

April 12, 2013

This correspondence is for all CSA members. However, in accordance with the instructions provided, it is only being forwarded only to:

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Comments on 81-407

Thank you for allowing me (and others) to comment on the CSA Proposal for 81-407. I would like to begin by pointing out that the comments provided here are strictly my own views. For the views of my employer or any other organization that I might be associated with, you should speak with those parties directly and separately. What follows are the views of one individual who has been able to sell mutual funds for nearly 20 years. I have also written a book, *The Professional Financial Advisor*, which first came out in 2003, with subsequent editions released in 2006 and 2012, that offers far more detail on this subject. For more depth and breadth regarding my own views, I ask that you read the third edition.

To begin, I would like to make an observation. The paper released in the autumn of 2012 by the CSA regarding the possible adoption of a fiduciary (best interests) standard must have had 200 questions in it. Having gone through this document, I do not recall having seen a single question. Surely to goodness, the CSA can find a happy medium between asking more questions than anyone could reasonably answer and asking none whatsoever.

The first substantive comment I would like to make is that the CSA is inconsistent within its own paper regarding terminology. At varying points, the phrase “trailing commissions” is used. In others, the phrase is “trailer fees”. The two phrases refer to the same thing. Which is correct? It strikes me as being rather odd- and more than a little disingenuous - to write a paper about mutual fund circumstances (including, but not limited to misunderstandings about their nature, structure, and cost) and to have that same paper perpetuate some of the problems enunciated in the paper! Nothing can be two things at the same time. Trailers are either fees or commissions. They cannot morph from legally being one entity into another – as they seem to in your paper. While we await more substantive reforms, action can be taken immediately to ensure consistent use of terminology.

Recommendation 1

I request that from this point forward, trailers be referred to exclusively as trailing commissions. The phrase 'trailer fees' should be banned.

My next comment is that I remain disgusted by the fact that discount brokers are allowed to sell mutual funds that pay trailing commissions. The industry insists that trailing commissions are paid in exchange for valuable advice. Since discount brokers do not offer advice (they require that their customers acknowledge this expressly before opening an account with them), it strikes me as rather disingenuous of them to receive compensation for advice that is never offered (nor even requested). Most reprehensible is when payment is received from companies that run ridiculously misleading advertising campaigns that say: "Invest With Advice". It is hypocrisy. The current arrangement does not protect consumer interests and leads to consumer confusion.

Recommendation 2

Prohibit discount brokerages from receiving trailing commissions immediately.

I have coined an acronym for what I believe needs to be done to truly "professionalize" the financial services industry. That acronym is STANDUP- *Scientific Testing And Necessary Disclosure Underpin Professionalism*. My view is that it is not enough for disclosures to be undertaken as a 'good idea' or 'best practice'. Seeing other jurisdictions forge ahead on matters like professionalism, alignment, investor education and consumer protection- all while Canada dithers- saddens me. There is a saying that "sunshine is the best disinfectant". To my mind, meaningful, unavoidable disclosure is that 'sunshine'.

Recommendation 3

As an interim measure, all mutual fund prospectuses and advertising should be required carry disclaimers similar to those mandated in the tobacco industry.

There is simply too much misinformation that needs to be clarified. This type of comprehensive disclosure ought to be mandatory- irrespective of the delivery channel. It ought to apply to mutual funds and segregated funds equally and, where possible, ought to apply to other products as well and include client sign-off at the point of sale.

The primary concern I have is one of reasonable perspective. Many relatively unsophisticated investors have no way to sift through information in order to come to a truly informed decision. Consider what the government has done to help consumers make informed decisions regarding energy consumption (something most consumers are similarly unfamiliar with).

Another example is that new appliances (dishwashers, microwaves, etc.) have stickers on them that show not only how much energy they use as discreet appliances, but also how that consumption level compares to other appliances on the market. It is this kind of information that provides meaningful context that allows for more informed decision-making at the point of sale. Similarly, if mutual funds and segregated funds had their MERs posted boldly on their front package along with a continuum showing how much comparable funds charge (i.e. where they rate within that continuum), consumers would be able to choose more effectively based on price.

Finally, and most importantly, I cannot help but notice how other nation states are getting on with the abolition of embedded compensation while Canada simply discusses it endlessly without ever taking tangible action. Glorianne Stromberg's report advocating the abolition of trailing

commissions was released in 1995. Embedded compensation is not homogeneous and has been shown (See the study done by Ron Sandler for the FSA in the UK in 2001) that about 75% of advisors in the UK admit that compensation considerations impact product recommendations. In spite of obvious and substantial problems, the situation has been allowed to persist.

Recommendation 4

Abolish trailing commissions at the first reasonable opportunity.

The benefits are numerous and substantial:

- Transparency- investors will understand very well that neither mutual funds, nor advice associated therewith is “free”.
- Cost arbitrage- both advisors and investors will be able to substitute higher-cost products with lower-cost products (including, but not limited to, other mutual funds).
- Exploding the myth that both mutual funds and the advice associated with them is “free”
- Allowing for potential deductibility depending on the nature of the account
- Removing the potential of compensation-induced bias- both within and throughout product lines
- Enhancing consumer confidence in both advisor motives and the actual advice given
- Improving consumer understanding of the constituent component parts of mutual fund costs
- Allowing for scalability of fees (a so-called ‘volume discount’) as accounts grow

I hope that the suggestions I’ve shared with you are given serious consideration. It is my hope that tangible steps will be taken to effect meaningful change going forward. To date, and in spite of a number of consultations, papers, focus groups and the like, there has been precious little done by way of consumer protection.

Members of the CSA are regulators. Their job is to regulate. This matter is far, far too important a matter to be left to the SROs. Foxes cannot be left in charge of the henhouse. Cigarette companies would have never moved to make the disclosures that they are now required to make of their own volition. Members of the CSA have an obligation to protect the public interest and they have failed miserably to date. You people are embarrassing yourselves and allowing the industry to atrophy to the point where consumer confidence is being lost like never before. It is up to the CSA to restore that confidence- and it is never the wrong time to do the right thing. For goodness sake- get on with it, already!

Should anything in this correspondence prove to be unclear or incomplete, please do not hesitate to contact me, as I would be delighted to explain my positions further or expand upon them if need be.

Sincerely,

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