Via email May 31st 2017

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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

It is great to **once more** have an opportunity to publish my comments on this subject. I am a retiree who is now 83, who has had an engrossing bad experience with the conflicted sales advice emanating from mutual fund commissioned salespersons. Any contribution I can make towards ending this unsavoury practice will then help to prevent this happening to others.

Before I open up with my current commentary, I have one question to ask of the CSA. What happened to all the constructive information the CSA received from 99 respondents to the - ***CANADIAN SECURITIES ADMINISTRATORS DISCUSSION PAPER AND REQUEST FOR COMMENT 81-407 MUTUAL FUND FEES Issued Dec. 13, 2012 ?*** It seems like next to nothing has progressed towards a resolution over the past 4½ years because here we are again now debating the same arguments for and against embedded commission issues. Hopefully, this time there will be an investor focused resolution!

Here is why I am still a skeptic when examining the concept of hidden embedded commissions

In preparation for this CSA Submission, I contacted the CSA with five questions related to the disposition of embedded commissions under certain changing "Advisor" to investor relations. I did not get answers to my questions. Instead, I received a response that I should click on a provided link to the OSC and rummage through **74** Rules, Instruments & Policies papers that should be related to my quest. That was a very good suggestion because coincidentally it led me to the **99** respondents to the CSA 81-407 December 13th 2012 Request for Comments. Right there was my 4-page Submission raising some questions about the very issues related embedded questions that are still the subject of this new CSA 81-408 Consultation !

Here is my April 2nd 2013 CSA 81-407 Submission - http://www.osc.gov.on.ca/documents/en/Securities-Category8-Comments/com_20130402_81-407_whitehouse_y_p(1).pdf

The following will in all probability duplicate some of my 2013 previously expressed views

Dealing Representatives (aka "Advisors") should not be receiving sales commissions from the fund company being recommended. It is pure conflict-of-interest (which I will later explain). A payoff - a kickback ! Embedded commissions can also lead to <u>an invitation for other investor abuses</u> such as selling 7-year DSC funds for immediate de-accumulating RRIFs to the elderly and infirm <u>without disclosing the associated liabilities of early redemption fee penalties for the investor.</u> There is also the improper use of Home Equity loans (leveraging) to invest, as well as designing unbalanced portfolios full of expensive equity mutual funds.

Advisors rarely ever recommend a low-cost Index fund or ETF. The more a client invests in mutual funds, the more in trailer commissions a salesperson makes, while at the same time exposing client accounts to subpar performance and greater risk. <u>The situation is even worse and accentuated when the salesperson works to a Commission Grid that increases the commission rate as sales increase.</u> These Commission Grids only skew the advice even more. There is no focus on the investor at all. Commission grids, embedded commissions and sales quotas are <u>wholly incongruent with the ethics of professional advice.</u> **<u>(There is a simple, genuine sales incentive alternative that can provide additional remuneration to the Advisor salesperson that obsoletes the guaranteed embedded commissions and Commission Grids which I will later explain).</u>**

The last two paragraphs sound like echoes from the past

The CSA, the OSC, IIROC and the OBSI cannot pretend that the subject of the inequity and one-sided unreasonableness of embedded commissions is a recent discovery. Why was it necessary to wait until there was a hue and cry of dedicated investor advocates, as well as aggrieved investors, before the subject was again escalated to a debating marathon with the Investment Dealers and their associations ? The damage of the incredible drain on investor assets over the past 20-years or so and into the open pockets of the Investment Dealers and their employees/agents has been a great incentive for attracting individuals to "Financial Advising" careers. And here we are today with a process that is now well engrained, not for the best interests of the investors, but rather for the best interests of Financial Advisors and the Investment Dealers and the Dealer management. Resistance to change of the status quo of embedded commissions should neither have been unexpected nor permitted.

There is more to the embedded commission remuneration process than meets the eye

In the process of examining my Submission, I would like to emphasize that there is more to the reasons why Investment Dealers, their Advisor employees and their associations have been resisting the removal of embedded commissions.

To those parties, the feature of embedded commissions represent more than just being an integral part of a remuneration. Of note, there has been a recent exposure of hidden double commission dipping by a particular group of Investment Dealers that has come home to roost. With embedded commissions, the "Financial Advisors" and the Investment Dealers do even better than the double dipping feature.

These are the additional beneficial attributes enjoyed by "Financial Advisors" and their employer Dealers when they sell embedded commission mutual/investment funds -

- The "Advisor" can negotiate a front-end sales commission with the investor when the "Advisor" is giving advice by recommending a particular mutual fund investment.

- Under the present regulatory rules, the "Advisor" is permitted to convince the investor that no front-end commission would be charged if the "Advisor" sells the mutual fund to the investor on a Deferred Sales Charge (DSC) basis. Hidden from the investor is the 5 ½% to 6% sales commission that would be **immediately paid** to the dealer/"Advisor" by the MF company when such a transaction is concluded. **With this large commission paid to the Dealer/"Advisor" for giving the related investment "advice", there is no commitment to future loyalty to the investor by the "Advisor" !** There is no regulatory requirement that this rate of sales commission be announced to the investor prior to the sales transaction. Also, there is no obligation on the part of the "Advisor" to convey the detrimental impact associated with purchasing on a DSC sales basis. (The absence of DSC sale conditions full declarations opens up a very serious related regulatory issue with the past non-delivery of mutual fund prospectuses (and/or Fund Facts) that I will be happy to convey in greater detail). (IIROCs response to the reported non-delivery of mutual fund prospectuses was that IIROC was happy with the dealers procedures and maybe the prospectuses got lost in the mail !)

- When an "Advisor" sells mutual funds with embedded trailer fee commissions, the "Advisor" then becomes a partner with the investor without having to risk any money. The "Advisor" is guaranteed to continue to get trailer commissions every quarter while ever the "Advisor" convinces the investor to retain the investment. That feature can become conflicting advice for the investor. Arguments put forward by the Investment Dealer interests that the continuing embedded trailer fee commissions from a mutual fund sale is an inducement for the "Advisor" to stick around to give future advice for free is an absolutely bogus projection !

  The facts are, if the investor has a continuing need for making new investments or realigning investments, (ie. RRIFs), the "Advisor" can earn a negotiated front-end commission for that advice when transacting that next sale, To consider that embedded trailer fee commissions are needed to give advice on the next purchase and then the investor pays a front-end commission or is cajoled into purchasing on a DSC basis, is tantamount to double-dipping.

- If the "Advisor" follows the rules, the "Advisor" will extract confirmation that the investor understands that the investment carries no guarantees that it will hold their original value or increase in value. Over time, the investor can lose valuable assets, however, every quarter the Investment Dealer and the "Advisor" are always guaranteed continuing embedded commissions as long as the investor retains the MF investment. This Investment Dealer and their "Advisor" employee regulatory allowed practice is an inequitable and repugnant unpublished privilege. (I have a personal experience of how our "Advisor" initially walked away with incredibly high 5 ½% and 6% Commissions selling us 80% of our RRIF investments with high risk mutual funds on a DSC basis, then continued to receive trailer commissions after the investments lost about 40% of their original value over a 2 ½ year period.. I am prepared to divulge the shocking full details of this unchecked deception.) **This must stop !**

- When the "Advisor" sells mutual funds with embedded trailer commissions to their lineup of client investors, the "Advisor" immediately creates an asset value with no cost to the "Advisor". With some agreement with their Investment Dealer employer, the "Advisor" can sell their list of clients to another "Advisor" (ie. Selling the Book). The relative value of the client list is greatly enhanced by the presence of continuing mutual fund trailer fee commissions. This is one more conflicting hidden financial incentive for the "Advisor" to load down the investor with mutual funds with embedded trailer commissions that must be prohibited.

Embedded commission hidden manipulations that are outside of the investors control

Prior to my contacting the CSA with questions related to the embedded commission issue, I made a request to the OSC and asked them for answers to the same questions regarding the disposition of embedded commissions under certain conditions. There was no answer from the OSC to my questions but they did respond by saying that embedded commissions are sent from the mutual fund company to the Investment Dealer who then distributes the embedded commissions on some pre-arranged agreement with the "Advisors"

Here are the questions I asked of the OSC but received no answers –

1. What happens to the **continuation of the embedded commission payouts** when an investor terminates their relationship with their Financial Advisor. Who gets the **future** embedded commission payouts ?
Q1. Is it just the Dealer ? If so why, when the investor gets nothing in return for the Dealer receiving the embedded commissions.

2. What happens to the **continuation of the embedded commission payouts** when a Financial Advisor employed by Investment Dealer "A" resigns from an investor's account.
Q2. Who gets the **future** embedded commissions payouts ?

3. What happens to the **continuation of the embedded commissions** payouts when the investor's Financial Advisor employed by Investment Dealer "A" sells the investor's account (selling the book) to another Financial Advisor employed with the same Investment Dealer "A" ?
Q3. a) Who gets the **future** embedded commission payouts ?
Q3 b) This raises the question as to **who owns the investor's accounts**.

4. What happens to the **continuation of the embedded commissions** payouts when the Investment Dealer resigns from the investors account ?
Q4. Who gets the **future** embedded commission payouts ?

5. What happens to the **continuation of the embedded commission** payouts when an investor terminates their relationship with a Financial Advisor employed by Investment Dealer "A" and **the investor transfers their account to Investment Dealer "B" ?** .
Q5. Who gets the **future embedded commissions** payouts ?

6. Considering the above questions, what are the regulations when applying the above questions to proprietary in-house mutual funds ?

The Mutual Fund Dealers (MFDA) Report, referred to in the May 23rd 2017 Investment Executive article entitled, "Ban on embedded commissions could take a toll on non-bank dealers", confirms why the Deferred Sales Charge (DSC) basis sales are promoted for the self-interests of Financial Advisors, which is in direct conflict with the investors best interest.

Here is the link to the full article "Ban on embedded commissions could take toll on non-bank dealers"

http://www.investmentexecutive.com/-/ban-on-embedded-commissions-could-take-toll-on-non-bank-dealers

The article subtitle explanation reads, "New MFDA report also finds that a switch to direct-pay arrangements will "have a greater impact on those smaller advisors who are more reliant on DSCs". This is an incredulous MFDA admission in their Report that, unbeknownst to the unsuspecting investor, they are being deceived to blindly believe that purchasing on a DSC basis is for the benefit of the investor, **when in fact the DSC sale is really for the financial benefit of the "Advisor" and the Investment Dealer with increased hidden commissions over competitive front-end commissions.**

The "Ban on Embedded Commissions" article reports that the MFDA acknowledges that the repugnant excessive 5 1/2% to 6% sales advice commissions of DSCs is needed to help keep a section of independent "Advisors" in business. The MFDA fails to consider and comment on the detrimental implications of unpredictable penalties that the investor must absorb when there is an unexpected need to change or redeem the DSC purchased investments. The potential for this liability for losses to the investor goes unmentioned.

This means that the MFDA condones the conflict of interest that is introduced and the need for investors to subsidize the way of life for a particular group of salespersons who should not be in business if they cannot provide beneficial investment advice worthy of reasonable fees. It would be very unintelligent for an adequately pre-informed investor to agree to take on a DSC liability so that the mutual fund salesperson can take home 5½ % to 6% commission, when the investor could negotiate a 1% or max 3% front-end commission, with no DSC early redemption penalty liabilities !

More importantly, by the MFDA making their observations on the continuing need for "Advisor" salespersons to sell DSC mutual funds in order to stay in business, the MFDA are inadvertently confirming that there is an inherent conflict of interest for the purpose for continuing embedded commissions. That's all the evidence the CSA needs to take immediate action to ban hidden embedded commissions.

***** A full read of the (below linked) May 23rd 2017 MFDA Bulletin Compliance **#0721-C** will help to verify the questionable foregoing information that is used by the SRO MFDA to try to influence a continuance of embedded commissions and especially the continuance of DSC basis mutual fund sales.

http://mfda.ca/wp-content/uploads/Bulletin0721-C.pdf#viewer.action=download

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When investments include locked-in embedded commissions, there is a conflicting self-interest incentive in the hands of the Investment Dealer

There are closely connected issues that require the CSA to examine and redefine, such as –

- Who should have the ultimate controlling and overriding influence over the investor interests once a Financial Advisor solicits investments from an investor and then opens up an account with the Investment Dealer employer ?

  Under the present operational practices that are permitted by the CSA, the Investment Dealer actually assumes ownership of the investor's account immediately after it is opened up by the Financial Advisor. This causes the investors interests thereafter to be subordinated to those of the Investment Dealer. This is wrong, because it is the investor who has the money at stake and who takes all the risks, not the Dealer. The dealer is only there to provide a transaction service, so how can the Dealer assume the power of the ownership of the investor's account when the time comes for the investor's account to be transferred from that Dealer to some other Dealer ?

- The investor pays administrative charges to the Investment Dealer for maintaining the investor's account. This is in addition to any embedded or other sales commissions. Therefore the Investment Dealer should have no legal right to apply discretionary operational practices as though the Investment Dealer owns the investor's account. That is now the case as you will see !
- There is imposing evidence that once a Financial Advisor has opened up an investor account with their Investment Dealer employer, the investor can be subjected to a variety of financial penalties should the investor close out their account because they are dissatisfied with either or both the Investment Dealer or their employee Financial Advisor. In other words, the Advisor can be providing unsatisfactory advice or, in the case of the Investment Dealer, unsatisfactory service. Yet, the investor has to pay penalties to withdraw their account. **This prejudices the investor interest in favour of the Dealer.**
- This discretionary freedom for the Investment Dealer to levy financial penalties is even more egregious when the Dealer causes an involuntary termination of the investor's account. This is a non-theoretical, very real situation that is well explained in a later narrative.

  This involves a case of where the Investment Dealer creates a situation that is against the investor's best interests. The Dealer then reacts by applying a punitive response when the investor moves their account to another Dealer, in order to protect the investor's own best interest.

<u>Here is the real case demonstration that calls for immediate CSA intervention to set up new rules</u>

As a result of recently announced changes in the operations of the Investors Group, there are some basic principles of their operational changes that likewise apply to all Investment Dealers that need to be addressed by the CSA/OSC. This relates to the disposition of investors portfolio investment accounts, especially those with embedded commissions, when Financial Advisors are terminated as employees of the Investment Dealer.

It is important to bring these real live associated issues to the attention of the CSA and the OSC for them to direct some policy decisions and apply appropriate rule changes.

The first issue this Investors Group scenario raises is the overriding very serious question that is, <u>once the investor has been solicited by a Financial Advisor and has purchased investments with embedded commissions through that Advisor, who owns the responsibility for the portfolio account ? Is it the Advisor or the Dealer or the investor ?</u>

<u>Conflicting self-interest discretion of the Investment Dealer</u>

This question of the <u>ownership of the investor portfolio account</u> looms very large when the investor negotiates with the Financial Advisor and understands and places trust that a satisfactory relationship will continue between those two parties. This relationship principle is disrupted and cannot coexist where there is an Investment Dealer discretionary freedom allowed for the Dealer to terminate Financial Advisors like the Investors Group are implementing. <u>The result is that the unsuspecting investor is then at the mercy of the conflicting self-interest discretion of the Investment Dealer.</u>

Here is the May 26th 2017 Investment Executive article detailing the Investors Group operational changes they are making as a result of their dismissing **400** of lower producing "sales force" down to 4,754 older "Advisors".

Here is the link to the IE article –
http://www.investmentexecutive.com/-/investors-group-moving-clients-to-experienced-advisors?utm_source=newsletter&utm_medium=nl&utm_content=investmentexecutive&utm_campaign=INT-EN-morning

Uninvited Investor punitive practices by the Investment Dealer

It is important for the CSA and the OSC to understand and reconcile the detrimental impact of the actions described in the IE article when an Investment Dealer terminates **400** "Advisors" (sales people). These operational actions demonstrate that it is the Investment Dealer who has the discretionary power over the investor's account, not the investor.

There are implications that will have a costly impact on the investor's inherent interests. Investors are being treated like a merchandise inventory when there is a terminating relationship between the Investment Dealer and the Advisor. The net result is that the unsuspecting investor then becomes an additional source of remuneration for the Investment Dealer, their management and a bequeathed successor Advisor, **when the Dealer initiates their employee termination.**

The Investment Executive article explains the Investors Group changes that will be undertaken resulting from the terminating of **400** Advisors, but the article does not offer any critical commentary ! The CSA and the OSC should consider the critical commentary of the impact from any Investment Dealer making similar changes to those being applied by the Investors Group, as covered in the IE article. Here is what the article says -

- Investor accounts whose "Advisors" have been terminated will be re-assigned (handed off) by Regional Managers to other veteran Advisors who have had absolutely no previous or ongoing relationship with the investor. It can only be assumed that this new "Advisor" will immediately inherit and start receiving the embedded commissions, although they have contributed nothing to the interests and relationship with the investor.
- This raises the question, who owns the investor's account, is it the Investment Dealer or the Advisor ? This is an especially pertinent question if the Advisor brought the investor account with them from another Dealer when joining the new Investment Dealer.
- Any investor who wishes to go along with the departing Advisor will be financially penalized for taking their account portfolios away from the Investors Group. But wait, this is a conflict of interest by the Investors Group against the investor, for it is the Investors Group who are seeking the benefit of reducing their sales and management costs at the expense of the investor. This is especially onerous when it involves investors being subjected to DSC early redemption penalties.
- A major consideration with some investment Dealers is that in all probability the Advisors would have sold in-house proprietary mutual funds which raises the question of should the proprietary mutual fund investments be transferable to other Investment Dealers without penalties ?

Considering the forgoing commentary, I highly recommend that the CSA prohibit embedded commissions for all investment products, not just investment funds, without undue delay.
All conflict-of-interest should be avoided- definitely do not depend on disclosure as an investor protection tool.

Investment firms have to do away with such special incentives and inducements, and leave the financial advisor undistracted in seeking the best investment vehicles of financial advice for the client. I urge the CSA to require securities firms and Financial Advisor salespersons to be subject to the more stringent fiduciary/Best Interests standard, as opposed to the looser suitability standard that traditionally has bound them and allowed much misselling and overcharging.

I especially like the idea of unbundling the cost of advice from the product. This will give investors a chance to evaluate the value-add of the advice. When it comes to the life span of a mutual fund, it should be the survival of the fittest, not the ones with the greatest sales financial influencing incentives for the Investment Dealers and their "Advisor" employees. Advice should not be tied to a product sale or retention !

<u>Here is a practical remuneration incentive system to encourage "Advisors" to provide "advice" to all investors, regardless of the size of their investable assets</u>

The arguments put forward by Investment Dealers and their affinity associations that investors with smaller investable assets need the services of embedded commissions because the smaller investors could not afford to separately pay the declared fees for the "advice" delivered. This theory may pass for education in a kindergarten class, but what is the difference between paying an annual 1½% to 2% as <u>declared upfront</u> "advice" fees, in quarterly segments versus hiding 1½% to 2% hidden embedded commissions ?

The idea that hidden embedded commissions are some form of subsidy for smaller investors to get investment "advice" just does not hold water. The facts are that the present hidden embedded commissions are a <u>guaranteed remuneration scheme for the Advisor and the Investment Dealer</u> without any commensurate guaranteed result for the investor. That is both inequitable and totally unacceptable !

Here is the structure of an Advisor remuneration system that is equitable for the value of the advice given to the investor and the performance capabilities of the "Advisor".

After a fully detailed KYC profile of the investor's investing needs are determined and agreed upon, the following agreement would be entered into -

1. At the time of the investor is engaging the services of an Investment Dealer and the "Advisor", there is a mutual agreement between the parties as to the front-end percentage commission or a dollar fee agreed upon for the investment purchases.
2. There is a mutual agreement that the investor will pay fees for the "Advisors" advice services –
   - **(a)** Every quarter the Advisor will provide the investor with a comment summary of the performance of the investor's portfolio.
   - **(b)** If the investor's portfolio has maintained its value, including any redemptions, the parties agree on a percentage fee or dollar fee <u>that would be paid directly by the investor to the Investment Dealer/Advisor</u> for the quarterly "advice" performance reporting summary.
   - **(c)** If the investor's portfolio has gained in value, in addition to the quarterly Advisor "advice" service fee, the Advisor would also receive a bonus percentage of the portfolio gain that is agreed upon by the parties. <u>This is an incentive for the Advisor concentrate on maximizing the performance of the investors portfolio.</u>
   - **(d)** If the investor's portfolio would lose value over the quarter, the parties would agree on a scale of reduction of the quarterly advice performance reporting fees. <u>This is an incentive for the Advisor to concentrate on adjusting the investors portfolio to maintain its performance.</u>

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I, like many other Canadians, should depend on trustworthy advice to manage my retirement account in my best interests. That clearly has been absent from my personal experiences with a bank-owned Investment Dealer over a 7-year period.

There is also the issue that many seniors are deceived by so-called "Free lunch" educational seminars. This is even more divisive when the investing sales presentation is promoted with the inviting title of "Wine, Women and Wealth Seminar". I highly recommend that more precise rules be imposed on how these seminars are promoted and conducted. In the vast majority of cases they are nothing more than sales pitches.

I also urge the CSA to prevent bank-owned investment dealers sending complainants to an "internal Ombudsman". At the best, all that results is a low ball restitution recommendation, not to mention the experience of an outright rejection of valid claims. As there is no regulatory disciplinary oversight of the internal bank Ombudsman when they make false and misleading reasons for rejecting a claim, it is time to remove the bank-owned Ombudsman entirely from the dispute resolution process. If a Dealer rejects a claim they should be directed to OBSI and NEVER to the unregulated entity of the bank "internal Ombudsman", as so many bank brochures do.

This debate on embedded commissions has been going on for decades. It's now time for the CSA to make a bold decision in the face of unrelenting industry opposition. No more monitoring- it's time for ACTION.

A reread of commentary on the **1995** Glorianne Stromberg Report critical of the undisciplined investment industry privileges would now be in order.

Here is the Stromberg Report -
http://www.sipa.ca/library/SIPAdocs/20040409_StrombergSub_NI%2081-107.pdf

Ten years later in **2005**, it seems that very little changed to discipline the undisciplined freedoms enjoyed by the investment industry. Here is the commentary -
http://investorvoice.ca/PI/1647.htm

A further twelve years later in **2017**, the beat goes on looking for the Regulatory authorities to take action to remove the inequitable investing conditions that have unfairly drained hundreds of millions of dollars from thousands of unsuspecting investors into the pockets of condoning Investment Dealers and their "Advisor" employees.

I sincerely hope that the CSA will finally take action to protect Canadians from skewed financial advice. I hope this feedback is useful to you as you set regulatory policy.

I agree to public posting of this letter.

Respectfully,

Peter Whitehouse
An 83-yearold Investor