To the OSC and CSA,

I am a younger advisor at HollisWealth, an independent dealer, and I rely on embedded investment costs for a large percentage of my income. I am writing to urge you not to place a ban on this type of compensation structure.

I have read arguments for and against discontinuing the embedded costs. I do agree with having transparency; however, I also agree with having choice. With the new disclosures, fund facts, point of sale disclosure, and the annual fee letter---those are a great start to full disclosure. Having the fund companies send out an annual fee letter should be introduced also, so the investor can see the full costs of the funds. It is important to have the banks send out the same letters and materials as well. It is not fair to investors that the same level of transparency is not available to them at the major banks[1]. They also operate on a model of embedded investment costs and they should have the same disclosure as all businesses who sell the embedded products.

Disallowing the embedded model will also have negative outcomes on smaller investors. The current model supports Canada's middle class, which is the majority of the population, so they can have easy access to financial advice---thus better life outcomes. There are many studies which illustrate how having access to financial advice provides better financial outcomes for people[2]. The IFIC report specifically states that, "Advised households have substantially higher investible assets than non-advised households, regardless of household income level"[2] (pg.5). How do we define smaller investors? I have reviewed Morningstar's report on this matter[3]. Morningstar is an unbiased entity that reports topics in a very objective manner. They specifically cited a study by Allianz Global Investors that found investors with portfolios of less than GBP 50,000 ($85000 CAD) would not be serviced by investment firms. They went onto say it is now harder for investors with smaller portfolios to get advice. Having a fee based model, whereby the investor pays an upfront fee is problematic due to that fee being a larger amount of their portfolio---further incentivizing them not to pursue professional financial advice. A recent report from Schroders in the UK also confirmed the initial report from Allianz.

A fee based approach also has inherent problems as well. The dealer costs are displayed monthly; however, the mutual fund company's costs are not shown. IIROC recently released a bulletin on their concerns with fee-based accounts[4]. One of their concerns was there still may not be adequate supervision. The mutual fund companies can also still give gifts (soft dollars) to advisors for promoting their funds. At the bank level advisors get bonuses based on how much mutual funds they sell. I would assume that equity funds generate higher levels of bonuses as well, although that is not disclosed to clients, and therefore not verifiable. The disclosure rules do not apply to segregated funds either which insurance companies sell. They have very high management costs (3-4%) and the CRM2 rules do not cover them.

I am very careful when recommending a particular mutual fund to a client that is has the right risk profile for that client and has returns that are in line with the benchmark on risk adjusted basis. I take the time to explain this to clients also. I can see there is room for all advisors to have more of those conversations with their branch managers perhaps, so that there are checks and balances on what an advisor is recommending. If supervisors and branch managers had skill and expertise in that area, then they could better assess whether an advisor's recommendations are suitable. More frequent and comprehensive enforcement, and audits in that respect could pay larger dividends for clients than banning the embedded model.

I am convinced that there is more room to continue to reform the present system through more transparency from the mutual fund, insurance companies and the banks. As well making the exams more rigorous for advisors entering the business which ensures that the quality of advice would be higher and more thorough. The answer seems to lie with applying the CRM2 rules to all constituents in the investment industry equally and leaving customers to choose what method of investing they prefer. There are also now online digital advisory firms (robo-advisors) that will place additional competitive pressures on all advisors to give quality advice and recommend investments that perform well on a risk adjusted basis. I will summarize by saying that banning embedded costs will have a negative outcome for younger advisors, like myself, who have multiple smaller accounts, as well as the middle class clients that we serve.

Thank you

Sincerely,

Troy Iwanik

References:

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