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Via Email

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June 9, 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 Commissions, 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:

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Dear Sirs / Mesdames:

Re: Canadian Securities Administrators (CSA) Consultation Paper 81-408 – Consultation on the Option of Discontinuing Embedded Commissions (CP 81-408) (the Proposal)

The Investment Industry Association of Canada (IIAC) appreciates the opportunity to comment on behalf of our members in response to the request for comment on the Proposal. The IIAC is the national association representing the position of 130 IIROC-regulated Dealer member firms on securities regulation, public policy and industry issues. We work to foster a vibrant investment industry driven by strong and efficient capital markets. The IIAC formed a Working Group of member firms to review the Proposal and assist in formulating a of our response.

The Proposal clearly outlines its rationale and objectives. It articulates the options considered and the reasons the CSA has chosen not to pursue certain options because they may not adequately address identified investor protection and market efficiency issues. We also applaud the CSA for the research undertaken in advance of the release of CP 81-408 to provide evidence for stakeholders to consider.

Overview

The IIAC agrees with some of the investor protection and market efficiency issues identified in the Proposal. In particular, we support the need to rationalize the fund series that currently exist, the desire to eliminate compensation-related conflicts and the objective to address transparency of dealer compensation costs. However, the IIAC does not agree with all the key investor protection and market efficiency issues identified by the CSA and that a discontinuation of embedded commissions will necessarily address and resolve these issues. The IIAC questions the CSA assumption that investors would pay less through direct pay arrangements than what is currently paid under embedded commissions arrangements. We believe that assumption is inaccurate especially for mass-market and mid-market investors.

Implementation of this Proposal will lead most IIAC members to consider how their businesses currently operate and the most effective and efficient means to ensure firms and advisors are compensated in the future under any revised regulatory model. The mitigation measures outlined in CP 81-408 fail to appreciate the shift of IIAC members to business models that charge a fee for advisory services. IIAC members have made it clear that this shift to fee-based accounts is the likely result should the CSA proceed with a ban on embedded commissions. This is a significant unintended consequence that the CSA has failed to consider.

Firms anticipate difficulties in adopting the other direct pay options the CSA has identified. Flat or hourly fee arrangements may introduce new potential conflicts of interest, more work and systems costs for dealers and significant adjustments in the client advisor relationship and the compliance oversight regime. It is not likely to reduce costs or fees paid by investors.   Firms outlined that it will be challenging to create arrangements that would make flat or hourly fees economically viable, including how to calculate in advance how much advice and service a particular client may want. Different clients will want more or less of a relationship with their advisor. IIROC advisors are also able to provide clients with an array of products beyond mutual funds and as a result, it would be difficult to separate out the advice provided direct pay arrangements for mutual funds as opposed to securities. It is unclear how an advisor could charge an hourly rate if the meeting with the client involves multiple product types. Consequently, determining a flat or hourly fee in advance that reflects potentially different levels of services and product needs that may be offered is a significant hurdle for firms to address.

The option of allowing investment fund managers to facilitate investors' payment of dealer compensation by collecting it from a client's investment and remitting it to the dealer on the client's behalf is also less likely to be an option that will be utilized by IIAC members.[1] It is unclear how many investment fund managers have the capability to offer this service or be willing to adopt it. How would that compensation be calculated - a percentage? A flat fee? There may also be tax consequences if the investment is in a registered account and redemptions are required to pay the fee.

Most investment dealers do not have the compliance or technological capabilities to track and replicate the "trailer" on a product-by-product level (currently, the fund managers provide this service for trailers). Generally, trailing commissions are standardized by fund type; i.e. equity funds generally have a 1% trailer, fixed income funds a 0.5% trailer, and money market funds a .15% or .20% trailer. If a client has a variety of funds in their account with different fee schedules, the investment dealer is unable to systemically track different fees and cannot replicate those trailer amounts at the product level. Investment dealers would instead likely impose a flat or tiered fee at the account level which could be costlier for the client.

Fee-based compensation is seen to be the most logical solution for the majority of IIAC member firms. This was, in part, recognized by the CSA, which stated in CP 81-408 that "some dealers and their representatives may decide to refocus their business on high net worth fund investors and/or charge a fee for advisory services that some investors may not be able to afford, thus increasing the potential for certain investors to lose access to advisory services."[2] Furthermore, "moving to a fee-for-service model could have the consequence of discouraging some investors from seeking financial advice."[3] It is our view that the shift by investment dealers to a fee-based arrangement is likely to drive up the cost of advice and exacerbate the advice gap.

The Proposal suggests that robo-advice is a solution should there be a prohibition on embedded commissions. Robo-advice may be the only viable option for lower net worth clients with account sizes below fee-based account thresholds assuming the investment dealer firm offers technology based robo-advisory services. However, those investors would lose access to face-to-face KYC advice and personalized service.

As indicated above, investment dealers will likely adjust to a prohibition on embedded commissions by introducing more clients to fee-based accounts. Not only do firms see it as the most practical solution, but firms have indicated that they have increasingly shifted away from a transaction-based model to a fee-based model in general as a business decision. Most firms have said they have seen significant growth in fee-based accounts. Some have indicated that it is a "strategic imperative".

To illustrate this, one need only examine the data in the Investor Economics, Winter 2016 report. For example, fee-based brokerage accounts increased from 11% in 2011 to 22% in 2016, while transaction-based business saw a drop from 85% to 67%. This is partly due to the fact that mutual fund assets were not included in the earlier transition to fee-based programs, but have more recently caught up. Specifically, F-series in fee-based accounts have grown from $9.2 billion in 2004 to $83 billion in 2015.

[1] One firm on the IIAC Working Group did indicate that they currently use this pay arrangement.

[2] See page 77 of CP 81-408.

[3] See page 66 of CP 81-408.

The data also shows that assets in fee-based accounts in general have increased from $202 billion in June 2011 to $448 billion in June 2016. Conversely, transaction-based accounts have been relatively stagnant over this same period of time. This will likely only accelerate in the future, as Investor Economics indicated that mutual funds have gained momentum and will continue to grow in fee-based brokerage programs, even without the implementation of a proposal to ban embedded commissions. By mid 2016, fee-based assets represented 43% of total assets in the full-service brokerage channel, up from 24% five years ago.

Also of note is that the adoption of fee-based accounts was even more rapid after the 2008 downturn. This point further illustrates that robo-advice may not necessarily be the method chosen by many investors, especially when a downturn in markets eventually occurs.

The CSA's assumption that investors will directly negotiate the fee they pay to dealers appears unfounded. Clients notionally have the ability to negotiate payment for certain services today, however it is rare and occurs almost exclusively with savvy, high net worth clients and certainly not "mass market" investors.

On page 72 of CP 81-408, the CSA outlines that rather than the clear disclosure of fees as required under CRM2, an upfront discussion and agreement regarding compensation will address the questions regarding what fees are being paid and what they are being paid for. While the CSA argues that the upfront negotiations will require advisors to better explain their value proposition, CRM2 has already increased the saliency of fees and prompted important discussions of value. All our members have indicated that in the last 18 months or so, they have been preparing their advisors to have these discussions with clients before the first performance reports were released in January 2017 under CRM2. Firms have spent countless hours with advisors to prepare them for these discussions that have been underway with clients for some time now. As a result of CRM2, clients, more than ever before, can see the true costs of trailer fees down to the last dollar and make a determination if they are receiving value for the fees paid and advice provided.

Related to this point is the IIAC's continued view that the CSA should delay any immediate regulatory changes until further analysis of the results of CSA survey on how firms are compensated for their services, how they compensate their representatives, and how they manage conflicts of interest is completed[4], as well as the multi-year research project by the CSA on the POS and CRM initiatives and their effectiveness in addressing the concerns outlined by the CSA. Throughout CP 81-408, the CSA has requested data and we encourage the CSA to adhere to their promotion of data driven policy-making by ensuring that not only the CSA survey data, but the IIROC's recent Compensation-related Conflicts Review as well as the just-released MFDA results, are fully considered as part of the policy decision making process for this Proposal. In particular, the MFDA results indicate broader use of investment funds among the mass-market Canadians and suggest a greater potential for an advice gap if there is a ban on embedded commissions than what is outlined in the Proposal.[5]

[4] CSA Staff Notice 33-318 *Review of Practices Firms Use to Compensate and Provide Incentives to their Representatives*. (2016), 39 OSCB 10115.

[5] MFDA Bulletin #0721-C *MFDA Client Research Report: A Detailed Look Into Members. Advisors and Clients.*

While the CSA argues that investors will have the choice of payment arrangements they prefer and are most convenient to them, in actual fact, most IIROC firms will require investors to enter into fee-based arrangements. We acknowledge that fee-based arrangements may not be suitable for all investors but in practice, this will be the most efficient and effective method for firms to be compensated for the sale of mutual funds. Those clients who do not meet the minimum requirements set by firms will have to seek advice elsewhere, or not at all.

Another assumption made by the CSA is that while the IIAC agrees that the complexity of the mutual fund fee structure and options of fund types can be overwhelming to investors, the CSA has failed to address the complexity and confusion that may arise in the future when investors begin to see two different charges for their mutual fund purchases – one for the MER that is now stripped of an embedded commission and another fee charged for the fund by the dealer as a direct pay arrangement. The CSA has seemed to exclude a discussion of the MER from CP 81-408 and that clients will continue to pay it even with a discontinuation of embedded commissions.

We expand upon our high-level concerns in our responses to the Proposal's questions below.

Response to CSA Questions

Questions 4. For each of the following investment products, whether sold under a prospector in the exempt market under a prospectus exemption:

- **mutual fund**
- **non-redeemable investment fund**
- **structure note**

should the product to 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?**

The IIAC is of the view that for many reasons, if embedded commissions were discontinued, it should apply for products sold in the exempt market and under a prospectus. From a practical perspective, having two different infrastructures for both would be challenging for firms. In addition, as suggested by the CSA, this could lead to potential conflicts of interests for representatives who could chose to sell a product via the exempt market with a trailing commission when such a commission would not be received if the product was sold under a prospectus.

Question 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?

The IIAC has not identified certain types of funds or structured notes that should not be subject to the discontinuation of embedded commissions should the CSA proceed with this Proposal.

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

The IIAC supports a level playing field for the industry and supports the inclusion of products that could otherwise present arbitrage opportunities, such as segregated funds, among others.

Question 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 fees.**

a. Marketing and Educational Practices

NI 81-105 policies regarding marketing and educational practices are well understood, managed and enforced, and as such, we do not believe there is a policy rationale that would justify discontinuing these payments or benefits. Members acknowledge there may have been historical abuses (pre-introduction of NI 81-105) but since the implementation of NI 81-105, firms have implemented robust internal policies in addition to being tightly regulated by IIROC to prevent abuses. Other jurisdictions such as the U.K., which banned embedded commissions, continue to allow marketing and educational payments recognizing their benefits. NI 81-105 requires the dealer incur 50% of the costs of the educational event, removing conflicts and financial incentives for dealers to participate in these events. Members believe educational payments are vital to help fund education and training events that are essential for front line sales staff. Without these events, the cost burden for firms to provide for additional education would increase.

b. Referral Fees

The Proposal does not provide any policy rationale for a potential ban of referral fees. The CSA should not consider wholesale policy changes without articulating the investor concerns and potential consequences. Sections 13.7 to 13.11 of NI 31-103, in addition to provisions in the Companion Policy, clearly outline restrictions and disclosure requirements for referral fees. CRM2 further increases the transparency of referral fees for registerable services, and there are overarching conflict of interest provisions that apply. IIROC dealers have strict internal policies that track and manage referral arrangements and do not believe that referral fees will provide arbitrage opportunities or are misused in the IIROC channel. Furthermore, given the tight controls advisors are subject to if they engage in referral arrangements, members find that advisors do not enter into such arrangements frequently. As such, the current regulatory framework for referral fees is satisfactory.

c. Underwriting Fees

Similar to our comments above, there has been no policy rationale provided for a potential ban on underwriting fees for mutual funds or structured notes. The removal of underwriting fees could be a disincentive for sales through this channel and have negative capital market consequences. Clients value access to new issues as they can buy the securities at new issue price versus secondary market pricing. Firms note that the sale of closed-end mutual funds requires additional work of the advisor, which justifies the additional fee.

Question 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?

IIAC members believe that the rules regarding marketing and educational practices should be maintained. As previously noted, there are already restrictions regarding contribution levels and we do not believe it is necessary to change the scope of the permitted payments or benefits. However, as the IIAC commented in relation to CP 33-404, we suggest that the application of NI 81-105 be expanded to include pooled investment vehicles and structured products, especially when they are targeted towards retail investors.

Question 10. With respect to internal transfers payments:

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?

Integrated financial service providers of the IIAC Working Group indicated that they do not provide internal transfers payments to their affiliated dealers instead of trailers with respect to mutual fund products. The affiliated dealers and their representatives receive the same trailing commissions as an unaffiliated dealer or those selling third-party products would.

Question 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.

IIAC members support preserving choice for client payment options for advice and products. This payment option is currently permitted and we believe this option should continue if embedded commissions are discontinued. While the majority of IIAC members intend to move clients to fee-based accounts and are unlikely to use this payment option, this payment option could be very important for client-name accounts where the client cannot maintain a cash component inside their account and for firms that serve clients who may not meet fee-based account minimums.

Question 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?

The IIAC does not agree with all of the investor protection and market efficiency issues identified and we do not believe that the Proposal, if implemented, would satisfactorily address those concerns. Further, throughout this submission, we have outlined a number of potential negative consequences, including decreased choice in payment options, and an increase in the cost of advice.

In addition, the Proposal may not have the desired impact on the cost of products that the CSA envisions. The IIAC questions the CSA's view that the Proposal could reduce overall investing costs through product movement from higher cost mutual funds to lower cost passive investments. The preference by many advisors for actively managed funds is not because of compensation, but based on the benefits of active management. The CSA appears to be comparing product costs without considering the value proposition between the products. ETFs are still a "newer" product and they have not been part of many clients' portfolios during a market downturn and it is not clear how clients will react when there is a market correction. Further, there are regulatory and operational impediments for advisors in the MFDA channel to sell ETFs.

Change in investor experience and outcomes

Question 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?

This question presupposes that clients are not currently receiving services aligned with the fees paid. IIAC members would disagree with that generalization for their clients and believe that initiatives such as CRM2 are helping clients understand the value they receive for their fees. Further, clients require different levels of service based on their unique needs, ability to pay for services and other factors. Service levels should not be judged against a checklist of "must-dos" to add value.

It is important to point out that for IIAC members, the embedded commissions that clients pay, regardless of the fund purchased, are generally consistent for each asset type; approximately 1% for equity funds and 50 bps for fixed income funds. There is little variability in the rates for each category of asset class that dealers receive. Trailer fees are more standardized today than they were in the past and thus, firms believe it is quite likely that clients will be paying more for the same funds in the future if these clients are required to purchase those funds within a fee-based account or other direct pay arrangement. This is especially true for clients with smaller investable asset amounts. For most fee-based accounts, the percentage of the fee is reduced for clients with higher investable assets. A client may now be charged a fee in excess of 1% for all account assets not just the specific fund. As a result, fees may be higher for many clients and the client needs will not necessarily have changed. While the fees and services may be aligned within fee-based accounts, some clients might be better served in a different sort of account arrangement, with reduced services and fees – although those options will also limit the ability for a high degree of face-to-face advice.

In addition, while the CSA believes that a discontinuation of embedded fees would result in a better and clearer advisor-client relationship, an hourly or flat fee will not necessary provide the client with the level of service envisioned by the CSA.

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

Currently, the products available and the level of personalized advice for clients using robo-advice is relatively limited. It is unknown at this time if robo-advice will expand to include a broader range of products and services, including actively managed products and offer increased levels of personalized advice. Further, it is undetermined what the pricing of robo-advice would be for those potential services.

While firms acknowledge the role that robo-advice has in today's market, it is still a small portion of the market and does not meet all investors' needs, especially those who are seeking face-to-face advice. Among Canadians who identified their primary investment relationship as full-service (i.e. with a dedicated human financial advisor), only 3% indicated they have tried using a robo-advisor.[6] As the CSA considered, it is also possible that these online entrants will not grow or stagnate at current levels.

A point made by the CSA in CP 33-404, and a point with which the IIAC agrees, is that there should be more emphasis on the need for increased professionalism of the industry and the provision of advice. However, by relying on robo-advisors to help certain clients, the focus becomes more on product advice rather than what the objectives of CRM 1 and 2 set out to achieve – that of enhanced communication and improvement of the advisor-client relationship in order to better inform the client of the nature of the account relationship and the services offered to clients.

This is evident from a recent article in Advisor.ca.[7] It demonstrated that while robo-advisors offer lower fees which can save investors a great deal of money, it fails to provide the advice that a human advisor can recommend – such as whether it is better to contribute to a TFSA or RRSP, how to pay off their credit card debt faster, how to create a budget, how to use tax savings from RRSP contributions to make lump-sum payments on a mortgage, etc. Therefore, while fees matter, it is clear that advice also matters.

As we outlined previously, many firms plan to only offer fee-based accounts if the Proposal is implemented. As a consequence, some clients will not have sufficient levels of investable assets to meet the minimums for fee-based accounts and may be forced to use robo-advice whether they wish to or not. Other clients may be seeking new advice models as a result of their investment dealer consolidating or leaving the advice space, and still others may choose robo-advice based on costs or other preferences. While these changes may certainly lead to additional growth in automated advice, based upon the present

[6] *2016 J.D. Power Canadian Full-Service Investor Satisfaction Study*

[7] See http://www.advisor.ca/news/industry-news/do-human-advisor-fees-offer-more-value-than-robo-advisor-fees-225908

robo-advice product and advice landscape, not all clients will be best served by shifting into the robo-advice channel.

Further, the IIAC is particularly concerned with how seniors may be negatively impacted if they are encouraged to shift to a robo-advisor. Additionally, as baby boomers near retirement and enter the de-accumulation phase, direct advice from an advisor will become increasingly important.

The IIAC and IIROC have both issued guidance and best practices for members on how to address seniors' issues. There are concerns regarding diminished capacity, use of powers of attorney and financial exploitation. One of IIROC's best practices relates to effective communication with senior clients and we wonder how robo-advisors will be able to manage communications with senior clients to assess if there are issues of diminished capacity or if someone is pressuring the client to change the asset allocation within their account. Emails, or phone conversations may not be able to pick up the same risk factors that an advisor could identify in face-to-face meetings. This is a regulatory area that must be considered if the CSA continues to promote robo-advisors as a solution to address the potential personalized advice gap that could result from CP 81-408 implementation.

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

Discretionary managed accounts require certain minimum asset thresholds (some firms have stated they are sometimes set at $250,000, however many PMs will have their own minimums which tend to be higher and closer to $500,000) and their growth will be limited to clients that satisfy those requirements. There are increased regulatory requirements, including proficiency and supervision requirement for discretionary accounts. In order to mitigate risk associated with managed accounts, they are generally limited to certain types of clients (often knowledgeable and sophisticated), and restrictions are placed on the types of products that may be purchased within such accounts. Most often, managed accounts have a much more limited shelf of permissible products, including the purchase of options or the use of margin. New issuances and structured products are also relatively rare. The most important difference is the full discretion the advisor has over the products selected. Further, given the specific investment strategies and value proposition for clients who have managed accounts, they would not expect the portfolio manager to be purchasing mutual funds within such accounts. Consequently, it is unlikely that there will be substantial growth of discretionary advice in the mass-market segment. Furthermore, as the CSA correctly pointed out, if an increase in discretionary advice were to occur, it would "be likely to drive up the cost of advice."[8]

Despite the inability of many investors to afford discretionary advice, other regulatory proposals such as a best interest standard with its accompanying legal implications and inherent risk, may result in many firms simply offering managed accounts to their clients, further encouraging the growth of discretionary managed advice.

[8] See page 61 of CP 81-408.

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?

There may be some growth in this channel for reasons similar to robo-advice as some clients will not satisfy the account minimums for fee-based accounts and may not have alternative account type options at a particular dealer, other clients may be disenfranchised as a result of their dealer consolidating or leaving the advice space, and other clients may choose online based on costs or other preferences. However, many clients do not have the financial knowledge, time or the desire to manage their financial investments themselves and want access to financial advice. It would not be beneficial for investors to be shifted into the discount brokerage channel if their preference would be to have access to personalized financial advice.

The Proposal would also likely have an impact on the fee structure for discount brokerage accounts. Embedded fees subsidize other costs associated with managing and operating the account. Some firms have said that without embedded fees, their platform would no longer be profitable or sustainable. Firms must determine how to adapt their trading fee structures – currently many platforms allow clients to buy or sell mutual funds without a trading fee and to make switch or redemptions without fees. Going forward, there may be fees for each of those transactions. As mutual fund trades are among the most expensive to process, firms may be required to increase or introduce new fees to recapture their costs, such as ongoing administration fees to ensure the model remains economically viable. Firms also indicated a possible reduction of offered products and the availability of tools and resources would have to be considered to potentially reduce expenses.

Question 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?

As previously discussed, most firms would move to fee-based payment arrangement and are generally not considering flat fees, hourly fees or front-end fees as payment arrangements.

Question 17. Do you think this proposal will lead to an advice gap?

On the topic of the advice gap generally, the IIAC notes that the CSA stated the following in CP 81-408:

Based on the experience in other jurisdictions, we note that an advice gap is not a phenomenon that occurs only because of a ban on embedded commissions, but rather it is a function of a number of factors (changes to existing business models, changes to consumer preference, technological changes, etc.) that occur normally in any competitive market for financial services.[9]

While the above comment may be true to some extent, the IIAC and our members firmly believe that the advice gap will necessarily widen with a discontinuation of embedded commissions. As we state

[9] See footnote 117 on page 63 of CP 81-408.

throughout this submission, IIAC members will largely move clients to fee-based accounts if embedded commissions are removed. This will automatically result in many clients either not meeting the minimum thresholds required to open fee-based accounts and/or potentially pay more in fees than they currently pay in trailing commissions.

We do not believe that the CSA sufficiently considered this result, based on its emphasis throughout CP 81-408 that clients would have a variety of options to choose from with respect to how fees might be paid in the future.

This result also occurred in the U.K. where it is noted that almost half (48%) of firms used a fee-based system post-RDR[10] even when previously existing ongoing commissions payments were permitted to continue until April 5, 2016.

The CSA also seems to believe that "market innovations" would help ensure that mass-market households still have access to advice. We find this sweeping statement somewhat troubling as there is little data provided to support it.

While the Financial Conduct Authority (FCA) report in December 2014 found limited evidence of an advice gap, HM Treasury and FCA launched the Financial Advice Market Review, published in March 2016[11], aimed to specifically address concerns regarding an advice gap. It outlined several key findings including that advice is expensive and not always cost-effective for consumers as well as the fact that there are many consumers who would be willing to pay for advice but who are discouraged by the cost.

Recent research from the Schroders Adviser Survey[12] in the U.K. show that account minimums have increased. In 2014, £25,000 was generally an account minimum but by 2016, that amount had increased to a £100,000 minimum. Even more concerning is that two out of ten advisors surveyed admitted to formally asking smaller clients to leave their practice post-RDR.

Which segments are likely to be affected?

The mass-market segment and mid-market segment are likely to be the most impacted by firms' movement to fee-based accounts and the potential increase in the cost of advice. Seniors in particular may be disenfranchised if they are not comfortable using robo-advice or online brokerages. We previously mentioned particular concerns for seniors' use of robo-advice relating to diminished capacity, abuse, use of power of attorneys, and the lack of access to personalized advice regarding the de-accumulation phase.

[10] See footnote 98 on page 57 of CP 81-408.

[11] See page 15 of CP 81-408.

[12] See http://www.thisismoney.co.uk/money/investing/article-4024484/Financial-advisers-hike-investment-fees-50.html

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

The differentiation between face-to-face advice and other advice is appropriate. Personalized advice cannot be replaced by robo-advice or online advice and it is important for the CSA to monitor if clients lose access to personalized advice as a result of the Proposal.

Do you think online advice could mitigate an advice gap? If so, how?

At this time, the level of personalization and the product selection in the online advice channel are not comparable to face-to-face advice and should not be considered a mitigation measure to address the loss of access to face-to-face advice.

Do you think that the significant market share of deposit-taker owned and insurer-owned dealers in the fund distribution in Canada will affect the size or likelihood of an advice gap to develop?

There is a concern that the Proposal could result in a reduction of the products and services available at deposit-taker owned dealers as it may become uneconomical to provide mutual funds. It is the IIAC's understanding that bank branches may have similar concerns to those of IIROC members regarding the implementation of other payment models such as hourly or flat fees and that it may be prohibitively expensive and administratively burdensome to have investment managers redeem fees. A potential narrowing of products or services available is a concern even if the clients have continued access to advice through a deposit-taker or insurer-owned dealer.

Question 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?

While a wholesale shift away from embedded commissions is unlikely, the industry has made significant changes to the mutual fund fee structure in recent years without regulatory intervention. For example, the industry has been moving away from the DSC option, with many IIROC firms no longer even offering DSCs. Furthermore, as we have indicated elsewhere in this submission, trailing commissions have become quite standardized and consistent throughout the industry with very few equity funds pay trailing commissions over 1%. These examples demonstrate how a market response occurred to address the misalignment of interests between fund managers and dealers with those of investors.

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

The IIAC has some concerns with Figure 8 on page 50 of CP 81-408. While we understand that the chart was based in part on data from Investor Economics, Morningstar and Ipsos, members had issues with the information presented under the IIROC channel. Specifically, it indicates that independent dealers have account minimum of $250,000 and that deposit-taker firms have account minimums of $500,000. While there are certainly some minimums for fee-based and managed accounts in that realm, most firms indicate that either they have no minimums (especially in non-fee based accounts, i.e. commission-based accounts) or the minimums are significantly lower than those represented (for example, a common minimum referred to is $100,0000). As a result, we are the view that this chart requires amendment.

We believe this correction in account minimums for IIROC dealers is important as Figure 8 currently would underestimate the impact of the Proposal on mass and mid-market clients who currently have access to advice with IIROC dealers.

Question 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?

IIAC members did not identify any regulatory or structural reasons for the limited use of fee-based series in Canada. Discretionary managed accounts are a sub-set of fee-based accounts and these advisors have access to a broader range of financial products beyond simply mutual funds and correspondingly, the use of funds in these accounts is more limited. Further, for clients with $100,000 to $150,000 in investable assets, it is generally less expensive to buy advisor series when factoring in the MER than to purchase F class funds.

Potential Impact on competition and market structure

Question 21. Please describe how discontinuing embedded commissions will affect competition and market structure and whether you agree with the analysis 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?

The investment industry is already undergoing a period of consolidation and the Proposal may only further accelerate the rate at which firms determine whether or not to merge or exit the industry. Smaller dealers may not be able to absorb a reduction in revenue while clients are being converted into a direct payment model. Since 2012, Canada has lost 60 boutique IIROC firms through either mergers or closures. There are another 50 IIROC firms that are currently losing money and their ability to remain operational is unknown. In this environment of tighter margins, and increased regulatory costs, the loss of a revenue source could have a significant impact on whether or not some of the boutique and independent firms are able to survive.

What are the likely impacts on investor outcomes and market efficiency of any potential consolidation?

The IIAC believes that the loss of independent firms would have a negative impact on investors. Independent and smaller firms may offer different services and products and will often have lower account minimums. Reduced choice or access is not an optimal outcome from the Proposal.

What opportunities and what challenges do you think the proposal would introduce for specific industry stakeholder groups?

IIROC Dealers

The Proposal presents numerous challenges for IIROC firms which are outlined throughout the response.

With respect to potential opportunities the Proposal may present, some firms may benefit from industry consolidation through mergers. The merged firm may be able to leverage technology to improve their scalability and increase asset levels. Other IIROC firms that have developed robo-advice channels may benefit if there is an increase in the number of investors that use robo-advice as a result of displacement. However, the challenge in a movement towards robo-advice is that this channel may not be able to appropriately address asset allocation. In addition, robo-advice may not be the best model for mutual funds in a registered account, which are usually held as part of a long-term strategy.

Online/discount brokers

As with other IIROC firms, discount brokerage firms similarly face numerous challenges on how to re-price their models if embedded commissions are banned. As previously discussed, firms may introduce new trading fees, custody fees or administration fees to compensate for the lost revenue. IIAC members did not identify any potential opportunities for online brokerage firms as a result of the Proposal.

Finally, online/discount brokers and other channels may wish to seek reasonable compensation from fund manufacturers for the substantial infrastructure costs of operating dealer firms, such as the costs of initial and ongoing education and registration of employees, technology to support sales and regulatory processes, market research to meet evolving client needs and client support services, including phone, online and digital channels. If this compensation were not directly tied to investors' purchases or continued ownership of investment fund securities or structured notes, this would not result in investors indirectly incurring embedded commissions.

What is the likelihood and magnitude of regulatory arbitrage across similar financial products such as segregated funds and deposit-taker products? What would be the impact on dually-licensed mutual fund dealers and insurance agents?

The potential differences in the rules for securities and insurance products provide an opportunity for arbitrage. IIROC advisors have suitability obligations that mandate what products should be recommended to clients. Further, many IIROC firms are including products like segregated funds and GICS in their CRM2 reporting.

However, firms stated that dually-licensed advisors can sell insurance products through an insurance carrier and those products would not be held within the IIROC dealer and would not be subject to the same suitability and reporting requirements. The IIAC has advocated for consistency of regulatory requirements across financial products.

Will the proposal lead new, lower-cost entrants to market? Why and how?

IIAC members believe that the Proposal will not necessarily result in "new" entrants but that current market participants could expand their distribution channels or develop new products. There are significant regulatory and monetary barriers to entry. The Proposal suggests that embedded commissions make it more difficult for new entrants to have their products distributed, however firms disagreed and stated that dealers have significant KYP requirements and new products must demonstrate their ability to perform. The CSA's CP 33-404 targeted reforms may further restrict product shelves and limit the ability of new entrants to have their products distributed.

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?

The IIAC believes that the proposals set out in CSA CP 33-404 contradict, in some instances, the assumptions set out by the CSA in CP 81-408.

One-Size-Fits All

For example, while the CSA has criticized the "one-size-fits-all" nature of trailing commissions which it believes misaligns the provision of services and advice customized to the investor's specific needs, expectations and preferences[13], many of the targeted reforms in CP 33-404 we believe, in fact contemplate the very opposite result.

The CSA has argued a discontinuation of embedded commissions will be replaced by an upfront discussion regarding compensation and what fees are being paid for and for what. The result, states the CSA, is more likely a "compensation arrangement that is most appropriate for the client's situation."

While we agree that compensation should be based upon the customized services received that specifically contemplate the client's situation, as we argued in the IIAC's CP 33-404 submission, the targeted reforms will result in all advisors being expected to offer services and have proficiency levels more akin to a financial planner or CFA rather than an investment advisor. We outlined in our submission that the CSA is creating a one-size-fits-all type of client ignoring that not all client's wish to receive certain services, nor pay for them.

As the CSA acknowledges in CP 81-408, "financial services and advice can, but need not always encompass a broad range of services such as investment recommendations, asset allocation, the setup of systematic savings plans and/or registered plans, the preparation of a written financial plan, tax planning, estate planning, debt management, budgeting cash flows, etc."[14]

The IIAC fully supports this statement; however, the proposed targeted reforms appear to create one, inflexible standard meant to work for each and every client. Specifically, the detailed KYC information (such as basic tax information, total net worth and outstanding debts) is more appropriate for an

[13] See page 15 of CP 81-408.

[14] See footnote 118 on page 63 of CP 81-408

individual opening a portfolio managed account but not an individual purchasing RRSP securities at a bank branch. This is also evident in the targeted reforms around suitability, requiring the consideration of "other basic financial strategies", including non-securities product strategies (such as suggesting the client not invest but pay down debt or directing cash into a savings account).

As we stated previously, and outlined by the FCA in their Financial Advice Market Review, clients do not want or need personal recommendations in respect of every decision, nor do they always need a comprehensive assessment of all their financial circumstances and requirements. [15]

While CP 81-408 appears to support this approach, the outcomes of many of the targeted reforms will lead to the opposite result.

Robo-Advisors and CP 33-404

CP 81-408 anticipates that robo-advice will be disruptive to the status quo and have the potential to increase access to advice over time and become an "important distribution model in Canada."[16]

However, as the IIAC set out in the submission to CP 33-404, that consultation paper fails to address the diversity of business models offered by our members. Specifically, CP 33-404 does not discuss how the targeted reforms and a best interest standard would be applied to members with discount brokerage operations. Most importantly, CP 33-404 is silent on how robo-advisors would satisfy a best interest standard.

Furthermore, how would a robo-advisor satisfy the proposed targeted reforms – for example, under the proposed suitability targeted reforms, whether a client should not invest, but pay down their mortgage instead.

Will a transition away from embedded commissions reduce fund series and fee complexity, as we have contemplated?

Fund companies can close series or merge series and that would force clients into reduced series options. For the fund companies, there would be administrative issues depending on whether or not they close or merge series. At the dealer level, it can be difficult for firms to switch their clients to other fund series as firms require client consent. Firms have stated that they do not expect that all clients will provide the necessary consent to switch series. This is a regular struggle for firms when they are attempting to reach clients and obtain necessary consent. Often clients simply fail to respond.

As such, firms may need regulatory assistance to address situations where there are "orphaned" client accounts. It is already a problem which was highlighted by CRM2, and firms expect to see more occurrences of orphaned accounts with this Proposal when client consent is required in order to switch clients into fee-based fund series or other direct pay arrangements. Firms should have the ability to end the client relationship when the client does not respond to communications by the dealer. Otherwise,

[15] https://www.fca.org.uk/publication/corporate/famr-final-report.pdf at pages 6 and 33.
[16] See page 58 of CP 81-408.

firms would no longer be collecting any revenue from the client but would still be required to provide tax reporting, CRM2 reporting and other various regulatory reporting at a loss. In such situations, we suggest the introduction of a default mechanism such as negative consent for those clients who fail to respond to repeated attempts by the firm to engage.

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 are already utilizing cross-selling and cross-subsidization and member firms do not believe the Proposal will result in an increase in these business practices.

What are the potential effects on competition of the rise in online advice? Are these effects likely to be large and positive?

IIROC dealers do not believe that robo-advice will directly compete with traditional face-to-face advice in terms of their pricing and value proposition. However, if there are more participants in the robo-advice channel, the competition among robo-advisors could influence pricing, product offerings and the level of services provided.

Question 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? To what extent, if any, does the use of direct pay arrangements by representatives today alleviate the need for some of these controls and oversight?

IIROC currently requires firms to have controls and oversight for their fee-based accounts so in that respect, members do not believe the Proposal would alleviate the need for most of those controls and oversight. In addition, members believe that other direct pay arrangements, such as hourly fees, would require more controls and oversight as firms would need to review invoices and monitor the time each advisor spent on each of their accounts and ensure that the charges are appropriate. Furthermore, at the front entrance point, the set-up time of such accounts would be quite significant. In addition, under direct pay arrangements, rather than charging at the product level, new arrangements will be required for charges at the distribution/account level. The challenge of this shift from product level pricing (where a fixed income fund is charged at 0.50%, an equity fund at 1.0% and a money market fund at 0.15-0.20% and are all standardized), is that once the charges are moved to an account level, it becomes much more challenging to determine the appropriate pricing and as a result, it is likely that firms will move to just one global account price (which may be a higher total cost).

With respect to the option for investment fund managers to facilitate payment, unless there is industry or regulatory consistency in the arrangements, there could be a number of control and oversight concerns. For investment dealers, it is very difficult to maintain oversight over these arrangements as some investment fund manufacturers will take instructions directly from clients or advisors, even in nominee account scenarios, meaning the dealer will not be aware of the fee arrangement, the appropriateness of the fee rate charged etc. until after the fee is applied and even at that point, the transaction code may not make this very obvious as systems such as Dataphile were built before these types of arrangement were put in place. In the current environment, it would be a very labour intensive process to manage.

Question 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?

As previously discussed, the loss of trailing revenue for some firms will be sufficiently disruptive and result in mergers or some firms exiting the industry entirely. For those firms that are able to transition to other revenue sources, they will ensure that their new models compensate for the loss of trailing revenue. Members believe that not all direct payment models will be able to compensate for the loss of trailers and that is one reason why certain models will not be utilized by most firms.

Question 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?

In general, members do not believe that representative compensation models will change. Members did note that there may be increased dealer costs with the introduction of the Proposal and CP 33-404 and correspondingly, the commission grids or advisor salaries may be modified to reflect that, or the costs may be passed on the investors.

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

- **a. access to advice for investors,**
- **b. choice of payment arrangements for all investor segments, and**
- **c. a level playing field amongst competing investment products?**

a. Access to Advice

As discussed previously, it is too uncertain at this time to assess whether innovations in technology, including various forms of online advice, will make the provision of advisory services to smaller accounts more viable. Robo-advice is still in its infancy and it is unclear to what extent investors will shift to robo-advisors in the future. An affiliate-dealer in the U.K. has observed that the use of robo-advice has not increased to a large extent since the banning of embedded commissions. The general experience in the U.K. appears to be a slower acceptance of this form of advice, partially due to the high infrastructure spending that is necessary, in addition to the lack of clear evidence regarding profitability for dealers. It is still a question as to whether robo-advice will assist smaller investors.

The mitigation measure referring to the fact that investment managers could facilitate investors' payment of dealer compensation by collecting payments from the investor's fund investment and remitting them to the dealer on the investor's behalf, presents some significant challenges. Members indicate that this type of arrangement would be extremely problematic to manage as compared to a fee-based arrangement. Specifically, it would be challenging to implement based on the wide variety of funds that would be held in each account. Dealing with this variety fund by fund, advisor by advisor and account by account could make such an arrangement unworkable. In addition, as the CSA recognized, not all investment fund managers have the capability to offer such a service to dealers, or to do so, would require a significant outlay of costs that have to be passed on. IIAC members also pointed out that currently just three fund companies provide such a service in a consistent and reliable manner today.

Furthermore, members indicated that there would be challenges in ensuring the integrity of the fee system. The CSA proposal would expect the client to negotiate the quantum of the payment with the dealer but then the investment fund manager is tasked with collecting the payment at the correct rate that the client negotiated with the firm. There would be issues regarding reconciliation – ensuring that the fee the client agreed to is in fact the fee that the dealer is receiving. Furthermore, if some fund companies offer this method of collection and some do not, it will cause additional complications for dealers potentially reducing the choice of investments available. Members also indicated that to have such systems in place for clients with smaller investable assets will not be cost effective for the client or the dealer.

Finally, while the CSA discussed their view that research suggests that embedded commissions encourage high fund costs and inhibit competition by creating a barrier to entry, the Proposal to have investment fund managers facilitate investors' payment of dealer compensation, would in fact create a significant barrier to increased competition by new entrants into the market. The costs of implementing such a system for new entrants would be prohibitive.

As we outline below in Question 30, such an arrangement also leads to issues regarding GST/HST where deductions are made from the purchase amount or from periodic withdrawals, as well as capital gain taxes where redemptions are made, in addition to more significant charges where such redemptions are made with respect to a registered account.

b. Choice for Investors

The CSA has provided no evidence that investors would in fact, be willing or able to negotiate the fees they pay nor even welcome such a system. Furthermore, as the IIAC has stated elsewhere in this submission, members have indicated that they will move almost all clients into fee-based arrangements should the CSA proceed with a prohibition on embedded commissions. As a result, investors will have little choice and in many instances, pay more for their mutual funds than they do today. This would be especially true for households with less investable assets who would pay more for a fee-based account than high net worth clients.

c. A level playing field amongst competing investment products?

As mentioned previously, the IIAC supports a level playing field for the industry regarding possible gaps in the regulatory framework for segregated funds and possible risks relating to regulatory arbitrage by dually-licensed insurance agents. We encourage the CSA to work cooperatively with the CCIR to ensure that both investor protection and market efficiency issues are addressed.

Question 28. What other measures should the CSA consider to mitigate the above unintended consequences?

The IIAC is unable to provide any further measures.

Question 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 payments 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?

Each type of direct pay arrangement presents its own tax challenges. With respect to flat or hourly rates, HST/GST would be added to the fees, thereby increasing the cost of any fee charged. Further, it could be very difficult for the client to determine how to allocate the fee in terms of what is an allowable tax deduction for investment advice in a non-registered account. For example, if the client and advisor meet for two hours and discussed financial planning and various mutual funds for the client's portfolio, how would that conversation be tracked and divided into what advice would be considered deductible and what would not.

Redemption pay arrangements could trigger capital gains or losses when securities are redeemed as compensation. These losses/gains could be triggered monthly as the fees are paid out and result in complicated tax reporting for the client and potential tax liability if there are gains, increasing the overall cost of this option. From a dealer perspective, this arrangement requires additional compliance and supervision policies as firms would need to create unique codes to track the redemptions to provide to the CRA. This option also has a risk of timing misalignments between redemptions and the payment of fees, which would put the account into a debit. Of concern is the situation where the account is a registered account, and any redemption that results in a debit balance may cause the firm to be liable to CRA for the amount of the advantage.

Another tax concern occurs when a client is invested in funds in a registered account and the client wishes to pay their fees from another account, the CRA is now considering whether paying the fees from another account is an advantage and this may no longer be permitted without penalties. In addition, firms will face complications when the client is invested in illiquid funds that may be problematic to redeem and therefore may need to pay the fees from outside the account.

Other potential impacts

In addition to the operational and tax impacts discussed above, the reduction of fund series or the switching of clients into different accounts could negatively impact CRM2 reporting. For many firms when a client is transferred to a new account, even internally, the performance reporting data is reset. Many firms rely on service providers, and one of the industry's largest providers for CRM2 data management and reporting resets performance for new accounts. As we have previously discussed, many clients will be moved to fee-based accounts, other clients may have to transfer firms as a result of industry consolidation or move to robo-advisors, so this could impact a large number of clients. We do note that some firms have the capability to retain performance history for internal transfers.

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?

The CRA currently views switches between series as a non-taxable event and therefore there should not be negative tax consequences to the client. However, the switches can impact tax reporting and make it more difficult to track historical information on the security. A switch is considered a purchase and data may be tracked from the "purchase" when the switch occurs making it more difficult to track the historical information.

What, if any, measures, regulatory or otherwise, could assist in mitigating potential operational and tax impacts?

In order to reduce the number of fund series, fund companies would either have to close funds or merge series. Each option would require convening a special meeting of shareholders. Administratively, this would be a significant burden for dealers to manage the proxy process. These meetings would be on top of the normal AGM proxy season. In order to mitigate this impact, the CSA should provide exemptions to the fund companies for these special meetings. If the series are being merged or closed for regulatory reasons, shareholders cannot prevent the mergers or closures and therefore the meetings would be an unnecessary expense and a misuse of firms' resources.

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,

a. **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?;**

b. **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**

c. **What measures may mitigate the potential effects on dealers, representatives and investors from the loss of the cross-subsidy?**

It is likely that the loss of this cross-subsidy would have some impact on the cost of providing advice and services to lower-wealth fund investors. As we have previously stated, this would also be the case where lower-wealth fund investors are moved to fee-based accounts. In such situations, in order to cost-effectively service these accounts, dealers would have to charge higher percentages for these smaller households, as well as charge upfront fees for services such as financial planning.

With respect to high net worth clients that are often in fee-based accounts, the higher amount of investable assets, the lower the percentage that is charged for these accounts. Furthermore, the higher the assets, the lower the MER that is often charged, so these clients generally pay fees that are aligned with the services they are receiving.

Question 32. For each transition option, please tell us how your business (investment fund manager or dealer) would have to operationally change on restructure in terms of systems and processes and the related cost implications. Where possible, please provide data on the estimate costs.

- **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?**

And

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

IIAC members do not believe that Option 2 is a workable or practicable option. The logistical challenges of transitioning a certain percentage of accounts by a certain date would only increase complexity and costs for both dealers and fund managers.

We believe that Option 1 is more appropriate. The proposed transition period of 36 months may prove to be challenging, especially in circumstance where flat or hourly fees are introduced, thus requiring clients to meet with their advisors and negotiate a new fee and payment method. Meeting with each and every client in a 36-month time frame would be extremely difficult. This time frame would also be challenging for dealers who plan to move clients into fee-based accounts and the accompanying discussions that would be necessary with these clients. Further, firms may be unable to obtain the required client consent to transition clients and this will impact timelines. It is an unfortunate reality that not all clients actively engage with their advisor or dealer and a certain number of consents will not be signed back. It could be as a result of the client not having an incentive to sign the form and the envelope may never be opened, it could be a forgotten account, or there was a change of address. Property law requirements related to unclaimed property would only become effective after several years and would not address situations where the client refuses to change to a fee-based account for example. Firms should be provided with the ability from regulators to impose a default fee schedule or to be able to move clients to fee-based accounts if, for example, that firm is no longer offering commission based accounts.

In addition, as IIAC members are dependent on third parties such as FundServ, it would be up to such companies to articulate the time frames necessary for the technology builds that would be required from their end. Similarly, dealers would need time to make the necessary changes to their technology as well as the systems, compliance and procedural changes, including receiving client instructions and building those into the client documentation. This includes the necessary documentation that would result with the collapse of series options.

With respect to DSC and low-load purchase options, the IIAC would leave this question to the fund managers to respond to regarding whether these options be maintained until the redemption schedule is completed or discontinued at the Transition Date. However, we imagine that fund managers would likely indicate that options be maintained until the schedule expires. This is due to the fact that the managers have already paid an up front commission to the dealer, so in order to recoup their costs, they must be permitted to continue to charge the ongoing management fees as well as any redemption fees until the completion of the redemption schedule. Furthermore, many fund managers would be unable to simply unwind and discontinue a schedule as they often have financing arrangements in place to pay the upfront commissions.

Question 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 IIAC does not believe the CSA should consider using a fee cap as a transition measure. To begin with, many of the conflicts of interest identified by the CSA in respect to embedded commissions would continue. In addition, we do not believe that the CSA should interfere with the fees charged in the investment industry and the challenges this would present in respect of setting the appropriate rate either in the present or future.

Furthermore, such a measure, especially as a transition or interim solution, would simply cause increased costs and complexity for investment dealers and additional confusion for clients.

Conclusion

While the IIAC does not, in principle, oppose a discontinuation of embedded commissions and the possible investor protection concerns it may address, it is important to highlight the business realities that would result in the investment industry from the Proposal - specifically a wholesale shift to offering only fee-based accounts for most clients, irrespective of the CSA permitting other direct pay arrangements.

As a result of this likely unintended consequence, we believe the CSA may need to consider possible alternatives to a ban of embedded commissions that may provide remedies to the issues the CSA has highlighted including conflicts of interest, transparency and investor awareness of fees paid, and the alignment of services to fees paid.

For example, as mentioned previously in this submission, the industry has recognized some of the issues surrounding DSCs, and the IIAC would support the removal of this fee option as it can result in the inhibition of movement to other products.

Although conflicts of interest management was specifically addressed by IIROC in its existing Guidance Note 12-0108 released on March 26, 2012, the IIAC acknowledges that the management of compensation-related conflicts of interest is certainly an area where improvements can be made, and believes this can be achieved if the industry and regulators work cooperatively on this issue.

IIROC has promoted this objective first in IIROC Guidance Note 16-0068 issued on April 6, 2016; then again in its Guidance Note 16-0297 issued on December 15, 2016 where it highlighted some preliminary results of its review to gather more detailed information on how firms identify, monitor and manage compensation-related conflicts; and finally in the recently released Guidance Note 17-0093 issued on April 27, 2017.

The IIAC and our members generally support the additional guidance provided in the recent Notice which helps to supplement and clarify IIROC Guidance Notice 12-0108. We recognized that additional guidance is needed to assist firms to not only reasonably identify, manage and supervise compensation-related conflicts of interest, but how to take steps to avoid them where possible. We fully support IIROC's statement that disclosure alone may not be sufficient. Further, we agree that IIROC's Business Conduct Compliance team should take additional steps to strengthen its oversight of compensation-related conflicts through enhancements to its exam process.

We concur with the findings from IIROC's review, specifically that firms can do more related to their compensation programs to ensure that they do not contain certain features that could result in a misalignment between the interests of advisors and those of their clients; that firms can ensure that disclosure is complete and in plain language, and that supervisor compensation should consider other factors to offset undue bias towards branch profitability at the expense of the client's best interest. However, we maintain our position that regulators should not interfere with the amount of fees or compensation charged by firms; market competition and demonstrating value to their clients should govern how fees and compensation are determined.

In addition, members have some concerns with the factors that IIROC may be focusing on in future examinations of a firm's fee-based account programs. While IIROC generally acknowledges that cost alone is not the only factor when determining to put a client in a commission-based or fee-based account, it is important to stress the value proposition of fee-based accounts beyond simply the fee charged. This includes the consistency and transparency of a predictable fee, the clarity provided to clients with these accounts, including understanding the value of the services they pay for, and more closely aligning the interests of the client, advisor and firm when the advisor compensation is not tied to trading. Fee-based programs are particularly appropriate for investors who prefer consistent and explicit monthly or annual charges. As such, it is inappropriate and misleading to determine the client benefits of a fee-based account solely based on costs related to transaction fees charged under a commission-based account.

It is also important to recognize that fee-based accounts can take on a number of forms and methods to determine the amount of the fee. Some firms offer a specified number of trades within a fee-based account and above that number the client pays per trade. Other firms may offer fee-based accounts with a commission per trade on top of the fee. There may also be a number of services that are offered in conjunction with a fee-based account based on the firm's offerings and expertise and the needs of the client. Thus, it is important to recognize that firms have differing business models and rationales for their fee-based offerings.

The IIAC would be pleased to work with both IIROC and the CSA in its determination and potential development of any additional amendments to and/or revised guidance on the Conflicts of Interest Rules. The IIAC believes that this approach may best address many of the concerns raised by the CSA under the Proposal.

We would welcome an opportunity to discuss our submission and address any further questions the CSA might have.

Sincerely,

M. Alexander

Michelle Alexander
Vice President and Corporate Secretary
Investment Industry Association of Canada