Quadrus Investment Services Ltd.

255 Dufferin Avenue
London, Ontario N6A 4K1
1.888.532.3322
1.877.814.6492 Fax

VIA E-MAIL: comments@osc.gov.on.ca, consultation-en-cours@lautorite.qc.ca

June 9, 2017

British Columbia Securities Commission
Alberta Securities Commission
Saskatchewan Financial Services Commission
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
New Brunswick Securities Commission
Superintendent of Securities, Prince Edward Island
Nova Scotia Securities Commission
Superintendent of Securities, Newfoundland and Labrador
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Yukon Territory
Superintendent of Securities, Nunavut

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

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

We are writing to provide comments with respect to the CSA Consultation Paper 81-408: *Consultation on the Option of Discontinuing Embedded Commissions* ("Paper").

Quadrus Investment Services Ltd. ("Quadrus") is one of the largest mutual fund dealers in Canada with more than 3770 registered investment representatives. It is the exclusive mutual fund dealer for London Life Insurance Company and preferred mutual fund dealer for investment representatives of The Great-West Life Assurance Company.

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Introduction:

Studies have shown that Canadians at all economic levels have significantly better long term economic outcomes when working with an advisor than when not[1]. However, as noted in the Paper, not all Canadians, particularly in the mass-market segment, use an advisor. In our view, the test of any regulatory initiative relating to advice is whether it is likely to *increase* (or at least not decrease) the number of Canadians obtaining good, qualified, understandable and affordable advice, and therefore obtaining improved financial outcomes. Our principal objective, when responding to this and other related CSA papers, is to arrive at a solution that maximizes the range of access to advice and payment options available to Canadians at all economic levels. We believe that in this regard our overall policy objective is shared with CSA members: providing a solid framework allowing Canadians to confidently invest and save for their own current and future needs. Certainly any initiative that is likely to eliminate or limit access to good, qualified, understandable and affordable advice is not likely to improve financial outcomes of Canadians and will not benefit the Canadian economy in general.

We strongly support CSA initiatives to improve the professionalism of advisors, clarify the costs of investments and of advice, clarify titles used in the industry and improve the financial literacy of Canadians. We are convinced that all of these initiatives will increase the quality of, and access to, investment advice thus leading to improved financial outcomes for Canadians.

Canada has benefited from a robust regulatory environment that differs materially from those of some other jurisdictions where scandals and investment failures initially led to the kinds of regulatory reform the CSA is currently contemplating. As the CSA notes in the Paper, Canada cannot fully compare itself to the experiences of other jurisdictions as Canada's starting conditions differ. Canada, and Canadians in general, were not subjected to the worst of the global recession or localized fraud and scandal. We have seen no convincing evidence of widespread negative consumer implications resulting from embedded compensation arrangements. To the contrary, given the massive growth in retail investment in mutual funds over the last 30 years and the popularity of embedded compensation models in that growth sector, a strong argument could be made that embedded compensation has played a major role in helping Canadians get and stay invested, allowing them to achieve their relatively strong retirement readiness level today.[2]

The Paper asks specifically that the industry not reiterate previous arguments and produce new, Canadian, evidence. We have done this when possible, but we also wish to stress the legitimacy of the positions the industry has raised to date. We acknowledge that the CSA has the best interests of Canadian investors and the health of a robust market as its core motivations. We do as well. We think that fair thinking market participants and regulators can work together for the benefit of all. The Paper makes it clear that the CSA has given this issue serious consideration. We respect that, but on many elements we do not arrive at the same conclusions, and in our response, we submit alternate proposals to address the items we agree cause concern. We are deeply concerned that the direction the CSA is proposing is dangerous for Canada, and not just for our business. The research and analysis presented by the Paper is not determinative, focuses on the wrong things and fails to establish any conclusive evidence that banning embedded compensation models will result in improvements to consumer outcomes. As another jurisdiction has pointedly noted, a ban is a "blunter option"[3]

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[1] CIRANO, Econometrics Models on the Value of Advice of a Financial Advisor, 2012, and The Gamma Factor and the Value of Financial Advice (2016) and IFIC, The Value of Advice, 2012

[2] See McKinsey & Company, "Building on Canada's Strong Retirement Readiness" (February 2015).

[3] Regulatory Impact Statement, Review of the Financial Advisers Act 2008,Ministry of Innovation & Employment, New Zealand, p. 46

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of public policy. If a payment method has undesirable implications, we should focus on working together to find solutions that do not run the serious and internationally recognized risks[4] of unintended and serious consequences for small and moderate Canadian investors that would likely be the result of a ban.

We are strongly in favour of offering a diverse selection of payment options to clients, consistent with their needs. Although we do not support eliminating all embedded fee models, as the market evolves and client needs change, we are not opposed to eliminating fee models that may no longer be aligned with those needs, such as deferred sales charges. We believe that targeting reforms in this manner results in a better outcome for Canadians and market participants than banning all types of embedded commissions.

In addition to our submission, we have been involved in and strongly support the submission of the Investment Funds Institute of Canada. That submission includes significant and relevant new data specific to Canada, as requested by the CSA. We will let the IFIC Submission speak for itself.

Implications for Access to Advice:

The Paper continues from the original Consultation Paper 81-407: Mutual Fund Fees, of 2012, noting that the CSA has reviewed a number of studies and commissioned additional research to assist it in its deliberations with respect to the implementation of a ban on embedded commissions. The CSA has concluded that embedded commissions raise three investor protection and market efficiency issues in Canada:

(1) Embedded commissions raise conflicts of interest that misalign the interests of investment fund managers, dealers and representatives with those of investors;
(2) Embedded commissions limit investor awareness, understanding and control of dealer compensation costs; and
(3) Embedded commission paid generally do not align with the services provided to investors.

These issues generally exist in one form or another for most compensation models and are not exclusive to embedded commissions. We agree with the CSA that improvements can be made on these three concerns, but we suggest that the solution is to develop targeted responses specific to each concern rather than a sweeping ban on a commission structure that has served Canadians well.

We strongly believe that the investment funds business should offer multiple ways for clients to pay for advice, and to the extent conflicts arise, disclosure is obscure or there is concern about the value clients are getting for those payments, they can be dealt with directly and for all payment methods. We discuss each of these concerns in more detail in the next section, and propose alternative approaches for consideration that would not create the serious risk of unintended consequences.

The Paper reviews the use of embedded compensation in the sale of investment funds, concluding that the only way to remedy the concerns raised is to completely eliminate the option. In our view, the imposition of a complete ban on any otherwise legal activity is an extreme measure and should only be done where the harm is clear, material and not remediable in a manner that would cause less disruption. We do not believe that the case has been made for any of these, and are very concerned that the real consequences of banning this

[4] Final Report, Review of the operation of the Financial Advisers Act, 2008, Ministry of Business, Innovation & Employment, New Zealand, pgs 78-9, including references to FCA Financial Markets Review final Report, 2016.

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method of paying for investment advice, intended or otherwise, will be to reduce access to advice by those Canadians most in need of it. In short, the proposal will not increase access to advice, and therefore will not improve investor outcomes.

The Paper suggests that advice will still be available and will be provided, but will be:

(i) paid for directly by the client in amounts negotiated with the advisor,
(ii) paid for at hourly rates for services rendered,
(iii) provided by employed advisors in bank owned firms, or
(iv) provided through algorithm based robo-advisor services.

What will be largely eliminated, however, is direct human advice provided to small and medium level investors by independent financial advisory firms. Our expectation is that firms will continue to require a minimum asset level of at least $100,000 before negotiating account fees because it will be driven by the cost of the time involved in properly engaging in the meetings and work required for account opening and client analysis. The vast majority of Canadians have less than $80,000 in savings – as a result, negotiated fees will simply not be available to them.

The Paper suggests that firms may develop fee based services, with charges based on specific activities provided by the advisor. The experience in the United Kingdom suggests that the price mass-market clients will be willing to pay for these services is materially lower than the price advisors will need to charge in order to maintain a viable business. As a result, a ban on embedded commissions will create an advice gap because many investors are not willing or able to pay the fees required to operate a viable advisor business. The likely result is that these investors will leave their current advisor and either turn to bank owned firms (significantly limiting choice and competition), move to self-managed tech solutions/robo advice (which do not offer the "gamma" element proven to be successful) or worse still, avoid investing entirely.

The Paper places significant weight on the CSA's expectation that bank owned firms will take on the vast majority of small and medium investors who currently obtain independent advice through embedded commissions. We are concerned about the loss of competition such an approach will create, and are particularly concerned about entrusting the financial future of an entire cohort of Canadians who are at risk of not meeting their retirement needs to one primary distribution channel. Fostering a competitive advice environment can improve the quality of the service provided and create incentives for lowering the cost, but it also tends to provide alternatives should one channel be found to have engaged in inappropriate selling behavior, for example. For all these reasons, actions that have the effect of limiting competition and fostering concentration are generally to be avoided.

The Paper also appears to rely strongly on the growth of technology based solutions which promise to provide platforms that will offer automated portfolio strategies for very low cost. We also support such initiatives, but such services do not offer the core value of advice – the "gamma" of coaching and convincing necessary to ensure clients engage and remain in the investment process through difficult times.

Alternatives:

Although we disagree with many elements of the Paper, we would prefer to work toward solutions with the CSA that may resolve our mutual concerns regarding some forms of embedded commissions without the need

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for their elimination. Such an approach has the benefit of dealing with the problem without eliminating a valuable payment option for Canadians. As noted above, the following three concerns expressed by the Paper apply to any compensation structure to varying degrees. We support more payment options – not less – and believe that properly framed rules can deal with the concerns without eliminating one of those options.

(i) Conflicts of Interest;

All forms of compensation create potential conflicts - embedded commissions are not uniquely problematic in this regard. In the classic economic situation, the client wants the service for free and the provider wants payment for minimum work. In reality, every payment method has this inherent conflict, which can be resolved through transparency and availability of alternative options. CRM2 initiatives already appear to be having an effect on all models and there is no evidence that eliminating a popular option will improve client outcomes on this point.

Similarly, as advisors' compensation is often a percentage of client assets, advisors and clients are fully aligned in their desire to increase those assets. We do not see a significant misalignment between advisor and client interests arising simply from the fact that advisors are paid by the manufacturer. Any percentage based compensation structure will serve to align interests as best as possible. Set fees for services may actually misalign interests, as the advisor would have an incentive to process as many such clients and transactions as possible, potentially driving the quality of each individual client experience down.

With respect to the concern that fund managers have the ability to enhance compensation in order to generate sales, whether the fund's performance warrants the attention or not, much of the research relied upon by the CSA pre-dates current market changes, which have generally flattened commission schedules among fund firms. This largely eliminates the argument that firms "purchase" sales: as funds move to common compensation grids, the incentive to sell one over the other for payment alone disappears. The CSA deserves significant credit for sparking this market movement, which in our view arose in no small part as a reaction to CSA Consultation Papers 33-404 and 81-407. These papers shed light on the issue, which led to advisors and dealers moving away from funds that paid non-market compensation.

We suggest that requiring advisors to take the cost of the investment into consideration as part of a suitability analysis has led to this result. As an alternative to an outright ban of embedded commissions, the CSA could continue to monitor compensation structures offered by fund families and act surgically if it has concerns that a fund is 'purchasing' sales. This would remove the misalignment of interest between the fund manager and client, driving fund managers to distinguish themselves on price, performance or both.

(ii) Awareness, Understanding and Control;

Embedded commissions no longer limit investor awareness given the adoption of CRM2 transparent disclosure rules. In fact, because of CRM2 embedded commissions are fully disclosed to the client. This provides a clearer picture for clients than they would obtain from working with salaried bank employees for example (who may receive bonuses or other incentives on the sale of certain products, but which would not be disclosed on a CRM2 statement). In addition, as embedded commissions are disclosed in Fund Facts they allow the market to operate using complete information. Negotiated fees are not disclosed to the market and therefore are not subject to market discipline. We are concerned that clients may find themselves put in a position where they

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are directed to a negotiated fee based account when that may not actually be in their best interest.[5]

We are concerned that the Paper includes a dangerous underlying assumption: that individual Canadians have the skills, knowledge and desire to "negotiate" fees with a trained advisor. Behavioural Economics research suggests quite the opposite, and in our experience a large majority of Canadians prefer not to negotiate, but to simply accept a reasonable price for services. Given that, the key is to ensure that potential clients are given the information they need.

We suggest that disclosure of the cost, in a clear and simple way, prior to the transaction resolves these concerns and provides clients with control over their investment decision. We also suggest that offering different payment options prior to sale achieves the same purpose as well. Perhaps a simple standard illustration could be developed that would indicate the impact of different fee payment options on the clients' account using standard assumptions. Alternatively, or concurrently with this proposal, clients could be required to acknowledge in writing the fee arrangement they have with their advisor (embedded or otherwise).

The Paper suggested that the large number of different fund series available to investors creates complexity and makes it difficult to understand the costs of investing. Many of these series are not available to the small and moderate investor in any event, and we think this can be easily resolved with simplified disclosure.

Tiered structures also should be considered. For example, given that the vast majority of Canadians have less than $80,000 to invest, most cannot meet the asset thresholds for fee based accounts (currently at least $100,000 for most firms). However, over time clients may achieve these thresholds. Firms could be required to alert clients when these options become available to them, and indicate the effect that such fees may have on their account.

All of the concerns raised under this section can be dealt with through simplified communications and disclosure.

(iii) Value for Compensation;

We agree that clients are entitled to understand the services they will receive for the compensation paid to their advisor. We think this can be done through a clear, simple services statement to be provided to the client at the point of account opening. Such a statement would set out the reporting, analysis, accessibility, number of meetings and the like that will be provided by the advisor, and include the anticipated annual compensation paid to the advisor and dealer for those services under different payment options. This has the benefit of clarifying, for all parties, exactly what is expected in return for the fees paid. We think such an approach will empower clients and allow advisors and dealers to distinguish themselves based on service, and does not require the elimination of embedded commissions.

We also think there is merit in considering whether embedded commissions should be subject to a cap or a trigger point where negotiated fees should be proposed to the client. Such an approach would help in avoiding situations where client accounts grow significantly, generating much more compensation to the advisor without any additional added value to the client.

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[5] IIROC Notice 19-0093, April 27, 2017, s. 2.3.1

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Appendix:

The Paper sought input on 36 specific questions. We attach an appendix setting out those questions and our responses.

In closing we thank the CSA for the opportunity to provide feedback on this Paper. The changes mentioned in the Paper are significant and far reaching, with the potential to seriously harm small Canadian investors inadvertently. Large investors will always have access to financial advice and the market. Smaller investors, who make up the bulk of Canadian society, do not have that luxury and any change that has the potential to weaken their abilities to invest for their futures should be subject to the most intense scrutiny and analysis. In particular, any prohibition of a method to pay for financial advice that has allowed average Canadians to invest and stay invested through market cycles, with a view to a long term goal that is of benefit to those individual Canadians and society as a whole, should be the very last option considered after all other methods have been tried and found wanting.

Yours truly,

Quadrus Investment Services Ltd.

By: Michael Campbell
President and Chief Executive Officer

Appendix A to Quadrus Investment Services Ltd Submission

Consultation Paper 81-408 – Consultation on the Option of Discontinuing Embedded Commissions

1. Do you agree with the issues described in this Part? Why or why not?

For clarity, we will respond to each issue as raised.

Issue 1: Embedded commissions raise conflicts of interest that misalign the interests of investment fund managers, dealers and representatives with those of investors.

i. Embedded commissions can reduce the investment fund manager's focus on fund performance, which can lead to underperformance.

The Paper concludes that embedded commissions "may" provide an avenue for fund managers to "buy" investment growth, allowing them to avoid actually having to focus on performance. The data relied upon by the Paper predates recent market activity by the few fund managers that offered compensation at above median rates. Currently most, if not all fund managers now offer the same compensation levels, effectively resulting in flat compensation across fund families.

This has come about since the release of the Cummings Report. We believe that the Report served a useful purpose by questioning the appropriateness of using compensation to drive product sales. The industry reacted quickly and responsibly by moving to a flat commission structure. As such, the problem has already been resolved by the consultation process, and this criticism of embedded compensation is no longer applicable.

In our experience fund managers focus almost entirely on performance in marketing their products. With the flattening of embedded trailing compensation already achieved, performance, reputation, service and cost are the only remaining differentiators, all of which are valuable fields for competition to generate improved results for consumers.

If the CSA has concerns that firms may slip back into paying embedded compensation that is higher than industry standard, then they can either mandate a maximum trailer level or monitor fee structures through the prospectus review process, depending on how market intrusive they wish to be. This would be less drastic than removing embedded compensation completely, yet would address the concern.

ii. Embedded commissions can encourage dealers and representatives to make biased investment recommendations which may negatively affect investor outcomes.

The Paper suggests four major categories of concern:

1. High compensation paid by some fund managers;

   The Paper makes it clear that any "bias" arises not from the existence of embedded commissions but from higher compensation for the sale of one fund family, or one fund category, over another. As noted above, that concern no longer applies and in any event could be addressed directly without resorting to a ban on embedded commissions.

2. Equity vs. Fixed Income;

Existing suitability requirements are designed to drive advisors to a portfolio recommendation in line with the clients' stated needs, timeline and risk appetite. In a low interest rate environment, most clients are required to take on some level of risk in order to achieve their goals. Generally speaking, fixed income funds pay lower compensation than do equity funds. In our experience advisors do not offer clients higher risk funds in order to obtain higher compensation, but because clients require higher returns in order to meet their investment goals in a low interest rate environment, and such funds are otherwise consistent with clients' needs, timeline and risk appetite.

3. Passive vs active managed funds;

   This issue is dealt with in issue iii, below.

4. Improper sale of Deferred Sales Charge (DSC) series.

   With respect to DSC's, we believe that they should be considered as a unique subset of embedded compensation. The Paper notes that the market appears to be dealing with the potential negative implications of DSC's, and we support market movement in that direction. If the CSA is of the view that conflicts inherent in the DSC model cannot be remedied in other ways, perhaps it should limit its proposed ban to DSCs, rather than applying it more broadly to all forms of embedded compensation.

The Paper notes that research indicates that many advisors' personal portfolios tend to look very similar to their client portfolios. It is not clear what this information is intended to imply. Certainly this result could be obtained by clients seeking advisors with similar investment approaches and vice versa. Having the same investment approach as your client does not suggest impropriety. From our point of view it actually shows that advisors and clients' interests are very closely aligned: both have the same interest in the success of comparable portfolios.

The studies cited in this section tend to conclude that advisors add no active management ("alpha") to justify the impact of fees on portfolio performance. Our position has consistently been that "alpha" is not the true measure of the value of advice: better financial planning ("gamma") is. In our view these studies are measuring the wrong thing, and consequently have limited value in the debate. The real question is whether clients would have achieved better outcomes without the involvement of an advisor at all than they would with an advisor, net of fees. The few studies on this point conclude in all cases that clients with an advisor are significantly further ahead than those without.[1]

The proposal to ban embedded fees means that many clients will be put in a position of having to negotiate fees with their chosen advisor. We have seen no evidence suggesting that this will improve client outcomes, and we are concerned that most small and moderate investors, even if they can find an advisor willing to advise them, will not have the skills or knowledge to effectively negotiate. Clients may end up paying more in a fee-for-service model than in an embedded fee model. Indeed, a recent guidance note from IIROC (17-0093, April 27, 2017) expressed concern regarding fee based and managed accounts relative to commission based accounts; "Our concern is that clients may be moved into fee-based accounts, whether or not such accounts are consistent with the client's best interest."

iii. Embedded commissions can encourage high fund costs and inhibit competition by creating a barrier to entry.

Evidence cited in the Paper suggests that on average active managers do not beat the index on a regular basis when fees are taken into consideration, suggesting that it may be more appropriate for consumers to invest in low fee passive index funds. We are concerned that market dynamics may change in unexpected ways should retail clients stop investing and instead buy the index. Buying the index is not "investing", as the consumer does not analyze the business or bond being considered. Writing in The Financial Times, Yves Choueifaty CEO of TOBAM noted an additional challenge:

[1] CIRANO, Econometrics Models on the Value of Advice of a Financial Advisor, 2012, and The Gamma Factor and the Value of Financial Advice (2016) and IFIC, The Value of Advice, 2012

> "By definition the average active manager cannot outperform the benchmark because the benchmark is determined by the sum of activity carried out by both active and passive managers. And because passive managers have no impact on the benchmark – they merely follow it – it is, in fact, the sum of all the bets taken by active managers that determines the benchmark. It is obvious that it is impossible for the average active manager to outperform (or underperform) the average active manager. The benchmark is, after all, the output of all the activities carried out by active managers"[2].

In short, the "average" active manager IS the index, and therefore cannot beat it. This does not mean that active management is inappropriate for retail investors - clearly some active managers add value by managing taxable gains and losses, selecting non-correlated investments and manage volatility – all beneficial actions for investors. It is not appropriate to conclude that these services are not worth the fees being charged. We think this issue deserves more research in itself.

The Paper also suggests that the Canadian investment industry structure creates a barrier to entry for low cost investment products that do not pay commission to advisors. This argument appears flawed, as the growing success of ETF's in Canada has shown. Note that low cost fee products have been available to self-managed accounts for years. It reasonably appears that advisors whose business models are based on payments by manufacturers are not inclined to offer products for which they receive no payment. The benefit of an embedded fee ban with respect to this issue would appear to be that if clients pay for advisors services, advisors will be free to recommend products irrespective of commissions and generally they would move to lower fee products to justify their service. That appears to have been the result in the UK for example. However what also happened in the UK was that advisors could only afford to offer fee based accounts for clients with in excess of 100,000 pounds, cutting off access to advice for the vast majority of moderate investors. We expect a similar impact in Canada – in fact the recent MFDA Client Research Report (Bulletin 0721-C, May 23, 2017) came to the same conclusion: "As mass market households are less likely to be able to afford direct pay arrangements and are less likely to be eligible for fee-based programs, they would be the most impacted by a ban of embedded compensation." (pg 15)

Simply banning one way to pay for advice that is most used by Canadians with less than $100,000 to invest may not remove a barrier to entry for lower cost products, but it does limit access to advice for the majority of Canadian citizens. We do not see this as a positive outcome.

Issue 2: Embedded commissions limit investor awareness, understanding and control of dealer compensation costs.

i. The lack of saliency of embedded commissions reduces investors' awareness of dealer compensation costs.

CRM2 and Point of Sale, stage 3 deliver transparency around dealer compensation. These critical initiatives have just been implemented and we do not yet know the extent to which they will change dealer, advisor and client behavior. It is reasonable to carefully assess the impact of these material regulatory changes before imposing additional changes that limit client choice and have strong potential for negative consequences for retail investors. We strongly support the CSA's detailed study of the impact of CRM2 and POS3, expected to occur between 2017 and 2019. This is the right way to manage regulatory change: make the change; test to see if it has accomplished the purpose; make additional changes if necessary.

We believe that when the fee options are fully explained to the investor, with full immediate and long term cost explained, many investors will still prefer embedded compensation to direct pay. As noted above, the Paper presents no compelling evidence that banning embedded compensation produces better outcomes for consumers. In a free market it's advisable that consumers retain as many options to pay for advice as possible, provided that those options are clearly explained.

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[2] Choueifaty, Yves, CEO of TOBAM; Active managers can't beat a benchmark, they are the benchmark / The Financial Times, January 4, 2016

The Paper raises concerns that when manufacturers pay compensation for product sales to dealers, the client loses control over what they are willing to pay for the service. This really comes down to ensuring the client has clear information on the cost to them of the service, whether they pay it directly or not, and the availability of other payment options. Given the information provided by CRM2 and POS3, we believe that clients will be able to decide if their advisor and dealer are providing value or not.

ii. Embedded commissions add complexity to fund fees which inhibit investor understanding of such costs.

Fund companies offer a broad range of fee options in an attempt to avoid creating a "one size fits all" approach to a heterogenous mix of consumers. This is a reasonable approach, and is not designed to confuse retail clients. For most small and moderate investors, the actual range of options are quite limited, and their advisor is there to present those options to them. If there are concerns about the clarity of that presentation, that can be addressed without resorting to a ban of one form of compensation.

We believe that this concern is misplaced: the real issue is not superficial complexity, but the fact that cost of ownership is not disclosed. CRM2 is very useful in that it establishes the cost of advisory services provided by the dealer, but it is also misleading as it may suggest to unsophisticated clients that this is all that they pay for. We strongly support a move to full cost disclosure, rather than partial cost disclosure. This would allow clients to have a complete picture of their cost to invest, and allow them to compare that cost to other potential investment options.

iii. The product embedded nature of dealer compensation restricts investors' awareness of dealer compensation costs.

As noted previously, CRM2 gives clients the ability to be aware of dealer compensation costs. We encourage the CSA to evaluate the improvement to investors' awareness arising from CRM2. In addition, if the concern is that CRM2 provides cost disclosure after the fact, consideration could be given to modifying the Fund Facts document to include dollars and cents comparable costs for each available fee option, so that clients could compare.

Issue 3: Embedded commissions paid generally do not align with the services provided to investors.

i. Investors do not receive ongoing advice commensurate with the ongoing trailing commissions paid.

This is not correct as a general statement. However, even though all advisors are paid the same on an embedded model, not all advisors provide the same services at any given time. We believe that the real issue is not the fee structure itself, but the clarity of the service agreement established between the client and advisor, and how that service can be monitored by the client, adviser and dealer over time. Banning embedded commissions will not improve outcomes for clients with respect to increasing ongoing advice/servicing. The issue is not how the fee is paid or by whom. Rather, it is about how the ongoing servicing of a client is defined and monitored. Ongoing service is not inherently stronger in a direct pay model (such as on fee based accounts). When the issue is properly defined in this way we suggest other approaches to resolve the problem are more appropriate, such as service commitments delivered to clients at account opening setting out exactly what the dealer and advisor agree to provide in return for the commissions paid. This would apply for any form of compensation – embedded or not. On this latter point we direct attention to IIROC Notice 17-0093 of April 27, 2017 which draws attention to concerns surrounding the value of negotiated compensation structures for a buy-and-hold investor, for example.

ii. The cost of advice provided through commissions may exceed its benefit to investors.

This concern appears to be rhetorical – the cost "may" exceed the value provided. "May" is not a reason to ban an entire compensation structure that allows small and medium investors to participate in the market and gain access to advisory services.

This is always the case in any service industry, and is usually (and inappropriately) measured with the benefit of 20/20 hindsight: it is always the case that at some point in the future the "value" of the service may not be readily apparent. We are concerned that the Paper does not truly take into account the real value of advice – the "gamma" element of coaching and mentoring – and instead focuses on "alpha" – fund picking. The Paper appears to suggest that advisors should foster a "market timing" approach to investment advice, given the research focus on fund flows. We strongly disagree, and in particular disagree that the CSA should even suggest that such an approach is appropriate.

Alignment around servicing accounts needs to be a major focus and this can be strengthened under the current embedded compensation model. Establishing improvements in these areas along with the improved transparency that is occurring as a result of the Point of Sale and CRM2 initiatives can address this concern. Again, establishing service expectations at the outset should resolve this issue without the need for a ban.

2. Are there other significant issues or harms related to embedded commissions? Please provide data to support your argument where possible.

The question is unfortunately phrased, because it assumes that there are "significant issues or harms" arising just from embedded commissions. As noted above, all of the stated concerns are not sourced in the nature of the fee, but in aspects of the process that have equal applicability to all fee structures to one degree or another.

There are no "significant issues or harms" only associated with embedded fees. The stated harms can all be resolved – for all fee structures – through processes and actions that are targeted at those concerns.

The consequence of a ban on embedded commissions will simply be a replacement of certain conflicts with other similar conflicts in the remaining compensation models.

"Embedded fees" as a category is comprised of two components: point of sale commissions (DSC) and trailing commissions. DSC structures (as noted in the recent MFDA Bulletin 0721-C) have been a source of regulatory concern and consumer complaints, as clients realize that they must pay a fee in order to sell out of the series. DSC series, though still comprising a significant segment of the MFDA dealer asset base, are declining and some fund firms have stopped offering them. We expect this trend will continue.

Trailer compensation not associated with DSC's do not have the same regulatory or consumer concerns, as they do not involve fees payable by clients on redemption. In our view, these are two very different fee structures and they should not be lumped together for purposes of this Paper. We would support action being taken to limit or eliminate DSC's, for example, but would not support the elimination of trailer compensation for the reasons stated in our comments.

3. Are there significant benefits to embedded commissions such as access to advice, efficiency and cost effectiveness of business models, and heightened competition that may outweigh the issues or harms of embedded commissions in some or all circumstances? Please provide data to support your argument where possible.

We believe that there are.

First, breadth of choice in payment methods is important when dealing with a broad and heterogenous consumer group. Often referred to as the "one size fits all" issue, consumers should have the ability to choose amongst as wide a range of options as possible unless a given option is inherently to their detriment.

It's important to acknowledge that clients come to advisors specifically because they don't understand all aspects of the business and don't want to. They expect the advisor to review their situation and make intelligent and informed recommendations, and then continue to assist them over time. They are generally willing to pay for this service over time: if they are willing to pay a percentage fee directly, then it is reasonable to assume that they would be equally willing to pay that same fee indirectly. In our experience when advisors have the fee conversation with

clients, most small and moderate investors prefer to invest on a front end zero, embedded trailer basis as opposed to their only alternative: direct deduction from their account. As noted above, we support the elimination of the DSC option, so we do not include it in our comparison.

The embedded compensation model provides for greater inherent protection against the informational asymmetries that direct compensation models suffer from. The average retail Canadian investor does not have the requisite knowledge, desire and/or ability to negotiate compensation levels with an advisor. As noted above, investors seek an advisor because they do not have this expertise. The embedded compensation model offers a fixed, and generally common, compensation level. It is fixed in the Fund Facts and, because of public disclosure, is available for comparison to competitors and regulators alike. If a commission payment is materially out of line, market and regulatory forces move it back into line. That has been the experience over the last four years as fund families with higher embedded commissions have fallen out of favour, largely in our view as a result of these CSA consultations and improved focus on client outcomes in a low return environment. All of these protections would either not be available, or would be in place to a much lesser degree, if each Canadian was forced to negotiate their compensation directly with an advisor. Negotiated compensation is not visible to competitors and is not subject to market discipline.

The CSA paper suggests that insurer and bank owned dealers will support the moderate investor because they are already doing so with a non-embedded commission structure. This is not true for our firm, which is an insurer owned dealer. Our current model uses embedded compensation to provide access to advice for thousands of Canadians. The vast majority of our clients are small and moderate investors. Most now invest on a zero front end load, trailer fee basis. Elimination of this payment option will have serious negative implications for our clients.

Our current dealer fee based program starts at account values of $250,000. Most of our clients do not meet this threshold. Assuming that embedded fees are discontinued, these clients would either have to be let go or agree to have at least the same fee amount deducted directly from their accounts. The Paper provides for this option to allow clients to direct the fund manager to deduct and pay amounts to the dealer. The end result is that the client pays the same net amount (assuming that the IMF for the fee based series drops by the same amount as the negotiated compensation payment), but has less to invest and redemptions from a non-registered account are fully taxable in their hands. The end result – the client pays more if for no other reason than taxes, and is exposed to the potential for higher fees because of unequal bargaining power with their advisor that is not subject to market discipline. The offsetting benefit: clarity of cost to the client, and a theoretical ability to control their costs through negotiation. We are concerned that the cost of advice for many Canadians will go up because of their inability or unwillingness to negotiate a fee equivalent to or less than what they are currently paying through the embedded compensation structure. We strongly believe that the only remaining benefit – clarity – can be achieved in an embedded model without risking the serious negative consequences of interfering in the market with a ban on an otherwise acceptable fee payment arrangement.

We strongly believe that choice in the payment of fees should be as broad as possible to accommodate as many potential consumers as possible. Advice has value, and if the level and cost of service is clearly indicated at the point of sale, consumers should have the option to select an embedded approach. The Polaris study of 2016 found that over 50% of Canadians prefer the embedded fee model. Embedded compensation allows investors who do not desire to have a negotiated fee conversation with advisors (either because of preference or lack of education or confidence) to still participate in the market and accumulate wealth.

We see the recent CSA Papers as a call to action for the industry to improve disclosure – of cost and services provided – to do better. We agree. Recent compensation changes by fund managers have eliminated most, if not all, incentives to sell one fund family over another. We think changes of this nature can and will continue to resolve the concerns expressed in the Paper, but for *all* fee models and not just for embedded compensation. This is not the time to put the future of consumers at risk by eliminating embedded compensation on theoretical grounds.

4. For each of the following investment products, whether sold under a prospectus or in the exempt market under a prospectus exemption:

- **mutual fund**
- **non-redeemable investment fund**

- **structured note**

Should the product be subject to the discontinuation of embedded commissions? If not:

a. **What would be the policy rationale for excluding it?**

Generally, we support a 'level playing field' with respect to regulation (including with respect to compensation arrangements) on various forms of investment products, and we note that a true level playing field would require that any compensation ban or rule apply equally to the products listed above, as well as to banking and deposit products (such as GIC's) and segregated funds.

Although we do not advocate for a ban of embedded compensation, if such a ban should be implemented by the CSA we agree that it should apply to all similar products whether sold under a prospectus or through the exempt market (or with respect to products sold by banking/deposit institutions). There is no valid policy rationale for an unlevel playing field within the securities regulatory space. As noted throughout our response, a ban of embedded compensation will result in a greater cost to the consumer than the corresponding benefits received. Although we do not support discontinuing all forms of embedded compensation, we do support discontinuing particular forms of embedded compensation that do not serve clients well, such as deferred sales charges. We encourage the CSA to go no further than to a ban DSCs.

b. **What would be the risk of regulatory arbitrage occurring in the exempt market if embedded commissions were discontinued for the product only when sold under prospectus?**

A consistent approach with respect to compensation rules across all aspects of the investment products market place (including banking/deposit institutions and segregated fund products) is the best approach to avoiding potential opportunities for arbitrage. As noted by the CCIR in the recent past, they have seen no evidence of such arbitrage with respect to segregated funds. However, as noted recently in another submission with respect to the Paper, there does appear to be some evidence that banks may direct clients to savings products over mutual funds when their capital requirements increase.[3]

5. Are there specific types of mutual funds, non-redeemable investment funds or structured notes that should not be subject to the discontinuation of embedded commissions? Why?

We do not support a complete ban on all forms of embedded compensation. However, if a ban is implemented by the CSA then we suggest that all types of mutual funds, non-redeemable investment funds, structured notes, banking/deposit products and similar products should be subject to comparable rules (see our answer to question 4(a) above).

6. Are there other types of investment products that should be subject to the discontinuation of embedded commissions? Why?

We do not support a complete ban on all forms of embedded compensation and, as noted in our answer to question 4(a), for purposes of a level playing field, if a ban on embedded commissions is implemented, it should apply equally to bank products (such as GICs and deposits). We agree with the position put forward by the CCIR and IFIC which suggests that insurance regulators should work in conjunction with the CSA to develop consistent compensation policies that give customers compensation disclosure that will allow them to have the information necessary to compare product offerings and related compensation among all types of available investments. This is an important benefit to Canadians that should be seriously considered.

[3] "The Pros and Cons of Discontinuing Embedded Commissions by Regulatory Fiat, June 5, 2017, Pierre Lortie, Dentons Canada LLP, pg. 15

7. Do you agree with the discontinuation of all payments made by persons or companies other than the investor in connection with the purchase or continued ownership of an investment fund security or structured note? Why or why not?

No, we do not agree.

We think that many Canadian investors will be harmed by the discontinuation of these payments. Specifically, we are concerned that many Canadians are not well suited to negotiate fees with their advisor, due to their level of financial education, the moderate size of their portfolio, and/or their confidence in negotation.

As noted in the recent MFDA Bulletin 0721-C (May 23, 2017) a ban on embedded commission structures will most materially impact “mass market households” – Canadians with less than $100,000 to invest. That Bulletin notes that this cohort of Canadians are also least able to afford direct pay arrangements or qualify for fee-based programs, most of which require asset levels in excess of $100,000.

Economic studies suggest that advice is a “credence good” – the value of which must be accepted in advance of it being proven over time. Studies suggest that advice adds significant value over a longer time horizon, but unless a client is aware of this value they are unlikely to be willing to pay a reasonable fee for it in advance of receiving that proof. Embedded fees make it easier for a mass market client to pay for advice in the absence of direct evidence of its value. Over time, as their account increases, they see the value and in due course may qualify for fee based programs. At that point they have experienced the value of advice directly and are more willing to pay directly for it. But without the experience gained under the embedded fee model, they may never reach that point.

For many Canadians, total cost of ownership of their investments may increase as a result of the CSA ban on embedded compensation. When the options are fully explained to them, we believe that many Canadians would prefer to pay compensation under their current embedded compensation structure. Removing this preferred method of payment (particularly when the related concerns can be fully mitigated in other ways) will have a negative and unnecessary impact on consumers and consumer choice.

Further, suggesting that compensation can be paid by redeeming investments from the investor’s account, and for convenience those redeemed funds can be paid by the fund manager directly to the dealer, is effectively allowing the same payment to the adviser and the same cost to the client as with embedded compensation, but with the added potential negative tax consequences for the non-registered investor. The only gain associated with this scenario is that the investor should be fully aware of the amount debited from their investment account. Although theoretically the investor has the power to negotiate that cost with the advisor, in reality we believe that advisors will set their fee and most clients will accept it. It therefore stands to reason that disclosure of compensation cost is the chief concern. We agree that investors should be made aware of all costs associated with their investments, and submit that this can be accomplished through other means without discontinuing embedded compensation and limiting investor choice.

8. Are there other fees or payments that we should consider discontinuing in connection with the purchase or continued ownership of an investment fund security or structured note, including:

a. **the payment of money and the provision of non-monetary benefits by investment fund managers to dealers and representatives in connection with marketing and educational practices under Part 5 of NI 81-105;**
b. **referral fees; and**
c. **underwriting commissions**

Why? What is the risk and magnitude of regulatory arbitrage through these types of fees and commissions?

Current rules prohibit the payment of material incentives to dealers and advisers. As the core issue underlying discussions of banning embedded compensation models appears to be either transparency or inappropriate incentives for behavior, we think the perceived potential for negative behavior is already dealt with appropriately. Enforcing existing provisions should be sufficient.

Funds often provide valuable educational opportunities to dealers and advisers, and these are not inherently bad. Nor is most marketing material.

Banning referral fees could result in advisers not passing appropriate clients on to another registrant category that may be more appropriate for them.

As an MFDA dealer, we have no comment on underwriting commissions.

With respect to concerns of "regulatory arbitrage", we have seen no evidence of it occurring between insurance and mutual fund dual registrants, and our observations are supported by the CCIR. This appears to be a concern rather than a reality. We cannot comment on whether banks have, from time to time, directed clients to deposit vehicles when a mutual fund may be a more appropriate option (or vice versa), but given recent publicity it is a question that should be explored. (Also see footnote 3, above).

9. If payments and non-monetary benefits to dealers and representatives for marketing and educational practices under Part 5 of NI 81-105 are maintained further to the discontinuation of embedded commissions, should we change the scope of those payments and benefits in any way? If so, why?

If there is evidence that payments and benefits received by dealers and representatives for marketing and education are having an undue influence, then we would encourage the CSA to better define the range of acceptable practices. It is our position that educational opportunities benefit the consumer by resulting in a more professional and articulate advisor. The professionalism of advisors is enhanced when they are better educated on the products available to their clients. As there can be a grey area between marketing and education, any conflicts arising from marketing practices can likely be dealt with through the enforcement of NI 81-105 as it is currently drafted, or subtle modifications to it designed to address specific, identifiable concerns.

10. With respect to internal transfer payments:

a. **How effective is NI 81-105 in regulating payments within integrated financial service providers such that there is a level playing field for proprietary funds and third party funds?**

Our firm offers one family of proprietary funds and a wide range of third party investment products. In our view NI 81-105 provides sufficient guidance to ensure that advisers have no incentive to offer proprietary funds over third party funds.

Although we are not directly familiar with the practice, it may be possible that integrated financial service providers could show lower fees paid to the dealer in their CRM2 disclosures even though the total cost of an investment to the client is similar to other funds. We support full disclosure of the cost of the investment, which is not currently required. CRM2 is only required to show amounts received by the dealer, and not how much the client paid during the statement period for the investment. We think that can mislead clients into misunderstanding the actual cost of the investment as a whole and to the extent that integrated financial service providers are able to take advantage of this, it would not be appropriate. Full cost disclosure would be sufficient to avoid this issue. We note that IFIC and the CCIR both support the concept of full cost disclosure, or "CRM3", and it would be appropriate to move forward on this initiative collectively. We are concerned that bank products are not subject to similar cost disclosure, and that creates an inappropriate situation.

b. **Should internal transfer payments to dealers within integrated financial service providers that are tied to an investor's purchase or continued ownership of an investment fund security or structured note be discontinued? Why or why not? To what extent do integrated financial service providers directly or indirectly provide internal transfer payments to their affiliated dealers and their representatives to incent the distribution of their products?**

Integrated financial service providers can provide services to affiliated dealers that are reasonable and at reasonable rates, and such arrangements are not inappropriate in our view. However, we do not believe that integrated providers should be permitted to make an indirect payment (that does not have to be disclosed to clients) if such payment would be required to be disclosed if it had been made to a non-integrated provider. Such arrangements lack transparency and result in an unjustified competitive advantage to integrated providers. The spirit of CRM2 (providing transparency of dealer costs to clients) is not respected if such payments between integrated providers are permitted; the result is harmful to clients, as they may be led to believe they are paying less for a product than they actually are. Internal transfer payments related to capital maintenance or services provision are reasonable and should not be of concern. This is because it is not the existence of an internal transfer payment that creates the problem; the problem is created by the lack of transparency to clients regarding actual product cost. As noted earlier, full cost disclosure would assist in this regard.

c. **Are there types of internal transfer payments that are not tied to an investor's purchase or continued ownership of an investment fund security or structured note that should be discontinued?**

See comments in our answer to question 10 (b) above.

11. If we were to discontinue embedded commissions, please comment on whether we should allow investment fund managers or structured note issuers to facilitate investors' payment of dealer compensation by collecting it from the investor's investment and remitting it to the dealer on the investor's behalf.

Yes, this should be allowed as it benefits the investor and facilitates payments to the dealer in an efficient way. However, we note that in practice, from the client's perspective, this structure is strikingly similar to embedded compensation payments but it can result in negative tax consequences to the unregistered client. Allowing this payment structure suggests that the CSA is not primarily concerned with money flowing from the investment fund manager to the dealer, but rather with the lack of transparency to and control by the client that may exist with embedded commissions. As noted above, transparency is already being dealt with through CRM2 initiatives, and in our view the "control" issue (requiring clients to negotiate fees) is neither a preferred approach by small and moderate investors nor is there evidence that average consumers are willing or capable of successfully negotiating fees with advisers. We expect that most clients will either take the proposed fee or leave it, and most will simply take it as proposed.

Addressing the issues – SECTION 4

12. Based on a consideration of the data and evidence provided in this Part, would a proposal to discontinue embedded commissions address the three key investor protection and market efficiency issues discussed in Part 2?

Although discontinuing embedded commissions may address the three key investor protection and market efficiency issues discussed in Part 2 with respect to embedded commissions, it will simply move eligible clients to other fee structures with similar issues. It will also create the negative consequences discussed in our preceding answers: potential negative tax implications for non-registered clients who pay fees themselves and an advice gap for lower and moderate level investors. We are very concerned about the CSA's assumption that such clients will be adequately served by bank owned dealers. We do not support actions that directly limit the scope of competition.

As noted above, rather than discontinue embedded commissions, we suggest that alternate measures could successfully address each of the three key investor protection and market efficiency issues discussed in Part 2, while avoiding the negative consequences to Canadian investors that a ban on embedded compensation would create. Such alternate measures will achieve our mutual goals of investor protection and market efficiency.

13. Are there other ways in which the CSA could address these issues that could be introduced in conjunction with, or separate from, the discontinuation of embedded commissions?

Yes – although the market has already begun to address some of these issues (for example, by fund managers lowering MERs), we suggest that there are other alternative ways to address the issues raised without banning embedded commissions.

For example, consumers who currently pay fees through embedded compensation could be given an option to modify their account to a fee-based model when the account reaches appropriate thresholds. Dealers could be required to alert eligible clients when this occurs, and in clear and simple language illustrate the impact different fee structures would have on their investment account. This provides clients with more choice (rather than limiting their options) and allows those who prefer the embedded compensation model to retain it. This also allows Canadians who prefer fee-based compensation structures to elect to receive the benefits of that model. We think that with proper supervision, enforcement and good disclosure, clients will be better served by having the opportunity to choose from a variety of payment models. We suggest that the industry and regulators could work together to create a clear and consistent communication guide addressing the options available to consumers.

We also suggest that effective disclosure will address significant concerns raised by the CSA. For example, a simple standard illustration could be developed that would indicate the impact of different fee payment options on the clients' account using standard assumptions. Alternatively, or concurrently with this proposal, clients could be required to acknowledge in writing the fee arrangement they have with their advisor (embedded or otherwise).

14. Are there other conflicts of interest that could emerge following a transition to direct pay arrangements that would not be addressed in the current securities regulation framework?

All compensation arrangements in any profession have an inherent conflict of interest - including direct pay arrangements. Eliminating embedded commissions will not solve the inherent conflict of interest issues related to dealer and representative compensation. Rather than eliminate embedded compensation and still be faced with the question of how to handle the remaining conflicts related to direct-pay arrangements, we propose that the conflict issues can be dealt with just as effectively without eliminating a popular payment option for Canadians.

As noted above, negotiated fee arrangements are private between adviser and client and not subject to market discipline. Clients seek out advisers because they have greater knowledge and expertise: there is an inherent - and intentional - information asymmetry to the relationship. That could provide an opportunity for advisers to set their prices at a level that they believe the client will accept, which could exceed amounts paid in an embedded model. We are not convinced based on the evidence presented thus far that the average Canadian is in a position to negotiate lower fees, or that they are inclined to do so. We think significantly more investigation is required before concluding that banning embedded fees improves investor outcomes, or results in a better environment for investors.

For this reason, we are strongly in favour of dealing with conflict issues that arise for all forms of compensation, rather than eliminating one investor option.

__Change in investor experience and outcomes__

15. What effect do you think the removal of embedded commissions will have on investor experience and outcomes? In particular:

- **Will investors receive advice and financial services that are more aligned with the fees they pay?**

We do not believe so. Advisors will not negotiate fees below a minimum asset threshold, simply because doing so is uneconomic for them; they are entitled to be paid for their services, and the work required to open an account will result in a cost – either fixed fee or percentage – that will not work for small accounts. As explained in our response to question 22, below, the minimum account size for fee based accounts is generally $100,000, which exceeds the average asset base for the vast majority of Canadians.

Advisors may be willing to accept direct payment of their fee from the clients/ account, but we are concerned that this could result in some clients paying more than they would in an embedded fee model.

We believe the best approach would be to develop a service promise between the advisor and the client, indicating what the client is getting and how much the client is paying for it in different payment options. We believe there is great confusion over the value of advice, and there is merit in clarifying the services rendered for the fee.

- **What effect will the proposal have on the growth of automated advice? Is this likely to be beneficial to investors?**

The trend towards automated advice has started in the absence of a ban on embedded commissions, and will continue to grow regardless of any change to compensation structures. Clients that benefit from this service and find it suits their needs and knowledge base will continue to do so.

However, the presence of automated advice does not mean that an advice gap that may be created by banning embedded commissions will be filled by automated advice. It is a further option that will be available, but not one that every investor will prefer. There is no evidence or data that supports the position that smaller clients who receive personal advice today will be just as well served by automated advice. In fact, a number of reports on the value of advice have shown that the principle factor in investor success when using an advisor is the "gamma" element of coaching and comforting – of convincing Canadians of the need to invest and to stay invested during difficult times. Automated advice services are "on demand", and do not seek out clients, nor do they provide the direct, personal interaction that many clients expect. A recently published Global survey by UK based HSBC Holdings PLC found that only 7% of Canadians would trust advice received from a robo-advisor, and only 18% believed that robo-advisors were able to offer more accurate advice than humans. ("Canadians prefer financial advisors to robo-advisors", Investment Executive, May 24, 2017).

- **Is discretionary advice likely to increase in Canada as we have seen in the other markets that have transitioned away from embedded commissions and, if so, would this shift be positive or negative for investors?**

It is possible that high asset clients will migrate to discretionary platforms – such platforms usually have minimum asset thresholds. Our primary concern relates to small and moderate investors who will not qualify for those programs. These clients will be effectively disenfranchised from personal advice. As noted above, we should be focusing our attentions on increasing access to advice for the small and moderate investor, not decreasing it.

- **What effect will the proposal have on the growth of the online/discount brokerage channel and cost of fund products offered in this channel? Is this likely to be beneficial to investors**?

See our answer to bullet above.

- **What effect will the proposal have on the cost and scope of advice provided to specific investor segments**

Moderate investors have a higher likelihood of being harmed by the proposal because they may have to pay more (if their advisor can negotiate a higher fee or has a threshold fee) or may not receive advice at all (if they cannot afford or choose not to pay what the advisor proposes). The evidence supports that independent dealers (including insurer-owned dealers) use the existing embedded compensation model to service moderate investors. If this compensation model is no longer available, those investors may not be serviced by representatives of independent dealers, resulting in an advice gap for small and moderate investors.[4]

16. What types of payment arrangements are likely to result if this proposal is adopted? In particular:

- **Would the payment arrangements offered by dealers to investors differ based on investor segment? If so, how and why?**

Pay arrangements that would result include: employed advisors, fee for service, hourly, and consultation service fee.

Employed advisors are generally limited to the bank channel. Compensation to these advisors will remain opaque to clients, who will have neither transparency nor leverage. Generally these advisors serve the small and moderate investor market, as higher asset clients are usually referred to affiliated broker dealers.

Today many fee based programs [are only available to clients once they reach a threshold investment amount, usually at least $100,000. Clients with account assets below this threshold (who are the vast majority of Canadians) will not be able to participate in these programs. In addition, clients who have saved enough to access these programs will eventually begin their decumulation program after retirement. As their assets drop below the threshold they will no longer be able to participate in the program. Banning embedded commissions could result in removing access to advice from both those who are starting small and seeking advice as they aim to build a lifetime of savings for retirement, and the elderly and more vulnerable client segment as they engage in the de-accumulation process; the result is a negative outcome for two segments of investors (who arguably need advice most), and for Canadian society at large.

17. Do you think this proposal will lead to an advice gap? In particular:

- **Which segments of the market are likely to be affected? Please consider segmentation by wealth, geography (size and location of community e.g. remote, small, medium, large), age, technological sophistication, the level of fund ownership across households, etc.**
- **Do you agree with our definition of an advice gap?**
- **Should we differentiate between an advice gap for face-to-face advice and an advice gap generally?**
- **What types of advice or services currently provided today would be most affected by the proposal?**
- **Are there any potential interactions between this proposal, existing reforms such as CRM2 and other potential reforms such as CSA CP 33-404 that may affect the size of any potential advice gap?**
- **How could a potential advice gap, face-to-face advice gap or financial service gap be mitigated?**
- **Do you think that online advice could mitigate an advice gap? If so, how?**

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[4] MFDA Bulletin #0271-C, May 23, 2017

- **Do you think that the significant market share of deposit-taker owned and insurer owned dealers in fund distribution in Canada will affect the size or likelihood of an advice gap to develop?**

As noted in our previous responses, we think that the elimination of any method of payment for advice is likely to have an impact on those investors that currently use that method of payment. Research has shown that small and moderate investors are most likely to use the embedded fee model until their asset levels are sufficient to make a negotiated fee model viable.[5] We are very concerned that these smaller investors – those with less than $100,000 to invest – will lose access to independent advisory channels and be forced to choose between no advice, self-service or bank owned employed staff advice generally offering proprietary product lines.

As shown in the recent MFDA Bulletin (0271-C), approximately 39% of MFDA member firm assets lie with independent financial advisory firms, 59% lie with bank owned firms and only 2% lie with direct sales channels. Although direct sales channels, including online advice services, are growing, they are unlikely to serve the needs of those currently using an independent channel. Further, direct sellers do not offer the "gamma" element critical to successful long term savings and investing that is available from independent dealers.

We think that there already is an "advice gap" in Canada – a significant number of Canadians are not currently seeking advice and not saving for their personal needs. There are likely many reasons for this, but as noted in our cover letter, we think the success measure of regulatory action in this area is whether the proposed action is likely to increase access to advice – not decrease it. Clearly, elimination of embedded fees will decrease payment options for consumers, and at least some of those consumers will forgo advice entirely, to their long term detriment. We do not see any balancing positive gain from this action that could not also be obtained through other, less damaging methods.

Industry change independent of regulatory response to discontinue embedded commissions

18. Given some of the changes we have seen in the industry over the past few years (fee reductions, introduction of DIY series, streamlining of fund series, automatic fee reductions increasing access to fee-based options etc.), what is the likelihood that the fund industry will transition away from embedded commissions without regulatory action? In particular:

- **Will the industry continue to transition away from embedded commissions if the CSA does not move forward with the proposal?**

We think it important to differentiate between "deferred sales charges" (DSC's) and "trailers", as both are paid for by the manufacturer, but they have different potential impacts on the consumer. DSC's pay a sales commission to advisors up front on behalf of clients, but clients have to pay a redemption fee if they want to sell out of the fund family within a set period of time. This limitation on the clients' ability to trade is problematic for many clients. Recently we have seen moves to eliminate DSC's by one major dealer and several fund managers. We support this trend and believe that it will continue. Certainly DSC sales have decreased rapidly over recent years, as clients' accounts reach negotiated fee levels or as advisors transition to a trailer based model.

We think that the fund industry and dealers will eliminate DSC's without further regulatory involvement in any event, but that regulatory support of their elimination would likely speed up the process.

We do not think that trailers will disappear, nor should they. Properly disclosed and explained, they are a reasonable method for low asset clients to pay for advice.

Generally, the trend towards fee based compensation structure is expected to continue. This is driven by competition, the focus of firms on the high net worth space, and the work that regulators have been undertaking. Many advisors and high net worth clients appreciate the transparency and negotiability of a fee based model. These commercial forces, if given enough time, will lead to a rationalization of fee structures.

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[5] MFDA Bulletin 0721-C

However, regardless of the current trend, there will always be a cohort of investors who will benefit from an embedded compensation model. This cohort will consist of small and moderate investors. These investors should have the option of selecting an independent financial advisor, and not be forced to proprietary bank channels or low interaction online models.

19. How accurate is Figure 8 regarding the purchase options available to fund investors by channel, account size and firm type? In particular:

- **Do you see payment options and business models evolving at present?**
- **How are they likely to change over time if the CSA were to choose not to move forward with the proposal**?

The recent MFDA Bulletin (#0721-C) sets out some interesting data that may inform assessment of Figure 8. Our firm falls into the "insurer owned" category, and a significant portion of our clients fall into the Front End Load Zero (FEL 0) category. Our experience has been similar to that noted by the MFDA: that DSC, though a high percentage of assets, is a rapidly declining percentage of sales and FEL0 is increasing significantly.

This suggests that advisors are moving their practices from a DSC basis to a trailer basis. We believe that, with appropriate explanation and disclosure to clients and an offering of options, this transition is reasonable. We note that the Gandalf Group recently published the results of surveys done on behalf of AGF[6] concluding that when different methods of compensation were explained to survey respondents, "most said they considered trailing commissions acceptable and no different than other forms of advisor compensation. Those who considered themselves to be relatively knowledgeable about investing were in fact more likely than others to say trailing commissions were acceptable."

We think that when payment options are explained to consumers, with examples, some will prefer fee based, some will prefer trailers and some will prefer no advice direct options. We believe that properly explaining the costs, limitations and implications of these options empowers investors to choose the approach best suited to them.

Potential impact on competition and market structure

20. We note that the distribution of fee-based series is still relatively limited in Canada versus other markets. Are there obstacles (structural, operational, regulatory, investor demand, etc.) specific to Canada limiting the use of fee-based series by dealers?

Fee-based series have grown in recent years, in our view at least in part as a result of the growth in client account sizes. As noted earlier, fee based programs generally require minimum asset levels to be economic for dealers and advisors. Consequently, as client account sizes grow (as baby boomers age and their lifetime savings increase through access to advice) more accounts qualify for fee based approaches. Generally speaking, higher net worth clients are more likely to access fee based structures, principally because they qualify for them. Small investors do not.

Only 33 of the 93 MFDA Member firms are configured to offer investments on a nominee basis. The 60 remaining firms offer client held investments only. Client held structures are not set up to allow the dealer to directly charge the client fees. As a result, two-thirds of MFDA members are not designed to offer this service. Dealers are moving to a nominee structure, but doing so has significant systems and compliance costs that can be inhibiting. As a result, removing trailer based compensation completely, and not just DSC options, will disadvantage their business model.

Dealers' system structures are important in the implementation of a fee based program. As noted earlier, many MFDA dealers are not structured to collect fees directly from clients. In addition, some dealers have been caught 'double dipping' (negotiating a fee-based charge with clients, and then investing that client's assets in a fund series that also pays embedded

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[6] "The Canadian Investors Survey", May 30, 2017

compensation ; resulting in the client being charged twice to invest in one fund). This 'double dipping' can occur if the dealer does not develop a system capable of separating fee-based compensation from embedded compensation structures.

21. Please describe how discontinuing embedded commissions will affect competition and market structure and whether you agree with the analysis set out in Part 4? In particular:

- **Do you think the proposal will have an impact on the level of industry consolidation or integration? What about with respect to the concentration of mass-market investor assets held in investment products managed by deposit-taker owned firms?**

Discontinuing all forms of embedded commissions will tend to eliminate independent firms and drive small and moderate investors to the options noted above: no advice/self-service online or banks offering generally proprietary products. 2/3rds of MFDA members offering client held only accounts will either consolidate or exit the business. This reduction in competition, investor choice, and investor access to a preferred advisor who is already familiar with their circumstances, does not advance the interest of Canadians.

- **What are the likely impacts on investor outcomes and market efficiency of any potential consolidation?**

The small and medium investor will have limited access to advice. Face-to-face advice will only be available through one channel if investors are forced to move to bank-owned firms in the wake of a ban on embedded commissions. Aside from lack of competition and choice, this could result in investors being underserved, We are concerned, for example, that in recent years banks have moved to close branches, particularly in outlying areas that are currently served by independent financial advisors. We are also concerned about any regulatory action that tends to concentrate a service in the hands of any one industry player, as that tends to place consumers in a position of having limited options.

- **What opportunities and what challenges do you think the proposal would introduce for specific industry stakeholder groups?**
  - **Independent dealers?**
  - **Independent fund manufacturers?**
  - **Integrated financial service providers?**
  - **Mutual fund dealers?**
  - **IIROC dealers?**
  - **Online/discount brokers?**

Independent firms will have a more difficult time competing with bank-owned firms if the proposal is implemented. This includes independent dealers, fund manufacturers and mutual fund and IIROC dealers.

- **What is the likelihood and magnitude of regulatory arbitrage across similar financial products such as segregated funds and deposit-taker products?**

We strongly support dual registration for persons offering financial advice, as it allows them to offer the appropriate product for the client's need. Our understanding is that the concerns about potential "arbitrage" have not occurred in practice. The CCIR indicated that in its view, for example, no such "arbitrage" was occurring between mutual fund and segregated fund licensed advisors. If an advisor sells an inappropriate product to a client principally for personal benefit, such a sale should be challenged under existing rules and codes of conduct.

With respect to "arbitrage" related to banking products, we believe further research should be done into the patterns of GIC recommendations relative to mutual funds in bank owned dealers.

- **What would be the impact on dually-licensed mutual fund dealers and insurance agents?**

As noted above, most dually licensed mutual fund and insurance representatives utilize the embedded compensation model. Eliminating this option would result in a dramatic impact to this community. We are concerned that many advisors – single or dual licensed - would leave the business and it would be more difficult for new advisors entering the business. The decline in the number of these advisors will have an adverse effect on access to advice for the small investor. Dually licensed advisors may be more likely to be acting in the client's best interest because of a broader suite of offerings and the requirement to fulfill the professional standards of both regulatory authorities, and impeding client access to such advisors by banning embedded commissions is not a favourable investor outcome.

- **Will the proposal lead new, lower-cost entrants to the market? Why and how?**

Lower costs products (such as ETFs) and lower cost delivery methods (such as automated advice) are already available in the Canadian marketplace, and they appear to be thriving in the current competitive environment. There is no restriction on investors preventing them from using these options. Indeed, fee based advisors are already using ETF's in their portfolio planning for clients and we expect access to ETF's to only grow. Note that although MFDA dealers have the regulatory ability to offer ETF's currently there are still costly administrative, compliance and technical issues that prevent many from adopting them. As effective solutions to these issues develop, ETF access through MFDA dealers will increase.

Many investors prefer dealing with an advisor and will prefer to continue receiving their financial advice and services through the advisor model. We support ETFs, automated advice, and other new products and delivery methods entering the market and believe that greater choice for consumers is beneficial, although we firmly believe that regardless of the product or its delivery method, there should be standardization of applicable rules. As a useful analogy, this may be somewhat akin to the taxi industry and the entry of Uber into that market – although Uber is available, it does not mean that everyone will prefer to use it – some users will still prefer taxis and the benefits inherent with that service. The increased choice for consumers is important to maintain, however with respect to fairness, competition and consumer protection, it is also important that the same rules be applicable to both services.

- **Does the interaction between this proposal and the proposals set out in CSA CP 33-404 change your responses to the questions above and, if so, how?**

No – we have taken both papers into consideration in our response. We are concerned that this proposal goes too far by eliminating an otherwise legitimate payment option used by the majority of small and moderate investors. We are also concerned that the proposal treats DSC's and trailers as comparable, when they give rise to different concerns and should be treated separately.

The "best interest" proposals require significant consideration given that they also go too far. Simply instituting an undefined "best interest" standard may seem like an easy answer, but it will create significant compliance challenges, unreasonable client expectations and very likely lower access to advice for average Canadians. We are pleased at the interim report from the CSA which indicates that most provinces understand these consequences and are giving serious consideration to alternative methods of achieving measurable objectives.

- **Will a transition away from embedded commissions reduce fund series and fee complexity, as we have contemplated?**

Clearly eliminating a fee option for consumers will by definition lower the number of series available. However, for retail clients the actual number of series available to them is a much smaller segment of the total number of fund series. If the concern is confusion for retail investors, there may be better ways of showing the different series – for example having separate fund facts for retail and HNW or institutional series of the same fund, or otherwise highlighting retail options. We do not think that this "complexity" is a material issue, and to the extent that it causes a concern, it can be dealt with outside of a complete ban of a payment option preferred by many small and moderate Canadian investors.

- **Do integrated financial service providers have an advantage in terms of their ability to cross-sell and cross-subsidize across business lines? If so, how?**

To the extent that integrated financial service providers have any advantage, it likely would be eliminated by requiring disclosure of the cost of investing rather than just the cost of advice. However, recent allegations of potentially inappropriate sales practices at Canadian banking institutions may indicate that client interests are not the focus of the sale of various types of products, which is an issue that should be addressed, particularly if investors do not have a clear understanding of the cost of those products.

- **What are the potential effects on competition of the rise in online advice? Are these effects likely to be large and positive?**

As noted in our previous responses, we do not believe that any one channel for advice will serve the interests of all Canadians. We strongly support a diverse, robust and equally regulated advice marketplace.

Competition amongst types of advice offerings provides a positive outcome in the market place. This includes on-line advice as well as other forms. The regulation of all types of advice including on-line should result in a level playing field among all forms of advice. Automated advice is not a panacea for all of the issues raised in the Paper. Automated advice is good for some (and some investors will seek it out regardless of compensation structures and other regulations) but not for others. As long as there is a level regulatory playing field among the various available delivery options, adding automated advice to the already-existing choices is good for competition and investor choice.

22. What impact will the proposal have on back office service processes at the investment fund manager or at the fund dealer? In particular:

- **Is there any specific operational or technological impact that we should take into consideration?**

Effectively managing fee-based compensation requires that such arrangements are appropriate for the client. This requires additional compliance structures and processes, which will increase the cost of providing advice. These additional costs are part of the reason why dealers have minimum account size thresholds for fee-based compensation. The added costs associated with maintaining appropriate safeguards for fee-based clients include:

1. Initial set up of client account must be completed by head office staff. All initial trades are placed by the order entry team. Once the client account is set up the advisor can then place subsequent investments.
2. Head office staff must monitor account balances that may fall below the minimum threshold due to redemptions
3. Head office staff must monitor advisors placing purchases into a fee based fund to ensure that minimums are met and fee agreements are provided
4. Head office staff must perform the manual calculations of fees when a client redeems or transfers mid quarter
5. Head office staff must monitor accounts to ensure that the account has sufficient assets to cover fees.

23. The payment of embedded commissions requires the dealer and the investment fund manager to implement controls and oversight (with associated compliance costs) in order to mitigate the inherent conflicts of interest today.

- **Would the transition to direct pay arrangements alleviate the need for some of these controls and oversight?**

No. Direct pay arrangements have their own inherent conflicts of interest. Allowing advisor/client negotiation under direct pay arrangements can actually create higher degrees of conflict. Controls and oversight are needed over either structure, and as a result there are no savings to be gained from moving to this model.

In our view oversight may be more difficult under the fee-based model because of the variety of negotiation tactics and arrangements that advisors may employ in such an open-ended negotiation environment. As noted in previous comments, this may result in investors paying more. Oversight to ensure suitable arrangements are agreed to will be more difficult, as there is generally no public market against which privately negotiated fees can be measured.

Furthermore, if the reforms proposed in the Paper and the CSA 33-404 best interest paper are both implemented, it will be difficult for advisors to comply with both in a generic sense. Advisors cannot simultaneously act in the 'best interest' of their client and also be expected to negotiate the fee that they will be paid. Advisors could more readily comply with a best interest standard if the fee was not required to be negotiable.

- **To what extent, if any, does the use of direct pay arrangements by representatives today (e.g. when a representative provides services under a fee-based arrangement) alleviate the need for some of these controls and oversight?**

As noted above, there are no savings to be gained from conducting oversight with respect to the fee based model, and in fact a fee-based model may result in higher oversight-related costs.

24. Embedded commissions, especially trailing commissions, provide a steady source of revenue for dealers and their representatives. If embedded commissions were discontinued, would dealers be able to compensate for the loss of this revenue with direct pay arrangements?

It is possible that some dealers would not be able to compensate for this loss of a steady source of revenue. This may result in smaller independent dealers exiting the market, and thereby decreasing competition and choice - a negative outcome for clients of those dealers.

We note that the CSA has proposed allowing clients to instruct manufacturers to deduct fees from their account and automatically pay the dealer. If this happens, we expect that many advisors and dealers will simply set a fixed price for advice that is comparable to current embedded fee structures, although there is potential for some to go higher and some to go lower. The end result is that in most cases there will be no material change for consumers other than that non-registered account holders will be subject to taxation on redemptions from their account to pay for the fees. We are not certain what policy objective this achieves, and based on recent consumer surveys[7] it is not entirely clear that Canadians, when fully informed of these results, would support them.

25. Aside from commission grids and salaries, what other approaches to representative compensation might dealers use if we were to discontinue embedded commissions? How are these approaches likely to change over time?

Dealers must charge enough to afford to stay in business, and advisors must be compensated for the work they do or they will exit the business. If embedded fees are a core element of a dealer and advisors business model, one can expect that they will find ways to replace the income or exit the business. We anticipate that exiting the business will amount to ceasing to provide services to clients who cannot afford or choose not to pay on a fee for service basis or who otherwise do not meet negotiated fee thresholds.

26. What impact will the proposal have on representatives in the industry? In particular, what impact will the proposal have on the:

- **career path;**
- **attractiveness of the job;**
- **typical profile of individuals attracted to the career;**

[7] "The Canadian Investor Survey", Gandalf Group, May 30, 2017

- **recruitment; and**
- **relative attractiveness of careers in competing financial service business lines?**

The proposal will make it more difficult for advisors to join the industry. New advisors tend to provide products and services to low and moderate investors as they are starting their careers, and their clients grow with them – and as described in detail above, these investors are not likely to be willing to pay on a fee for services basis, nor will they meet the thresholds for a negotiated fee service. Additionally, many seasoned advisors who have built their business on the embedded compensation model may exit the business prematurely if their client base can no longer afford their services.

PART 5

<u>27. How practicable are the mitigation measures discussed and how effective would these measures be at assuring:</u>

- **access to advice for investors,**
- **choice of payment arrangements for all investor segments, and**
- **a level playing field amongst competing investment products?**

The mitigation measures proposed include: increased access to automated advice; allowing investment redemptions to be paid directly from the fund manager to the dealer; continue working on investor financial literacy; allowing various fee-based arrangements; and an intention to act proactively to prevent the opportunity for regulatory arbitrage.

Automated advice is not and will not be the choice for all clients, and in any event requires the client to seek advice in the first place. It does not include the "gamma" element which has been shown to be the core basis for successful advisory services. Is it practicable? Yes, because it is available now. Is it a panacea? No.

Allowing redemptions to pay for services will not change the costs of advice for most investors and will simply become a way for "trailers" to be paid via taxable redemptions. We understand that it could be achieved with relative ease, but it is not clear to us that it improves client outcomes. In addition, it increases the direct cost for unregistered investors by adding a taxable disposition element.

Financial literacy is an important task and we fully support it. Our best clients are those who are reasonably educated about investment and household finances. Financial literacy will not make every Canadian an advisor however, anymore than increased health education makes everyone a doctor. We want our clients to be engaged and financially literate enough to have an informed discussion about their personal financial futures. Such clients will better understand the cost and value of advice.

Fee based arrangements are fine, and we already have them, but experience in the UK suggests that consumers are not willing to pay the actual cost of the work required to provide them with informed advice. Adding a "fee for service" menu of prices may also be useful, and we do not oppose it. However, we believe that if given an informed choice between trailer fees, fee for service and negotiated fees, including realistic costs and long term portfolio performance impacts, many low and moderate investors would choose the trailer fee option. As noted above, a recent survey has come to this conclusion[8].

With respect to the comments on "regulatory arbitrage", acting proactively to deal with something that is currently not happening does not seem like it will have much impact. We do not oppose it though. However it does not require a ban on trailer fees to implement.

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[8] "The Canadian Investor Survey", Gandalf Group, May 30, 2017

For the reasons indicated above, each of these mitigation measures have inherent issues, and/or do not adequately address the concern.

28. What other measures should the CSA consider to mitigate the above unintended consequences?

As described above, rather than creating unintended consequences and then attempting to mitigate them, we propose targeting reforms to address the issues raised, rather than banning embedded commissions. We have suggested a number of alternative approaches in our letter and this appendix that we believe will resolve any core concerns relating to trailer fees without eliminating a popular and useful payment option.

29. Other than the potential impacts we have identified in Part 4, what other potential unintended consequences, including operational impacts and tax consequences, may arise for fund industry stakeholders and investors further to the discontinuation of embedded commissions? In particular:

- **Would there be a negative tax impact to investors associated with their payment of dealer compensation under direct pay arrangements? In particular, would the investor's payment of dealer compensation through periodic fund redemptions facilitated by the investment fund manager attract tax consequences? Please explain.**

  Yes, this would result in negative tax consequences to investors, specifically those invested through non-registered account. This type of pay arrangement is a redemption, which will trigger taxable gains or losses, for the purpose of paying a fee (rather than a fund-level deduction which does not have direct tax implications for the investor). That redemption is taxable in the investor's hands.

- **To the extent a transition to direct pay arrangements results in the rationalization of fund series, could this rationalization attract negative tax consequences for investors?**

  We defer to fund management firms to comment on this element.

- **What, if any, measures, regulatory or otherwise, could assist in mitigating potential operational and tax impacts?**

  Short of CRA allowing redemptions to be made on a tax-free or tax-deferred basis, mitigating tax consequences to investors in the instances above will be difficult if not impossible.

30. With respect to the loss of a form of cross-subsidy from high net worth investors to lower wealth investors in a fund further to a transition to direct pay arrangements,

- **To what extent (please quantify where possible) would the loss of this cross-subsidy increase the cost of providing advice and services to lower-wealth fund investors under direct pay arrangements?;**

  It is not clear to us what this comment is attempting to capture. If such a "cross subsidy" exists, we look to fund managers to comment. Generally, we do not agree that high net worth investors are subsidizing lower wealth investors. High net worth investors have access to fee-based arrangements because, at a certain threshold, continuing to charge the same percentage-based fee to these clients is not suitable. Lower wealth investors are serviced under embedded commission models for many reasons, one of which is the unavailability of fee-based models to these clients due to the increased systems and monitoring costs associated therewith (as detailed above). Therefore, high net worth investors are not subsidizing lower wealth investors; rather, these investors have access to different pay arrangements based on the economic realities of their circumstances.
  We are concerned that discontinuing embedded fees will lead to lower and moderate wealth investors not being serviced by independent dealers, and others who rely on an embedded compensation model, such as Quadrus. It is not our concern that 'subsidies' by high net worth investors will end if embedded commissions are discontinued; but rather that many dealers will no longer be capable of servicing low and moderate investors.

- **Does the existence of this form of cross-subsidy suggest that high net worth fund investors may be indirectly paying fees that are not aligned with the services they are receiving (i.e. do the fees they pay exceed the actual cost of the services and advice they receive?); and**

  No – see our response to the previous bullet. Many high net worth investors pay threshold tiered fee-based commissions or negotiate lower compensation to account for this.

- **What measures may mitigate the potential effects on dealers, representatives and investors from the loss of the cross-subsidy?**

  See above – we do not believe there is a cross-subsidy. We do not see this as a relevant factor in the discussion.

31. What measures could fund industry participants proactively take to mitigate the unintended consequences that may stem from the discontinuation of embedded commissions?

As indicated throughout our responses, we do not support discontinuing embedded commissions and then attempting to mitigate the inevitable negative consequences. Instead, we propose targeted reforms that will surgically deal with the current issues, while increasing investor choice rather than decreasing it.

32. For each transition option, please tell us how your business (investment fund manager or dealer) would have to operationally change or restructure in terms of systems and processes and the related cost implications. Where possible, please provide data on the estimated costs.

- **Are there unique costs or challenges to specific businesses?**

  As noted above, there would be significant system changes and costs associated with discontinuing trailer fees.

- **What transition period would be appropriate?**

  Although we firmly disagree with any ban, and strongly support targeted approaches to resolving the key issues, the degree of market disruption, exiting from business and client transfers involved suggests a longer, rather than shorter period. We suggest five years.

- **Should existing redemption schedules for DSC and low-load purchase options be maintained until the redemption schedule is completed, or discontinued at the Transition Date?**

  As noted above, we are supportive of discontinuing DSCs only, rather than all forms of embedded commissions. Having said that, fund managers paid compensation to advisors and incurred financing charges and expenses as a result, on a basis agreed to by the client. We believe that existing DSC programs should be grandfathered and allowed to run out.

33. Which transition option would you prefer? Why? Are there alternative transition options that we should consider?

We are not inclined to comment on transition options, as we firmly believe that targeted approaches are the more logical and appropriate response. Targeted approaches can be implemented reasonably quickly and effectively, and in many instances are already occurring without direct regulatory direction in response to existing market forces.

34. As discussed in Appendix B, the CSA did not retain the option of capping embedded commissions, either as a stand-alone solution to the key issues discussed in Part 2 or as an interim step toward an eventual discontinuation of embedded commissions. Should the CSA further consider using a fee cap as a transition measure? Why?

As noted above, the market has already effectively moved to impose a cap of 1% on FEL/NL based trailer commissions. The CSA can certainly monitor this to ensure that trailer fees do not become a differentiating factor in the future, but this does not require the elimination of the category entirely.

We support the elimination of DSC fees generally, and are of the view that doing so will eliminate much of the concern applicable to "embedded fees" generally without eliminating the beneficial concept of annual trailer compensation. Rather than focusing on a fee cap, we think the CSA should consider looking at embedded fees as two separate things (DSC and FEL/NL trailers) and consider discontinuing DSC only.

35. Please explain whether you think each of the initiatives discussed above will, either alone or in combination:

- **Address the three investor protection and market efficiency issues and their sub-issues identified in Part 2; and**

No, discontinuing embedded commissions will not address the issues identified. In particular, conflict of interest issues will persist, and become more difficult to manage if advisors (with a power and information imbalance in their favour) are required to negotiate fees with all clients. Further, this initiative will result in decreased funds invested and/or increased tax consequences to investors. And finally, and perhaps of most concern, discontinuing embedded compensation will exacerbate an existing advice gap that will not be sufficiently filled by automated advice or bank-owned/insurer-owned dealers. Rather than pursue initiatives that will limit access to personal advice, the CSA should be looking to increase the number of Canadians with access to such advice. That will enhance investor outcomes.

- **Address or not address any additional harms or issues that you have identified.**

The most concerning additional harm relates to low and moderate level investors being underserved, not served at all, or served almost exclusively by banks (which decreases competition and drives investors to institutions which, according to recent reports, may have a lack of regard for customer-centricity). As indicated above, not all investors will want to seek out automated advice, and may not be well served by the banks, particularly if they develop a monopoly over moderate level mutual fund investments. Currently bank owned MFDA firms service approximately 59% of MFDA member assets, independent advisors service 39% and direct sellers 2%[9]. Although banks do service a significant portion of Canadians, independents do as well. Abandoning almost 40% of the market to banks does not appear to be an appropriate course of action. This concerning harm is noted in the Paper, but we do not agree that the mitigating factors suggested by the CSA will be sufficient to come to the aid of moderate investors.

36. Are there alternative options or measures, whether regulatory or market-led, that could successfully address the three investor protection and market efficiency issues and their sub-issues identified in Part 2. If so, please explain.

Yes, as identified above, we strongly suggest that various targeted reforms could sufficiently address the issues examined in the Paper. These include:

- a cap on embedded commissions (effectively already in place) and/or a threshold amount at which investors must be offered the opportunity to take advantage of fee-based compensation;
- a requirement that investors sign an acknowledgement of the available fee options and their desired choice;
- complete disclosure of the total cost of investment to investors rather than just amounts received by the dealer; and

[9] MFDA Bulletin #0721-C, May 23, 2017

- a recognition that lower-cost investment options have the ability to come to market through a variety of sources (such as via ETFs, or a dedicated distribution channel) and are currently already growing in popularity and accessibility.

The risks associated with discontinuing embedded fees outweigh the benefits. However those risks can be eliminated and the benefits still realized by instituting the targeted reforms we have suggested rather than moving forward with a complete ban on embedded commissions.

We note that New Zealand has taken such an approach – discontinuing trailing commissions was considered as an option and subsequently rejected after a government examination concluded that elimination of these commissions (i) could restrict access to advisory services, and (ii) would not reduce certain conflicts of interest. New Zealand ultimately made the decision to regulate advisor behaviour rather than eliminate these commissions. At the same time, New Zealand made it clear that it would be observing that behavior and if it did not change, it reserved the right to use the "“blunter” options to ban or restrict conflicted remuneration…" [10].

[10] Regulatory Impact Statement, Review of the Financial Advisers Act 2008, Ministry of Business, Innovation and Employment, NZ, page 46