FRANKLIN TEMPLETON
INVESTMENTS

Franklin Templeton Investments Corp.
200 King Street West, Suite 1500
Toronto, Ontario, Canada M5H 3T4
telephone 416-957-6000
toll free 1-800-897-7280
facsimile 416-364-6615
www.franklintempleton.ca

VIA EMAIL

June 9, 2017

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

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

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

Dear Sirs/Mesdames:

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

Franklin Templeton Investments Corp. ("FTI") is writing to provide comments with respect to the Canadian Securities Administrators ("CSA") Consultation Paper 81-408 – *Consultation on the Option of Discontinuing Embedded Commissions* (the "Consultation Paper").

FTI is currently registered in most provinces and territories in Canada as an adviser, investment fund manager, mutual fund dealer and/or exempt market dealer. FTI is a wholly owned subsidiary of Franklin Resources, Inc., a global investment organization operating as Franklin Templeton Investments. Through its subsidiaries, Franklin Templeton Investments provides global and domestic investment advisory services to the Franklin, Templeton, Franklin Bissett, Franklin Mutual Series, Franklin Templeton and Franklin Quotential funds and institutional accounts. In Canada, FTI has almost 500 employees providing services to nearly 500,000 unitholder accounts and over 100 pension funds, foundations and other institutional investors.

The discontinuation of embedded commissions would have a significant effect on the Canadian investment fund industry and, therefore, FTI appreciates the opportunity to provide feedback regarding this very important topic. FTI is a member of the Investment Funds Institute of Canada ("IFIC"). We have reviewed and generally support the comments made by IFIC in its letter dated June 9, 2017. In addition, FTI wishes to provide its own comments with respect to the Consultation Paper.

In our submission, we highlight our concerns with various aspects of the Consultation Paper. Next, we address the possible consequences of discontinuing embedded commissions. We also offer some alternatives for the CSA to consider. FTI believes there are other options that would address the perceived issues outlined in the Consultation Paper without having the negative consequences that may occur if embedded commissions are banned. Finally, we describe additional research that we believe should be undertaken by the CSA before any decisions are made regarding possible regulatory action. Although the CSA cites various inputs it obtained in formulating the Consultation Paper, given the significant impact a ban on embedded compensation would have on the Canadian investment fund industry, we believe additional evidence and research is needed. The CSA request that industry stakeholders provide analysis and perspectives that wherever possible, is evidence-based, data-centric and Canadian-focused; while we are happy to be actively engaged in the process, it is our view that the CSA should be responsible for providing the necessary level of research and evidence to warrant any regulatory changes.

First, we articulate some key principles that inform our comment letter.

General Comments

FTI believes in the following key principles.

- *Best interests of investors is paramount* – FTI strongly believes that the best interests of investors should be the primary consideration in determining what, if any, regulatory initiatives the CSA decides to pursue. We believe the best interests of investors includes having various options/choices available to them.

- *Transparency* – FTI believes in the need for full and effective disclosure of information to investors, including the components of a mutual fund's management expense ratio ("MER") and the compensation paid to dealers. Much of this information is already provided in a mutual fund's simplified prospectus, annual information form, fund facts, financial statements and/or management reports of fund performance. Furthermore, several recent regulatory initiatives, including the Client Relationship Model ("CRM2") and Point of Sale ("POS") have improved the disclosure available to investors. FTI supports regulatory initiatives that improve the disclosure provided to investors. If the CSA believes that existing and new forms of disclosure are not providing investors with the information they need to make informed decisions, we urge the CSA to review these disclosures with a view to improving them before other regulatory actions are considered or taken.

- *Investor choice* - FTI believes that, if provided with complete transparency about an investment product and a full explanation of their options/choices, investors should, with or without the assistance of an advisor, be allowed to make their own choices regarding the type of fund, class or series and purchase option that is most suitable for their individual circumstances. This includes the ability to choose a series of an investment fund with embedded compensation.

- *Value of investment funds* – For many years, investment funds have been the preferred investment vehicle for Canadian investors because of the advantages they offer. Investment funds provide investors with access to professional investment management, broad diversification, transparency and a strong regulatory framework at a reasonable cost. The investment fund industry has continued to innovate to provide investors with the options/choices they need to achieve their financial goals. Such innovation includes series and fee structures that are suitable for many different types of investors.

- *Value of financial advice* – FTI believes in the value of financial advice. Most retail investors should seek financial advice and such advice should play a critical role in investors' investment decision making. Studies have shown that investors who have access to financial advice believe they have better financial outcomes[1] and the advice from financial advisors generates significant benefits to investors in terms of more disciplined savings behaviour and higher overall higher asset.[2] We believe such advice is more important than ever given the increasing number and complexity of financial products and the fact that Canadians are increasingly responsible for their own retirement savings.[3]

<u>Concerns with the Consultation Paper</u>

While the CSA states in the Consultation Paper that it has not made a decision to discontinue embedded commissions, FTI is concerned that various comments made by the CSA in the Consultation Paper evidence a bias in favour of the elimination of this

---

[1] POLLARA Inc., "Canadian Mutual Fund Investors' Perceptions of Mutual Funds and the Mutual Fund Industry" (2016) Report prepared For: The Investment Funds Institute of Canada.
[2] Claude Montmarquette and Nathalie Viennot-Briot, "The Gamma Factor and the Value of Financial Advice", CIRANO Institute, August 2016.
[3] Pierre Lortie, "A Major Setback for Retirement Savings: Changing How Financial Advisers Are Compensated Could Hurt Less-Than Wealthy Investors Most", *University of Calgary School of Public Policy Research Papers*, Vol. 9, Issue 13 (April 2016).

practice. The Consultation Paper discounts the experience of other jurisdictions and the impact of other current regulatory initiatives such as CRM2 and POS. The Consultation Paper also puts the onus on industry participants to disprove the CSA's position that regulatory action should be taken, but FTI believes that further research should be undertaken by the CSA and evidence obtained to prove that a ban on embedded compensation is the appropriate regulatory action. The discontinuation of embedded commissions is the most radical way to address the issues identified by the CSA in the Consultation Paper and, in our view, other more appropriate alternatives that would promote investor protection and choice have not yet been fully considered.

FTI also has some specific concerns with the Consultation Paper. Those concerns include:

- *Alignment of interests of industry participants* – FTI does not agree that there is a misalignment of interests between investment fund managers, dealers and representatives and investors. In manufacturing and selling investment products, investment fund managers and dealers have a strong interest in ensuring that the products they offer are suitable for investors and meet their investment objectives. The ability of an investment fund manager to compete in the industry is dependent on maintaining its assets under management ("AUM") on a long-term basis, which makes it important that the products it offers perform well and in a manner consistent with how they are offered. Furthermore, investment fund managers and dealers are both incented to offer products that perform well over time since their compensation is directly related to the performance of the product. We believe the objective of investment fund managers, dealers and representatives and investors in offering, selling and/or holding investment funds that perform well and in a manner consistent with how they are offered are aligned.

- *Regulatory interference in registrants' compensation* – FTI does not believe it is the role of regulators to interfere with the commercial bargain between registrants and investors. Furthermore, the CSA is contemplating intervening in only one segment of the investment industry without regulating the compensation models established for many competing products/services (e.g., fee based platforms). This would put investment funds at a competitive disadvantage to other financial products and would create the potential for regulatory arbitrage. This type of approach would put regulators in the position of affecting investor choice, access to advice and competition.

- *Bias in favour of passively managed funds* – FTI believes the Consultation Paper also evidences a bias in favour of passively managed funds.[4] FTI acknowledges that there are benefits to both actively and passively managed investments and we believe that such investment strategies can complement each other in an investor's portfolio. However, we do not believe it is the role of regulators to

[4] For example, at pgs. 54-55 of the Consultation Paper, the CSA discusses a shift to passively managed funds if embedded commissions are discontinued. This is repeated later at pg. 62.

advocate for, or shift the regulatory landscape in favour of, a particular style of investing. In fact, passive investing may create certain risks for capital markets.[5]

- *Embedded compensation does not inhibit competition or act as a barrier to entry* – FTI does not agree with the CSA's assertion that the elimination of embedded commissions would attract lower-cost product providers to the Canadian mutual fund market. The Canadian investment fund market is already a very competitive industry and has seen new entrants in recent years. Moreover, we fail to see how embedded compensation acts as a barrier to entry. Since embedded compensation is paid out of the management fee charged by an investment fund manager, new market entrants are not at a disadvantage to existing market participants (i.e., they can create products with similar characteristics). In fact, we believe the bigger challenge for both existing and new entrants is having their investment funds included on dealers' platforms. Overall, we believe that fund management costs are on the decline as Canadian investment fund managers have been reducing their management fees to stay competitive.[6] The elimination of embedded compensation may actually decrease competition since it would be more difficult for independent fund managers and independent fund distributors to compete with integrated financial service providers. This would ultimately lead to less investor choice.

- *Investment fund managers are not incented to rely more on embedded commission payments to dealers than on generating performance to attract and preserve AUM* – The CSA believes that investment fund managers are more incented to rely on embedded commissions than on generating performance to attract and retain AUM. FTI disagrees with the CSA's position. We believe fund flows from out-performance far outweigh any additional fund flows resulting from incenting dealers with embedded compensation. In addition, the reality is that historical discrepancies in embedded commission structures have largely disappeared in response to market forces and perceptions and nearly all investment fund managers now offer similar embedded commission structures on their products. Therefore, there is no incentive for dealers to choose one company's product over another based solely on higher embedded commissions. Instead, dealers are much more concerned about the performance of the investment funds they recommend to their clients.

- *Discontinuing embedded commissions would not result in a decrease in fund management costs* – FTI does not agree with the Consultation Paper's suggestion that the elimination of embedded commissions may cause investment fund managers to focus more on fund fee levels, which will put pressure on them to reduce fees. As noted above, the Canadian investment fund industry is very competitive and market forces have already resulted in decreasing fund management costs.[7] It is very possible that investor costs could actually increase if embedded compensation is banned since there would be no limit on the fee

[5] One example is cited in John Sedgwick, "Shift to passive could be 'real problem' for governance", *Ignites Asia*, March 15, 2017.
[6] Investor Economics, *Investor Economics Insight*, July 2016.
[7] Ibid.

charged by dealing representatives to their clients for the advice they provide. Dealers' fee based platforms already charge fees that are greater than embedded compensation levels; since such platforms have minimum charges, they can be detrimental to clients who do not meet the minimum account size.

Possible Consequences to Banning Embedded Compensation

The Consultation Paper lists certain unintended consequences the discontinuation of embedded commissions could have for retail investors and the investment fund industry. FTI believes there is a real possibility these consequences would occur if the CSA decides to move forward with regulatory action. FTI believes that banning embedded compensation would likely have the following consequences:

- *Reduction in access to advice* – It is unlikely that lower-wealth investors and investors who are just beginning to save for future events (e.g., home, retirement, childrens' education, etc.) have the means to enter into direct pay arrangements with their dealing representatives. The Consultation Paper notes that most households purchase their funds through a deposit-taker or insurer owned dealer.[8] Discontinuing embedded commissions could accelerate that trend, thereby minimizing the role played by independent fund distributors. While the Consultation Paper suggests that these impacts could be mitigated by innovations in technology, we fail to see how online advice alleviates the burden on dealers and their representatives; the current regulatory environment imposes the same obligations on dealers and their representatives regardless of the form the advice takes. Dealers could also increase their minimum account sizes and/or impose other conditions or restrictions on their clients, thereby limiting investors' choices.

- *Limiting investor choice* – As stated above, FTI believes that the best interests of investors is paramount but that includes access to the broadest choice of investment options (including payment arrangements) possible. If investors are provided with complete transparency regarding the payment options/choices available to them, they should then be allowed to choose what is most suitable for their individual circumstances. Although there are alternative compensation arrangements such as commissions on trades, hourly rates, flat fees, fee-based arrangements, the majority of investors are currently invested in mutual funds with embedded compensation.[9] Discontinuing embedded commissions would reduce the options/choices available to investors and would eliminate the option that has historically been used most frequently. FTI believes that such action cannot be in best interests of investors.

- *Lower savings* – In an era where the availability of employer sponsored pension plans is on the decline and investors must increasingly bear the burden of saving for their own retirement, discontinuing embedded commissions could have a

[8] At pg. 30, the Consultation Paper states deposit-taker and insurer owned fund dealers dominate fund distribution in Canada.
[9] At pg. 46, the Consultation Paper states that, at the end of 2015, trailing commission paying purchase options made up 67% of assets.

significant impact on investors' savings. If investors are either unwilling or unable to invest in mutual funds because of more limited payment options, it could result in an overall lower savings rate leaving investors less prepared for retirement and less able to achieve other financial goals they have.[10]

- *Higher cost of advice* – In addition to reducing access to advice and limiting investor choice, discontinuing embedded commissions could increase the cost of advice for investors. In transitioning to direct pay arrangements, dealers may have to increase their costs to deal with lower-wealth clients (the group of investors who have the greatest need for investment advice). There is no guarantee that direct pay arrangements would result in lower costs. Although fund MERs may decline, the actual cost of advice could increase when the dealers' costs are added.[11]

- *Regulatory arbitrage* – FTI is concerned about the uneven playing field and regulatory arbitrage opportunities that would be created by the discontinuation of embedded commissions. This potential exists with products and services covered by securities regulation as well as other competing financial products. A ban on embedded compensation represents regulatory intervention into only one segment of the investment industry, leaving other products/services not subject to the same regulatory requirements.[12] Apart from products and services covered by securities regulation, competing products offered by the banking and insurance industries would also be at a competitive advantage and, since such products are not regulated by CSA members, there is less likelihood that regulation will be done in a coordinated fashion. Note that securities regulators released final amendments to National Instrument 31-103 – *Registration Requirements, Exemptions and Ongoing Registrant Obligations* implementing CRM2 in 2013 while the Canadian Council of Insurance Regulators only announced in 2016 that they would publish a consultation paper to consider new disclosure requirements for segregated funds.[13] This lack of coordination creates regulatory arbitrage opportunities and leaves investment funds at a competitive disadvantage.

- *Reduction in competition in the investment fund industry* – In the Consultation Paper, the CSA contends that embedded compensation acts as a barrier to entry and that its elimination may attract new industry participants. FTI believes the opposite trend could easily occur. As acknowledged by the CSA in the Consultation Paper, the transition to direct pay arrangements would involve substantial changes to current dealer business models. The impact could be magnified for independent fund distributors. The CSA's own research reveals that most households purchase funds through a deposit-taker or insurer owned

[10] Pierre Lortie, supra note 3.
[11] Brondesbury Group, "Mutual Fund Fees Research", Spring 2015. In the Brondesbury Group's review of research, one of their conclusions is that, while removing commission lowers product cost, advisory fees may rise as a means of paying for the cost of the service.
[12] Mutual Fund Dealers Association of Canada, "MFDA Client Research Report: A Detailed Look into Members, Advisors and Clients" (May 2017) (the "MFDA Report").
[13] Megan Harman, "Insurance regulators contemplate new disclosure requirements for seg funds", *Investment Executive*, March 30, 2016.

dealer. Discontinuing embedded compensation could accelerate that trend, which could result in an increase in conflicted advice. Independent fund managers like FTI, who rely on third party dealers to distribute their funds, would be impacted because of fewer available options for the distribution of their products. Ultimately, this would limit investor choice in the number and types of products that are available to them. By taking regulatory action, the CSA would be favouring certain business models, which is not the role of regulators.

- *Significant costs for registrants* - Discontinuing the practice of embedded commissions would be a significant change for investment fund industry participants. It would require administrative, operational and systems changes for both investment fund managers and dealers. These changes are in addition to changes that have been made by registrants to comply with CRM2. The CSA also assumes investment fund managers would be willing to pay for the costs associated with facilitating investors' direct payment of dealer compensation through payments taken from the investor's investment. Furthermore, registrants would be burdened with additional costs if/when the CSA adopts some or all of the targeted reforms described in CSA Consultation Paper 33-404 – *Proposals to Enhance the Obligations of Advisers, Dealers and Representatives Towards Their Clients* (the "BIS Consultation Paper"). The cost to comply with new regulatory requirements continues to increase for registrants. Ultimately, such costs would be borne by investors. Therefore, FTI believes a comprehensive cost-benefit analysis of recent regulatory initiatives is needed (see comment below).

Both options offered in the Consultation Paper to mitigate the negative consequences are transition periods which allow for a phased implementation of any regulatory action discontinuing embedded commissions. FTI believes that neither one of these options adequately address the unintended consequences that could result from a ban on embedded compensation. Instead of transition periods, FTI urges the CSA to consider other alternatives.

Alternatives

In the Consultation Paper, the CSA states that its goal is to ensure that any regulatory action it takes will provide a Canadian solution to challenges specific to the Canadian market, will result in more positive outcomes for Canadian investors and will minimize disruption for market participants. FTI believes there are other alternatives that address the perceived issues identified by the CSA in the Consultation Paper - the adoption of one or more of the following alternatives could lead to more positive outcomes for Canadian investors while minimizing disruption for market participants and investors and avoiding the unintended consequences that could result if embedded compensation is banned.[14]

[14] As noted earlier, FTI believes that it is not the role of regulators to interfere in the commercial bargain between registrants and investors. FTI also believes that banning embedded compensation is not a proportionate response to the perceived harm identified by the CSA in the Consultation Paper. If the CSA insists on proceeding with some form of regulatory action, there are other alternatives that would be less disruptive for market participants and the investing public, including: (i) standardizing the amount of trailing commissions (which largely exists now); and (ii) placing restrictions on the use of the deferred sales charge ('DSC") option.

- *Dealers to provide an explanation of fee and purchase options and obtain an acknowledgment signed by clients at the time of purchase* – FTI believes that investors should be able to choose the series and purchase option most suitable for their individual circumstances. However, investors should make an informed decision. For this reason, FTI suggests that dealers provide an explanation of the various fee and purchase options to their client before a trade is made on the client's behalf. Such explanation could also include a description of the services provided by the dealer (see comment below). Following the explanation, the investor would have the opportunity to choose the series and purchase option most suitable for them. This option would be similar in many respects to the direct pay arrangement described in the Consultation Paper in that investors would be given an upfront explanation by the dealer and would have to acknowledge this. This alternative would increase investor awareness and understanding and would align the option chosen by the investor with the services provided by the dealer. FTI believes that most dealers are already having these conversations with their clients and explaining the various options.

- *Dealers to provide a list of services for which they receive an ongoing trailing commission* – One of the concerns expressed in the Consultation Paper is that embedded commissions generally do not align with services provided to investors. For the reasons noted above, we do not agree. Dealers and their dealing representatives provide many different services to investors – such services go well beyond investment recommendations and include financial, tax, succession, estate and retirement planning, insurance consulting and advice (if dually licensed) and/or financial education. Furthermore, it is important to understand that trailing commissions paid to dealers cover much more than the advice provided by dealing representatives to investors – such costs include administrative, operational, systems, compliance and regulatory costs. FTI encourages the CSA to consider having dealers provide a list of those services to their clients so that investors have a better understanding of the services they receive in exchange for the compensation dealers receive. Being provided with a list of services would increase investor awareness and understanding and, together with the cost disclosure now mandated by CRM2, would provide a mechanism for investors to measure the value of the services they receive. FTI believes that disclosure of services should not be limited to compensation received for investment funds; such disclosure should extend to all investment products/services offered by dealers to their clients and for all investment fund compensation structures.

- *Introduce more flexibility into securities laws to allow DIY investors to purchase investment funds directly from fund managers* – The current regulatory structure requires all investment fund trades to be made through dealers and for dealers to discharge their know your client and suitability obligations prior to placing a trade on behalf of their clients (discount brokers have been granted exemptions from many of these obligations). The Consultation Paper notes that one of the key investor protection issues with embedded commissions is that they do not align with services provided to investors. As stated above, one of FTI's key principles is the value of financial advice and FTI believes most retail investors are best served by having a financial adviser. However, for those investors who are do-it-yourself ("DIY") investors and do not wish to receive financial advice or the services offered by a dealer, FTI encourages regulators to consider allowing the purchase of investment funds directly from investment fund managers without the need for a dealer. Investors would then have access to fund series without any embedded commissions. Currently, investment fund managers that wish to sell direct must register as a dealer or establish a dealer affiliate with related staffing, operational and compliance costs. Allowing DIY investors to purchase directly would offer a different method of distribution and would promote greater access to mutual funds at a lower cost.

- *Increase financial literacy* – One of the CSA's concerns with embedded commissions is that they limit investors' awareness, understanding and control of dealer compensation costs. In order for investors to make well informed decisions about their investment options, they need to have a minimum level of financial education and understanding. FTI believes financial literacy for investors is critical. FTI encourages the CSA to work with provincial governments to create new and/or expanding existing financial literacy programs offered to students (both secondary and post-secondary) in teaching financial skills about saving and investing money. This would ultimately help Canadians make informed decisions about managing their money and the options/choices they have when they invest.

- *Improved disclosure* – The Consultation Paper discounts disclosure as an effective way to address conflicts of interest in the advisor-client relationship. However, disclosure is a fundamental element of securities regulation. Over the years, the CSA has added new forms of disclosure (e.g., management reports of fund performance and fund facts) to what is already an extensive disclosure regime for investment funds. If the CSA believes that current disclosure is not effective, it should be considering ways of simplifying and improving the disclosure provided to investors in order to improve investors' awareness and understanding of the investment products they are purchasing and the costs associated with such products.[15]

- *Enforcement of existing rules* – One of the key investor protection issues noted by the CSA in the Consultation Paper is conflict of interest issues raised by embedded commissions. FTI believes that, since trailing commissions are already largely standardized, there is greater potential for conflicts of interest to occur and for the interests of investment fund managers, dealers and investors to be misaligned as a result of mutual fund sales practices. National Instrument 81-105 – *Mutual Fund Sales Practices* ("NI 81-105") was introduced to restrict or prohibit many of these practices. We believe the CSA should put more focus on

[15] One of the priorities in the Ontario Securities Commission's draft statement of priorities in 2017-2018 (Ontario Securities Commission Notice 11-777 – Statement of Priorities – Request for Comments Regarding Statement of Priorities for Financial Year to End March 31, 2018) is to identify opportunities to remove redundant and ineffective disclosure and reporting requirements for investment funds. FTI believes this is an important initiative.

enforcing existing rules such as NI 81-105 as a way to mitigate or eliminate the conflicts that exist.

Additional Research Needed

Given the significant impact that a ban on embedded compensation could have on various stakeholders in the Canadian investment fund industry, FTI believes that additional work and research is necessary. We encourage the CSA to undertake this work in order to determine the best regulatory approach to address the CSA's concerns. Examples of additional research include:

- *Investor survey* – We are not aware of any research conducted by the CSA where it surveyed investors to determine their preferences. Investors should be consulted to determine what, if any, regulatory action they feel is necessary to achieve these goals. As noted above, FTI believes investor choice is important and therefore investors should be consulted for their opinions on whether they view embedded compensation as an issue and whether they would prefer to move to direct payment arrangements.

- *Investment fund costs* – The CSA asserts that discontinuing embedded commissions will put pressure on investment fund managers to reduce their fees. The Consultation Paper states that the potential entrance of lower-cost product providers will likely increase the competitive pressure to decrease fund management costs even further over time. The Canadian investment fund industry is already highly competitive and the entrance of exchange-traded funds ("ETFs") has only increased the competition. FTI believes that market forces are already forcing industry participants to lower their management fees and other costs. There has also been a movement away from the sale of investment fund securities with a DSC.[16] In the past year, FTI announced its Simplicity Pricing initiative and it previously implemented other management fee reductions for many of its investment funds.[17] Many industry competitors have announced their own initiatives and/or management fee reductions in recent years.[18] FTI is also seeing a shift to fee-based series by investment advisors on behalf of their clients – 70% of its fund flows are now invested in series with no embedded commissions. FTI believes that investment fund costs are declining and market forces are causing a shift to fee-based series. For these reasons, regulatory intervention is not necessary. FTI encourages the CSA to conduct research to study the decline in investment fund costs and shifts in fund flows from series with embedded commissions to fee-based series.

- *Cost to investors* – According to the CSA, discontinuing embedded commissions may help to increase investors' control over dealer compensation costs. However, a potential unintended consequence is an increase in investor costs if investors are switched to alternative higher cost products/services or direct pay arrangements

[16] MFDA Report, supra note 12.
[17] The MERs of FTI's Canadian mutual funds have declined by 19%, on an asset-weighted basis, in the last five years (to December 31, 2016).
[18] Investor Economics, supra note 6.

result in higher overall costs for investors. The CSA should review the experience of other jurisdictions to determine if investor costs are actually lower when all costs (including direct fees charged by the dealer) are taken into consideration. The CSA should also study fee based platforms to understand the costs of such platforms, how they compare to the investor costs associated with embedded commissions and whether the average investor is able to negotiate better fees in a direct pay arrangement.

- *Cost-benefit analysis* – Any regulatory action to discontinue embedded commissions would have a significant cost for the investment fund industry. There are both tangible and intangible costs to industry participants and we estimate those costs to be considerable (the recent implementation of CRM2 cost the investment industry millions of dollars to implement). Furthermore, there are the costs of unintended consequences that may result from a ban. Accordingly, FTI believes that a comprehensive cost-benefit analysis should completed by an independent consultant retained by the CSA.

- *Monitoring outcomes of POS and CRM2* – In the Consultation Paper, the CSA discounts its own POS and CRM2 initiatives as means of addressing the perceived investor protection and market efficiency issues identified with respect to embedded commissions. FTI does not agree. The POS fund facts were introduced to provide investors with key information about a fund in a simple, accessible and comparable format on a timely basis. The requirement to deliver the fund facts before a fund purchase only came into effect two years ago. The CRM2 initiative introduced many new disclosure requirements for registrants, all with the aim of increasing investor awareness and understanding of mutual fund costs. The final stage of the CRM2 requirements only recently came into effect when investors started receiving performance and cost disclosure information. FTI believes that POS and CRM2 are both important initiatives that improve transparency and increase investor awareness and understanding of the funds they are purchasing, including the costs of such products. Since both initiatives have only recently been implemented, it is premature to conclude that they will not adequately address the perceived issues identified by the CSA in the Consultation Paper. These regulatory initiatives should be given time to implement and then their effectiveness properly evaluated before the CSA decides to pursue a ban on embedded compensation.[19]

- *Best interest standard* – In CSA Discussion Paper 81-407 – *Mutual Fund Fees* (the "Original Consultation Paper"), the CSA identified the imposition of a statutory best interest standard as one possible means of addressing the issues it identified. The CSA has since published the BIS Consultation Paper and recently issued a status report, indicating the direction it intends to take on various proposals. Certain CSA members continue to support a regulatory best interest standard and have committed to further work in this area. A regulatory best

[19] The CSA is currently engaged in a multi-year research project measuring the impact of these initiatives; FTI believes the results of that project will provide an important input in the study of embedded commissions as well.

interest standard is also a significant regulatory initiative. The regulatory best interest standard initiative and the initiative to consider discontinuing embedded commissions appear to be moving on parallel tracks without any coordination. FTI believes that, given their importance to the Canadian investment industry and the inter-relationship between the issues identified in both the Consultation Paper and BIS Consultation Paper, it is incumbent upon the CSA to better coordinate its work on these initiatives. The CSA should refrain from taking any regulatory action until all relevant impacts are considered.

Conclusion

The CSA's proposal to discontinue embedded commissions would have a significant impact on investment industry participants, including investment fund managers, dealers and their representatives and, most importantly, investors. FTI believes a prohibition on embedded compensation would likely have unintended consequences, including a reduction in access to financial advice and choice regarding the types of products available, lower investor savings, higher cost of advice for investors, regulatory arbitrage opportunities, a reduction in competition in the investment fund industry and increased costs for registrants. Ultimately, this would have the greatest impact on investors. For these reasons, we believe a prohibition is not the appropriate regulatory response. Instead, we urge the CSA to consider other alternatives described above that would still lead to more positive outcomes for investors while minimizing disruption for all market participants. In considering these other alternatives, we believe the CSA should undertake additional work and research before determining the appropriate regulatory response, if any.

Thank you for your consideration of this submission. We look forward to participating in further consultations on this very important topic. Please feel free to contact me at 416.957.6010 should you have any questions or wish to discuss our submission.

Yours truly,

FRANKLIN TEMPLETON INVESTMENTS CORP.

Brad Beuttenmiller

Brad Beuttenmiller
Senior Associate General Counsel