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INVESTMENT INDUSTRY ASSOCIATION OF CANADA
ASSOCIATION CANADIENNE DU COMMERCE DES VALEURS MOBILIÈRES

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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
Registrar 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

Attention:

The Secretary
Ontario Securities Commission
20 Queen Street West
19th Floor, Box 55
Toronto, Ontario M5H 3S8
Email: comments@osc.gov.on.ca

- And -

Me Anne-Marie Beaudoin, Corporate Secretary
Autorité des marchés financiers
Tour de la Bourse
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C.P. 246, 22 étage
Montreal, Québec H4Z 1G3
Via Email: consultation-en-cours@lautorite.qc.ca

Dear Sirs and Mesdames:

RE: Canadian Securities Administrators Discussion Paper 81-407: Mutual Fund Fees (the Discussion Paper)

The Investment Industry Association of Canada (IIAC or the Association) appreciates the opportunity to comment on behalf of our member firms on the Canadian Securities Administrators (CSA) Discussion Paper examining the mutual fund fee structure in Canada.

The IIAC understands that this consultation process has been undertaken to determine if any regulatory response is necessary to ensure there is clarity and transparency with respect to fees investors pay when purchasing mutual funds. However, as we outline below, the IIAC questions the timing of this consultation given the current state of implementation of other overlapping initiatives.

The Discussion Paper rightly recognizes that the CSA has recently focused on initiatives aimed at improving the transparency of mutual fund fees and embedded commissions as a way to enable investors to better understand the costs of investment in mutual funds and to make more informed investment decisions. These initiatives include the Fund Facts under the Point of Sale (POS) project, and through the new Client Relationship Model (CRM) under National Instrument 31-103, including the cost disclosure and new performance reporting requirements that have just recently received final approval, together with the rules of the self-regulatory organizations.

Thus, the Canadian securities industry has been proactively advancing a regulatory regime that will provide clients with enhanced information and protection. Both CRM and POS have been in development for over ten years, and are still in the process of being implemented. Although there have been regulatory initiatives undertaken in other jurisdictions, with the final Stage 3 of POS still in development and CRM in the midst of implementation, we are unclear as to why the CSA determined that this is the appropriate time to release the Discussion Paper. We can only assume that the CSA has already decided that POS and CRM, once fully implemented, will fall short of their intended policy objectives.

However, in our view, these regulatory initiatives will adequately address concerns regarding the clarity and transparency of mutual fund fees. This is especially true with CRM, which is intended to ensure that clients better understand the relationship with their advisor. The new regulatory regime should be allowed to be fully implemented and evaluated before a decision is made in regards to whether there are any remaining areas that require further attention and if so, whether concerns expressed by the CSA can be achieved through tailored enhancements to the current regulatory regime.

Current Regulatory Regime and Initiatives in Canada

The Client Relationship Model

The IIAC is of the view that CRM contains specific requirements that directly address clear and transparent disclosure of mutual fund fees and embedded commissions. This is illustrated by IIROC's Guidance on the Client Relationship Model, which states:

> Consistent with the requirements of National Instrument 31-103 ("NI 31-103"), IIROC staff expects the discussion of account operation and transaction fees/charges will include all charges a client may incur during the course of acquiring, selling or holding an investment product position, including amounts to be paid indirectly to the Dealer Member by the client. For example, mutual fund fees/charges disclosure should include a discussion of the management expenses that are deducted from fund performance by the mutual fund manager and the types of fees/charges, such as trailing fees, which may be paid to the Dealer Member by the mutual fund manager from these collected management expenses.[1]

These requirements took effect on March 26, 2013 for new clients and will take effect on March 26, 2014 for existing clients.

This discussion of charges and fees must be included in the Relationship Disclosure information and once the phased implementation of cost disclosure and performance reporting requirements is complete (CRM Phase 2), members will also be required to provide a description of charges, including trailing commissions, at the time of account opening. CRM Phase 2 will further require firms to provide, on an annual basis, a summary of all charges incurred by the client and all compensation received by the firm relating to the client's account, which would include the dollar amount of trailing commissions.

Further, under CRM Phase 2, there will be a requirement for the pre-trade disclosure of charges before a firm accepts an instruction to purchase or sell a security, including the charges the client will pay (or a reasonable estimate thereof if the actual amount is not known) and, in the case of a purchase to which deferred charges may apply, that the client might be required to pay a deferred sales charge on the subsequent sale of the security and the fee schedule that will apply. In addition, the pre-trade disclosure must state whether the firm will receive trailing commissions in respect of the security.

Point of Sale Framework

The Fund Facts document is central to the Point of Sale framework. It must be written in plain language, be no more than four pages and highlight key information that investors consider important, including past performance, risks and costs. The CSA has stated that

[1] IIROC Guidance Note 12-0108 *Client Relationship Model – Guidance.*

"delivery of the Fund Facts would provide investors with access to key information about a mutual fund, in language they can easily understand, at a time that is relevant to their investment decision."[2]

As the CSA's implementation of the POS disclosure framework continues to progress, the CSA indicated that it is working towards achieving the Joint Forum of Financial Market Regulators' vision for the point of sale disclosure regime described in the framework. This vision focuses on three principles:

- Providing investors with key information about a fund;
- Providing the information in a simple, accessible and comparable format; and
- Providing the information before investors make their decision to buy.

The CSA stated that these principles keep pace with developing global standards on point of sale disclosure and delivery, which the CSA considers essential to the continued success of the Canadian mutual fund industry.[3]

Some anticipated benefits of the POS framework envisaged include:

- Less risk of investors buying inappropriate products or not fully benefitting from the advice services they pay for;
- Investors being in a position to better understand and compare one mutual fund to another, particularly the costs of investing in the mutual funds;
- Greater transparency in areas such as charges or commissions, which may enhance the overall efficiency of the market; and
- Comparability and ease of readability reinforcing investor confidence in mutual funds.[4]

The Fund Facts document contains clear and concise information regarding mutual fund costs. It includes both initial and deferred sales charges, fund expenses including the management expense ratio and the trading expense ratio, and trailing commissions. With respect to trailing commissions, it now includes a requirement to confirm whether trailing commissions are paid, and added disclosure regarding the potential conflicts arising from the payment of trailing commissions.

The CSA has devoted significant attention and resources to POS resulting in an extremely comprehensive framework, providing investors with clear and easy to understand information regarding mutual fund costs including sales charges and ongoing fund fees.

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[2] CSA Notice and Request for Comment: Implementation of Stage 2 of Point of Sale Disclosure for Mutual Funds, Proposed Amendments to National Instrument 81-101 *Mutual Fund Prospectus Disclosure*, Form 81-101F3 and Companion Policy 81-101CP *Mutual Fund Prospectus Disclosure* and Consequential Amendments (11 August 2011).

[3] *Ibid.*

[4] CSA Notice and Request for Comment: Implementation of Point of Sale Disclosure for Mutual Funds, (Supplement to the OSC Bulletin) (19 June 2009).

That being the case, the IIAC is unclear what perceived "gaps" in the POS framework the CSA believes would require additional, largely duplicative, industry reforms.

The CRM and the POS initiatives are comprehensive regimes centered on investor protection. Furthermore, both CRM and POS will require clear and concise disclosure at the time of opening an account, as well as at the time of purchasing a mutual fund and, after the fact, via annual reporting. These initiatives will appreciably improve investors' awareness and understanding of mutual fund costs, making them more informed consumers. It is unclear how some of the proposed changes outlined in the Discussion Paper would result in additional understanding for investors. Further, it is important to ensure that clients receive *useful* information. Any additional information requirements proposed by the CSA should only be adopted if, in fact, the additional information provides meaningful information to investors. Excessive information may confuse investors and therefore should be examined in light of current regulatory initiatives underway.

What Trailers Pay For

A possible change suggested in the Discussion Paper calls for "a minimum level of ongoing services that advisors must provide to investors in exchange for the payment of these commissions...". We are concerned that the CSA may not fully recognize the role trailers play in the business of our members firms and the scope of services dealers provide with the assistance of the trailer revenues. Investment advice is not the sole service dealers provide their mutual fund clients. There are a many other services provided by investment dealers that facilitate the management of the mutual fund investment such as product information and research, tax documentation, corporate action processing and efficient clearing and settlement of securities. The following is a list of some services supported by trailing commissions that are provided by investment dealers on an ongoing basis (many apply equally to execution only and full-service dealers):

- Printing and mailing of disclosure documents (prospectuses, Fund Facts, other shareholder communications including proxy material);
- Processing of corporate events and distributions (Since mutual funds held by investment dealers are typically registered in nominee name, the dealer takes on responsibility for updating client account records for things such as mutual fund reorganizations and client payments of interest, dividends, etc.);
- Preparation and distribution of tax reporting information such as annual trading summaries, and, in some cases, T3 and T5013 tax slips;
- Provide the widest selection of mutual funds from multiple fund families (This requires efforts by the dealer/advisor to conduct extensive product due diligence and legal documentation before making these funds available to clients.);
- Custody services;

- Portfolio monitoring of margin requirements;
- Clearing and settlement for purchase and sales through FundSERV and/or CDS.

The services above should be taken into consideration with respect to the importance of trailers to advisors and their firms.

U.S. 12b-1 Fees

The Discussion Paper considers that a trailing commission could be unbundled from a mutual fund's management fee and instead disclosed as a separate asset-based fee to the fund. This would be similar to Rule 12b-1 in the U.S. where marketing and service fees, which includes the payment of trailing commissions to advisors as well as other distribution-related services, are charged separately from the management fee.

The proposed Rule 12b-2 is intended to make changes to the 12b-1 fees which the Securities and Exchange Commission (SEC) indicated are confusing to investors because investors do not perceive that a portion of the 12b-1 fee is an asset-based sales load.[5]

Rule 12b-2 would permit a "marketing and service fee" of up to 0.25% to be charged on mutual fund assets to pay for distribution related activities, including the payment of trailing commissions to advisors. Any amount charged in excess of 0.25% of mutual fund assets would be labelled an "ongoing sales charge."

Rule 12b-2 would also require the disclosure of these fees as separate line items in the mutual fund prospectus and trade confirmation. We believe such disclosure in Canada would not be necessary given other disclosure requirements surrounding mutual fund fees.

If the CSA is considering an "SEC-style" approach, we believe that it would be important to clearly identify the specific activities that would fall within the category of *distribution activity* and thus be paid out of the 12b-2 fee, and those activities that would not. It is also important to recognize that not all service fees are distribution-related. Guidance would also be needed to understand whether an advisor may receive more than the 25bps servicing fees, given that many platforms charge more.

Unintended Consequences

The IIAC also fears certain potential policy directions outlined in the Discussion Paper, such as a cap on trailing commissions, could result in unintended negative consequences with respect to investor choice. Specifically, a cap could cause firms and advisors to reexamine their lines of business to see whether it remains economically feasible to continue to provide mutual fund products and related services to their respective clients. We expect that smaller firms would be most heavily impacted as they are more likely to rely on trailers not only as a means to compensate their advisors, but also to help fund their firms'

[5] See SIFMA submission to the SEC on Mutual Fund Distribution Fees, November 5, 2010, available at http://www.sifma.org/issues/private-client/mutual-fund-distribution-fees-(12b-1)/activity/.

operations. As such, these firms might have to change business models or exit the industry completely.

All these factors together could result in less affluent investors bearing the brunt of additional regulation that would compel advisors and dealers to focus on servicing the needs of only higher net worth clients.

Global Regulatory Regime

While it is sometimes beneficial to monitor global regulatory initiatives, we are concerned that the policy initiatives in the U.K. and Australia outlined in the Discussion Paper are too new and unproven to serve as models for Canada. The U.K.'s Retail Distribution Review (RDR) rules, which prohibit advisors from receiving any commissions, only took effect as of January 1, 2013. In Australia, the Future of Financial Advice rules, which will prohibit "conflicted remuneration", become compulsory on July 1, 2013. These regulators have not yet assessed the impact on investors to determine whether the changes have had the intended effects. Early research with respect to the U.K.'s RDR rules indicates that up-front fees might be causing investors to be diverted to the non-advice channel.[6] This could suggest that decreased affordability of advice is a serious unintended consequence of a policy designed to increase transparency of fees.

As outlined earlier, Canada has been very proactive in its regulatory development with respect to CRM and POS and we should allow current policy initiatives to be fully implemented and their effects then evaluated to determine whether regulatory gaps have been adequately addressed. Canada should not deviate from its current planned approach on the basis of unproven regulatory initiatives in foreign jurisdictions, such as the U.K. and Australia.

Conclusion

We hope that the CSA considers some of the concerns we have raised in response to the questions posed. The IIAC would greatly appreciate the opportunity to discuss these issues with your further, or provide additional input as required.

Sincerely,

M. Alexander

Michelle Alexander

[6] Financial Times, Fewer to take advice under RDR, Steve Johnson (February 10, 2013).