June 9, 2017

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**RE: CSA CONSULTATION PAPER 81-408 - CONSULTATION ON THE OPTION OF DISCONTINUING EMBEDDED COMMISSIONS**

Serving one in three Canadians, Manulife is a leading financial services organization offering a wide range of protection, estate planning, investment, and banking solutions through a diversified multi-channel distribution network.

Manulife Investments, a division of Manulife Asset Management Limited, represents the wealth management arm of Manulife's Canadian Division. As one of Canada's leading integrated financial services providers Manulife Investments offers a variety of products and services including mutual funds, non-redeemable investment funds and exchange traded funds. As of April 30, 2017, Canadian mutual fund assets for Manulife Investments were approximately C$53 billion.

Manulife Securities, consisting of the IIROC regulated Manulife Securities Incorporated and the MFDA regulated Manulife Securities Investment Services Inc., are wholly owned subsidiaries of the Manufacturers Life Insurance Company (Manulife). Our advisors and life agents provide investors with access to stocks, bonds, mutual funds, and other investment products as well as a suite of insurance solutions.

We are pleased to provide our thoughts on CSA Consultation Paper 81-408 and we note that our response intends to complement and support the submission made by the Investment Fund Institute of Canada (IFIC) to CSA Consultation Paper 81-408.

We provide opening comments below before reviewing the value of financial advice, providing our thoughts on embedded and fee-based payment arrangements, and discussing the possible impacts of the CSA proposal on the market for financial advice and investments.

**Opening Comments**

Canadian investors are best served when the regulatory framework for investment funds supports strong consumer protection and facilitates access to a wide-variety of financial services, products, and professional advice.

Our assessment of the CSA's proposal suggests that banning the use of embedded commissions (i.e. payment by an investment fund manager to an investment dealer, which is used in part to pay an advisor) will disrupt the market for financial advice and make it difficult for average Canadians (i.e. those with less than $100,000 to invest) to afford this valuable service.

The mechanics of embedded compensation arrangements permit fund managers to off-set the costs of collecting and calculating client account fees and expenses for participating investment dealers. Many investment dealers rely on this business model to service smaller investors.

A ban on embedded commissions would inhibit this business model and require these costs to be borne by the dealer and passed through to customers; increasing the overall cost of the service.

We expect these higher costs will disproportionately affect smaller investors who will be unable to afford access to financial advice or will lack the investible assets to attract an advisor.

Rather than pursuing a ban on embedded commissions, we encourage the CSA membership to pursue the alternative regulatory approaches being presented by IFIC in its submission to CSA CP 81-408. Taken by themselves or in combination with existing regulations, these alternative approaches should appropriately address or mitigate the CSA's concerns regarding possible conflicts of interest in embedded compensation arrangements and avoid disruption for average Canadian investors, to the degree possible.

If these conflicts are effectively contained, then we believe that embedded compensation can continue to serve as a complementary payment option for investors alongside fee-based arrangements.

**Value of Financial Advice**

Rather than focusing solely on stock picking or trying to out perform the market, financial advisors also play an important role as the coach and partner of their clients by providing them with valuable investment discipline, confidence and planning. This behaviour is especially important for smaller and newer investors who need the benefit of time to build their retirement savings as early and consistently as possible.

Well-trained advisors work hard to instill life-long savings habits through the regular knowledge transfer that is the hallmark of the advisor-client relationship. And for most investors, access to advice has a measurable influence on their long-term success. Advice is important, especially in the early years of investing, because informed investors make better decisions and they are more disciplined about staying the course during changing markets and uncertain economic times.

Independent studies continue to show that individuals who work with an advisor over time benefit from more savings, more confidence in their investment decisions, and a more disciplined approach to their savings behavior.

For example, in 2012, the Center for Interuniversity Research and Analysis of Organizations (CIRANO) released a study entitled, *Econometric Models of the Value of Advice of a Financial Advisor*, by Claude Montmarquette and Nathalie Viennot-Briot examining the value of financial advice.

The CIRANO study drew four main conclusions about financial advice in Canada:

1. Advice has a positive and significant impact on financial assets after factoring out the impact of almost fifty socio-economic, demographic and attitudinal variables that also affect individual financial assets. This positive impact is more pronounced the longer the tenure of the advice relationship.

2. The positive effect of advice on wealth accumulation cannot be explained by asset performance alone. The greater savings discipline acquired through advice plays an important role. For example, the paper finds that advised households save at twice the rate of non-advised households.

3. Advice positively impacts the retirement readiness, even after factoring out the impact of other variables.

4. Having advice is an important contributor to levels of trust, satisfaction and confidence in financial advisors; a strong indicator of value.

In August 2016, Montmarquette and Viennot-Briot revisited their 2012 study with updated and new data to address potential bias and criticisms of their previous work. With this new study entitled, *The Gamma Factor and the Value of Financial Advice*, the authors reaffirm, and in fact strengthen, the results found earlier (i.e. that clients with an advisor grow their assets at substantially higher rates than clients without advice).

It is also important to recognize that investment intermediaries provide a valuable and legitimate service for millions of Canadians and are entitled to fair and reasonable compensation for their efforts.

Many independent investment fund dealers are small and medium sized-businesses. Fees and commissions paid to the dealer by the client and/or the investment fund manager, either directly or indirectly, are used to cover the dealer's operating, administrative, and labour costs and encourage owners of these businesses to grow their practice, hire new staff, and expand their expertise to the benefit of Canadians.

**Consumer Choice**

The investment industry offers consumers choice in how they pay for their services, allowing Canadians to select a payment method they feel is appropriate based on their personal preferences.

Embedded commission mutual funds, with options such as front-end or back-end loads (e.g. deferred sales charge), provide an affordable payment option for thousands of average Canadians.

Rather than eliminate payment options we believe that disclosure and transparency regarding fees and commissions should be enhanced, both at point of sale and on an ongoing basis. Specifically, Manulife supports controls on the sale of deferred sales charge mutual funds as proposed by IFIC to protect and serve the interests of investors, including seniors and investors with shorter time horizons.

Over the last decade, the Canadian market has seen a dramatic increase in the number of investors and dealers adopting fee-based arrangements, whereby the client pays a direct fee, often based on a percentage of the investments in their account, to the dealer. The February 2017 Investor Economics Insight, for example highlights that in recent years, mutual fund growth has been largely accounted for by funds with unbundled distributor fees (F-Class), particularly in full-service brokerage.[1]

As both a fund manufacturer and investment fund dealer, Manulife expect sales in this structure will continue to grow in popularity, regardless of the position the CSA ultimately takes in respect to banning embedded commissions.

We think it is important to note however that, in our experience, the growing trend towards fee-based arrangements, and particularly the purchase of F-Class series funds, is primarily occurring with investors who have enough assets to make the costs of these programs worthwhile.

As such, we encourage the CSA to allow smaller investors, for whom fee-based arrangements are not economical, to continue to have access to financial advice through commission based accounts.

**Impact of a Ban on Average Canadians**

As noted in our opening comments, the CSA's proposal to ban embedded commissions has the capacity to disproportionately impact smaller and first time investors and make it difficult for average Canadians to access affordable financial advice.

Under a ban, we expect most investment dealers will move to some variation of a fee-based arrangement. While fee-based accounts provide a cost-effective and efficient payment option for many Canadians it may not be an appropriate or affordable model for all investors or investment dealers.

[1] Investor Economics Insight, Investment Funds Advisory Service – Canada. Strategic Insight. February 2017

*Mechanics and Costs Associated with Dealer-Sponsored Fee-Based Accounts*

Manulife Securities is familiar with the mechanics and costs associated with offering a dealer-sponsored fee-based account platform and it is important for the CSA membership to have a strong understanding of these costs as well.

Due to the business-sensitive nature of this information, we would feel more comfortable sharing these details in a separate, private communication. We will direct our Manulife staff to follow up directly with CSA member staff in the coming weeks to provide a written, detailed overview of the mechanics and costs associated with our dealer-sponsored fee-based accounts.

More generally, for the purposes of this consultation, please consider that to replace an embedded commission with a dealer-initiated fee, a dealer must:

1. Calculate fees plus taxes based on the market value of the account using an in-house or outsourced fee engine.
2. Administer fees by accepting fee agreements, setting up fees in the fee engine, processing and reporting fees, remitting sales taxes on the fee to the respective jurisdictions.
3. Execute sells to clear fee debits that have been posted to the account (Note: since dealers have the authority to clear indebtedness *only* in nominee accounts, client name accounts are not eligible in fee-based account programs).
4. Settle trades onto the custody system.
5. Print and mail a trade confirm.

For each of these functions there are tangible, quantifiable costs to the dealer that do not exist when fund companies calculate and pay embedded commissions.

If the CSA moves forward with a ban on embedded commissions, we expect investment dealers will pass the costs of these functions to investors. Consumers who choose to continue to invest with advice will pay more to get the same products/service/advice. Consumers who become disenfranchised with the increased cost of investing with advice will voluntarily abandon the advice channel.

Alternatively, dealers that are forced into offering a direct pay model for all their accounts will likely raise their account minimums creating an advice gap. Dealers faced with setting up a fee-based platform, or extending an existing platform, to cover tens of thousands or hundreds of thousands of new accounts will face an overwhelming challenge both operationally and financially. To bring the number of accounts and the expected dealer revenue per account into a zone that makes it financially viable, dealers will raise their minimum account size thresholds. Dealers that currently operate solely in client name, faced with the prospect of converting to both a nominee name platform and a fee-based platform at the same time, will not likely have the financial wherewithal to make the shift.

To put the scope of the consumer impact of an increase to minimum account sizes in perspective, Pollara research from 2016 suggests that Canada-wide, 68% of investors had less than $50,000 when they first met their advisor and 37% had less than $10,000.[2] Moreover, new research from the Mutual Fund Dealers Association of Canada (MFDA) indicates that about 83% (or 7.3 million households) of the almost nine million households that invest with a MFDA representative have less than $100,000 in assets.[3]

Although discount brokerages and robo-advisors provide an attractive, and low-cost alternative for a niche segment of investors, research by Ipsos suggests that many Canadians, especially older Canadians, prefer face-to-face professional advice and do not have the desire to invest through a robo-advisor.[4] Moreover, these channels are generally restricted, either by regulation, business model, or technology, in their ability to offer comprehensive financial advice, planning, and other services. Ultimately, without access to an attractive option, many Canadians will choose not to invest, hampering their ability to save for retirement and other large events.

**Conclusion**

Given the possible impacts that the CSA's proposed ban on embedded commissions could have on the ability of average Canadians to afford access to traditional financial advice, we recommend that the CSA evaluate and pursue the package of alternative reforms proposed by IFIC in its submission to CSA CP 81-408.

These alternative reforms, taken by themselves, or in combination with existing regulation will address the concerns raised by the CSA, allow investors to continue to have affordable access to the Canadian financial marketplace, and avoid the unintended disruption created by a prohibition.

Thank you again for the opportunity to provide feedback to CSA Consultation Paper 81-408. We would be happy to provide further information upon request and answer any questions that you may have.

Sincerely,

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[2] Canadian Mutual Fund Investors' Perceptions of Mutual Funds and the Mutual Fund Industry. Pollara Inc, prepared for the Investment Fund Institute of Canada. 2016
[3] MFDA Client Research Report: A Detailed Look Into Members, Advisors, and Clients. Mutual Fund Dealers Association of Canada. May 2017.
[4] Canadians & Financial Advice 2016. Ipsos 2016.