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June 2, 2017

British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumer Services Commission, New Brunswick
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Yukon
Superintendent of Securities, Nunavut

Attention:

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

Me Anne-Marie Beaudoin
Corporate Secretary
Autorité des marchés financiers
800, rue du Square-Victoria, 22e étage
C.P. 246, Tour de la Bourse
Montréal (Québec) H4Z 1G3

Dear Sirs/Mesdames:

Re: CSA Consultation Paper 81-408: Consultation on the Option of Discontinuing Embedded Commissions

Capital International Asset Management (Canada), Inc. ("CIAM") is writing in response to the CSA's consultation paper 81-408 (the "Consultation") regarding a consultation on whether to prohibit embedded dealer compensation and require investors to enter into direct pay arrangements.

CIAM's responses below are intended to address the three key investor concerns identified in the Consultation as set out below. While we are supportive of investor protection initiatives and generally agree with the disclosure reforms that are currently underway, we do not believe that banning embedded commissions would either (i) resolve the concerns identified in the Consultation or, (ii) be in the best interests of investors.

In addition to our comments below, CIAM supports and agrees with the comments provided by the Investment Funds Institute of Canada in their response letter dated June 9, 2017 (the "IFIC letter") to the Consultation.

While CIAM is registered in the categories of investment fund manager, portfolio manager and exempt market dealer, our responses below are primarily from the standpoint of an independent investment fund manager and address the three key investor protection and market efficiency issues identified by the CSA in its Consultation.

As a private firm with an independent charter, we are focused on doing what's right for investors over the long term. In Canada, the majority of Capital Group's assets are fee-based; Capital Group has never offered a full (5%) DSC option, and our fees have declined as assets have increased.

1. Embedded commissions raise conflicts of interest that misalign the interests of investment fund managers, dealers and representatives with those of investors

Consistent with the Brondesbury report, we believe that conflicts of interest are inherent in any type of compensation scheme, whether through the payment of embedded commissions or through fee-based arrangements. While the nature of conflicts may be different in varying compensation models, conflict mitigation strategies could be applied to appropriately address the specific conflicts in order to better align the interests of investors with those of market participants. This was evident in recent reviews conducted by the CSA, IIROC and MFDA regarding the impact of compensation arrangements and related incentives including conflicts associated with such arrangements.

We commend the CSA's survey conducted in 2014 to identify compensation arrangements and incentive practices used by SRO firms to motivate their representatives which resulted in its Staff Notice 33-318 (dated December 15, 2016) and identified several conflict-based practices used by firms to incent its representatives. Such practices included monetary and non-monetary incentives favouring proprietary products, higher grid payout rates for accounts such as fee-based accounts, revenue recognition biases towards types of products sold, product and service-specific promotions and competitions to encourage sales of specific products, among other related practices.

Similarly, related findings pursuant to reviews conducted by the MFDA and IIROC are summarized below:

MFDA Research: The MFDA published its results on May 23, 2017 of a client research report which was conducted in June, 2016 to further evaluate its members' business operations and various business models. As approximately 95% of MFDA members AUA includes mutual funds, the information in the MFDA report identified those business models, advisors and clients on which the CSA Consultation would have the greatest impact in the event embedded fees were prohibited. The MFDA research summarized the following impacts on such stakeholders.

Financial advisory firms (those that almost exclusively employ advisors as agents who are responsible for developing their own book of business and financing their own operations) would likely be most impacted. According to the MFDA report, approximately 56% of advisors with financial advisory firms have small books of business and predominantly rely on DSC commissions to finance their operations. Their clients include mass market clients (i.e. smaller retail investors) who are serviced by advisors who are generally dually-licensed to sell both insurance and mutual fund products. Since the ban on embedded compensation would not apply to insurance products (such as segregated funds), such advisors may be encouraged to recommend products that may not necessarily be in the investor's best interests or those that are subject to the same regulatory requirements and protections. In its summary remarks, the MFDA report states that in its consideration regarding embedded compensation, "regulators will also need to be mindful of all conflicted compensation arrangements that raise similar or even greater regulatory concerns". In addition to insurance offerings, the MFDA report noted concerns with exempt securities and referral arrangements, not covered by the CSA Consultation.

IIROC Compensation Review: The IIROC report dated April 17, 2017 based on a compensation review that focused on (i) business models; (ii) compensation program and (iii) supervision and compliance processes revealed a number of conflict-related concerns with respect to compensation. The IIROC report highlighted a compensation bias in favour of fee-based accounts over commission-based, since: "most Dealers provide the highest possible grid payout to representatives for fee-based revenue… significant number of Dealers provide additional incentives to representatives in the form of performance bonuses linked to fee-based assets." In this regard, IIROC identified potential conflicts regarding fee-based accounts such as reverse churning and several instances where clients in fee-based accounts paid additional fees or where the advisor received additional compensation (i.e. "double-charging"). Another "significant concern" identified related to dealers providing a higher payout for proprietary products which did not result in cost savings for their clients.

According to its report, IIROC will continue to assess dealers' compensation grids, conduct targeted substantive testing of specific NI 81-105 areas related to compensation conflicts and include a new risk factor that considers compensation arrangements in their future compliance reviews.

Next, we would like to address the CSA's assertions in the Consultation based on Professor Cumming's research that embedded commissions can reduce the investment fund manager's focus on fund performance, which can lead to underperformance and inhibit competition in the industry. The Consultation supports the entrance of lower-cost product providers such as passive ETFs as a means of increasing the competitive landscape if embedded commissions were discontinued.

It appears the marketplace is already addressing this issue. As noted in the IFIC letter, there are strong growth trends for both ETFs and fee-based series of funds. Numerous reports, including those from McKinsey, Morningstar and Investor Economics, support the observation that results are the most important contributor to growth of assets.

Capital Group constantly seeks ways to reduce fees to bring economies of scale to our investors. Our funds, which are distributed primarily by third-party dealers, are sold on the basis of their respective long-term performance, low fees and competitive MERs, our marketing materials reflect that we are focused on delivering consistent long-term results using high-conviction portfolios, rigorous research and individual portfolio manager accountability. None of our marketing materials promote the payment of trailer fees; to the contrary, we promote our funds' low MERs in comparison to industry averages.

As noted in the IFIC letter, there is a dominant industry trend towards lower management, administration fees and fee simplification. The competitive market-place is driving constructive change at a notable pace.

We are concerned that the CSA seems to be favouring passive ETFs and index funds in the Consultation. A passive product, while having merits including potentially lower fees, may not necessarily be in the best interests of or be suitable for all types of investors. We believe the market-place, including registered financial advisors, as opposed to the CSA, can best determine which product is most suitable for investors based on a variety of criteria including KYC, KYP, investor risk tolerance and choice.

An unintended consequence of banning embedded compensation is that the cost of advice will likely increase. The IFIC letter documented the value of advice in mitigating detrimental investor behaviour traits. As the MFDA report noted, a typical entry-level fee-based account carries a 150bp fee for services. A typical 60% equity, 40% fixed income portfolio of mutual funds with embedded compensation would have a trailing commission for advice and service of 80bp.

A second unintended consequence, documented in the IFIC letter and MFDA report, is the possibility of an advice gap for investors with lower account balances.

2. Embedded commissions reduce investor awareness, understanding and control of dealer compensation costs

The Consultation comments that the complexity of fund fees increases information asymmetry between investors and product manufacturers and dealers. We agree with the CSA that investor awareness of fees and product structures could be enhanced. While the amount of embedded commissions is already transparent to investors as they are currently receiving annual reports which include the amount of trailing commissions paid in dollar terms, we believe the CSA should focus on enhancing targeted reforms to better educate investors.

In this regard, we commend the CSA's efforts with the implementation of CRM2 and POS and strongly encourage the CSA to consider further amendments to those initiatives to both educate investors and increase fee transparency. Future CRM2 reports could be standardized to show performance and cost information, including MERs, which would serve the dual purpose of increasing investor awareness and competition among market participants. The POS Fund Facts documents could also be enhanced to include:

- the components of the MER in efforts to better educate investors; and
- an investment objective of the fund which is consistent with the objective disclosed in the fund's prospectus. This is particularly relevant as the industry constructively evolves to goals-based investing.

An additional alternative to increase investor awareness would be to consider capping or standardizing embedded fees, as suggested in the IFIC letter. This would assist in leveling the playing field amongst market participants and eliminate the perceived conflict associated with embedded compensation.

3. Embedded commissions paid generally do not align with the services provided to investors

The CSA is concerned that the 'one-size-fits-all' nature of trailing commissions misaligns services and customized advice provided based on investor's specific needs and expectations. Since the overriding concern is with conflicts of interest, we strongly urge the CSA to pursue some of the policy options retained in the Consultation, namely the regulatory reforms referenced above, reviewing sales incentives pursuant to 81-105 and implementing a regulatory conduct standard on advisors per its prior proposal under 33-404.

The perceived misconduct by advisors could be addressed through a code of conduct governing standards that are consistent with legislative obligations similar to the efforts underway in New Zealand by their Ministry of Business, Innovations and Employment. Focusing on the "conduct" of the advisor rather than an ambiguous "best interest" standard, we believe would enhance the advisor-client relationship and thereby, the services provided to investors.
In addition to the above, we strongly support a review and application of the existing NI 81-105 sales practices as an alternative to banning embedded commissions. Currently, these sales practice rules only apply to the distribution of prospectus-qualified mutual fund securities including investment fund managers and dealer firms who offer or distribute such funds. As mentioned above, this limited application to mutual funds creates opportunities for regulatory arbitrage for other market participants. Since its implementation in 1998, NI 81-105 has not been amended to reflect new industry developments. While we are in agreement with the spirit of these rules, we believe there are significant amendments that should be considered to address current issues and conflict-related concerns.

Concluding comments

As discussed above, we believe that banning embedded commissions would have a significant impact on mass market clients without reducing or eliminating the compensation conflict concerns that the CSA is attempting to address in the Consultation.

Thank you for the opportunity to provide our comments. If you have any questions, please feel free to contact the undersigned.

Yours truly,

CAPITAL INTERNATIONAL ASSET MANAGEMENT (CANADA), INC.

(signed) "Mark Tiffin"

Mark Tiffin
President