Investors Group

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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

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

We are pleased to provide comments on behalf of Investors Group Inc. (Investors Group) on the CSA's Consultation Paper dated January 10, 2017 which seeks to assess the potential effects on investors and market participants of discontinuing embedded commissions; identify potential measures that could assist in mitigating any negative impacts of such a change; and obtain feedback on alternative options that could sufficiently manage or mitigate the investor protection and market efficiency issues identified by the CSA.

Our company

Investors Group is a diversified financial services company and one of Canada's largest managers and distributors of mutual funds, including the exclusive distributor of its own products. It carries out its distribution activities through its subsidiaries Investors Group Financial Services Inc. (IGFS) and Investors Group Securities Inc. (IGSI), which are members of the Mutual Fund Dealers Association of Canada (MFDA) and the Investment Industry Regulatory Organization of Canada (IIROC), respectively, with assets under management of over $85 billion as at April 30, 2017. Investors Group also carries out insurance advisory services through I.G. Insurance Services Inc. Serving our clients since 1926, Investors Group distributes its products and offers financial planning through 93 region offices, represented by over 4,500 representatives to approximately one million clients across Canada.

Investors Group is part of IGM Financial Inc., which is a member of the Power Financial Corporation group of companies.

Overarching Comments

Investors Group agrees with the CSA in the desire to better align the interests of investment fund managers, dealers and representatives with those of investors; to deliver greater clarity on the services provided and their costs; and to empower investors in the dealer compensation process. We are committed to improving our clients' financial well-being.

For over 90 years, we have firmly believed that building long-term relationships with clients is the best way to help individuals reach their financial goals at each stage of their lives. Our focus is on comprehensive financial planning that includes investments, retirement, tax planning, estate planning, insurance and mortgages. We have long encouraged and provided financial support to representatives to obtain the Certified Financial Planner (CFP) designation or, in Québec, the Planification Financière (F.Pl.) certification, which we believe instills high standards of competence and professionalism through rigorous requirements of education, experience and ethics. More recently, we integrated these programs into our internal training programs and in May of this year, we made the enrollment and completion of the CFP or F.Pl. for all representatives mandatory within a prescribed period. We further provide our representatives with financial planning support and training through comprehensive financial planning tools and access to financial planning, investment planning, retirement, mortgage, securities, tax and insurance specialists. As at March 31, 2017, approximately 1,578 Investors Group representatives hold a CFP or F.Pl. designation, and another 2600+ are working toward their certification.

We do not believe we should wait for regulators to tell us what is right for our clients. We should be doing that ourselves. Toward that end, we have developed at IGM Financial Inc. a list of seven commitments that reaffirm our core values, from putting our clients first to fostering a culture of excellence.[1]

On September 19, 2016, Investors Group announced that we would discontinue the deferred sales charge (DSC) purchase option for our mutual funds effective January 1, 2017. While DSC was created to provide discipline to long-term investing, we concluded that the marketplace had evolved. Investors Group remains committed to servicing mass-market households because we know that the benefit of advice on wealth accumulation is ongoing and significantly greater the longer the advice relationship.[2] While we do not anticipate the CSA's proposal to discontinue embedded commissions will impact our ability to provide a wide array of financial products and services to households with little to invest, in part because of the vertically integrated nature and size of our firm, we know that there will be many dealers and their representatives who may only be able to continue to service more modest clients because of the embedded commission model.[3]

Therefore, as the CSA deliberates on whether or not to proceed with a ban on embedded commissions, we believe an essential prerequisite for the CSA to consider must be for any reform to not disproportionately impact or favour certain registrants to the detriment of others. As the CSA acknowledges in the Consultation Paper, discontinuing embedded commissions does just that, favouring deposit-taker owned fund dealers who today already dominate investment fund distribution in Canada, and significantly disadvantaging independent and small fund dealers. This, we believe, could ultimately lead to an even greater concentrated market, with fewer choices for products and advisory services resulting in less innovation and competition in our capital markets, to the detriment of Canadian investors. We also know that fewer choices of compensation model

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[1] Our stated commitments are: (i) inspiring financial confidence, (ii) putting our clients first, (iii) helping our clients reach their financial goals, (iv) keeping stakeholders informed, (v) fostering a culture of excellence, (vi) being a good neighbour, and (vii) making sound decisions for the long term.

[2] Advice has a sizeable and ongoing, positive impact on financial assets that increases with the tenure of the advice relationship, controlling for all other variables: the ratio of advised to non-advised financial assets was found to be 1:7 early in the advice relationship, growing to 3:6 for relationships 15 years or longer (Source: CIRANO, *The Gamma Factor and the Value of Financial Advice,* 2016).

[3] The MFDA indicates that MFDA members provide advisory services to close to nine million households in Canada, or about 56% of all Canadian households, and of them, about 83% (or 7.3 million households) fall within the mass-market space, defined as those with less than $100,000 in financial assets. MFDA non-deposit taker owned fund dealers form a significant part of the industry servicing 2.36 million households and licensing approximately 32,000 advisors within the MFDA membership, of which 56% (or 19,021) of these advisors have small books of business and predominately rely on DSC commissions to finance their operations (Source: MFDA Bulletin #0721 C – *MFDA Client Research Report: A Detailed Look into Members, Advisors and Clients* (May 23, 2017) ("MFDA Client Research Report")).

can limit access to advice and result in higher overall cost if only fee-based compensation services are available, particularly for households with more modest investment levels.[4]

Given these potential outcomes, we question whether the “complementary” benefits the CSA say may occur with discontinuing embedded commissions outweighs the very real and adverse impacts that will occur to some dealers, their representatives and most importantly, to Canadian investors.

We firmly believe that when fully implemented, the outcomes that will be achieved with the CSA’s Point of Sale disclosure (POS) and Client Relationship Model (CRM) projects, together with the reforms in CSA Consultation Paper 33-404 (CSA CP 33-404),[5] will substantially address the key investor protection and market efficiency issues identified in the Consultation Paper. Moreover, as the Investors Group decision to discontinue DSC illustrates, we submit that the financial services industry in Canada today is undergoing rapid and significant changes due to investor preferences and competitive market forces independent of regulation, which is furthering the CSA’s stated objectives.

Therefore, to the extent the CSA considers that there remains any regulatory gap, we believe that there are other regulatory options that the CSA can and must consider first that will, in conjunction with current regulatory reforms, address the CSA’s concerns while maintaining investor choice, accessibility to advice and a fair and efficient capital markets. In our view, the discontinuation of embedded commissions is not required to address the key issues identified in the Consultation Paper.

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[4] In the United States, the average total cost of fee-based advice is comparable to the cost of advice in Canada (2.00% to 2.20%), however the cost is higher for modest investors with less than $100,000 of financial assets (2.40%) than for high net worth investors (1.70%) (Source: Investor Economics & Strategic Insight, *Monitoring Trends in Mutual Fund Cost of Ownership and Expense Ratios: A Canada-U.S. Perspective,* 2015). Where regulation has been changed to ban or limit commissions, the absence of embedded compensation has been found to lower the cost of the product, but the cost of advice was seen to go up. It has also been found that in jurisdictions that have moved to fee-based compensation, those with less wealth or income found it more difficult to get advice than others. Ultimately, all forms of compensation affect advice and outcomes and there is not enough evidence indicating that fee-based compensation will lead to better long-term outcomes than commission-based compensation (Source: Mutual Fund Fee Research prepared for the Ontario Securities Commission on behalf of the Canadian Securities Administrators, written by Dr. Edwin Weinstein, PhD The Brondesbury Group, Spring, 2015 (“The Brondesbury Report”)).

[5] CSA Consultation Paper 33-404 Proposals to Enhance the Obligations of Advisers, Dealers, and Representatives Toward their Clients (April 28, 2016). In our response letter to CSA CP 33-404, we identified some potential unintended consequences arising from the targeted reforms and provided some alternative suggestions where possible. We also stressed the importance of treating firms and advisors subject to the same proficiency requirements and standards of conduct the same, no matter the product shelf, and the need to provide firms and their representatives the flexibility to provide streamlined services and financial advice. In our view, the targeted reforms, applied consistently to registrants and business models, and with flexibility in the framework to recognize client engagements will vary in scope and services, can achieve positive outcomes for Canadian investors.

On this point, we believe it is noteworthy for the CSA to consider that while regulators globally have been focused on issues similar to those articulated in the Consultation Paper, a number of regulators and particularly government policy makers, when engaged in this review, have explicitly chosen not to ban embedded commissions. Their reasoning, in part, includes the recognition that it would be detrimental to impose a reform that will have a negative impact on independent and smaller market participants and create further concentration of asset management with deposit-takers. In New Zealand, policy-makers very recently decided to focus their regulatory efforts on the conduct of those providing financial advice, rather than imposing a ban or restriction on commissions, concluding that "banning commissions is not a 'silver bullet' that will improve the quality of advice".[6] While in the United States, we note that the Department of Labor (DOL) fiduciary rule still permits firms and their individual advisers to receive most common forms of compensation for advice to retail clients under the best interest contract (BIC) exemption, so long as the firm and adviser provide advice in the client's best interest, charge only reasonable compensation, and avoid misleading statements about fees and conflicts of interest.[7]

Given this global regulatory landscape, we believe the CSA should provide a more detailed analysis as to why the approaches taken in such countries such as Sweden, Hong Kong, Germany, New Zealand and Singapore, all of whom have chosen not to ban embedded commissions, would not be equally appropriate approaches for the Canadian market and for Canadian investors.[8] This analysis was absent from the Consultation Paper and we believe it is worthy of a more in-depth discussion and a public consultation before a regulatory decision is made to discontinue embedded commissions in Canada.

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[6] Ministry of Business, Innovation & Employment (MBIE), *Factsheet – Review of Financial Advisers and Financial Services Providers Acts*, July 2016 (see also: MBIE, *Review of the Financial Adviser Act 2008 and the Financial Service Providers (Registration and Dispute Resolution) Act 2008*, July 2016. We also have seen Sweden's minister for Financial Markets and Consumer Affairs indicate that the government will be proposing legislation that will not ban commission-led sales of financial advice and products in order to allow investors to continue to have access to a wide range of products and advice (Source: Investment Europe, *Swedish government proposes not to ban commission-led sales*, May 24, 2016).

[7] The White House, Office of the Press Secretary, *Factsheet – Middle Class Economics: Strengthening Retirement Security by Cracking Down on Conflicts of Interest in Retirement Savings*, April 6, 2016.

[8] Currently, only four countries have imposed a ban on embedded commissions: Australia, Netherlands, South Africa and the United Kingdom. In the Netherlands, the discontinuation of embedded commissions is a voluntary arrangement among the five large banks that dominate investment fund distribution. While under the MIFID II reforms, the imposed ban on embedded commissions only applies to independent financial advisors, which make up only 11% of the European market. Despite MIFID II, a number of jurisdictions have concluded not to impose a ban on embedded commissions, including: Belgium, Denmark, France, Germany, Ireland, Italy and Sweden. Additionally, we have seen a number of other jurisdictions decide not to proceed with the regulatory option to discontinue embedded commissions, among them: Brazil, Hong Kong, India, Israel, Japan, New Zealand, Singapore and South Korea.

Structure of Our Response Letter

In our submission, we provide insights and specific data of our experience in the Canadian market, as well as offer alternative regulatory options for the CSA to consider that we believe address the stated concerns in the Consultation Paper. In the appendices to our letter, we provide more detailed responses to some of the operational and tax questions posed in the Consultation Paper and also give some insights into the value of active-management, which we find positioned in the Consultation Paper as being somehow an undesirable outcome for investors that will be remedied through the discontinuation of embedded commissions.

Our submissions are predicated on the desire that (i) we retain an innovative, competitive and fair financial services industry in Canada, which provides investors with access to choices to a broad range of products, manufacturers and dealers, and (ii) that financial advice in Canada remains accessible and affordable for mass-market householders.

Importance of Preserving an Innovative, Competitive and Fair Financial Services Industry in Canada

a. Avoiding regulatory arbitrage

As we have noted in prior consultations, it's important to remember that the securities industry is only one part of the financial services sector in Canada. Insurance and deposit products are also significant segments of the industry. For example, deposits and short-term savings vehicles in the bank branch channel account for approximately $1.2T, just slightly less than the approximate $1.4T in mutual fund assets in Canada.[9] We have long advocated that the obligations owed by registrants to their clients and the regulation of retail financial products should not depend on the legal nature of the investment vehicle being sold or the licence held by the registrant. Insurance and deposit investment products are also significant segments of the industry, and compete directly with the sale of investment funds. As the CSA is aware, there are embedded commissions and costs built in to many of these other financial products, notably segregated funds as well as spreads on guaranteed investment certificates (GICs) and daily interest accounts (DIAs).

From the client experience, it is only fair and reasonable that the same set of rules that apply to investment funds apply to other similar financial products. With the POS and CRM projects, as well as the proposals in CSA CP 33-404, there already exists a schism in terms of disclosure and registrant conduct regulation across the financial services industry in Canada. This, in our view, creates complexity and confusion for investors and can lead to inconsistent client experiences and investment outcomes.

We believe it is noteworthy that in each of the jurisdictions that has introduced a complete ban on embedded commissions, the ban has extended beyond investment funds. This is a very important distinction to what is proposed in the Consultation Paper. We welcome the CSA's support for a

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[9] Investor Economics, *Household Balance Sheet*, 2015.

harmonized regulatory approach for similar products, and the recent paper by the Canadian Council of Insurance Regulators (CCIR) on segregated funds.[10] However, the potential for regulatory arbitrage remains. The Consultation Paper gives no indication of the timeline for the CCIR's review or a commitment for coordinated action with the CSA, nor is there any discussion in the Consultation Paper of whether a similar review is being considered by the Office of the Superintendent of Financial Institutions (OSFI) with respect to banking products, such as GICs and DIAs.

At Investors Group, we apply the same standards of conduct and compliance supervision as applicable to our duly registered securities and insurance representatives in each jurisdiction. For example, we have similar supervision programs for mutual fund and segregated fund recommendations, including trade review processes related to suitability in relation to client KYC information.

As part of the CSA's deliberations, the potential impact of product and regulatory arbitrage cannot be disregarded or discounted. We found it particularly disconcerting that the CSA suggests in the Consultation Paper that the high level of horizontal integration at deposit-taker owned dealers somehow leads these firms to focus less on any one business line and more on "gathering assets across all business lines and on directing clients to the appropriate business line". Respectfully, we submit the recent CBC Go Public reports suggest otherwise.[11]

Without harmonized product and registrant conduct regulation across the financial services industry, the concerns expressed by the CSA in the Consultation Paper with respect to embedded commissions and misalignment of interests will continue to be just as relevant in the distribution of other types of financial products. This in our view is inconsistent with the CSA's mandate of achieving strong investor protection and fair and efficient capital markets.

We therefore strongly urge the CSA to work collaboratively with insurance and banking regulators. Given the make-up of the financial services sector in Canada, we do not believe it is sufficient for the CSA to say that it "assumes" that the self-regulatory organizations and regulators of non-securities products will remain vigilant and take any necessary action in the case of non-compliance. Should a decision be made by the CSA to proceed with discontinuing embedded commissions, any such securities regulatory reform must only proceed if it is accompanied by concurrent and consistent regulatory initiatives for investment fund-like products across the insurance and banking industries.

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[10] Canadian Council of Insurance Regulators, *Segregated Funds Working Group Issues Paper*, May 2016.

[11] See: CBC News reports by Erica Johnson, http://www.cbc.ca/news/canada/british-columbia/td-tellers-desperate-to-meet-increasing-sales-goals-1.4006743 (March 6, 2017), http://www.cbc.ca/news/business/td-bank-employees-admit-to-breaking-law-1.4016569 (March 10, 2017), http://www.cbc.ca/news/business/banks-upselling-go-public-1.4023575 (March 16, 2017), http://www.cbc.ca/news/business/bank-s-deceptive-titles-put-investments-at-risk-1.4044702 (March 29, 2017) and http://www.cbc.ca/news/business/financial-investment-rules-client-interests-1.4069847 (April 17, 2017).

b. Preserving a competitive and innovative industry

The CSA acknowledge that discontinuing embedded commissions will have more of an impact on some dealers (such as smaller independent dealers) than others. In fact, the Consultation Paper notes that a ban on embedded commissions will have little to no effect on deposit-taker and insurer owned dealers as most households who purchase investment funds purchase through such dealers, which dominate investment fund distribution. While the impact of a ban on embedded commissions may appear small in terms of distribution, we believe it is critical for the CSA to consider the important role non-bank dealers and manufacturers play in the Canadian market, especially relative to this segment's size.

The concentrated and vertically integrated distribution landscape in Canada has made it increasingly difficult for independent dealers and investment fund manufacturers to effectively compete and ensure investors retain access to choice in terms of financial advice and financial products. As the CSA now considers discontinuing embedded commissions, considering how such a regulatory change will affect the vibrancy of the financial services industry in Canada is critical, as this too has a significant impact on the client experience and investment outcomes.

In our view, the assertion in the Consultation Paper that "investment funds are less popular than traditional savings vehicles with mass-market households" is much more a result of the oligopoly and horizontal integration of the banks, than a testament to investor preference. We strongly disagree with what seems to be the CSA's sentiment that the avoidance of an "advice gap," because deposit-taker owned dealers in Canada will continue to service mass-market households, somehow negates the adverse impacts that a ban on embedded commissions may cause.

Market Forces are also Driving Changes Independent of Regulation that are Achieving Regulatory Objectives

We strongly believe that competitive market forces are already effecting industry changes that the CSA identifies as some of the positive outcomes that they expect may occur from discontinuing embedded commissions. In particular, we are seeing today (a) the growth and availability of direct-pay (negotiated advisory fee) options to all investors in all channels; (b) reductions in fund fees and fund fee complexity; (c) increased price competition and (d) market innovations in product distribution and advice.

a. Fee-based and direct-pay options continue to grow in all channels

The CSA is correct to identify that the share of mutual fund assets held in fee-based purchase options (F series) is growing, and growing quickly. Competitive market pressures are driving the growth of F series for many fund manufacturers, with frequent changes to the F series offering or pricing. Fee-based program assets as a percentage of total assets is gaining ground in IIROC platforms, and in full-brokerage the shift in advisor compensation is in-line with the shift to fee-based.[12] Investors Group, through IGSI, introduced non-discretionary Fee Based Accounts and dealer discretionary Separately Managed Account (SMA) programs in 2016.

b. Reduction in fund series and fund fee complexity underway

In the last few years, we have seen a number of proactive actions taken on the part of investment fund managers aimed at reducing fund fee complexity and series simplification. At Investors Group, we have made an ongoing and active effort to reduce the number of funds on our product list. Our perception is also that fund management fees and embedded distribution costs have become more uniform, and are continuing to decline. Finally, we continue to see fund managers either simplifying asset house-holding programs or move to a flat fee pricing strategy. While we believe there will always be some differences across asset-managers, in part because of competition and innovation, this dynamic innovative and competitive environment, coupled with recent regulatory changes, has led to improved client experiences and investment outcomes.

c. Increased Price Competition Occurring

In the last few years, we have seen a number of investment fund managers announcing fee cuts,[13] trailer fee cuts, administration fee cuts as well as an increasing number of share classes with lower MERs year-over-year.[14] Asset-weighted management expense ratios (MERs) and management fees for long-term funds[15] also continue to decline.[16]

d. Market innovations in product distribution and advice

The CSA is correct to identify the growth of online advice within the Canadian market. We were surprised, however, to see the CSA imply that the adoption by incumbents of online platforms will somehow have a negative impact on the pricing pressures these new entrants have brought to the market. We find no evidence in the Consultation Paper to support this assertion. Rather, we see this as an opportunity for incumbents to leverage new technologies to create efficiencies and enhance client experiences and investment outcomes.

In our view, the increasing innovation and technology we're seeing with online platforms will continue to offer investors additional choices both in services and products. Coupled with the impact of the proposals in CSA CP 33-404 and the POS and CRM projects, we anticipate there

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[12] Source: Strategic Insight, *Retail Brokerage and Distribution*, Summer 2015.

[13] Includes companies that have introduced preferred pricing programs.

[14] December 2014 – December 2015, source: Insight Advisory Service, July 2016.

[15] Excludes funds with performance fees, funds with management fees charged at account level and labour sponsored funds, source: Insight Advisory Service, July 2016.

[16] Ibid.

will continue to be pricing and competitive pressures on more traditional registrant models to demonstrate alignment of overall services and advice with dealer compensation.

The Current Regulatory Initiatives underway achieve the Key Investor Protection and Market Efficiency Issues Identified by the CSA

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

Investment Fund Managers

Today we identify and respond to material conflicts of interest through avoidance, controls and timely disclosure. This includes disclosure related to our proprietary business model.

Our experience is that the majority of embedded commissions offered by investment fund managers in the market today are substantially the same across asset classes and series and that manufacturer margins and costs (management expense ratios) are decreasing. All of this means that fund managers today are aggressively competing on fund costs and performance. For Investors Group, the competitiveness of the market in which we seek to attract and retain not only clients but also representatives, requires that we compete on fund costs and most importantly, fund performance, in order to maintain and grow market share.

At Investors Group, we strongly believe in an alignment of interests between our Portfolio Managers and our clients and this principle underscores our approach to incentives. All our Portfolio Managers have a substantial financial interest in delivering competitive relative investment performance and those managers who deliver poor relative investment results simply do not receive incentives for that performance. We also believe that it is important to focus on long-term performance and as such the majority of our incentives are measured against 3-5 Year results. In addition, our Portfolio Manager deferred incentive program is designed to further enhance this alignment through co-investment where a portion of the managers' incentives are linked to the performance of the fund(s) they manage.

In our view, the introduction of the proposals in CSA CP 33-404 will impose further pressure on fund managers to compete on fund costs and performance. For firms with a proprietary product list, such as Investors Group, the know-your-product (KYP) proposals will require such firms to compare all of the products on their shelf against key criteria such as fees, costs and performance, to establish their relative competitiveness to each other and to the market. This, in our view, responds directly to the issue cited in the Consultation Paper with respect to research which finds that flows with embedded commissions, and/or where there is an affiliated dealer, may be less sensitive to past performance.

We therefore strongly believe that with the reforms and/or guidance that will emerge from the proposals in CSA CP 33-404, the CSA has effectively addressed any residual reliance fund managers may still have to compete on embedded commissions to promote sales or retain assets.

Dealers and their Representatives

The stated purpose of the proposals in CSA CP 33-404 is "to better align the interests of registrants with the interests of their clients". As we've indicated, we believe the CSA achieves this aim, and that CSA CP 33-404 addresses many of the concerns expressed in the Consultation Paper, namely that embedded commissions may encourage dealers and their representatives to recommend higher cost fund products, or promote a particular purchase option, that pays them a higher commission to the detriment of investor outcomes.

In fact, we consider the breadth of the proposed conflicts of interest reform and accompanying guidance in CSA CP 33-404 on compensation arrangements and incentive practices to capture much more than simply any potential influence caused by embedded commissions. The proposal requires firms to assess whether <u>any remuneration</u> could reasonably be expected to inappropriately influence how representatives deal with their clients. Investors Group supports this more principle-based approach to addressing all types of compensation bias, as this approach recognizes that conflicts of interest and the potential for misalignment of interests can exist in <u>any fee model</u>. As noted in The Brondesbury Report, "all forms of compensation affect advice and outcomes".[17]

Alternative Regulatory Option to Address Issue 1

***Cap Embedded Commissions* –** We believe that the CSA should consider further whether a maximum limit (cap) on the amount of the trailing commission that investment fund managers may pay to dealers and their representatives could solve for any residual concern related to this issue, as an alternative to discontinuing embedded commissions. As noted in the Consultation Paper, this option would not preclude dealers and their representatives from directly charging their clients commissions or fees, either as a supplement or a substitute to embedded commissions. It could also serve as an interim step, to measure if standardizing and reducing the variability of trailing commissions across funds sufficiently reduces any residual incentives for dealers and their representatives.

It surprises us that the CSA states that in pursuing this option it would be taking on a non-traditional role to set fee caps and that it would be very challenging to determine and justify the appropriate cap rate in the circumstances. The U.S. Financial Industry Regulatory Authority (FINRA) imposes limits on embedded 12b-1 fees. We also note that the CSA does, in fact, set fees, most recently lowering the cap on active trading fees that are listed on a Canadian exchange.[18] We submit the CSA could, *through a public consultation process*, come to similar appropriate caps for embedded commissions paid by the manager. As we discuss below, we believe the other issues identified with embedded commissions are effectively addressed (or can

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[17] The Brondesbury Report, p 4.

[18] CSA Amendments to National Instrument 23-101 Trading Rules and Companion Policy 23-101CP to National Instrument 23-101 Trading Rules (January 26, 2017).

be through other regulatory options) and so the "shortcomings" raised by the CSA with respect to this option in not addressing all of the other concerns raised in the Consultation Paper should not be seen as a barrier to proceeding with this more measured approach.

b. Embedded commissions limit investor awareness, understanding and control of dealer compensation costs

We believe the POS and CRM projects address the issues the CSA has identified with respect to embedded commissions limiting investor awareness, understanding and control of dealer compensation costs. From the beginning, the POS project was intended to increase investors' awareness and understanding of such costs, as well as better equip investors to compare the costs of one mutual fund to another, and to understand the impact of such costs on their investment returns. In fact, the CSA went even further in expressing the anticipated benefits of POS in an early release, indicating that some anticipated benefits of a more effective disclosure regime would include a heightened engagement of investors in determining the product and compensation costs, with "less risk of investors buying inappropriate products or not fully benefiting from the advice services they pay for".[19]

Similarly, the CRM reforms introduced, in the first phase, new relationship disclosure to investors at account opening, explaining the types of products and services provided by the dealer as well as more fulsome information on charges, including transaction charges, which they may expect to pay in connection with their investment.[20] Phase 2 of CRM (CRM2) next introduced new annual account level reporting on charges and other compensation of commissions and other amounts paid to dealers, including any embedded commissions in dollar amounts. Like the POS project, the CRM project was intended not only to increase investors' awareness and understanding of dealer compensation costs, but to also lead to better, more informed decision making when it comes to dealer compensation costs and the corresponding level of service that's being provided.

The CSA has identified investor knowledge, attitude and behaviour, registrant practices, fees and product offerings, as all possible positive impacts of the POS and CRM2 projects.[21] With this in mind, we do not agree with the suggestion in the Consultation Paper that discontinuing embedded commissions is necessary to create greater investor fee awareness, or opportunities to negotiate and have greater control over dealer compensation. It's our understanding that this is exactly what the CSA's research project to measure the impacts of POS and CRM will tell us. This position

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[19] CSA Notice and Request for Comment Implementation of Point of Sale Disclosure for Mutual Funds (June 19, 2009).

[20] This includes the initial sales charge and DSC options and any trailing commissions or other embedded commissions paid.

[21] See press release: CSA to Measure Impact of Point of Sale Amendments and Phase 2 of the Client Relationship Model (August 22, 2016).

also seems contradictory to the ongoing regulatory work by the MFDA and the CSA[22] to move forward with still further disclosure enhancements to CRM2 as an effective way to make investors more aware of the embedded fees paid to issuers, such as mutual fund management fees, and the non-cash incentives that may be paid to the dealer or adviser and its representatives.

Alternative Regulatory Options to Address Issue 2

Dealers Offer a Direct-Pay Option – If the CSA concludes that there continues to be a necessity to further promote investor understanding of dealer compensation costs and empower investor engagement over how such costs are paid, we recommend the CSA consider and consult on the regulatory option of requiring dealers with an embedded commission option to have a direct-pay arrangement available to all clients. This option, we would envision, could allow investment fund managers to facilitate investors' payment of dealer compensation, as contemplated by the Consultation Paper. The direct-pay option could be offered and explained alongside the embedded commission option at account opening for new clients, and by notice to existing clients, giving clients a clear choice in remuneration methods.

Enhance Annual Report on Charges and Other Compensation – CRM2 does not extend to the ongoing costs of owning securities with embedded fees paid to issuers, such as mutual fund management fees and operating expenses. As a way to make clients more aware of such fees, the CSA could proceed with the proposals published in July, 2016,[23] to add a general notification in the annual report that would remind clients invested in mutual funds, or other securities with embedded fees, about these costs and that such costs may reduce the client's investment returns. The CSA has also suggested adding specific disclosure to the annual report on the non-cash incentives that may be paid to the dealer or adviser and its representatives.

We welcome the CSA's continued review and consideration of expanding CRM2 to include the full management expense ratio (MER) of investment funds. Should this work proceed, we believe that it will be important that there be corresponding disclosure to investors of the ongoing costs of similar financial products with embedded commissions, such as the spread on GICs and DIAs.

c. Embedded Commissions paid generally do not align with the services provided to investors

The concern raised by the CSA in the Consultation Paper of the need for advice and services to better align with the costs paid by investors (directly or indirectly through the trailing commission) is an important issue. However, just as all forms of compensation may affect advice and outcomes, in our view this issue of advisory services aligning with dealer compensation paid is

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[22] MFDA Bulletin #0671-P – Report on Charges and Compensation – Consultation Regarding Cost Reporting for Investment Funds (December 18, 2015) and CSA Notice and Request for Comment on Proposed Amendments to National Instrument 31-103, Companion Policy 31-103CP and National Instrument 33-109 (July 7, 2016).

[23] Ibid.

an issue not limited to an embedded commission model, nor solved by discontinuing such payments.

Today fee-based accounts, which are the predominant direct-pay arrangement in the market, are typically based on a percentage of the client's assets under management, without necessarily being customized to the investor's specific needs or reflective of the level of service delivered. Clients selecting a direct-pay option today may not be aware of the fee levels other clients are paying, often will have no market strength to negotiate fees, and may not realize or be able to calculate the impact those fees have on the returns of their portfolio. In fact, we have seen IIROC, in their review of compensation related conflicts, indicate that fee-based accounts may not always be in the best interests of clients.[24] As noted in The Brondesbury Report, no empirical studies have been done to document whether investors have greater after-fee investment returns with fee-based compensation instead of commission-based compensation.[25]

We believe the increased performance reporting and saliency of fund costs and dealer compensation created by the POS and CRM projects will lead to better alignment of overall services and advice with dealer compensation paid. The CSA has indicated that these initiatives, fully implemented, are expected to prompt investors to question the overall level of services and advice they are receiving, which in turn is anticipated to cause representatives to better demonstrate their value proposition or, lead to investors switching to lower-cost alternatives, including online platforms. If the CSA's articulated aims for the POS and CRM projects are met, investors will be empowered to make more informed decisions on whether the commissions they're paying, whether embedded or not, are commensurate with their specific needs, expectations and preferences for service and advice.

We also believe, contrary to what's expressed in the Consultation Paper, that the proposals in CSA CP 33-404 will, in fact, have an impact on aligning compensation with services provided to investors. In our view, the targeted reforms, particularly the proposals related to know-your-client (KYC) and suitability, will create a more consistent minimum level of service and advice to be provided to investors, a key objective of the proposals. This in turn, we anticipate, will prompt greater competition amongst dealers and their representatives to demonstrate their value proposition and review the level of services provided to their clients, again, whether the compensation is embedded or not.

Finally, we strongly support the proposals in CSA CP 33-404 for increased proficiency for representatives, mandated on-going continuing education (CE) requirements and for allowing only the use of designations earned through an approved credentialing organization. Heightened proficiency and CE on key securities regulatory obligations such as suitability, KYC and KYP as well as conflicts of interest and ethics will, in our view, further help to ensure a consistent quality

[24] See IIROC Notice 16-0297 Managing Conflicts in the Best Interest of the Client – Status Update (December 15, 2016) and IIROC Notice 17-0093 Managing Conflicts in the Best Interest of the Client – Compensation-related Conflicts Review (April 27, 2017).

[25] The Brondesbury Report, p 18.

of service is provided to all investors. As we indicated in our response letter to CSA CP 33-404, we encourage the CSA to consider mandating a financial planning designation as a way to instil a high standard of competence and professionalism in the financial services industry.

Alternative Regulatory Options to Address Issue 3

***Enhanced Dealer Supervision* –** The CSA's concern that the "one-size-fits-all" nature of embedded commissions may continue to be misaligned with the services and advice actually provided to investors is, as we've noted, just as relevant a concern in direct-pay arrangements. Accordingly, we propose that if the CSA wants to fully address the issue of alignment of the costs paid by individual investors with the services and advice provided, a more impactful regulatory option for the CSA to consider would be, as part of the next iteration of CSA CP 33-404, to explicitly enhance the guidance related to existing dealer obligations; specifically, to clarify the need to supervise that a commensurate level of advice and service is in fact being provided in exchange for the payment by the dealer to the representative, whether that payment is embedded or not.

***Greater Specificity at Account Opening* -** The CSA could also require that the relationship disclosure delivered to clients at account opening include greater specificity as to the advice and services that will be provided in exchange for the dealer compensation to be paid.

***Mandating only "D" Series be Available on Discount Brokerage Product Lists* –** Finally, while we agree with the CSA that it may not be desirable for the CSA to compel investment fund managers to create a new "execution only" series (typically denoted "D" series which has a reduced trailing commission), we would encourage the CSA to proceed with mandating that discount or order-execution only (OEO) dealers be required to only distribute D series or a series without any advisory commission on their product list. This will address the issue the CSA has identified in the Consultation Paper that the majority of mutual fund series sold through the online/discount brokerage channel are the full trailing commission fund series despite the increased availability of discount/DIY fund series in the market.

This regulatory initiative would allow the CSA to address the specific issue of investors who do not seek services and advice to not inadvertently pay for them. We believe this change could be easily implemented by amending IIROC Member Rule 3200, which sets out the minimum requirements for IIROC dealer members seeking approval under Rule 1300.1(t) to offer OEO services. We note that IIROC recently issued guidance for comment on OEO services and activities, which makes this proposal timely.[26]

[26] IIROC Notice 16-0251 Guidance on Order Execution Only Services and Activities (November 3, 2016).

The importance of Retaining the Accessibility, Choice and Affordability of Financial Advice

a. The importance of preserving financial advice for Canadians

According to Investor Economics, 63% of the $3.8T in personal financial assets is held in accounts where a financial advisor is engaged.[27] Personal savings is a key component to the accumulation of financial wealth and retirement readiness. In this regard, the role of financial advice is a critical element, contributing positively and significantly to the retirement readiness of Canadians.[28]

As the CSA has noted, evidence shows that the average individual's knowledge of basic financial products and concepts is quite limited. In fact, in the 2016 CSA Investor Education Study,[29] it was found that investors' primary source of investment information comes from their advisors. A 2016 Pollara survey among mutual fund investors highlights the confidence investors have in financial advice and the positive savings behaviours they've adopted because of advice.[30]

Economic theory explains that there is a net positive value of using a financial advisor.[31] In addition, financial advisors play an important role in counteracting the behavioural biases of investors by coaching them towards long-term savings habits, advising against panic sales, and providing good quality information to promote better long-term decision-making. [32]

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[27] Investor Economics, *Household Balance Sheet*, 2016.

[28]Canada's retirement system is well balanced and effective, with 83% of Canadian households on track for retirement. Of the mid- to high- income households with no employer pension plan, "savers" (i.e. households with an above-average savings rate) are far more prepared for retirement than "non-savers" (i.e. households with a below-average savings rate). "Savers" are almost twice as likely to use financial advice and significantly more likely to use tax-advantaged savings vehicles such as RRSPs and TFSAs than non-savers – both of which are linked to increased financial security in retirement (Source: McKinsey & Company, *Building on Canada's Strong Retirement Readiness,* Feb 2015). Canadians over 65 rank 7th highest among OECD countries in terms of relative income compared to the national mean income of the total population, and have the 11th lowest poverty rate – on both measures, ranking better than the USA, UK and Australia. (Source: OECD, *Pensions at a Glance*, 2013).

[29] Key Highlights CSA Investor Education Study 2016 prepared for the CSA by Innovative Research Group, Inc., April 2016.

[30] Pollara, *Canadian Investors' Perceptions of Mutual Funds and the Mutual Fund Industry,* 2016.

[31] PricewaterhouseCoopers, *Economic Impact Assessment of Banning Embedded Commissions in the Sale of Mutual Funds* (Submission by the Investment Funds Institute of Canada on Consultation Paper), June 2017.

[32] Benzartzi & Thaler, *Heuristics and Biases in Retirement Savings Behavior,* 2017. The authors identify the biases as loss aversion, short-term thinking and overconfidence.

Research has demonstrated the significant value of the advice model to the investing public, at all demographic, income and asset levels. Among other things, advised households (i) are twice as likely to save for retirement at all ages (ii) have significantly higher levels of investable assets at all ages (iii) improve their regular saving for retirement at all income levels (iv) rate themselves as more financially knowledgeable, and (v) are more confident in their ability to achieve a comfortable retirement.[33]

A number of academic studies (in Sweden,[34] Australia[35] and the United States[36]) provide tangible estimates of the significant positive net benefits that financial advisors provide to investors through a holistic approach of financial wellness. We have similarly seen this demonstrated in recent Canadian research.[37] In fact, this research found that not only do investment outcomes improve with advice tenure, but that an interruption in the client-advisor relationship can worsen client investment outcomes.

The value of financial advice is not simply the value of selecting securities to invest in. The value proposition includes providing ongoing financial education, making appropriate investment policy decisions around portfolio construction and regular rebalancing, tax planning and most importantly, in providing behavioural advice and coaching with respect to client habits around

[33] Advised households are not only more likely to save but save at twice the rate of non-advised, passive households (8.6% compared to only 4.3%) and among the behavioural disciplines, savings is the most affected by the presence of advice. Controlling for all other explanatory variables, having a financial advisor has been found to increase the probability of a respondent declaring confidence in achieving a comfortable retirement by more than 13% relative to a similarly situated non-advised respondent (Sources: CIRANO, *Econometric Models on the Value of Advice of a Financial Advisor*, 2012 and *The Gamma Factor and the Value of Financial Advice,* 2016). Advised households, at all age levels, are twice as likely to save regularly for retirement than non-advised households, with advised households having higher net worth than non-advised households across all ages and income levels (Source: IFIC *The Value of Advice,* 2011).

[34] In Sweden, researchers compared a group of investors who received financial advice and a control group of investors who did not receive financial advice and assessed the impact on savings of having a financial advisor to be an additional 22% saved (Source: Hermansson & Song, *Financial advisory meetings and their impact on saving behavior – a difference-in-difference analysis,* 2016).

[35] KPMG EconTech used a regression analysis and estimated the impact of having a financial advisor to be an additional $1,590 per year in savings greater than investors without advisors. The analysis controlled for factors that influence savings behaviour such as income, wealth and employment (Source: KPMG EconTech, *Value Proposition of Financial Advisory Networks – Update and Extension,* January 18, 2011).

[36] In the United States, researchers showed that using a financial advisor improves savings behavior through the positive impact on overall financial planning including awareness of retirement needs and diversification of retirement savings. They additionally highlighted the better response of the advised to the financial crisis in 2008 compared to those without advice (Source: Marsden, Zick & Mayer, *The Value of Seeking Financial Advice,* 2011).

[37] Ibid., footnote 34.

savings and market discipline.[38] The importance of these aspects of the client-registrant relationship should not be underestimated. As part of the CSA's deliberations, the CSA should be mindful of not proceeding with regulatory changes that may diminish the range and choices of advisory services provided to Canadians.[39]

b. *The importance of ensuring there remains choice in advisory services, that is affordable and accessible for modest investors*

Financial advice is not only used by the wealthy. Approximately 47% of households in Canada with less than $100,000 in assets use financial advice, compared to approximately 56% of households with greater than $100,000 in assets.[40] This is significantly greater than other countries, such as Australia and the U.K.[41]

Modest investors (those with under $100K in investible assets) make up 80% of all Canadian households,[42] and 83% of the households serviced by MFDA members.[43] We also know that in 40% of cases where there is a financial advice relationship it was initiated with financial assets not more than $10,000. In addition, in 70% of such instances, investments were under $50,000 at the start of the relationship.[44] This means nearly three quarters of all advice relationships begin with financial assets of not more than $50,000.

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[38] Beyond active management ("Alpha") and asset allocation ("Beta"), better financial planning decisions ("Gamma") have a significant impact on an investor's retirement outcomes. "Gamma" can increase the arithmetic "Alpha" on a portfolio by approximately 1.59% (Source: Morningstar, *Alpha, Beta and Now… Gamma,* 2012).

[39] We note that among Canadians, a recent global study found that there's still a strong preference for taking guidance from a human financial advisor over advice generated through an algorithm powered by artificial intelligence (Source: HSBC, *Trust in Technology: Country Report/Canada*, May 24, 2017).

[40] Ipsos Reid, *Canadians & Financial Advice*, 2015.

[41] In Australia, only about 10 percent of the population receives advice in a given year (Source: Rand Corporation, *Financial Advice Markets – A Cross Country Comparison,* 2015). In the U.K., approximately 17% of the population currently uses advice (Source: BlackRock, *Global Investor Pulse Survey,* 2015).

[42] Investor Economics, *Household Balance Sheet*, 2015.

[43] MFDA Client Research Report, p 6.

[44] Pollara, *Canadian Investors' Perceptions of Mutual Funds and the Mutual Fund Industry,* 2016. These percentages have been nearly identical for the last three years.

The willingness to pay upfront for advice (direct pay arrangements) depends on the level of wealth, formal education and financial knowledge of the investor.[45] Most Canadians also still have a strong preference for taking guidance from a financial advisor over online platforms.[46] Therefore, it is critical that the regulatory framework continues to promote Canadians' engagement to seek and obtain the delivery of financial advice when they are just beginning to save, by ensuring financial advice remains attainable in terms of cost, administration and delivery.

Conclusion

We firmly believe that the impact of the regulatory actions taken to date by the CSA, once fully implemented, together with the changes already underway in the Canadian marketplace, substantially address the concerns identified by the CSA in the Consultation Paper. To the extent that there remains any regulatory gap, we believe that the CSA can achieve the desired regulatory outcomes through alternative regulatory options that sufficiently manage or mitigate the issues identified in the Consultation Paper, without the same adverse impacts that a complete discontinuance of embedded commissions may cause.

The market and business models are changing at a rapid pace, particularly with respect to compensation structures, as evidenced by our own transformation. We would encourage the CSA to allow this evolution to continue, without the further regulatory intervention of a ban on embedded commissions. Preserving choice and accessibility to high quality financial advice as well as an innovative, competitive and fair financial services industry, is critical.

As the CSA moves forward in its deliberation on CSA CP 33-404 and the Consultation Paper, we encourage the CSA to consider the formation of working groups with market participants, to assist not only in identifying and working through various operational questions and issues, but to effect as seamless a transition process as possible for investors. We envision a model where the CSA would commit to ongoing and frequent engagement with stakeholders throughout any implementation process, to assess whether further CSA guidance and/or any extension of a transition period is needed.

Investors Group welcomes the opportunity to participate in such an endeavour.

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We thank you for the opportunity to provide comments on the Consultation Paper. We look forward to an ongoing collaboration. Please feel free to contact Donald MacDonald, Senior Vice-

[45] Michael S. Finke, Sandra J. Huston and Danielle D. Winchester, *Financial Advice: Who Pays* (Association for Financial Counselling and Planning Education, 2011).

[46] Ibid., footnote 17.

President, General Counsel & Secretary at (204) 956-8088 or myself, if you wish to discuss this further or require additional information.

Yours truly,

Jeffrey R. Carney
President and Chief Executive Officer

Appendix - Tax Impacts

Overview

Generally, mutual funds pay a management fee to the investment fund manager, and the investment fund manager then compensates the dealer out of its management fees. Within this structure, the management fees paid to the investment fund manager are deducted by the fund to arrive at taxable income. Typically, in a mutual fund, distributions are paid to the investors to eliminate taxable income in the mutual fund. If there is a ban on embedded commissions, then the management fees paid by the mutual fund are reduced, and conversely the taxable income of the mutual fund would increase. There would be additional taxable income in the mutual fund requiring additional distributions to be paid to investors to eliminate taxable income in the mutual fund.(1)

In a direct-pay model, the investor is responsible for compensating the dealer. Generally, these advisory fees are tax deductible to the extent that these fees are reasonable, are for non-registered accounts, are not commissions, and are:

- For advice as to the advisability of purchasing or selling a specific share or security of the taxpayer, or;

- For services in respect of the administration or management of shares or securities of the taxpayer.

Generally, the additional distributions paid to investors should be offset by the advisory fees paid to the dealer.

In order to facilitate the payment/collection of the advisory fees, the investment fund manager/investor/dealer may agree to redeem units to fund the payment of the fees. The advisory fee is subject to GST/HST/QST (Sales Tax).

We set out below our observations of the key implications to investors, investment fund managers and dealers in transitioning all clients to direct-pay arrangements.

Impact of Removing Embedded Commissions	Investor	Investment Fund Manager	Dealer/Advisor
More fund series are likely to require distributions and quantum of distributions are likely to increase	Additional administration required to track distributions and report for tax purposes.	Increased demand on system resources to process higher volume of distributions.	Additional system resources to track the transactions. Additional investor support to track and understand transactions
Tax neutrality of “embedded commission” component not ensured	Tax deductibility of fees paid by the investor to its dealer dependent upon the services being provided in exchange for the advisory fees being charged.	N/A	Communication with the investor to be managed
Additional volume of transactions as a result of redemptions to fund direct-pay fees	Additional administration required to track transactions and report gains/losses for tax purposes including monitoring superficial losses.	Increased demand on system resources to process higher volume of transactions.	Additional system resources to track the transactions.
Advisory Fee subject to Sales Tax	Amount of Sales Tax payable by the investor on the advisory fee will be determined by the investor’s province of residence as opposed to the	Impacted to the extent the investor’s units in the funds are redeemed to pay for the advisory fees. The investment fund manager requires the systems to determine the quantum of the	Exempt commission paid by the investment fund manager being replaced by a taxable advisory fee paid by the investor. Systems to be enhanced to handle

	"blended rate" of the fund. Generally, Sales Tax paid will be added to the cost of the advisory fee.	Sales Tax to withhold on behalf of the dealer.	the additional administration and compliance required to collect, report, and remit the Sales Tax (and related taxable revenue).
Rationalization of fund series would require an exchange of investors' units within a fund	Generally, an exchange of units from one series of a fund to another can be accomplished on a tax deferred basis. Eliminates a level of complexity in understanding offering.	Initial increased demand on system resources to process transfers to be offset by ongoing administrative efficiencies due to reduced number of series. Simplifies investment fund manager's offering.	Initial additional system resources to track the transfers to be offset by ongoing administrative efficiencies due to reduced number of series. Eliminates a level of complexity in product offering.

(1) A mutual fund corporation can only distribute (by way of dividend) its net capital gains and dividends to shareholders. A reduction of management fees within the corporation could result in trapped income, which would be subject to tax. The end result is double taxation on the income; once in the corporation and again in the investor's hands upon redemption.

Appendix – Operational Impacts

Overview

We believe that consistent with the predominant trend in direct-pay arrangements today most dealers would, if embedded commissions were discontinued, shift to a fee-based account model, which is typically based on a percentage of the client's assets under administration. On review of this structure, we have identified the following primary operational implications of mandating this type of direct-pay arrangement:

1) Developing the systems and processes necessary to collect and report client fees for a much wider range of clients and account types;

2) Increased transaction volumes and client reporting which may increase dealer and investment fund manager administration costs;

3) Enabling the charging of fees in some registered account types that have rules regarding withdrawals for the purposes of paying fees; and

4) Transitioning existing clients' funds positions and systematic purchase and redemption transactions to direct-pay accounts.

1) Systems and process changes

Changing systems and processes to administer direct-pay arrangements will require significant effort and expense by dealers and investment fund managers.

Client name accounts will be particularly challenging to automate and effectively administer and report on a client's fee payments, because transactions to collect the account fee must be charged directly to one or more mutual fund positions held within the account. Direct-pay arrangements for mutual funds in accounts held in nominee name and administered on a nominee systems platform, on the other hand, will be able to be administered more effectively and efficiently.

Nominee accounts allow for a cash position through which all securities buys, sells and daily calculated and accrued account fees can be processed. A cash position enables the client to maintain a cash balance and the dealer to collect client paid fees from the cash balance without the dealer having to sell any of the mutual fund positions in the account to cover the fee. It also enables the dealer to automate the collection of the client's accrued fees part way through a month based on the client's transactions through the cash position (e.g. - a full redemption of all fund positions in the account).

The challenge is that many dealers, including Investors Group, currently administer a large proportion of their clients' mutual fund positions in client name accounts. Today, approximately 95% of Investors Group's 1.65 million accounts are held in client name. Therefore, the transition to a direct-pay model would require us moving essentially all of our clients' fund positions to a series that can be held in a direct-pay account, and possibly moving the positions from a client name account to a nominee account.

The recent changes that the industry has implemented as a result of POS and CRM2 serve as a good starting point with respect to the extent to which systems, procedural and educational enhancements and updates will be needed to effectively transition all clients to direct-pay arrangements. We found the CRM2 requirements in particular to be very complex and requiring significant time and expense to implement. These changes involved obtaining accurate and complete data at a detailed level that was not always readily available, analyzing the data to categorize the transactions and fee types, and building new functionality in our systems. Gathering the data proved more difficult when it resided in a vendor's system.

The costs and complexities associated with these changes were significant. We estimate that the cost to discontinue embedded commissions and transition towards a direct-pay model would be several multiples more of this amount. We anticipate that the time and costs that will be incurred to effectively implement a transition to direct-pay arrangements will directly impact our ability to engage our people and energies in investing in digital services and technologies to improve the client experience. While we are confident that we could transition our clients effectively, our concern is that for smaller independent dealers and investment fund managers, the complexity and costs of transitioning their clients and business models to direct-pay arrangements will potentially create business viability concerns.

2) Transaction volumes, client reporting and administration expense

Discontinuing embedded commissions will likely increase the volume of fund transactions in clients' accounts due to more fund distributions to clients, the introduction of client fee transactions, and the likelihood of more fund redemption transactions to cover the client's direct-pay fees. From an operational perspective, volume increases could increase the costs of administering client accounts because of the systems resources required to process the higher volume and associated increased reporting of the transactions to clients.

3) Registered Accounts

Moving to direct-pay arrangements will also present some challenges to certain types of registered plans in a client account. We would encourage the CSA to consider exempting these accounts should the CSA move forward with discontinuing embedded commissions.

a) RRIF / LIF Plans

i) The minimum / maximum payment calculations will be impacted by the decrease of the account's market value due to the application of fees that will presumably be paid out of the investment.
ii) The RRIF / LIF minimum payment is calculated based on the year end market value. If investment fund managers facilitate the payment of dealer compensation from the investor's fund investment, the application of the fees will decrease the year end market value and consequently the minimum in the following year.
iii) The LIF maximum payment is also calculated based on the year end market value. Collecting dealer compensation by payments from the fund investment will decrease the year end market value and consequently the maximum in the following year.

b) RESP and RDSP Accounts

For investment fund managers to facilitate the collection of clients' payment of dealer compensation from the investor's fund investment, the deductions would need to be charged to the income portion, followed by the capital portion and subsequently the government incentive portion of the notional information.

Based on Investors Group's agreement with the Employment Social Development Canada, we would note that fees cannot be charged to the government incentive portion of the account. Therefore, the ability of the investment fund manager to facilitate direct-pay arrangements as a way to alleviate the concern that mass-market investors may be hesitant to pay directly for advice may not be as impactful as envisioned for these types of accounts.

4) Transitioning Clients

Current securities regulations require receipt of client approval for switches between mutual fund series, moving from a client name account to a nominee account, and moving to a direct-pay arrangement – all of which also require significant client communications and administration challenges and expense. Most significantly, these changes often are disruptive for clients. The opportunity for regulatory relief that would enable dealers to notify clients of these types of transitions instead of obtaining and administering client approvals could significantly simplify the process for dealers and investment fund managers to transition clients to direct-pay arrangements while minimizing client disruption.

The CSA proposes two alternatives for dealers to transition to a direct-pay arrangement over a three year time period. From both an operational perspective and to provide clients with the best possible transition experience, Investors Group believes the best approach should the CSA proceed with a ban on embedded commissions would be to set a defined transition period and deadline and allow dealers and investment fund managers to determine how best to manage the transition to meet such a deadline. A phased account method may not fit the particular circumstances of a client holding multiple account type, and may be very difficult to achieve without significant disruption to clients.

Adding to the transition challenge will be that many dealers rely on systems vendors in various capacities. These vendors may provide services to more than one dealer and there may be multiple impacts on them from the dealers they service. Vendor resource constraints may limit their ability to meet the needs of dealers within a short transition period.

Accordingly, Investors Group believes that a transition date of 36 months as proposed in the Consultation Paper may be too aggressive. We strongly recommend that if the CSA proceeds with a complete discontinuance of embedded commissions, there is a commitment by the CSA to seek feedback from stakeholders part way through the transition period, to assess and determine whether guidance and/or an extension will be needed to effect an orderly transition to direct-pay arrangements.

Appendix – The Value of Active Management

Overview

Active and passive management are both beneficial in helping investors reach their financial goals. Active managers have shown that they can add value where market inefficiency exists, while generating potential alpha by exploiting off-benchmark opportunities when appropriate. In constructing a well-conceived portfolio, investors should view investing from a total portfolio perspective and utilize active asset allocation strategies to add value.

Active managers subscribe to a common belief that markets are not perfectly efficient, which creates an opportunity for portfolio managers to exploit security mispricing and outperform the overall market. Passive managers, on the other hand, seek to replicate the return of a given market index.

Market efficiency describes the degree to which the price of securities reflects all public and non-public information (timeliness and interpretation). Hypothetically, if the capital markets were perfectly efficient, active managers on average would not outperform the markets as securities would already reflect their fundamental value. On the contrary, if markets could be described as inefficient, there would be many opportunities for active managers to identify and profit from mispriced securities and hence outperform the overall markets. In practice, capital market efficiency resides somewhere in between these two scenarios. Active management can add value to portfolio returns over a broad range of different asset classes.

Active management generally refers to an investing strategy whereby a portfolio manager makes specific investment decisions with the typical goal of outperforming an investment benchmark or index. Active management can have advantages over market capitalized indices - and more importantly - protecting investor wealth over full market cycles - particularly during market downturns.

Actively managing asset allocation enables investors to be focused on individual objectives beyond benchmarks and the short term. This is essential for aging investors as they move from wealth accumulation into decumulation, where the emphasis is on consistency and persistency of income. It is much more difficult for wealth levels to recover from an investment loss when capital is being liquidated in retirement.

To better protect investors' capital, active managers are able to purchase securities that are undervalued and sell securities that become overvalued. They are also able to minimize losses by avoiding troubled securities and overly concentrated sectors or regions. Many active investment strategies also have the ability to hedge currencies, buy put options to lessen drawdowns, retain cash to reduce volatility, and utilize other tools to minimize potential investment losses. Furthermore, actively managed funds are able to effectively diversify their assets by avoiding the limitations of the benchmark through the avoidance of security and sector overconcentration.

Challenges

Successful active management is by no means an easy task. By simple definition, and for the most part, it can be a "zero sum game" where the gains of one investor come at the expense of another. Vanguard Asset Management describes it as follows:

> "The concept of a zero-sum game starts with the understanding that at any one time, the holdings of all investors in a particular market make up that market. As a result, for every invested dollar that outperforms the total market over a given period, there must by definition be another dollar that underperforms. Another way of stating this is that the asset-weighted performance of all investors, both positive and negative, will equal the overall performance of the market."

Writing in The Financial Times, Yves Choueifaty CEO of TOBAM noted an additional challenge:

> "By definition the average active manager cannot outperform the benchmark because the benchmark is determined by the sum of activity carried out by both active and passive managers. And because passive managers have no impact on the benchmark – they merely follow it – it is, in fact, the sum of all the bets taken by active managers that determines the benchmark. It is obvious that it is impossible for the average active manager to outperform (or underperform) the average active manager. The benchmark is, after all, the output of all the activities carried out by active managers".

Investing in the index does not on its own however ensure a positive outcome. For example, over the 25 year period beginning in 1929, the S&P 500 index did not recover to its former high until 1954. Yet, considerable wealth was amassed during this period through effective trading of individual securities. As cited by the CMG Capital Management Group:

> "It's a little-known but startling fact: The average buy-and-hold stock market investor spends 74% of his or her time recovering from cyclical downturns in the market (from 1900 – May 2015). We like to think of investment approaches as types of aircrafts. Passive investments are like hot air balloons. In favorable conditions, they can indeed carry passengers to their financial goals.
>
> Active investments, on the other hand, are like planes. When winds are fair, they, too, can carry you in the right direction. They also have the flexibility to maneuver through bad weather, protecting their passengers from harm and keeping them moving toward the destination".

The relevance of these numbers gain even greater importance in the context of Deutsche Bank's Bradley Jones whose analysis revealed that a portfolio comprised of 60% equities and 40% bonds produced negative real returns over a rolling ten year holding period for almost a quarter of a 111 year period in the US market commencing in 1900. This is perhaps even more pervasive in a low interest rate environment where negative returns have come into existence and depending upon global events, could become more prevalent.

With this in mind, arguably the ultimate goal and value of active management is to provide downside protection, with secondary consideration given to muting volatility and out performing in bull markets. MFS Investment Management stresses this importance in their piece, "There's No Substitute for Skill":

> "To outperform in falling markets, active managers must have differentiated risk management. It should be an important part of their investment process, rather than an overlay, using active security selection to view risk from multiple perspectives before adding a security to a portfolio. Through a strong risk framework, they must manage risk on several levels, from the security to the portfolio to the firm. Investors consider this capability a high priority."

Opportunities

Russell Investments has stated:

> "Dynamic active management – the real-time management of portfolio exposures to specific factors, countries, sectors, or currencies – can be used to help to avoid downside risk in chosen asset allocations. With this kind of focus, active management works to help create a smoother ride that can help to keep investors from exiting the market at the worst possible time".

Perhaps most importantly for the retail investor, Russell also singles out the importance of after-tax returns, for of all the costs incurred by an investor - be it trades, investment management, or advice, the greatest cost will be taxation.

> "As so many of us have heard over the years, 'It's not what an investor earns. It's what they keep.' Being active around after-tax returns is often an underappreciated way active managers can help to provide value to investors. Unlike index-based passive investing, active management can use an expanded toolkit to actively maximize after-tax returns. This includes active loss harvesting – potentially increasing the absolute return an investor sees. Active, by its very nature, strives to do better".

For many managers active management employs innovative factor weightings to outperform market capitalized indices. Morgan Stanley identifies these new approaches as:

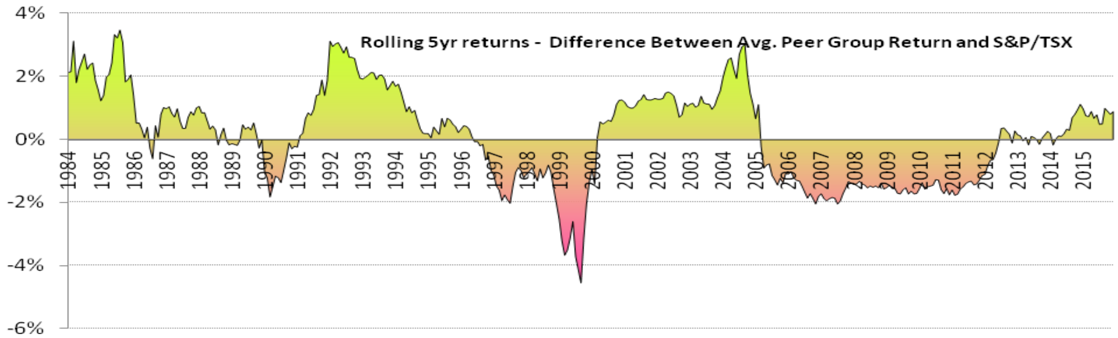
> "'Smart-beta' strategies which attempt to replicate pure factor strategies (like value, momentum or low volatility) are the next evolution in the active/passive debate. While their systematic approach may be a low-cost replacement for some active managers, we still believe that 35 to 40% of the top managers add idiosyncratic alpha over long periods of time and thus their investment selections can be additive to diversified portfolios."

Employing new approaches to challenge long held beliefs enables diverse opportunities for active managers**.** MIT's Andrew Lo, well known for his paper, "Physics Envy May Be Hazardous to your Wealth!" (that demonstrated how the economic system developed by financial markets created a false sense of mathematical precision as the models developed were not as predictive as those used in physics) urges investors to view financial markets and institutions from the perspective of evolutionary biology rather than physics:

> "Markets are well behaved most of the time, but like any other human invention, they are not infallible and they can break down from time to time for understandable and predictable reasons".

Analysis

According to data from Morningstar Canada, the average performance of the actively managed Canadian Equity peer group (Canadian Investment Funds Standards Committee (CIFSC) category) has exceeded that of the benchmark S&P/TSX index 58% of the time since 1980. Even more impressively, 1st quartile funds in the same category outperformed the index 79% of the time.



During each bear market since 1980, the benefits of active management have been quite evident as the average return of the CIFSC Canadian Equity peer group exceeded that of the passive index as can be seen in the following table.

Start	End	S&P/TSX Composite	25th Percentile Return	50th Percentile Return	Cdn. Equity Avg. Fund Return
Jun-81	Jun-82	-36.7	-26.7	-29.1	-30.8
Aug-87	Nov-87	-25.4	-20.8	-25.0	-24.1
Jan-90	Oct-90	-20.1	-10.5	-15.1	-12.8
May-98	Aug-98	-27.5	-23.7	-25.7	-25.5
Sep-00	Oct-02	-22.6	-12.0	-14.9	-14.5
Jun-08	Feb-09	-43.5	-39.8	-43.4	-42.6

Various studies and writings in recent years have pointed to the seeming inability of most actively managed funds to match or beat their index benchmarks. Most of these studies, however, looked only at average equity funds without making distinctions between those that were truly active and those that were not.

A more discriminating study in 2009 by Martijn Cremers and Antti Petajisto found that investment funds that were truly active, taking positions that significantly deviated from their benchmarks, were able to outperform those benchmark indices both before and after expenses.

Supporting Strong Capital Markets

Passive investment vehicles have low costs mainly because they do not do any of the research and trading that active managers do. Without this research and making prices informative, individual securities can become mispriced and markets distorted. According to Lasse Pedersen of AQR Capital Management:

> "If most investors were passive, the liquidity in individual securities not included in the index would vanish as investors would only trade the index. Securities could become severely mispriced. The collapse of liquidity and the lack of active management would make the process much less informative. When the secondary market is illiquid and uninformative, buying in the primary market becomes much riskier."

A lack of liquidity in the market is not an issue if you don't have to sell or buy immediately. Actively managed funds are not forced to liquidate securities to meet investors' needs as they usually maintain a cash reserve. This cash reserve also benefits active management strategies by allowing them to exploit the market when mispricing occurs. In fact, the more investors use ETFs and other passive strategies, the more opportunities are created for active managers and the larger those opportunities are.

A further benefit is that within the market, active managers can profit at the expense of passive strategies in assessing the value of an initial public offering (IPO). Pedersen continues:

> "Research has shown that IPO securities are, on average, sold at a discount relative to their price in the secondary market when the shares start trading on the exchange. Informed investors can buy the new shares cheaply and then sell some in the secondary market to other (passive) strategies at a premium. As a result, passive investors are not guaranteed the same IPO performance as the group of active investors since they trade at different prices and quantities."

In competing for outperformance, active managers seek relevant information, analyse it to determine value, and select securities accordingly. In the process, they help to set prices and provide trading liquidity. The efficient allocation of capital in our market-based economy relies on this mechanism. According to Nitin Mehta, managing director of the CFA Institute for Europe, the Middle East and Africa:

> "Passive investors are relative free riders, having to pay only the marginal cost of market participation as price takers, rather than the higher average cost for making fair prices and supporting the real economic purpose of financial markets".

Conclusion

Active and passive investments are both beneficial in helping investors reach their financial goals. Active managers have shown that they can add value where market inefficiency exists, while generating potential alpha by exploiting off-benchmark opportunities when appropriate. In constructing a well-conceived portfolio, investors need to view investing from total portfolio perspective and utilize active asset allocation strategies to add value.

Active managers have shown they have the ability to outperform the index and can be less volatile than the index during bear markets. They are able to avoid less attractive, slow growing companies and provide greater exposure to companies with superior valuations or growth potential. Equities are inherently risky and active strategies can diversify that risk by investing in stocks with lower correlations, and by underweighting sectors that are overly concentrated in the index.

Effective diversification is about maintaining the right balance of stocks, not simply owning a basket of the largest stocks. Active management does not aim to invest only in the largest companies nor look to match the weight of the best performing stocks in the index. Instead, the focus is on selecting the most fundamentally sound and profitable companies, as well as those that are not highly correlated and so can be expected to react differently to market events.

Given the many uncertainties that global capital markets present, investing in stocks and bonds has never been more challenging. Actively managing those risks is critical for those who depend on stocks to grow their wealth and bonds to add an element of stability to their investment portfolios.

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