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

Thank you for the opportunity to comment on CSA Consultation Paper 81-408 – *Consultation on the Option of Discontinuing Embedded Commission* ("**CP 81-408**").

CI Financial Corp. ("**CI**") is a diversified wealth management firm and one of Canada's largest independent investment fund companies. Our principal business is the management, marketing, distribution and administration of mutual funds, segregated funds, exchange-traded funds, structured products and other fee-earning investment products for Canadian investors. CI's business is carried on

through two main business segments: asset management through our subsidiaries CI Investments Inc., Marret Asset Management Inc., CI Private Counsel LP, and First Asset Investment Management Inc., and asset administration, through our subsidiary Assante Wealth Management (Canada) Ltd. ("**AWM**"). We also carry on our asset management business in Australia and New Zealand through our subsidiary Grant Samuel Funds Management Pty Limited.

As at May 31, 2017, CI, through our subsidiaries, managed approximately 245 conventional mutual funds and 70 exchange-traded funds, closed-end investment funds or limited partnerships which are sold under various fund family names, with assets under management of $123.3 billion. As at May 31, 2017, AWM, through its subsidiaries and affiliates, administered approximately $41 billion in mutual funds, stocks, bonds, GIC's, insurance products and other investments for its clients.

Accordingly, we believe we are well positioned to comment, both from the standpoint of an investment fund manager and a securities dealer, on CP 81-408 and the effects we expect it to have on the mutual fund industry and the capital markets more broadly.

General Comments

While we support the initiative of the Canadian Securities Administrators (the "**CSA**") to protect investors, we believe the approach proposed in CP 81-408 is premature and based on assumptions about the industry that may not be correct. Furthermore, and perhaps most importantly, we are concerned that the proposed approach may result in negative unintended consequences for investors and the capital markets.

Our concerns with the CSA's proposal in CP 81-408 fall into three broad categories:

a) The CSA's proposal will likely have a negative impact on investors and the capital markets.

b) The proposal is premature, given the capital markets, CSA members and industry regulators have not yet had time to digest and understand the impact of the recently enacted Point of Sale ("**POS**") and Client Relationship Model ("**CRM**") reforms.

c) The CSA's proposal may not be fully informed by all available and relevant research, as certain data we have reviewed contradicts the data relied on by the CSA.

A. Negative Impact on Investors and the Capital Markets

In our view, the discontinuation of embedded commissions would negatively impact both investors and the capital markets generally.

Investor Impact

First and foremost, we believe the CSA underestimate the advice gap that will likely develop for lower wealth investors.

With the decline in employer-offered pension plans, investors have come to rely more and more on mutual fund investing to save for retirement, and lower wealth investors are often the ones that most benefit from financial advice in connection with such investing.

If embedded commissions are discontinued, it is not clear how investors with small account sizes would obtain the advice they require in order to appropriately plan for retirement. Such investors are unlikely to have enough assets to meet the minimum account size requirements that many dealers impose for fee-based accounts which allow dealers to charge fees directly to clients. Further, the idea that such investors could or would want to enter into fee arrangements with dealers for advice is not realistic, given the cost of the advice relative to their account size.

As noted in CP 81-408, concerns of an advice gap have arisen in the United Kingdom after embedded commissions were banned there, given the high costs of advice relative to the small amounts many investors had to invest. One doctoral dissertation, looking at the situation in the United Kingdom, indicates that, as a result of the prohibition of embedded commissions, advisors have moved to servicing only wealthier clients, and the author, citing other research, concludes that advisors would not be expected to work with a client who had investable assets of less than approximately £150,000.[1] In fact, the same dissertation states that nearly a fifth of advisors in the U.K. have asked their smaller clients to leave and 69% of such clients had investible assets below £50,000.[2]

The impact of this advice gap will be that investors will have much less capital available by retirement, as studies have shown that investors who work with financial advisors accumulate more wealth than those who do not. One 2016 Canadian study found that, within four years, households using a financial advisor had 69% more assets than comparable households not using a financial advisor. Further, this effect was compounded over time, such that households using a financial advisor had 3.9 times the value of assets after 15 years than comparable households without a financial advisor.[3] The same study also found that the savings rate of investors who worked with a financial advisor was higher than for those investors who did not (10.75% vs. 6.70%).[4] Another earlier study had similarly found that investors who work with an advisor have an average net worth nearly three times greater than those who do not.[5]

In addition, the discontinuation of embedded commissions, which would also result in the discontinuation of deferred sales charge ("**DSC**") options, is harmful to lower-wealth investors, given the smaller amounts such investors have to invest. A DSC option allows more of the investor's capital to be invested initially (as a portion is not used to pay the dealer an up-front sales charge), thereby allowing more opportunity for growth over time.

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[1] Kendall Wesley Yeomans, "Facing Canada's New Financial Regulations and the Widening Advice Gap", thesis submitted in accordance with the requirements of the University of Liverpool for the degree of Doctor of Business Administration, April 2017 at 21.
[2] Ibid. at 22.
[3] Claude Montmarquette and Nathalie Viennot-Briot, "The Gamma Factor and the Value of Financial Advice", CIRANO, Montreal: August 2016 at 24.
[4] Ibid. at 26.
[5] Investment Funds Institute of Canada, *The Value of Advice: Report* (November 2011) at 2.

Given the importance provincial governments, particularly in Ontario, have been putting on pensions, and the concern with retirement savings, we do not believe the CSA should proceed with any discontinuation of embedded commissions without a complete understanding and appreciation for the potentially harmful impact on lower wealth investors and their ability to save for retirement.

We also note that, in her seminal 1995 report, Glorianne Stromberg expressed reluctance towards any ban on trailer or service fees given the potential for negative unintended consequences of doing so.[6]

Impact on Capital Markets

In addition to the negative impact on investors, there is currently a concern with the increasing regulatory burden on participants in Canadian capital markets. The Ontario Securities Commission has already recognized this increasing regulatory burden and is looking for ways to reduce it in the capital markets.[7]

One result of lower wealth investors being unable to access financial advice, as discussed above, is that such investors, anxious to invest may move into passive investment funds. While these funds generally have lower fees, they may not be the most suitable investment. In our view, policies that focus on costs without a balanced discussion of potential benefits, perhaps unintentionally, promote certain investment strategies that, while easy to execute, may not be in the long term interests of the investor.

We strongly believe that that the entire financial system benefits from an active, diverse mutual fund industry, as it injects liquidity into the capital markets. Active managers play an important role in capital raising by providing much needed financial support to small and medium cap companies and new entrants to the marketplace. On the other hand, passive managers are required to invest in the issuers that comprise the benchmark their funds are tracking. Therefore, an issuer will only attract investment from passive fund managers to the extent that it is included in such a benchmark. This means that issuers coming to market for the first time in initial public offerings, and the majority of small and medium sized enterprises, would not attract passive fund investment.

Another important consideration is that active managers seek out well governed companies and hold management accountable. Passive fund managers, on the other hand, only invest in companies that are in the benchmark their funds are tracking. Accordingly, good corporate governance is not directly a consideration for passive fund managers.

We believe these factors result in active mutual funds being a stabilizing force in the Canadian capital markets, which will be lost if assets move to passive funds.

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[6] Stromberg, Glorianne, "Regulatory Strategies for the Mid-90s -- Recommendations for Regulating Investment Funds in Canada", January 1995 at s. 10.01.

[7] OSC Notice 11-777 – *Statement of Priorities – Request for Comments Regarding Statement of Priorities for Financial Year to End March 31, 2018*, (2017), 40 OSCB 2579.

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B. CSA's Proposal is Premature

The CSA have recently completed implementation of the POS and CRM reforms, which are meant to improve investors' awareness and understanding of the costs associated with their investments.

In CP 81-408, the CSA state that they do not believe disclosure alone will fully address the inherent conflicts of interest created by embedded commissions, and therefore, the CSA may consider a ban on embedded commissions as a complement to the disclosure-based POS and CRM initiatives. However, CP 81-408 also states that the CSA have begun a multi-year research project to measure the impacts of POS and CRM on investors and the industry, which project is expected to be completed in 2021.[8]

In our view, the CSA will not be in a position to say with any degree of confidence that the conflicts of interest created by embedded commissions cannot be addressed through disclosure until the monitoring of the POS and CRM reforms has been completed. It is inconsistent for the CSA to state on one hand that they must wait until 2021 to fully assess the impact of the POS and CRM reforms, but then also say that they know now that these reforms are not sufficient to address the conflicts of interest created by embedded commissions.

For example, we note that according to a study prepared for the British Columbia Securities Commission, after receiving their CRM2 reports, investors became more aware of fees, both direct and indirect (76% and 59% compared to 67% and 47% in November 2016).[9] Further, investors with small portfolios became substantially more aware of direct fees (61% from 31% in November 2016). The same study also found that investor knowledge of different fees and how fees impact returns increased after receiving CRM2 reports.

Further, we would like to better understand where the CSA ends up in respect of their initiative regarding the targeted reforms and introduction of a best interest standard in Ontario and New Brunswick. Some of the targeted reforms discussed in Canadian Securities Administrators Consultation Paper 33-404 *Proposals to Enhance the Obligations of Advisers, Dealers, and Representatives Toward Their Clients* relate to the mitigation of conflicts of interest between financial advisors and investors. Therefore, before implementing any discontinuation of embedded commissions, we respectfully submit that it is necessary to first understand the CSA's plans with respect to the mitigation of conflicts in the context of a best interest standard. We submit that, until this is done, any discussion or commentary on the discontinuation of embedded commissions would be premature.

Therefore, we believe that the increased transparency of fund costs resulting from the POS and CRM initiatives should be permitted to have its effect before additional measures are brought in that may be unnecessary and have unintended consequences.

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[8] CSA Consultation Paper 81-408 – *Consultation on the Option of Discontinuing Embedded Commissions*, January 10, 2017, at 87.
[9] "Investor Readiness for Better Investing 2016-2017 Panel Study: Part 2", Prepared for the British Columbia Securities Commission by Innovative Research Group (April 26, 2017).

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C. CSA's Proposal Not Fully Informed

While we fully support the CSA's desire to use data driven research in crafting policy, we believe that the universe of relevant and available research has not been incorporated into CP 81-408.

Importance of Performance for Fund Flows

CP 81-408 draws upon research showing that embedded commissions reduce fund flow sensitivity to fund performance. From this, the CSA conclude that the conflict of interest created by embedded commissions may diminish an "investment fund manager's focus on risk-adjusted outperformance, thus impairing investor returns."[10]

However, a study by Environics Research found that the top two reasons cited by advisors for choosing a mutual fund company to invest with are product range or quality (37% of advisors) and good performance (28% of advisors).[11] This is supported by research from Morningstar which shows that, globally, most fund flows among equity, fixed income and balanced funds are towards funds that have five star Morningstar ratings.[12]

Accordingly, we believe that investment fund managers that wish to increase fund flows are generally quite focused on the returns of their funds, as this has a large impact on sales and redemption activity, rather than embedded commissions, which, in our experience, are generally the same across funds in the same sector or asset class.

Benefits of Other Compensation Arrangements Unclear

While CP 81-408 contemplates other compensation arrangements that it considers preferable to embedded commissions, the research on the benefits of other compensation arrangements is unclear. Even the CSA's commissioned report from the Brondesbury group concludes that there is not enough evidence to state with certainty that a fee-based compensation model will lead to better long-term outcomes for investors.[13] Further, the Brondesbury group states that "there is ample evidence" that types of compensation other than embedded commissions can lead to biased advice.[14]

Conclusion

In light of the above noted considerations, we submit that the proposals will not further the CSA's objectives of investor protection and promotion of efficient capital markets. We respectfully suggest that at the very least further study is required as to the potential negative impacts of introducing such

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[10] Ibid. at 10.
[11] "2015 Advisor Perceptions in Canada: A Focus on the Future & Consumers", Environics Research, (http://environicsresearch.com/wp-content/uploads/2016/02/Infographic-E_FINAL.pdf).
[12] Warren Miller, "Asset Management Trends: Flows and Risk", Morningstar Direct Forum, Toronto (July 21, 2016). Cited with permission.
[13] Brondesbury Group, "Mutual Fund Fees Research", Spring 2015, https://www.securities-administrators.ca/uploadedFiles/General/pdfs/Brondesbury%20Mutual%20Fund%20Fee%20Research%20Report_engwr.pdf at 74.
[14] Ibid. at 20.

legislation. Further, we strongly feel that the issues addressed in this paper are inextricably linked to those being considered under the targeted reforms initiative and, therefore, should be considered in tandem.

Yours truly,

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