

June 9, 2017

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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 Consumers 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  
Registrar of Securities, Northwest Territories  
Registrar of Securities, Yukon Territory  
Superintendent of Securities, Nunavut

In care of

The Secretary  
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Me Anne-Marie Beaudoin  
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Dear Sirs/Mesdames:

**RE: CSA Consultation Paper 81-408 - Consultation on the Option of Discontinuing Embedded Commissions (“Paper”)**

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InvestorCOM is pleased to provide our comments to the Canadian Security Administrators’ (CSA) Consultation Paper 81-408 - Consultation on the Option of Discontinuing Embedded Commissions (“Paper”) dated January 10, 2017.

InvestorCOM is an affiliate member of the Investment Funds Institute of Canada (IFIC) and The Federation of Mutual Fund Dealers (the “Federation”). Having participated in the Advisory Task Force for both organizations, we support IFIC’s and the Federation’s comment letters submitted to the CSA on June 9, 2017.

As a Regulatory Technology (“Regtech”) solutions provider for the investment funds industry, our comments reflect both industry and investor research responses to the CSA investor protection and

market efficiency issues outlined in the Paper. In addition to the comments summarized in IFIC's and the Federation's letters, we wish to emphasize the following points.

### Embedded commissions provide investors with choice

Based on the CSA Investor Index (October 2012), 80% of Canadian households own less than \$100,000 in investible assets and mutual funds, held by 4.3 million households, are the most common and important holding in their RRSP and RRIF accounts. There are many different dealer and advisor compensation models in the mutual fund industry, embedded compensation being one.

The CSA's concern is that payment by the investment fund manager to the investor's dealer, which is used in part to pay the advisor (embedded fee) is a conflict of interest. It is relatively simple for the industry to provide further disclosure and transparency around the embedded fee structure, which will largely eliminate the conflict of interest concern while still providing investors with a fully informed choice as to how they pay for investment products and services.

Low net-worth investors (<\$100,000) who invest in mutual funds today have an advice component included in the product fee. If embedded fees are eliminated, many of these investors will not be able to afford to pay for advice through a "fee for service" model or will forego paying for advice and choose a direct investing or robo advice model which may not be suitable for their level of investment knowledge. The embedded commission model fills the "advice gap" for many investors with assets under \$100,000 by investing in funds that meet their risk tolerance and long-term savings objectives.

### Eliminating embedded commissions will not significantly improve investor fee awareness

CRM2 and POS3 regulations are already in place to make direct and indirect mutual fund fees more transparent. Since CRM2 was only fully implemented in 2017 and POS3 in 2016, more time is needed to measure the effectiveness of these regulations on investor awareness. The industry is committed to ensure that advisors are using these regulations for investor education and fee disclosure. With increased investor education and greater transparency on fees and costs, investors will be armed with better information, leading to net improvement in overall returns to investors.

### Investors need help

Despite all the regulatory changes, industry changes, advisor and investor education, the fundamental problem remains that a large majority of investors need the help of an advisor to plan for their future and retirement. The skills required to understand increasingly complex financial products and compare investment alternatives is significant. Investors need the help of advisors to guide them through the wide range of investment choices including securities, mutual funds, exchange-traded funds (ETFs) and deposit products. Bundling financial advice with financial products in the current embedded commission model for mutual funds makes it easier and more accessible for low net worth investors to make choices between investment options.

### Unintended Consequences

Independent research conducted by IFIC, the Federation and The School of Public Policy at University of Calgary all conclude that eliminating embedded commissions will hurt low net worth individuals most. This has also been shown to be the case in other jurisdictions as well, including the UK and Australia. Restricting access to advice for low and middle income families in Canada will

adversely affect their wealth accumulation and ultimately their retirement savings and the Canadian economy.

## Role of the Regulator

The role of the regulators is to ensure that the policies and guidelines protect investor interests and address market failure. The role of the regulator should not be to promote a market outcome. The shift towards a fee-based advice model is underway in Canada, however this should be allowed to occur in a marketplace that allows for all relevant investment options and fee options.

## Advisors play a critical role

Advisors play a critical role in helping investors accumulate wealth and prepare for their retirement. Research continues to show that the average investor has limited knowledge of basic financial products and how their advisors are compensated. The recent implementations of CRM2 and POS3 are aimed at increasing investor knowledge and awareness which can be monitored and measured over time. The industry needs time to see the positive impact of these changes. Research indicates that Canadians who use financial advice accumulate significantly more wealth as compared to non-advised households.

## Robo advice is one of many investment channels

There is room for both digital technologies and advice products in the marketplace. Digital technologies including robo advice and direct investing provide choice for those investors who have good investment knowledge and are comfortable managing their own investment choices. However, these channels do not serve the needs of low net worth investors who have limited knowledge of investment products and who are currently invested in mutual funds with embedded commissions.

## There are alternatives to an outright ban

Instead of an outright prohibition, IFIC has proposed a number of reforms that, if implemented, would address most of the harms identified by the CSA, and would continue to allow investors the choice of paying for a mutual fund investment directly or indirectly, while also avoiding the unintended consequences of an outright ban. These include:

- Providing investors with a choice of both embedded and unbundled fee arrangements with enhanced transparency around fees paid
- Leveraging the current CRM2 and POS3 regulations that mandate fulsome disclosure regarding fees and services to be provided upon account opening, before each purchase and annually
- Standardizing embedded fees across the industry to remove the financial incentive for an advisor to recommend one fund over another based only on trailer fees since all funds would pay the same trailer
- Restricting the sale of Series A funds only in channels where advice is permitted
- Establishing guidelines under which sales of Deferred Sales Charges (DSC) funds are sold, so investors are not locked into funds that are not suitable for their age or time horizon
- Allowing modest investors access to embedded fee series funds so they can continue to receive financial advice

- Separately disclosing embedded fees to increase transparency and standardize naming conventions for fund series to facilitate comparisons of MERs and trailer fees across similar products

## Conclusion

The dynamic consequences of an outright ban on embedded commissions will not elicit the results that the regulators or investor advocates are looking for, but rather will result in a negative impact on the retirement savings and wealth of the low to middle income investor; exactly the target group for which the ban was intended to help.

Our recommendation is to keep embedded commissions as a marketplace choice for investors and make fees more transparent. We agree that the industry needs competent financial advisors that can deliver affordable and transparent financial advice to all Canadian households. We also agree that the industry needs to increase investor proficiency standards, promote best practice and enhance suitability requirements.

As a Regtech provider to the industry, InvestorCOM is committed to working with the industry and regulators to develop products and services that help advisors disclose fees, help educate clients and help fund managers monitor compliance.

Thank you for giving the industry an opportunity to comment on the consultation paper.

Sincerely,



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