and dealers. It sees itself as a lender "that serves a network of 27,000 financial professionals." It reassures them that "we don't compete with our clients by offering products directly to the public." No, indeed. Under this business model the manufacturer doesn't sell its products (investment loans) directly to consumers. Instead, the manufacturer's clients (advisors and dealers) are utilized, in effect, as product distributors. They're the sales force for these loans..."
http://www.investmentexecutive.com/-/margin-of-error-why-advisors-shouldn-t-be-off-book-loan-distributors?redirect=%2Fsearch

Stromberg report on mutual funds (1998)
http://www.sipa.ca/library/SIPAdocs/Stromberg_InvFunds-Oct1998.pdf

The Fund Library: Columns: **New fund risk-ratings regime a blessing in disguise?**
"...Now this does not mean that all managers will immediately lower the risk rating for these funds, because they do have the discretion to keep the ratings higher. However, understanding that lower risk ratings can increase the pool of potential investors and thus increase sales, it is logical to think that if some companies begin to lower their risk ratings, other will soon follow. It will also be interesting to see what happens in 2017 when the volatility we saw during the financial crisis in 2007 and 2008 begins to drop out of the 10-year SD calculation. If we do not experience a spike in market volatility within the next year, the volatility numbers will begin to fall and inevitably, so will risk ratings. So what at first what looked like an attempt by the regulators to increase the risk ratings in the fund industry could potentially give managers the ammunition they need in order to lower the ratings on many of their funds. Stay tuned...."
http://www.fundlibrary.com/features/columns/page.asp?id=16061 Kenmar continue to believe the CSA has created a risk disclosure system that will mislead investors and cause them harm. It is by far the world's worst fund risk disclosure system.

The lowdown on paying for referrals | Advisor.ca
http://www.advisor.ca/my-practice/paying-for-referrals-13121

Indexing and Active Fund Management: International Evidence January 5, 2015
Abstract: We examine the relation between indexing and active management in the mutual fund industry worldwide. Explicit indexing and closet indexing by active funds are associated with countries' regulatory and financial market environments. We find that actively-managed funds are more active and charge lower fees when they face more competitive pressure from low-cost explicitly indexed funds. A quasi-natural experiment using the exogenous variation in indexed funds generated by the passage of pension

laws supports a causal interpretation of the results. Moreover, the average alpha generated by active management is higher in countries with more explicit indexing and lower in countries with more closet indexing. Overall, our evidence suggests that explicit indexing improves competition in the mutual fund industry.
https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1830207

90% SALES 10% ADVICE :A SNAPSHOT OF THE FINANCIAL PLANNING INDUSTRY
http://www.industrysupernetwork.com/wp-content/uploads/2011/10/A-snapshot-of-the-financialplanning-industry-110930-1010version.pdf "The facts set forth in the report support the position long held by ISN that ongoing commissions and asset-based fees for advice enable planners and dealer groups to earn 'passive' income at the expense of consumers and should be banned, along with all other forms of conflicted remuneration. If ongoing asset-based fees are permitted to continue, credible reform requires that these fees be subject to a regular 'opt-in' mechanism. The ASIC [Australian Securities Commission] report has pulled back the curtain to reveal the extent to which the structure of the financial planning industry impedes planners from being able to act in the best interests of their client. The Future of Financial Advice reforms are essential to restructure this industry to serve the interests of clients, who are relying on advisers to help them save for retirement, build wealth, and otherwise manage their financial lives. However, the financial planning industry has stridently opposed the key aspects of reform legislation that would clean up their industry. The ASIC report makes this opposition easy to understand: this is an industry built around conflicted remuneration and passive income charged to millions of unwary clients (often from their compulsory super) who receive no ongoing services. "

Banning Investment Commissions – moving beyond "if" towards "how" | Chalten Fee-Only Advisors Ltd. | Blog
We continue to emphasize that the root cause of the Caveat Emptor advice environment is management, not the front line dealer Reps. A large minority are merely trying to survive in a toxic environment and do what they can to protect their clients. The low recruitment criteria, attractive sales inducements and weak compliance systems created by Bay Street management are the cancer that permeates the so-called Wealth Management industry today. Prohibiting trailers may be necessary but it is not sufficient to bring about a trusted advisory marketplace.
http://www.chaltenadvisors.com/blog/banning-investment-commissions-moving-beyond-if-towards-how/

PMAC Supports the CSA's Consultation on Option of Discontinuing Embedded Commissions - PMAC
PMAC see the future of personalized advice in Canada as avoiding conflicts of interest
http://www.portfoliomanagement.org/pmac-supports-csas-consultation-option-discontinuing-embedded-commissions/

Mid 2016 SPIVA Canada Scorecard

Not a single manager investing in U.S. equity was able to deliver higher returns than the benchmark, the S&P 500, over a five-year horizon. http://ca.spindices.com/documents/spiva/spiva-canada-scorecard-mid-year-2016.pdf

Investing industry is a drag on returns- by design http://www.theglobeandmail.com/globe-investor/investment-ideas/strategy-lab/growth-investing/why-mutual-funds-hurt-your-returns/article4619712/ "..One simple example of that drag is the fees charged by actively- managed mutual funds. Those levies take a big bite out of your returns. Andrew Hallam, the millionaire teacher and a fellow Strategy Lab contributor, has written compelling articles demonstrating that actively-managed funds underperform a broad stock market index. He's right." G&M Oct 18, 2012. , Pg B16

Conflict -of- interest part of DNA In "Conflicts of Interest and Competition in the Mutual Fund Industry," Ajay Khorana (Georgia Institute of Technology) and Henri Servaes (London Business School) examine how conflicts-of - interest in the U.S. mutual-fund industry affect competition and investor behaviour (their database covered the period 1979-1998). Overall, their paper "highlights a number of conflicts between fund families and investors," say the authors. For example, they found "no evidence that investors derive any benefit" from annual fees for marketing and distribution (12b-1 fees in the U.S). Furthermore, "fund families generally want to maximize assets under management … and the resulting management fees," an objective at odds with investors' "desire for high risk-adjusted performance at low cost."

Should Canada's financial advisors be held to a fiduciary standard? http://dtpr.lib.athabascau.ca/action/download.php?filename=mba-15/open/punkon-aprj-final.pdf

The Cost of Active Investing Tuck School of Business at Dartmouth; National Bureau of Economic Research (NBER) April 9, 2008
Abstract: I compare the fees, expenses, and trading costs society pays to invest in the U.S. stock market with an estimate of what would be paid if everyone invested passively. Averaging over 1980 to 2006, I find investors spend 0.67% of the aggregate value of the market each year searching for superior returns. Society's capitalized cost of price discovery is at least 10% of the current market cap. Under reasonable assumptions, the typical investor would increase his average annual return by 67 basis points over the 1980 to 2006 period if he switched to a passive market portfolio.
https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1105775

A Dissection of Mutual Fund Fees, Flows, and Performance by Douglas J. Cumming, Sofia Johan, Yelin Zhang: SSRN
Abstract: This paper provides a dissection of both mutual fund fees and flows into several categories, and presents evidence that relates specific components of fees to flows, and fees and flows to performance. For stand-alone funds that cannot be purchased directly from fund managers, fees that compensate fund advisors when investors maintain their portfolio positions, and fees that penalize investors for early withdrawal, have a much

flatter flow-performance relationship ("flow-performance slope"), and higher flows regardless of past performance ("flow-performance intercept"). Further, the data indicate that flow-performance intercept and slope are significantly negatively and positively, respectively, related to future risk-adjusted performance, which is consistent with the view that flow-performance provides a strong incentive to generate future returns. These findings are quite stable over time, and robust to numerous sensitivity checks. We find some consistency in the evidence but less robust statistical significance amongst the subsamples of direct purchased funds, and among fund-of-funds.
https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2678260

The Genesis of DSC Mutual Funds | WhereDoesAllMyMoneyGo.com
http://wheredoesallmymoneygo.com/the-genesis-of-dsc-mutual-funds/ Shows how the trailer was born.

Leave deferred sales charges for mutual funds to the dinosaurs - Globe and Mail
http://www.theglobeandmail.com/globe-investor/funds-and-etfs/funds/leave-deferred-sales-charges-for-mutual-funds-to-the-dinosaurs/article28088507/

Talk versus action on embedded commissions ban | Advisor.ca
http://www.advisor.ca/news/industry-news/talk-versus-action-on-embedded-commissions-ban-223245

Favoritism in Mutual Fund Families? Evidence on Strategic Cross-Fund Subsidization by Jose-Miguel Gaspar, Massimo Massa, Pedro P. Matos: SSRN
Abstract: We investigate whether mutual fund families strategically allocate performance across their member funds favoring those more likely to generate higher fee income or future inflows. We find evidence of strategic cross-fund subsidization of 'high family value' funds (i.e. high fees or high past performers) at the expense of 'low value' funds in the order of 6 to 28 basis points of extra net-of-style performance per month, depending on the criteria. This overperformance is above the one that would exist between similar funds not part of the same fund family. We further document how this family strategy takes place by looking at preferential allocation of IPO deals and at the amount of opposite trades among 'high' and 'low value' funds belonging to the same fund complex (a practice that can encompass 'cross-trading'). Our findings complement the existing literature on distortions in delegated asset management by highlighting the role played by family affiliation. They are also relevant to the regulatory debate concerning 'cross-trading' between funds under common management.
https://papers.ssrn.com/sol3/papers.cfm?abstract_id=557078

Impact of Fees on Investor Returns

Numbers and percentages Most economists protect the returns for the decade ahead. This could have a major effect on the impact of product fees on your retirement security. In the past, if the benchmark return was 10 per cent and you under performed by 2%

then you left 20% of this potential return on the table. Going forward if the benchmark return is 6% and you still underperform by 2%, now you're still taking all the risk but you've left one third of the potential return on the table. Pay attention to product cost and account fees- they are more important than ever before. Be sure to scrutinize the new personalized cost reports that dealers will be issuing to you shortly.

Research: The $25 billion annual mutual fund rip-off
http://cupe.ca/pensions/The_25_billion_annua
A comprehensive study by Canadian pension fund expert Keith Ambachsheer has found that defined benefit pension plans in Canada achieved annual average returns at least 3.8% higher than mutual funds with comparable investments. Defined Benefit pension funds outperformed the market by 1.23% per year, while mutual funds had average returns that were 2.6% below the market during the 1996 to 2004 period. Returns for most mutual investors were even less than this, as a result of sales fees and consistently poor selection of mutual funds by misinformed investors: buying high and selling low. This means that those with savings in mutual funds lost a total of about $25 billion a year from the higher management fees and lower returns compared to workplace pension funds. Higher management fees are responsible for about $15 billion of this.

How much do investors lose from conflicted advice? « The Mathematical Investor
http://www.financial-math.org/blog/2015/02/how-much-do-investors-lose-from-conflicted-advice/

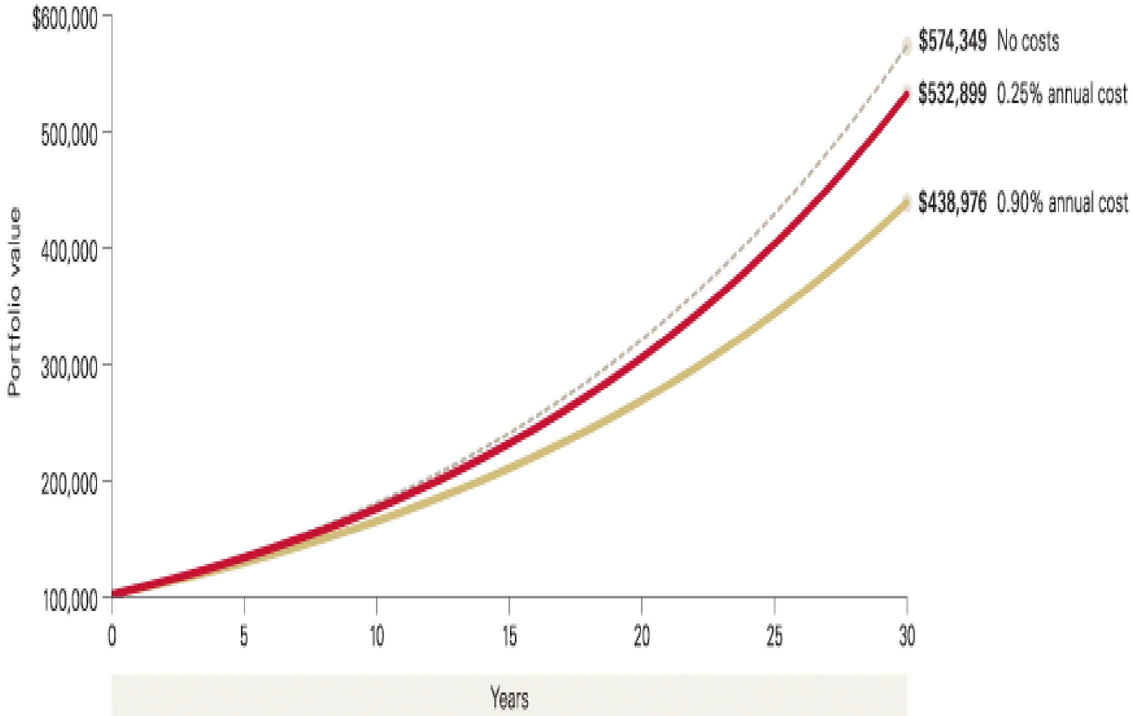
A Dissection of Mutual Fund Fees, Flows, and Performance by Douglas J. Cumming, Sofia Johan, Yelin Zhang: SSRN
https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2678260

Invesco comment letter on mutual fund fees
http://www.osc.gov.on.ca/documents/en/Securities-Category8-Comments/com_20130412_81-407_adelsone.pdf

Wrap accounts add costs but yield questionable benefits .The CSA confirms our experience with wraps. Over the last several years, wrap accounts (fund-of-fund products) have grown in popularity, now accounting for approximately 47% of long-term mutual fund assets under management, up from 37% in 2006 .Wrap .accounts hold substantial appeal for Reps since they are per-packaged mutual fund investment portfolios which eliminate having to do any fund selection and asset allocation . In the case of a wrap, the advisor need only assess the suitability of the top level fund rather than assess the suitability of every fund in the portfolio. Notwithstanding the dramatic workload decreases that wraps provide for dealer Reps, the trailing commissions payable on wraps are the same or higher than on stand-alone equity mutual funds. We have found no evidence clients obtain more face time with Reps; instead we are told, the time freed up is used for prospecting for even more buyers. Fund manufacturers also gain by sales [AUM] of their own proprietary funds rather than using Best-in-Class funds. The client ends up with a package of expensive funds whose asset allocation is not tailored to their individual needs, personal situation and objectives.

A fund-by-fund break down of the hidden advice fees Canadians are paying - The Globe and Mail
http://www.theglobeandmail.com/globe-investor/funds-and-etfs/funds/table-trailer-fees/article29792039/

Investment fees cost Canadians hundreds of thousands
Next to buying a home, fees paid on investments can be the single biggest lifetime expense many Canadian households will have to deal with. Over the course of an investor's life, mutual fund fees can end up costing the average Canadian household $323,654.40, according to Nest Wealth, a Toronto-based digital wealth manager (www.nestwealth.com). "Put in context, the average Canadian household will spend $80,000 more on investment fees than they'll spend to raise their child to the age of 18," says Randy Cass, founder and CEO of Nest Wealth. "It's not surprising that Canadians feel like no matter how much they try to save, they keep falling further behind their goals."
http://www.newswire.ca/news-releases/next-to-buying-a-home-investment-fees-can-be-the-average-canadian-households-largest-single-expense-587432951.html



Note: The portfolio balances shown are hypothetical and do not reflect any particular investment. The final account balances do not reflect any taxes or penalties that might be due upon

distribution. Source: Vanguard.
https://personal.vanguard.com/us/insights/investingtruths/investing-truth-about-cost

The Tyranny of Compounding Fees: Are Mutual Funds Bleeding Retirement Accounts Dry?
https://www.onefpa.org/journal/Pages/The%20Tyranny%20of%20Compounding%20Fees%20Are%20Mutual%20Funds%20Bleeding%20Retirement%20Accounts%20Dry.aspx

Lessons from proprietary mutual fund returns - Yahoo! Finance Canada
http://ca.finance.yahoo.com/news/lessons-proprietary-mutual-fund-returns-195227448.html

The costs and benefits to fund shareholders of 12b-1 plans
In Canada there is a trend to set a fixed administration rate (%) so that any gains in assets are not passed on as savings to fund unit holders.
https://www.sec.gov/rules/proposed/s70904/lwalsh042604.pdf

How Fund Fees are the Best Predictor of Returns | Morningstar
http://www.morningstar.co.uk/uk/news/149421/how-fund-fees-are-the-best-predictor-of-returns.aspx

Wrap mutual fund disappointment
http://www.fa-mag.com/news/wrap-mutual-fund-disappointment-12154.html

Wrap Account Ripoff (Forbes.com): "In 2007 Josephine DesParte, an 88-year-old Chicago widow, had $8 million tucked into an account at William Blair & Co. One-quarter of it was in municipal bond funds and cash and the rest in three stocks dear to her heart: Together the securities were generating more than $100,000 in annual dividend and interest income. DesParte's coupon-clipping strategy made good sense for the widow, but she claims the inactivity made the commission-based account a dud for William Blair. In October 2007 brokers Brian L. Kasal and William H. Ross persuaded DesParte to begin selling her stocks and many of her bonds and to diversify into a number of blue chips. They also moved her into a wrap account, which, DesParte would later claim, gave William Blair the advantage of shaving off 1.5% of her assets a year, or $120,000, in annual fees. The brokers' moves further saddled her with a $322,000 capital gains tax bill for 2007, DesParte claimed. DesParte filed a $2 million claim with the Financial Industry Regulatory Authority seeking compensation for wrongful investment losses and taxes. She was awarded $1.1 million in November 2009.
http://www.forbes.com/forbes/2010/0412/investing-brokerage-commission-retirement-finra-ripping-you-off.html?boxes=Homepagetmagazines " Needless to say, wrap accounts and managed accounts are on the upswing in Canada and wreaking havoc with portfolio performance.

Research: Why Does the Law of One Price Fail? An Experiment on Index Mutual Funds

http://www.ncbi.nlm.nih.gov/pmc/articles/PMC2872995 ABSTRACT : We conduct an experiment to evaluate why individuals invest in high-fee index funds. In our experiments, subjects allocate $10,000 across four S&P 500 index funds and are rewarded for their portfolio's subsequent return. Subjects overwhelmingly fail to minimize fees. We can reject the hypothesis that subjects buy high-fee index funds because of bundled non-portfolio services. Search costs for fees matter, but even when we eliminate these costs, fees are not minimized. Instead, subjects place high weight on annualized returns since inception. Fees paid decrease with financial literacy. Interestingly, subjects who choose high-fee funds sense they are making a mistake.[The composition of their subject pool , college staff/MBA students made it more likely that they would find support for rational theories; given the dismal results it is thus no surprise that ordinary Canadians have trouble figuring out fund fees]

The behaviour of individual investors
https://www.umass.edu/preferen/You%20Must%20Read%20This/Barber-Odean%202011.pdf

OSC Investor Advisory Panel Report Conflicted compensation can undermine the trust that is an integral part of the advisor client relationship. The Panel's 2013 Survey Findings on Adviser/Investor Relationship http://www.osc.gov.on.ca/en/Investors_nr_20130318_iap-adviser-investor-relationship.htm found that only 20% of investors strongly agree that they trust their financial advisor's advice while 64% overall believe that how a financial advisor is paid impacts the recommendations they receive. Furthermore, a majority (58%) rely on their financial advisor as their main source of information and yet more than 4 in 10 don't know how their advisor is being paid. The Panel also saw strong support for a statutory best interest duty – 93% agree that it is needed.

Global Fund Investor Experience Study: Morningstar June 2015
https://corporate.morningstar.com/US/documents/2015%20Global%20Fund%20Investor%20Experience.pdf Canadian mutual fund fees are among the highest fees in the world as supported by numerous independent research studies [portfolio transaction expenses add to investor costs but are not included in the MER]. Needless to say, this severely impairs the retirement income security of Canadians.

High Fees Destroy Bond Fund Performance | Morningstar
http://www.morningstar.co.uk/uk/news/95449/high-fees-destroy-bond-fund-performance.aspx

The arithmetic of all- in investment expenses: J. Bogle
A very interesting paper. Results may be different in Canada due to higher Mutfund MER's and trading expenses. Even worse for Segregated funds. Vulnerable investors, such as seniors, may be disproportionately disadvantaged according to other research. All regulators report that complaints from seniors are disproportionately high, mostly due to unsuitable investments.

http://johncbogle.com/wordpress/wp-content/uploads/2010/04/FAJ-All-In-Investment-Expenses-Jan-Feb-2014.pdf

Banning Trailer Commissions Could Give Canadian Investors a Wealth of Lower-Cost Products | The Motley Fool Canada
http://www.fool.ca/2017/01/13/banning-trailer-commissions-could-give-canadian-investors-a-wealth-of-lower-cost-products/

Uncovering the hidden fees: Questrade
http://media.questrade.com/downloads/manuals/crm2_free_guide.pdf

Trailer commissions are BIG $$'s http://www.thestar.com/business/article/846861--daw-industry-defends-mutual-fund-trailer-fees According to a August 12th 2010 article by the Toronto Star's James Daw *, Industry defends mutual fund trailer fees* , a lot of money is at stake. He quotes Carlos Cardone, senior consultant with research house Investor Economics who says about $2 billion was deducted from Canadians' mutual fund assets in 2009 to pay advisers what are called trailer commissions. That compares with about $9.5 billion in the U.S., with ten times the population. The Canadian figure excludes what banks embed in their funds to pay sales and advisory staff. Bank funds hold roughly 30 % of total mutual fund assets in Canada. According to the CSA Consultation "A significant portion of the management fees earned by most Canadian mutual fund manufacturers on the mutual funds they manage is used to pay an ongoing commission to dealer firms. This payment was originally intended to compensate dealer firms for the ongoing services their advisors provide to investors after the mutual fund purchase, including investment advice. This is generally referred to as the "trailer fee" or "trailing commission"...Trailing commissions are usually paid by mutual fund manufacturers to dealer firms quarterly for as long as their clients hold investments in the manufacturers' mutual funds. Each dealer firm then pays out a portion of those trailing commissions to its representatives according to the firm's own compensation grid. Generally, under this compensation grid, the more commission or fee revenue the advisor generates for the firm, the greater the portion of that revenue the advisor gets to keep." There is ZERO connection to the amount or quality of advice provided or any measures of client satisfaction.

How much do actively-managed mutual funds cost investors?
http://independentinvestor.info/content/view/961/236/1/0/ "When you add up the numbers for MER, taxes and load fees you come up with the following (what is sometimes called the croupier's take; see Davis 2009 Reveal the true cost of the croupier's take doc.1825).In the US -the MER, impact and load costs add up to 3.87% of fund investments. In Canada - the comparable number is 5.13%. Therefore, the typical US and Canadian equity funds needs to outperform their index benchmarks by almost 4% and by more than 5%, respectively, in the two countries before its investors do better than the market as a whole. This is a major challenge, and the odds of any active fund manager overcoming these types of numbers are very poor. And remember these numbers do not take into account expense categories 2 (non-MER MER expenses), 3

(non-traditional management fees), 4 (mutual fund shenanigans) and 7 (risk premium) in our list because we have not been able to quantify them but which are nevertheless very real expenses."

Influence of "Advisors"

Research: ***What is the Impact of Financial Advisors on Retirement Portfolio Choices and Outcomes?*** http://www.nber.org/programs/ag/rrc/NB10-05%20Chalmers,%20Reuter%20FINAL-revised.pdf

What Do Financial Advisors Do? | Investopedia
Does your "advisor" perform these tasks?
http://www.investopedia.com/articles/personal-finance/050815/what-do-financial-advisers-do.asp

Financial Advisors: A Case of Babysitters? by Andreas Hackethal, Michael Haliassos, Tullio Jappelli: SSRN
Abstract: We use two data sets, one from a large brokerage and another from a major bank, to ask: (i) whether financial advisors are more likely to be matched with poorer, uninformed investors or with richer and experienced investors; (ii) how advised accounts actually perform relative to self-managed accounts; (iii) whether the contribution of independent and bank advisors is similar. We find that advised accounts offer on average lower net returns and inferior risk-return trade-offs (Sharpe ratios). Trading costs contribute to outcomes, as advised accounts feature higher turnover, consistent with commissions being the main source of advisor income. Results are robust to controlling for investor and local area characteristics. The results apply with stronger force to bank advisors than to independent financial advisors, consistent with greater limitations on bank advisory services. http://www.csef.it/WP/wp219.pdf

The value of advice- an investor viewpoint
http://www.investingforme.com/pdfs/reports-studies/Advice-An-Investor-View.pdf

Why Don't Most Financial Planners Plan Finances?
A recent article http://www.milliondollarjourney.com/why-don%E2%80%99t-most-financial-planners-plan-finances.htm on financial planning stated:" While many financial planners claim to do financial planning and provide holistic advice, very few actually provide comprehensive planning with written financial plans, as taught in the CFP courses.The issue is best highlighted by Alan Goldhar, Professor of Financial Planning at York University and Manager for the Ontario Public Trustee. The Public Trustee takes over the finances for people that are mentally unable to make financial decisions. They have taken over more than $500 million in investments for 10,000 clients, most of which had a financial planner, broker or bank advisor. They interview the client and the family and then send in a team to obtain all financial documents. The shocking fact is that, of the 10,000 clients they took over, none had a financial plan! Not one!". For seniors, such a state of affairs is more than troubling.

Advisor Risk
https://docs.google.com/viewer?a=v&pid=forums&srcid=MDQyNjM4MzIyMTkzMjczODgyNDABMTQxNTYxNzExMTMwMjcyMzE2NzEBV2lUMEYtb1ZrejBKATQBAXYy Trailer commissions are embedded in the management fee rather than shown separately. Many retail investors mistakenly believe there is no cost to buying or owning a mutual fund. They don't grasp the long-term significance of distribution costs on account performance. Dealer Representatives aren't required to disclose all forms of their compensation that they earn from clients' fund investments. If mutual fund costs and compensation practices aren't mentioned to clients, they don't become a factor in a client's decision-making. This creates a risk for unsuspecting clients.[Costs deter only one of six investors from buying, according to an Investor Education Fund survey which is a major financial competency problem in itself.]

The value of advice: An investor viewpoint Kenmar Associates
http://www.investingforme.com/pdfs/reports-studies/Advice-An-Investor-View.pdf

Financial Abuse - (this insightful exposition was written several years ago before the IDA morphed into IIROC). Author Andrew Teasdale is an expert on suitability, KYC and portfolio construction)
http://moneymanagedproperly.com/new_folder/rights%20and%20abuse/financial%20abuse.htm **" "…Trailer fees:** Trailer fees are annual fees paid by a mutual fund company to an investment advisor for recommending the mutual fund. The investor does not need to be told about this even though the money is paid from the investor's own funds. Likewise the advisor has no obligation to do anything for the client to earn these fees. Trailer fees and other referral type fees are an abuse of the client -advisor relationship and, unless these fees are disclosed and used to offset valid and identifiable services performed by the advisor, they increase costs and are detrimental to an individual's financial position. The greed of the industry has seriously affected the ability of mutual funds to meet the objectives and needs of the individual. Indeed, the benefits of one of the most efficient investment vehicles ever invented have been submerged under the self- interests and costs of an industry that has lost sight of its reason for being…." [The fact that trailer commissions as a percentage of "adviser" income has risen since 1996 was not known to retail investors .The lack of disclosure added to investor risks and may explain the apparent increase of leveraging and the rapid rise of wrap accounts]

Research: Legal liabilities of Financial Advisors in Canada
http://www.canadianfundwatch.com/2012/10/legal-liabilities-of-financial-advisors.html

Financial Advisors Encourage Bad Behavior
http://www.forbes.com/sites/rickferri/2012/03/30/financial-advisors-encourage-bad-behavior/

The Market for Financial Advice: An Audit Study This working paper by Sendhil Mullainathan (Harvard), Markus Noeth (University of Hamburg), and Antoinette Schoar (MIT), was recently published by the National Bureau of Economic Research (NBER), a private, non-profit, non-partisan research organization. Most individual investors consult a financial advisor before purchasing investments. Given the central role of advisors in the investment process, Mullainathan, Noeth and Schoar tested whether financial advice serves to de-bias individual investors and thus correct mistakes they might make without these inputs, or whether advisors encourage the same bad behavior. The study defines 'good advice' as recommendations that move investors toward a low-cost, diversified index fund approach, which textbook analyses on mutual fund investing suggests. Overall, their findings suggest that the market for financial advice does not alter individual investor biases, and if anything may exaggerate existing biases. They also found that advisor self-interest plays an important role in generating recommendations that are not in the best interest of the clients. They are unwilling to lean against these biases even when they know they exist because not doing so helps them further their own economic interest.

Research on Fund fees: Out of Sight, Out of Mind: The Effects of Expenses on Mutual Fund Flows
http://faculty.haas.berkeley.edu/odean/papers%20current%20versions/Out%20of%20Signt.pdf The more opaque the fees, the easier it is to bamboozle retail clients. The paper by Brad Barber, Terrance Odean and Lu Zheng concluded that: "..*We report evidence that mutual fund marketing does work. On average, any negative effect of expense fees on fund flows is more than offset when that money is spent on marketing; non-marketing expenses, however, reduce fund flows. Though [front load] load fees are also spent on marketing, the positive effect of marketing on flows does not appear to be sufficient to offset investors growing awareness of and aversion to loads…" While operating expenses (including embedded trailers) constitute a steady drain on a fund's performance, the effect of that drain is masked by the considerable volatility in the returns on mutual funds..."* [We've always found it curious that the fund manufacturer marketing materials and advertisements do not refer to the advice component of the mutual fund value proposition. It is strange because IFIC gives advice such emphasis in their lobbying literature.]

Macro Considerations

Have active Canadian fund managers earned their keep?: Morningstar
http://www.morningstar.ca/industry/articles/Active_Passive_White_Paper.pdf

CFA Institute Integrity List: 50 Ways to Restore Trust in the Investment Industry
http://www.cfainstitute.org/about/vision/serve/Pages/integrity_list.aspx #3 **Place the client's interests before your own ;** #8 **Strive for a conflict-free business model**

Barriers to financial advice for non- affluent consumers
https://www.soa.org/researchbarriers/

Risks to Customers from Financial Incentives: FSA
http://www.fsa.gov.uk/static/pubs/guidance/gc12-11.pdf [UK FSA] This is an excellent document demonstrating how incentives distort advice. After extensive research the FSA found that:
• Most firms did not properly identify how their incentive schemes might encourage staff to mis-sell. This suggests they had not sufficiently thought about the risks to their customers or had turned a blind eye to them.
• Many firms did not understand their own incentive schemes because they were so complex, making it harder to control them.
• Firms did not have enough information about their incentive schemes to understand and manage the risks.
• Most firms relied too much on routine monitoring, rather than risk-based monitoring, such as performing more checks on staff with high sales volumes.
• Some firms had sales managers with a clear conflict- of- interest that was not properly managed.
• Many firms had links to sales quality1 built into their incentive schemes that were ineffective.
• Some firms had not done enough to control the risk of potential mis-selling in face-to-face situations.
Such results have caused the FSA to essentially ban commissions

Why hasn't indexing taken root in Canada? | Christopher Davis | Fund Investing | Morningstar
"..That's not a problem for Canada's six largest banks, which have successfully used their built-in distribution network of bank branches to sell in-house funds. The banks control an increasingly large slice of long-term mutual fund assets. According to Morningstar data, the banks' combined share rose from 39% at the end of 2011 to 48% by September 2016. (Investors Group, which controls 7% of long-term fund assets, uses a distribution model similar to the banks, selling only funds with its house label through its giant national network of advisors.)..."
http://cawidgets.morningstar.ca/ArticleTemplate/ArticleGL.aspx?culture=en-CA&id=781441

Horizons abandons advisor-class ETFs
Horizons says it will halt sales of its advisor-class units by Jan. 31, and expects to fully eliminate these units by the end of April by converting them into common units of the same ETFs. The Horizons announcement on Dec. 29 comes less than two weeks before the scheduled Jan. 10 release of a consultation paper by the Canadian Securities Administrators, which is expected to propose a ban on embedded commissions paid by mutual funds and ETFs.
http://cawidgets.morningstar.ca/ArticleTemplate/ArticleGL.aspx?culture=en-CA&id=787238

Study shows trust for advisors in Canada down

Entitled *From Trust to Loyalty: A Global Survey of What Investors Want*, the survey also showed that in Canada, strong ethics was the most important factor for clients. "Overall, trust globally is up from 50% to 61% so that's the good news," she says. "In Canada, we are still above the global average with 64 per cent, but that is down from the 2013 survey when we were at 76%. Globally the financial markets have done better in that timeframe, while the reverse is true for Canada, so I think that might be the rationale for the change in sentiment." http://www.wealthprofessional.ca/news/study-shows-trust-for-advisors-in-canada-down-208737.aspx and https://www.cfainstitute.org/about/press/release/Pages/02172016_128524.aspx

Fund Fact sheets littered with weaknesses
http://www.theglobeandmail.com/globe-investor/investment-ideas/fund-fact-sheets-littered-with-weaknesses/article625822/ In this piece respected fund analyst Dan Hallett discusses FF deficiencies re risk disclosure . We agree with Dan's observations and also add that we have for the past 4 years been pleading with regulators to spell out Rep/dealer conflicts-of-interest and locate fund fees disclosure ahead of performance on the Fund Facts form. Relocating cost information would give costs more prominence.

Managing conflicts of interest in the financial services industry: ASIC
The paper seems to suggest that extraordinary effort is required to "manage" conflicts but in the end ASIC concludes that if the efforts are expended, ASIC will consider the conflicts "managed" re investor protection. Corporate culture, policies, employee training, oversight and regular audit are required. Maybe better to avoid conflicts of interests altogether.
http://download.asic.gov.au/media/1327370/Conflicts_discussion_paper_April_2006.pdf

Guidance on conflicts of interest for investment advisors: Research
It appears that under a fiduciary or BI advice standard, the "management" of conflicts of interest is extremely difficult. Avoidance may be the only way since disclosure has been shown to be ineffective even detrimental in the retail investor case. We wonder if there is any research that demonstrates conflicts can be satisfactorily managed at the retail investor level.
http://www.foxrothschild.com/content/uploads/2015/05/Horn-Guidance-on-Conflicts-of-Interests-for-Investment-Advisers-February-2015.pdf

Seniors/ Retirement

The Feeling's Not Mutual | Canadian Centre for Policy Alternatives
The High Costs of Canada's Mutual Fund Based Retirement System
David Macdonald **FEBRUARY 25, 2015** Download
Abstract: This study compares the management fees charged by mutual funds and pension plans, and finds that high management fees will cause Canadians relying on mutual funds for their retirement income to work longer or retire with less, compared to those with pension plans. The study recommends an expansion of inexpensive workplace

pension plans or public pension plans, like the CPP; and as a stopgap measure, trailers fees—the portion of mutual fund fees that go back to the advisor—could be capped or banned entirely.https://www.policyalternatives.ca/publications/reports/feeling’s-not-mutual

OSC IAP Seniors Roundtable: Facilitator's Report
http://www.osc.gov.on.ca/documents/en/Investors/iap_20141212_facilitators-report-seniors-roundtable.pdf

University of Toronto Research Report: Fraudsters Take Aim at the Baby Boomers (May, 2007)
http://www.utoronto.ca/difa/PDF/Research_Projects/DIFA2007

PROTECTING SENIOR INVESTORS: REPORT OF EXAMINATIONS OF SECURITIES FIRMS PROVIDING “FREE LUNCH” SALES SEMINARS – U.S. Securities and Exchange Commission
https://www.sec.gov/spotlight/seniors/freelunchreport.pdf

Seniors, Suitability and Ethics
http://fpawi.org/downloads/Symposium_2011/2._2011_symposium___ethics___seniors_suitability_handout.pdf

Fact Sheet: Middle Class Economics: Strengthening Retirement Security by Cracking Down on Conflicts of Interest in Retirement Savings | whitehouse.gov
https://www.whitehouse.gov/the-press-office/2016/04/06/fact-sheet-middle-class-economics-strengthening-retirement-security

Retirement Security - theZoomer: Television For Boomers With Zip!
Great feature story on advisors and retirement security Lawyer Harold Geller, Alan Goldhar, Keith Ambachtsheer, John DeGoey, Cary List and investor Peter Whitehouse explain the sorry situation. A strong argument for Best interests is made.
http://www.thezoomertv.com/videos/retirement-security/

Purse Strings Attached: Towards a Financial Planning Regulatory Framework
.The report reveals that the pace of reform has been slow for an industry entrusted with the retirement security of Canadian consumers. “It’s time all employees of the financial planning industry in Canada face the reality-they need to employ a uniform standard of care for investors, complete with a full disclosure of how they’re being compensated,” notes Jonathan Bishop, co-author of the report. The research reveals Canadian consumers are potentially leaving thousands of their retirement dollars in someone else’s hands by conflicts of-interest .The report concluded that the time remains ripe for provincial consumer and finance ministries to work towards a regulatory framework for financial advisors. http://www.piac.ca/wp-content/uploads/2014/11/pursestrings_attached_final_for_oca.pdf

According to a Broadbent Institute study **An Analysis of the Economic Circumstances of Canadian seniors** https://d3n8a8pro7vhmx.cloudfront.net/broadbent/pages/4904/attachments/original/1455216659/An_Analysis_of_the_Economic_Circumstances_of_Canadian_Seniors.pdf?1455216659 a large percentage of older, working Canadians are heading to retirement without adequate savings. Unbiased advice would help reduce the percentage.

A recent study **Old Age and the Decline in Financial Literacy** http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1948627 shows the ability of the elderly to manage their money may decrease after they reach retirement age, but confidence in their ability to make good financial decisions stays the same. The study, found financial literacy declines at a consistent rate after retirement. The ability to answer basic financial questions decreases as respondents age, and this rate of decline almost exactly matches the gradual erosion of memory and problem-solving abilities later in life. This is worrisome because households aged 60 years and older control about half of the wealth in Canada. Since fewer employers provide pensions than ever before, more people are dependent entirely on their retirement savings and that in turn is dependent on trustworthy investment advice.

Protecting Seniors and Their Life Savings: Policies and Practices of Missouri's Investment Firms
A specific policy that ensures account information for senior clients is maintained, regularly reviewed, and updated is a solid approach to avoiding unsuitable recommendations. This information is vital because as investors age, their investment time horizons, and objectives, risk tolerance, family's needs and tax status may change. Liquidity becomes a higher priority, and products that were once a sound investment may no longer be suitable if money is locked up in complicated products where liquidation is possible only after a substantial penalty is paid. These changes in investment needs and goals can be recognized in a timely manner through regular account maintenance and updating.
http://www.sos.mo.gov/securities/MIPC/SecuritiesReport_ProtectingSeniorsLifeSavings.pdf

PROTECTING SENIOR INVESTORS –Compliance, Supervisory and Other Practices When Serving Senior Investors
http://iiac.ca/wp-content/uploads/Canadas-Investment-Industry-Protecting-Senior-Investors_March-18-2014.pdf

MFDA sets out regulatory priorities - investmentexecutive.com
" ....In terms of leveraging, it stresses that firms should have policies in place to ensure they meet their leveraging suitability obligations, including criteria for assessing the suitability of a client's use of leverage and describing appropriate circumstances for recommending the use of leverage.
The bulletin also stresses that protecting senior investors is "an area of focus and a strategic initiative" for the MFDA. It says firms should consider certain senior-specific

issues in their supervisory work, including: reviewing new account and KYC paperwork, suitability reviews, marketing and advertising, and the use of business titles specifically directed towards senior investors (to ensure they don't mislead clients). It suggests that firms should consider developing specific procedures to supervise activity with senior investors. Additionally, it notes that dealers are responsible for maintaining policies and procedures to ensure the fair and prompt handling of client complaints, and it sets out what those policies should include. This may be a particular issue for seniors, it suggests, as they may have physical limitations that would make it difficult to submit a formal written complaint; so, it suggests that dealers should be prepared to assist senior clients in documenting their verbal complaints..."
http://www.investmentexecutive.com/-/mfda-sets-out-regulatory-priorities

Attitudes Toward the Importance of Unbiased Financial Advice
AARP conducted a nationally representative survey of adults ages 25 and older who currently have—or who have had—a retirement savings account.
http://www.aarp.org/content/dam/aarp/research/surveys_statistics/econ/2016/attitudes-unbiased-fin-advice-rpt-res-econ.pdf

The Best Interest Standards and the Elderly - Canadian MoneySaver
https://www.canadianmoneysaver.ca/the-best-interest-standards-and-the-elderly/

The Best interests Advice Standard
https://www.canadianmoneysaver.ca/the-best-interests-advice-standard/
The Changing State of Retirement in Canada – Fidelity (Oct., 2007)
http://m.twmg.net/state_of_retirement_cda.pdf A survey of more than 2200 households shows that Canadians are on track to replace only 50% of their pre-retirement income. To maintain a comfortable lifestyle they may need as much as 80% of pre-retirement income. That's one reason that investing fees and expenses are so important.

Retirement brings new financial challenge
https://secure.globeadvisor.com/servlet/ArticleNews/story/gam/20121127/SRWEALTHMGMTQAMPAATL The investor de-accumulation phase will have a major impact on the advice industry.Drawing down assets in retirement encompasses more than simply ensuring that clients have enough money to cover living expenses and such lifestyle choices as vacations and golf fees each year, but also that clients are not pulling so much out of retirement nest eggs that they are bumping into higher and higher tax brackets. Retirement income planning, covers just how much income people should draw from various sources: tax-deferred, tax-exempt and taxable income accounts. This is true financial planning and is significantly different from transaction based selling of mutual funds. The Regulatory and fund industry implication are self -evident. We're surprised there is so little debate about opening up a supplemental tranche of CPP as an obvious and elegant solution to most retirement concerns being discussed. Securities regulators are not qualified and ill suited to develop retirement incomes policies in Canada. Canadians at large are not willing allocators of capital. It's something they are forced into

doing in the absence of alternatives. Many cost and behavioural finance concerns would be resolved with the CPP option. Flaherty came close to going this route at the PEI first ministers conference but caved to the insurance lobby and we got the stillborn PRPP instead. We stand with Keith Ambachtsheer and Malcolm Hamilton in support of an expanded CPP.

CPP 'economies of scale' make it a cheaper alternative to PRPPs
http://business.financialpost.com/2012/11/27/cpp-economies-of-scale-make-it-a-low-cost-alternative-to-prpps/ "In the final report of the Ontario Expert Commission on Pensions, Professor Harry Authors notes: "I feel obliged to report that a significant number of submissions raised the possibility [of] an expanded or two-tier CPP. I was particularly struck by the fact that this idea was raised in different ways in briefs from stakeholders as disparate as the Canadian Federation of Independent Business and the Canadian Labour Congress.""

General interest

White Paper: The "advice gap"? Kenmar Associates
http://www.canadianfundwatch.com/2015/11/white-paper-advice-gap.html

What Investors Want: CFA Institute
https://blogs.cfainstitute.org/investor/2016/02/18/what-investors-want-2/

Investment risk and financial advice: Vanguard
Excellent summary on risk profiling issues and shortcomings. Applies to robos as well as advisors. Demonstrates the serious shortcomings of FF risk disclosure. If there is an advice gap, the lack of robust risk profiling processes must certainly be a part of the problem. Note the OSC IAP supported report (PlanPlus) on risk profiling reported serious risk assessment issues in Canada suggesting that advice based on faulty risk assessment leads to faulty advice regardless of the impact of trailers.
https://www.vanguard.co.uk/documents/adv/literature/investor-risk-profiling.pdf

Regulating remuneration systems: distribution of financial products - Oxera
http://www.oxera.com/getmedia/c28539cd-c6dc-42e4-9940-a624b0ff47ea/Remuneration-systems_Final-report_Jan2015.pdf.aspx?ext=.pdf

Are Investors Willing To Pay Up-Front For Advice? - Financial Freedom
Certainly appears to support banning of trailer commissions - however Canadians are so used to being told advice is free , it is not obvious what reaction would be . It will be interesting to see investor reaction when the first CRM2 reports are received.
http://boomerandecho.com/are-investors-willing-to-pay-up-front-for-advice/

DIY Investing Is the Only Way to Avoid Conflicts of Interest
http://www.doughroller.net/investing/conflicts-of-interest-diy-investing/

Many Canadians on shaky financial ground
http://m.wealthprofessional.ca/news/many-canadians-on-shaky-financial-ground-217634.aspx

Research: Mutual Fund Investors: Sharp Enough?
Who are mutual fund investors? The answer is critical to regulatory policy. The mutual fund industry portrays fund investors as diligent, fairly sophisticated, and guided by professional financial advisors. The SEC paints a more cautious portrait of fund investors, though touts improved disclosure by the fund industry as a sufficient antidote. However, an extensive academic literature finds that fund investors are unaware of the basics of their funds, pay insufficient attention to fund costs, and chase past performance despite little evidence that high past fund returns predict future returns. These findings suggest that policymakers should rethink current regulatory policy. Disclosure may not be enough. http://ideas.repec.org/a/ris/jofitr/0948.html

Research**: Investor behaviour and beliefs: Advisor relationships and investor decision-making study** OSC Investor Education Fund
http://www.getsmarteraboutmoney.ca/en/research/Our-research/Documents/2012%20IEF%20Adviser%20relationships%20and%20investor%20decision-making%20study%20FINAL.pdf ".In summary, advisors are the key influence in investor decision-making. Investors rely upon their advisor for planning and asset mix advice, as well as advice on what specific investments to buy. Other sources of information are secondary to the advisor's opinion. Investors trust their advisor to provide advice that benefits the client first. This trust is underpinned by a belief that their advisor has a legal responsibility to 'put the client's best interest first'. With this as a foundation of investor belief, investors find little reason to be concerned about fees, and perhaps as a result, fewer than half of advisors disclose what they are paid..". Another troublesome finding is that disclosure of trailing commissions declines as the age of the investor increases. Some 40% of 20-39 year olds agree that trailing commissions were disclosed versus 24% for age 40-59 and just 18% for those age 60+. This suggests to us that a seniors vulnerability issue has developed.

Can financial education improve financial literacy and retirement planning?
http://irpp.org/assets/research/faces-of-aging/can-financial-education-improve-financial-literacy-and-retirement-planning/IRPP-Study-no12.pdf "..."Danger lurks, however, when financial education is viewed as a *substitute* for, rather than a *complement* to, these other policies. Willis argues that "[a] society that believes that financial...education will solve consumer financial problems has an all-too-convenient excuse not to engage in the difficult task of finding better...public policies" (2008, 272).This is not to say that developing financial capability is unimportant — innovative efforts to help Canadians understand the need for retirement planning, to avoid the many perils of the financial services market and to take an active part in policy debates should be encouraged. Such efforts are necessary but far from sufficient... "

Pollara Poll IFIC 2016

According to the 2016 Canadian Investors' Perceptions of Mutual Funds and the Mutual Fund Industry, confidence in financial advisors is strong, with 95 per cent of mutual fund investors indicating they can trust their advisor to provide them with sound advice and 88 per cent saying that they get better returns as a result of the advice they receive. Eighty-two per cent credit their advisor with helping them achieve better savings and investment habits, and 91per cent say they get value for the money they pay to their advisor. One-half of investors say retirement funding is their primary motivation for investing in mutual funds and an additional 14% say their mutual funds are intended to augment their income at retirement or later in life. The current market gives consumers choices about how they access and pay for savings products and advice. The Pollara research found that mutual fund investors prefer to have choice when it comes to payment options. Just over half (54%) would prefer to compensate their advisor through bundled fees, while 37% would prefer to pay a direct fee. https://www.ific.ca/wp-content/uploads/2016/09/IFIC-Pollara-Investor-Survey-September-2016.pdf/15057/

Investor Awareness Booklet
Enhancing the Client-Financial Advisor Relationship (Presented by Onus Consulting Group) *Evaluating Your Financial Advice While Gaining a Better Understanding of Canada's Retail Investment Industry*
http://www.onusconsultinggroup.com/uploaded_files/InvestorAwarenessBooklet.pdf

Is this the end of the line for trailer fees? Aka commissions**: Vanguard**
" Given how common trailer fees are in the mutual fund industry, any hint that commissions may be limited (or even banned as in the United Kingdom and Australia) naturally raises alarm bells from advisors worried about the impact of any restriction on compensation. Our Vanguard colleagues in the U.K. have reported that the advisors who weathered the commission ban best were those who proactively decided to adjust their practices to thrive and not just survive. Many shifted to a fee-based compensation structure, as Vanguard has advocated in our advisor's alpha framework. Our own recent global survey of advisors found this view was shared by a majority, with 83% of Canadian advisors surveyed indicating a fee-based model was better for their practices than a commission-based model, as the illustration shows."
https://www.vanguardcanada.ca/advisors/articles/research-commentary/vanguard-voices/is-this-the-end-of-the-line-for-trailer.htm?lang=en Report at
https://www.vanguardcanada.ca/documents/global-advisor-trends-en.pdf

Miscellaneous

G20 HIGH-LEVEL PRINCIPLES ON FINANCIAL CONSUMER PROTECTION
See section 6 conflicts of interest
https://www.oecd.org/g20/topics/financial-sector-reform/48892010.pdf

TR14/4 – Risks to customers from financial incentives – an update - Financial Conduct Authority https://www.fca.org.uk/news/tr14-4-risks-to-customers-from-financial-incentives

The motivations, needs and drivers of non-advised clients: FCA
https://www.fca.org.uk/publication/research/non-advised-investors-research-paper.pdf
Rethinking Mutual Fund Pricing, Entirely: Morningstar
http://news.morningstar.com/articlenet/article.aspx?id=788545

Supervising retail investor advice: inducements -FCA
https://www.fca.org.uk/publication/finalised-guidance/fg14-01.pdf

Impacts of conflicts of interest in the financial services industry: U.D DOL
https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/proposed-regulations/1210-AB32-2/conflictsofinterestreport4.pdf

Funds overpriced? Various studies, including Standard & Poor's well-known SPIVA reports, have shown that most funds fail to outperform their relative benchmark index fund. In some cases, the fund underperformance can be attributed to the fund's higher incremental costs relative to the benchmark's fees. In fact, a recent study concluded that a large percentage of actively managed mutual funds are priced to fail, as their fees and other costs sometimes negate their actual outperformance of their benchmarks based purely on returns...." https://iainsight.wordpress.com/2017/01/08/the-gotcha-that-wont-go-away/

If he's not rich, don't listen to him – letters to the ROB editor - The Globe and Mail
http://www.theglobeandmail.com/report-on-business/rob-commentary/rob-letters/july-23-if-hes-not-rich-dont-listen-to-him-letters-to-the-rob-editor/article31082809/

Opinion News: Opinion: **Why the time to eliminate trailers has come**
".., The mutual fund industry has no moral authority left when it comes to retaining embedded compensation. The Cummings report has shown that embedded compensation causes conflict and, as such, the people who are pro client choice are effectively pro conflicted advice..."- John DeGoey http://www.wealthprofessional.ca/opinion/opinion-why-the-time-to-eliminate-trailers-has-come-207554.aspx

FCA cracking down on inducements Report at
https://www.fca.org.uk/news/inducements-conflicts-interest-thematic-review-keyfindings
Trailer commissions not the only way advice is skewed.

UK FCA suggests reforms that would make financial advice and guidance work better for smaller investors http://www.fca.org.uk/news/reforms-will-make-financial-advice-and-guidance-workbetter-for-consumers Some of the ideas would work well in Canada too and should be considered by the CSA/Government.

Why it's hard to hope for mutual fund fee reform
http://www.globeinvestor.com/servlet/ArticleNews/story/GAM/20170203/RBGISTRATLABHALLAM

It's time to ban embedded fees - Investment Executive
"...One of the biggest beneficiaries of such a move is likely to be independent advisors. For too long, advice has been devalued by embedded compensation, which distorts the market for advice and undermines advisors' value to clients. Trailer fees work well for the investment fund companies and for dealers because trailers serve as a powerful incentive to accumulate assets - but these fees don't reward superior advice to clients and don't allow high-quality advisors to distinguish themselves. That's why advisors should embrace the CSA proposal to eliminate embedded compensation as a once-in-a-lifetime opportunity to shed a system that devalues their service, deters them from developing into genuine professionals and often compels them to be simply salespeople..."
http://www.investmentexecutive.com/-/it-s-time-to-ban-embedded-fees?redirect=%2Fsearch

Canadian Fund Watch**: Kenmar review of "A Major Setback for Retirement Savings: Changing how Financial Advisers are Compensated could Hurt Less-Than-Wealthy Investors Most "**
http://www.canadianfundwatch.com/2016/04/kenmar-review-of-major-setback-for.html

Self-assessment tool to manage conflicts of interest: IIAC
http://iiac.ca/wp-content/uploads/Conflicts-of-Interest-Self-Assessment-and-Materiality-Weighting-Considerations-June-1-2012.pdf

Is Conflicted Investment Advice Better than No Advice?: NBER
http://www.nber.org/papers/w18158

Supervising retail investor advice: inducements and conflicts-of-interest -FCA
https://www.fca.org.uk/publication/finalised-guidance/fg14-01.pdf

The Market for Conflicted Advice by Briana Chang, Martin Szydlowski: SSRN
Abstract: We study decentralized markets in which advisers have conflicts of interest and compete for customers via information provision. We show that competition partially disciplines conflicted advisers. The equilibrium features information dispersion and sorting of heterogeneous customers and advisers: advisers with expertise in more information sensitive assets attract less informed customers, provide worse information, and earn higher profits. We further apply our framework to the market for financial advice and establish new insights: it is the underlying distribution of financial literacy that determines the consumers' welfare. When advisers are scarce, the fee structure of advisers is irrelevant for the welfare of consumers.
http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2843050

Collapsing Arguments for Conflicted Advice | Huffington Post
http://www.huffingtonpost.com/dan-solin/collapsing-arguments-for_b_8311552.html

Fund Stewardship Matters: Morningstar Research Shows Link Between Good Stewardship and Strong Performance
Morningstar evaluated the 27 Canadian fund providers to which Morningstar analysts had assigned a 2010 Stewardship Grade. The group includes both large and smaller providers, and represents approximately 75 percent of the industry's assets and 1,500 distinct funds. Among this group, Morningstar analysts assigned five firms a Stewardship Grade of "A," six firms received a "B," 15 firms received a "C," and one firm received a "D." Overall, Morningstar found that fund companies with higher Stewardship Grades had better-performing funds during the study period, as measured by their Morningstar Success Ratios.http://www.prnewswire.com/news-releases/fund-stewardship-matters-morningstar-research-shows-link-between-good-stewardship-and-strong-performance-for-canadian-fund-companies-277431651.html

Financial Illiteracy meets conflicted advice: John Turner
http://www.actuaries.org/stjohns2016/presentations/Tue_Plenary_Turner.pdf

Opinion: Conflicted advisors – when weekly sales targets take priority over client care
http://m.wealthprofessional.ca/opinion/opinion-conflicted-advisors--when-weekly-sales-targets-take-priority-over-client-care-207865.aspx

Carl Richards: **Six Things the Investment Industry Can Do to Change the World |** CFA Institute Annual The “behavior gap,” he said, comes from measuring time-weighted versus dollar-weighted rates of return. “Most of the money in a mutual fund is advised; it gets there because an adviser put it there. So if there is a big difference between the time-weighted and dollar-weighted rate of return on mutual funds, and most of the money is advised, we are part of the problem,” he said. “We are constantly creating new products. It is easy to sell to clients what they want, but it takes a bit more to have them purchase what they need, and often we are facilitating this mess we have created. Our industry has to be one of the most opaque industries in the world. Nobody really knows what they pay. It’s really hard to even figure it out.”
https://annual.cfainstitute.org/2014/05/06/carl-richards-six-things-the-investment-industry-can-do-to-change-the-world/

FAIR Canada **» Reforming Mutual Fund Fee Structure Critical For Canadians**
http://faircanada.ca/whats-new/reforming-mutual-fund-fee-structure-critical-for-canadians/

FAIR Canada » **Report to CSA Indicates Trailing Commissions Impact Fund Sales to the Detriment of Investors**
http://faircanada.ca/whats-new/report-to-csa-indicates-trailing-commissions-impact-fund-sales-to-the-detriment-of-investors/

Trailers paid to on-line brokers

We do not understand why IIROC permit trailer commissions to be received by online brokers transacting class A mutual funds. Regardless of the outcome of this consultation, IIROC should use its enforcement powers to prevent online brokers from receiving cash for advice that they do not and cannot provide. There is no way this can be considered as dealing fairly, honestly and in good faith with clients.

Bloomberg TV Canada. **Video on embedded commissions**
It's time we **Do Something' About Mutual Fund Fees in Canada:** OSC Chair Jensen
http://bloombergtv.ca/2016-09-07/news/its-time-we-do-something-about-mutual-fund-fees-in-canada-osc-chair/

Conflicted advice and second opinions: Lowenstein
http://www.cmu.edu/dietrich/sds/docs/loewenstein/ConflictedAdvice2ndOpinions.pdf

Ambachtsheer and Waitzer comment letter to CSA re Best interests
http://www.osc.gov.on.ca/documents/en/Securities-Category3-Comments/com_20160909_33-404_waitzere-ambachtsheerk.pdf

Kenmar Comment letter to CSA Best Interests
http://www.osc.gov.on.ca/documents/en/Securities-Category3-Comments/com_20160711_33-404_kenmar.pdf

It's Time to Ban Advisor Commissions | Canadian Couch Potato on Advocis position
With an investment advisor, the situation is completely different. Selecting appropriate funds for the client is (or should be) a fraction of the overall service. An advisor's time is spent primarily on goal planning, risk assessment, tax planning, portfolio maintenance, behaviour management and a host of other ongoing services. None of that has anything to do with financial products. So why should a professional advisor be compensated primarily by mutual fund commissions?
http://canadiancouchpotato.com/2013/06/13/its-time-to-ban-advisor-commissions/

Anxiety, Advice, and the Ability to Discern: Feeling Anxious Motivates Individuals to Seek and Use Advice
Across 8 experiments, the influence of anxiety on advice seeking and advice taking is described. Anxious individuals are found to be more likely to seek and rely on advice than are those in a neutral emotional state (Experiment 1), but this pattern of results does not generalize to other negatively valenced emotions (Experiment 2). The relationships between anxiety and advice seeking and anxiety and advice taking are mediated by self-confidence; anxiety lowers self-confidence, which increases advice seeking and reliance upon advice (Experiment 3). Although anxiety also impairs information processing, impaired information processing does not mediate the relationship between anxiety and advice taking (Experiment 4). Finally, anxious individuals are found to fail to discriminate between good and bad advice (Experiments 5a–5c), and between advice from advisors with and without a conflict of interest (Experiment 6).

http://www.hbs.edu/faculty/Publication%20Files/gino_brooks_schweitzer_jpsp_2012_fd79893e-9f44-4a69-9460-848527d2d598.pdf

The Gamma Factor and the Value of Financial Advice: CIRANO
This study, based on a new Canadian survey and adjusting for the causality issue, reconfirms the positive value of having financial advice. As in our earlier paper, the discipline imposed by a financial advisor on households' financial behaviour and increased savings of advised households are key to improving asset values of households relative to comparable households without an advisor. Benefitting from a subset of participants in both surveys, dropping an advisor between 2010 and 2014 was costly: those households lost a significant percentage of their asset values while the households who kept their advisor have gained in asset values.
https://www.cirano.qc.ca/en/summaries/2016s-35

How Financial Advisors Can Help Close the Behavior Gap
https://blogs.cfainstitute.org/investor/2015/07/27/how-financial-advisers-can-help-close-the-behavior-gap/

The costs and benefits to fund shareholders of 12(b)-1 plans: SEC
Some history of US embedded commissions in mutual funds.
https://www.sec.gov/rules/proposed/s70904/lwalsh042604.pdf

Why U.S. equity funds in Canada are so lousy | Christopher Davis | Fund Investing | Morningstar
http://cawidgets.morningstar.ca/ArticleTemplate/ArticleGL.aspx?id=761077&culture=en-CA

Most US equity funds are priced to fail — Morningstar
http://www.evidenceinvestor.co.uk/most-us-equity-funds-are-priced-to-fail/

Fund Fees Predict Future Success or Failure: Morningstar
http://news.morningstar.com/articlenet/article.aspx?id=752485

Blowing smoke on trailer fees - MoneySense Cummings
http://www.moneysense.ca/save/investing/blowing-smoke-on-trailer-fees/

Younger investors most willing to pay for financial advice: Cerulli
http://www.investmentnews.com/article/20170104/FREE/170109984/younger-investors-most-willing-to-pay-for-financial-advice-cerulli?ito=583

Financial Advice: Does it Make a Difference? by Michael S. Finke:: SSRN
Abstract: The financial advice profession provides a potentially valuable service to consumers within an increasingly complex financial marketplace. Financial advice professionals can substitute for costly investment in financial knowledge by households. This paper provides evidence that financial advisers improve financial outcomes when the

interests of the advisor and household are aligned. However, professional advice can harm consumers if conflicts of interest create high agency costs. Understanding how differences in compensation methods and regulatory frameworks affect incentives is essential to improving the breadth and quality of professional advice.
https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2051382

OSC Annual Report-Dealers/Advisors A recent OSC report airs concerns over advice to seniors. The Report states:
"Through recent compliance reviews or investor complaints, CRR and the Investor Office, have detected concerns related to the provision of investment advisory services or sales of products to vulnerable investors; in particular, senior investors, but also investors with other vulnerabilities (e.g. a diminished cognitive capacity, a severe or long term illness, a physical disability, mental health problems, a language barrier). Senior investors, especially those who may have diminished capacity, are vulnerable to investment advice that is unsuitable, investment fraud and financial abuse. OSC staff is concerned with issues related to senior investors because: ☐ they are growing as a demographic, both in terms of population and also in terms of household investable assets, ☐ they are relying on investments to fund retirement costs, and in some instances agreeing to invest in high-risk products to generate a desired level of income, and they may have a reduced investment time horizon to recover from financial losses, ☐ they may not understand the risks and investment features of the product they have invested in. We are prepared to take serious regulatory action when we find unsuitable investments."
http://www.wealthprofessional.ca/news/osc-report-airs-concerns-over-advice-to-seniors-other-regulatory-red-flags-211059.aspx Report at
http://www.osc.gov.on.ca/documents/en/Securities-Category3/20160721_sn_33-747_annual-rpt-dealers-advisers.pdf

Canadians deserve real price competition in mutual funds - Inside Track - Investment Executive
http://www.investmentexecutive.com/-/canadians-deserve-real-price-competition-in-mutual-funds

Regulatory Guide 246 Conflicted Remuneration: ASIC
http://download.asic.gov.au/media/1247141/rg246.pdf

Some alternative viewpoints

A Major Setback for Retirement Savings: Changing how Financial Advisers are Compensated could Hurt Less-Than-Wealthy Investors Most: P. Lortie
http://policyschool.ucalgary.ca/sites/default/files/research/financial-advice-lortie.pdf

Four reasons to pay dreaded trailer investing fees
An alternative view of trailing commissions often referred to as fees. Conflict of interest not covered in this article

http://www.globeadvisor.com/AdvisorContext/Articles/20150331_001/Invesco-story-commission.html

In Defense Of Mutual Fund DSC Fees For Smaller Investors
http://www.moneysmartsblog.com/defense-mutual-fund-dsc-fees-investors/

Commission-based clients may not want to switch A new JD Power report on US investors' reaction to the conflict-of-interest rule advanced by the Department of Labor (DOL) has found that investors currently paying commissions do not want to switch to fee-based payment in their retirement accounts, according to Financial Advisor IQ. Under the DOL's fiduciary rule, financial advisors have to always act in their clients' best interests when servicing retirement accounts. The rule also requires for retirement account-holders to be charged fees on a percentage of assets under management instead of on a per-trade or commission basis. While fee-based compensation can motivate advisors to grow their clients' assets, fees can be more expensive than commissions. Responding to a question about their willingness to switch to fees, only 8% of commission-paying investors favour the switch, and another 33% say they probably will. Forty percent are leaning toward disagreement, while 19% are adamant in refusing. http://www.wealthprofessional.ca/news/commissionbased-clients-may-not-want-to-switch-222906.aspx and https://financialadvisoriq.com/c/1590253/182213

Invesco Canada responds to the CSA report on mutual fund fees 2015
http://image.e.invescocanada.com/lib/fe961372756c047c72/m/1/Invesco+Response+to+CSA+report.pdf

Embedded Commissions Article - An Important Read | Advocis Calgary
At the crux of the compensation debate in Canada is the desire to see the consumer properly advised and properly protected. If consumer protection is the real issue for regulators, why not start with increasing advisor professionalism? Consumers would benefit tremendously from a requirement that their advisor meet ongoing proficiency standards, satisfy continuing education requirements, and adhere to a code of professional and ethical conduct that ensures the client's interest is always put first. With this approach, consumers are better protected by knowing their advisor is held to a higher standard — not by having their freedom to choose how they pay for advice taken from them. http://www.advociscalgary.ca/embedded-commissions

Investor Economics report on fund flow factors
https://www.ific.ca/wp-content/uploads/2015/12/Investor-Economics-Analysis-of-Factors-Influencing-Fund-Flows-September-2015.pdf/12353/ [Cumming publicly commented on the IFIC sponsored report by Investor Economics in a few places, perhaps most notable here: http://www.osc.gov.on.ca/documents/en/Securities-Category8/rp_20160209_81-407_faq-dissection-mutual-fund-fees.pdf See, e.g., page 16 ;The last para on page 16 succinctly points out the flaws.

Don't ban trailer fees without all the facts | Steven G. Kelman | Fund Investing | Morningstar
http://cawidgets.morningstar.ca/ArticleTemplate/ArticleGL.aspx?id=721159&culture=en-CA

Embedded Fee Model Under Current Regulatory Structure Serves Canadians Well | IFIC.ca
https://www.ific.ca/en/news/april-16-2013-embedded-fee-model-under-current-regulatory-structure-serves-canadians-well/

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