Vanguard®

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June 9, 2017

**DELIVERED BY EMAIL**

Alberta Securities Commission
Autorité des marchés financiers
British Columbia Securities Commission
The Manitoba Securities Commission
Financial and Consumer Services Commission (New Brunswick)
Nova Scotia Securities Commission
Ontario Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan

Delivered to:

The Secretary
Ontario Securities Commission
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Me Anne-Marie Beaudoin
Corporate Secretary
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Montréal, Québec H4Z 1G3
consultation-en-cours@lautorite.qc.ca

Dear Sirs/Mesdames:

**Re: CSA Consultation Paper 81-408 *Consultation on the Option of Discontinuing Embedded Commissions* – published for comment January 10, 2017**

**Summary**

Vanguard Investments Canada Inc. (Vanguard) is pleased to provide the various members of the Canadian Securities Administrators (CSA) with feedback on the above-noted highly significant Consultation Paper, for which we commend you.

Vanguard is a wholly owned indirect subsidiary of The Vanguard Group, Inc. (VGI) and manages more than CAD $12 billion in assets invested in publicly offered Canadian-domiciled exchange-traded funds (ETFs), as of May 31, 2017. VGI is the world's largest mutual fund manager, one of the world's largest investment management companies and a leading provider of company-sponsored retirement plan services. VGI manages USD$4.2 trillion in global assets, including over USD$700 billion in global ETF assets (as of March 31, 2017). VGI has offices in the United States, Canada, Europe, Australia and Asia. The organization offers more than 360 funds, including ETFs, to its more than 20 million investors worldwide.

VGI operates under a unique operating structure. Unlike firms that are publicly held or owned by a small group of individuals, VGI is owned by Vanguard's U.S.-domiciled funds and ETFs. Those funds, in turn, are owned by VGI clients. Vanguard considers that this unique mutual structure aligns Vanguard's interests with those of its investors and drives the culture, philosophy, and policies throughout the Vanguard organization worldwide, including in Canada.

Vanguard's mission worldwide is "To take a stand for investors, to treat them fairly, and to give them the best chance for investment success." The very essence of our firm is that investors interests must be paramount in all that we do. For this reason, we support a ban on embedded commissions in Canada. We are supportive of this initiative, as we believe the market operates in the best interests of investors where product providers compete on the price and quality of their products in order to secure distribution; and where dealers and advisors are not unduly influenced, or may be perceived to be influenced, by the payment of embedded commissions when recommending investment products to clients. In our view, a ban on embedded commissions will:

- Remove product bias or perceived bias on the part of the dealer and advisor, thereby enhancing investor protection by ensuring investment decisions are based on the suitability of the product rather than the compensation paid to the dealer and advisor.
- Increase cost transparency, product access and cost competition leading to a wider range of investment products, including greater access to low-cost investment products, to investors through all channels including advisors, planners and discount brokerages; and
- Provide the opportunity for advisors to highlight their value proposition and enable investors to clearly understand the costs for the services they are receiving.

At Vanguard, we firmly believe in the value of advice and we are supporters of the fee-based model for advisors, as this model provides investors with full transparency in terms of fees and removes potential or perceived conflicts of interest in portfolio construction or asset allocation decisions by the advisor. The value a skilled advisor provides his or her client is through the development of a carefully planned investment policy, including the right asset mix based on an investor's individual goals, risk tolerance, and time horizon, as well as disciplined rebalancing and behavioural guidance, while minimizing taxes and investment costs.

Our business has been built on diversification, discipline, low-cost investing, and working with our advisor partners to give them and their clients the best chance for investment success. At Vanguard, we support initiatives that benefit investors, and as such, we are pleased to provide our response to the CSA's paper and in particular, the questions highlighted below.

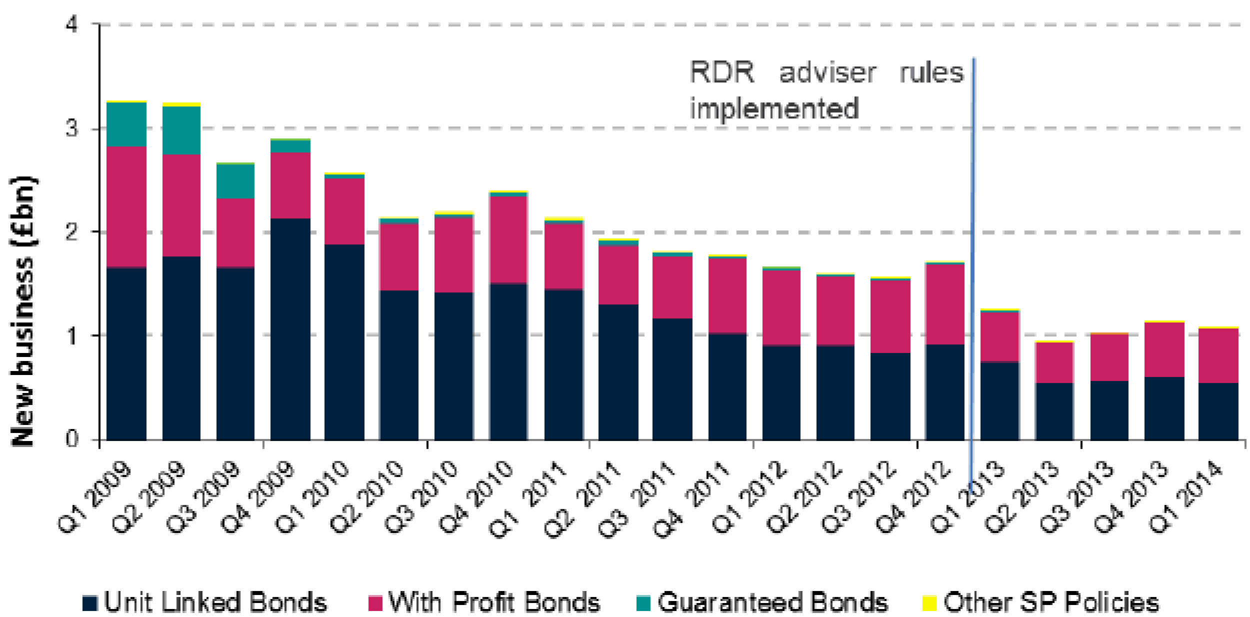
**Question 15**

**What effect do you think the removal of embedded commissions will have on investor experience and outcomes?**

As you are aware, there has been an increasing global trend to ensure greater transparency for costs associated with investing in the U.S., U.K., Netherlands and Australia. Here in Canada, we support and applaud the recent CSA initiatives, including CRM2, that we believe will enhance transparency to Canadian investors, while also solidifying the relationships between advisors and their clients.

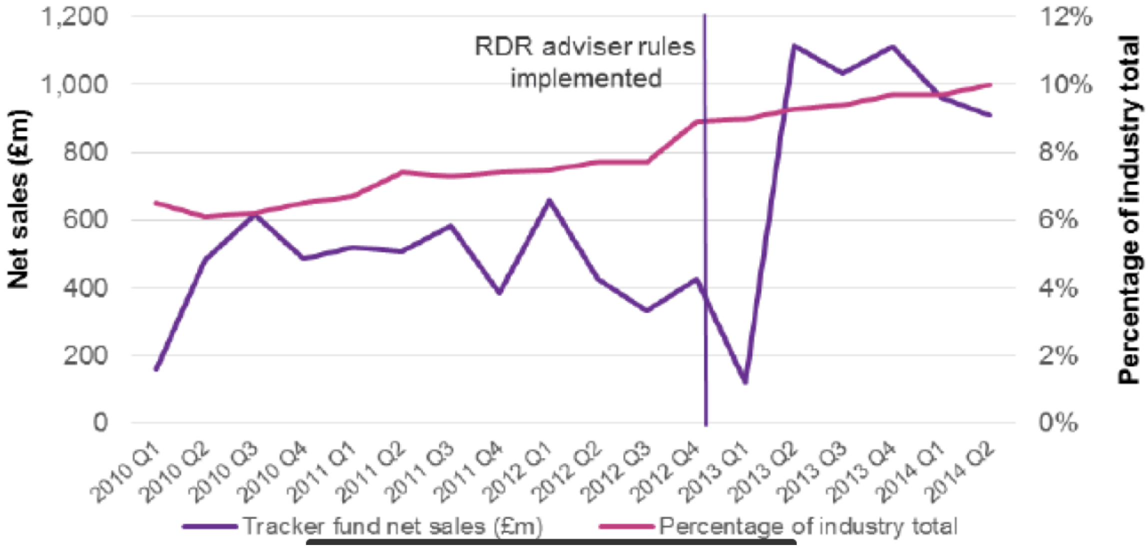
In the U.K. market, following the Retail Distribution Review (RDR), there is evidence that the removal of commission payments by product providers has enabled investors to better compare pricing across platforms and that product prices have fallen by at least the amounts paid in commission pre-RDR. In fact, fund product charges in the U.K. have been reduced by approximately 75 basis points since the implementation. Even if the aggregate cost following implementation equates with current product charges, the increase in cost transparency will be in investors' best interests, and we believe that, over time, the distribution costs will decrease with competition. The charts below illustrate the decline in higher cost investment bonds in the U.K. following RDR, followed by a chart showing the corresponding increase in the purchase of lower-cost index funds. We note that, in the example below, an investment bond is different from a sovereign or corporate debt bond, and can be purchased from an insurance company or through a financial advisor.

- Decline in sale of investment bonds (high commission paying product) - p75 of Europe Economics report https://www.fca.org.uk/publication/research/rdr-post-implementation-review-europe-economics.pdf




Source: Association of British Insurers (2014). Note data refer to ABI members only.

- Rise in net sales and percentage of total funds under management for index funds post-RDR (lower-cost product) - p75 of Europe Economics report https://www.fca.org.uk/publication/research/rdr-post-implementation-review-europe-economics.pdf




We believe that investors should be able to discern the cost of the services they are paying for and expect that the elimination of embedded commissions will aid this objective. While it remains to be seen if this leads to an actual lower cost to the end investor, it does ensure that investors have full cost transparency to make an informed decision.

Studies have shown that Canadian retail investors feel it is important for investment firms to fully disclose fees and other costs (90%). In fact, generating returns was not ranked as high a priority as fee transparency, with 82% of Canadians indicating its importance when working with an investment firm.[1]

**Question 17**

**Do you think this proposal will lead to an advice gap?**

A U.K. report (*Review of the RDR Implementation Review* published on December 16, 2014, https://www.fca.org.uk/publication/research/post-implementation-review-rdr-phase-1.pdf) from the Financial Conduct Authority found that there was "little evidence that the availability of advice has reduced significantly, with the majority of advisers still willing to take on more clients", in the U.K. post-RDR. However, there has been evidence that some investors have reevaluated whether they are receiving value for their money and deciding, in some cases, that they are not.

We are sensitive to the issues raised by the CSA and a recent report by the *Financial Advice Market Review* in the U.K. (https://www.fca.org.uk/publication/corporate/famr-final-report.pdf) in reference to mass market investors, those with assets under $100,000, and their potential difficulty in obtaining the amount of financial advice they desire, at a price they want to pay.

While we disagree with the notion of an "advice gap", as we feel that new lower-cost competitors and online digital platforms and robo-advisors would enter the market and service this group of mass-market investors, we do feel it is important that any ban on embedded commissions be accompanied by a corresponding effort to educate investors on the changes and promote lower-cost and technology-enabled advice, to ensure that access to advice does not change.

Wider use of online advice and robo-advisor platforms will become more important for the industry, in addition to industry initiatives promoting technological innovation, such as the recent launch of the OSC LaunchPad, OSC Fintech Advisory Committee and CSA sandbox. Ultimately, we believe the interests of investors are served when there is a greater focus on lower fees and accessibility to a wide and diverse range of investment products.

**Question 18**

**Given some of the changes we have seen in the industry over the past few years, what is the likelihood that the fund industry will transition away from embedded commissions without regulatory action?**

In our view, we believe that significant change away from embedded commissions is unlikely to occur organically. Additional delays run the risk of exacerbating the three key investor protection and market efficiency issues identified in the CSA consultation paper.

Our studies have shown that Canadian financial advisors are seeing a greater shift in their industry to fee-based platforms with many believing this is better for their business and for their clients.[2] However, this shift is limited. It is also important to note that while F-series funds are lower cost and more transparent than regular funds, they are still significantly higher cost than ETFs in Canada. Currently, the average management expense ratio of a Vanguard ETF is 0.15% versus 1.00% for the average F-series fund, which results in a significant difference, in performance, over time.

Vanguard's own experience in Canada is that we have seen great success with fee-based representatives who value our low-cost approach (in relation to commissioned A-series funds and fee-based F-series funds). We expect that a broader menu of products (including lower-cost ETFs) will be selected by advisors as a result of increased transparency on fees. The removal of embedded commissions will put all investment products on equal footing and result in a better system for investors – who focus on value for money from their financial advisor and a better system for their financial advisor, who focuses on offering the most suitable solutions to clients.

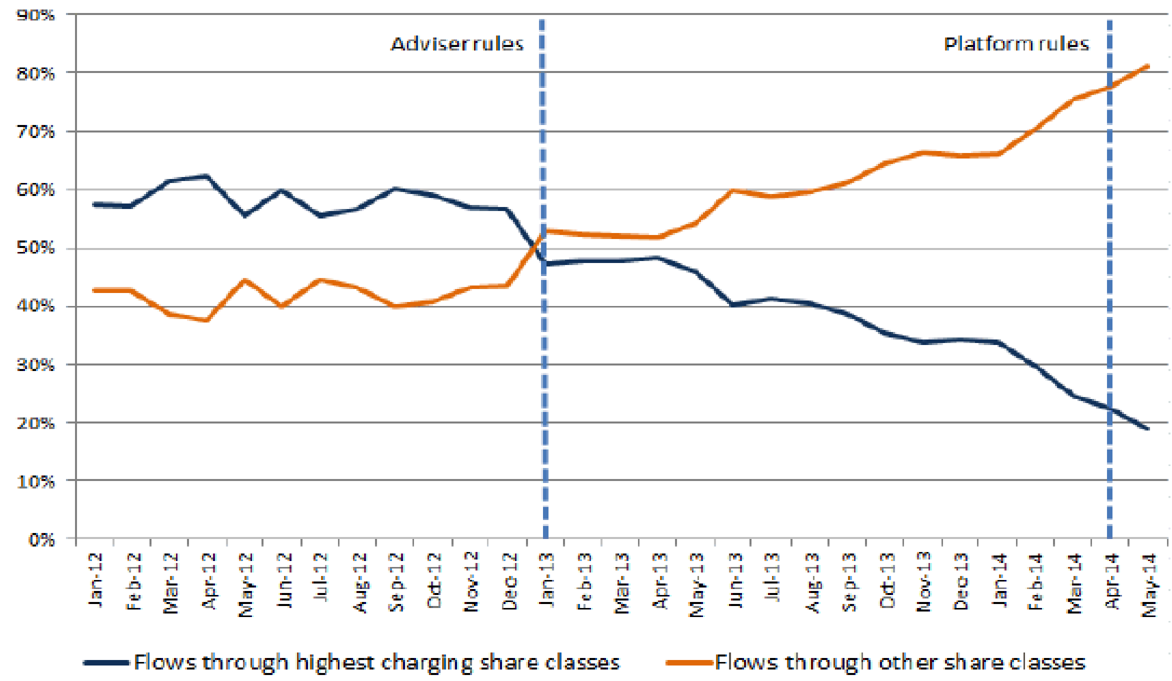
**Question 21**

**Please describe how discontinuing embedded commissions will affect competition and market structure, and whether this will address the CSA's three main concerns (outlined above).**

It is our view that the elimination of embedded commissions will lead to greater competition and a broader range of lower-cost investment providers offering greater access to a variety of different products.

Evidence in the U.K. for example, saw a shift toward the sale of lower-cost products when the playing field was levelled by the Retail Distribution Review ("RDR") as highlighted in the chart below.

- Gross retail flows through highest-charging class shares and other shares – page 74 Europe Economics Retail Distribution Review – Post Implementation Review – December 2014 https://www.fca.org.uk/publication/research/rdr-post-implementation-review-europe-economics.pdf




Source: IMA (2014), "Asset management in the UK 2013 – 2014".

**Question 27**

**How practicable are the mitigation measures discussed and how effective would these measures be at assuring; access to advice, choice of payment arrangements for all investor segments, and a level playing field among competing investment products?**

We feel that the mitigation measures discussed are prudent and address the impact of this change to investors and the financial services industry. While there will likely be a transitionary period to ensure all industry participants have time to prepare for and implement the changes, we feel the overall positive impact on investors is worthwhile and significant.

It is worth noting that many similar regulatory changes related to compensation for representatives have often been accompanied by a consumer education and advocacy effort which seeks to inform investors about the change and its implications.

Recent regulatory reforms, such as CRM2 and POS, will aid in this overall effort to increase investor protection, fee transparency and enable a more level playing field amongst investment fund products. As the CSA consultation paper indicates, it is clear that there is a global trend toward reducing conflicts of interest, enhancing fund fee transparency and aligning financial service with the compensation paid by investors.

We appreciate the opportunity to comment on the CSA's paper and would be pleased to further discuss our comments with CSA staff at your convenience.

Sincerely,

(Signed) "*Atul Tiwari*"

Atul Tiwari
Managing Director
Vanguard Investments Canada Inc.

[1]CFA Institute Survey – From Trust to Loyalty – A Global Survey of What Investors Want
[2]Vanguard Global Advisor Trends Study 2016 - https://www.vanguardcanada.ca/advisors/articles/vanguard-news/news-from-vanguard/gat-press-release.htm