

BY ELECTRONIC MAIL: comments@osc.gov.on.ca, consultation-encours@lautorite.qc.ca

April 11, 2013

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

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

Dear Sirs and Mesdames:

RE: CSA Discussion Paper 81-407: Mutual Fund Fees Published on December 13, 2012 (the "Discussion Paper")

National Bank (“NBF”)¹ appreciates the opportunity to comment on the Discussion Paper. We acknowledge that the CSA is examining the mutual fund fee structure in Canada to determine whether there are any investor protection or fairness issues to address, and to determine whether there could be regulatory initiatives to address such issues. NBF supports the objectives of the CSA as well as greater financial literacy for investors.

In recent years, the regulators and SROs have provided guidance and introduced many regulatory initiatives which have improved transparency on mutual fund fees and embedded commissions, such as point of sale disclosure and the Client Relationship Model. These key regulatory initiatives will benefit investors by enabling them to better understand the costs of investing in mutual funds and therefore make more informed investment decisions. It is important to keep in mind that implementing any new regulatory initiatives will require significant resources to adapt industry systems and operations. The regulators should also ensure that the consequences of any regulatory initiative have no adverse impact on the investor. NBF considers that investor protection and fairness must, above all, be the driver for change.

NBF is a diverse financial group which: (i) manufactures mutual funds, owns a proprietary distribution channels and supplies services to third party distributors; (ii) operates a discount brokerage firm; and (iii) is an IROC-regulated investment dealer throughout Canada. We therefore take great interest in the regulatory initiatives contained in the Discussion Paper and their potential impact on investors, the mutual fund industry, the investment industry and financial intermediaries. Accordingly, our intention is to share our concerns regarding the regulatory initiatives contained in the Discussion Paper and our experiences. We trust that our comments will be taken into account during the review process and also provide a positive and productive contribution to the outcome of the regulatory initiatives proposed in the Discussion Paper. Three topics will be discussed in our comment letter (i) the proposed regulatory initiatives contained in the Discussion Paper; (ii) NBF Business Units; and (iii) the United Kingdom (“UK”) regulatory initiatives.

1. Proposed Regulatory Initiatives Contained in the Discussion Paper

We acknowledge that the Discussion Paper proposes several regulatory initiatives to enhance investor protection. However, it is not clear that all of them would ultimately achieve the objectives of the CSA. The mutual fund fee structures and the different mutual fund classes currently available are already complex for a retail investor to understand, and some of the proposed regulatory initiatives would increase this complexity. For example, a commission cap is suggested (when a threshold is reached)

¹ With approximately \$184 billion in assets as at January 31, 2013, National Bank of Canada (www.nbc.ca), together with its subsidiaries, forms one of Canada's leading integrated financial groups, and was named among the five strongest banks in the world by Bloomberg Markets magazine in May 2012. National Bank of Canada has close to 20,000 employees and is widely recognized as a top employer.

requiring an automatic conversion into a class of fund with no ongoing asset based sales charge. This change could initially create confusion with the retail investor and later some difficulty to track acquisition cost for tax purposes.

NBF strongly believes that clients' financial literacy is a key element of investor protection. For example, Clear Facts.ca² site traffic demonstrates through a wide range of financial questions to which investors and consumers seek answers that they have numerous interests and concerns about their money. We support regulatory initiatives, such as CRM (phase 2) which provides better transparency to investors and also informational tools which would permit investors to make informed investment decisions.

NBF strongly suggests that any CSA regulatory initiative be supported with empirically based analysis to determine the impact on the financial industry and investor behavior. There is already evidence in the United States that the unbundling of costs has raised the total investment cost for some investor segments³. This unintended consequence of the regulatory initiative in the United States is certainly not what the regulators wanted to achieve. Therefore, enhanced disclosure and performance reporting will most likely be much more effective than an unbundling of fees.

The CSA should take into consideration all the other investment products that could eventually become substitute investments for advisors seeking to retain a commission-based fee structure. It would be counter to the overall objectives of the CSA if an unwitting consequence of regulatory initiatives incited advisors to move investors from, say, mutual funds to investment products with different commission structures. As an example, in recent years some ETF manufacturers have introduced series of ETFs with imbedded trailer fees, which could become an alternative to mutual funds.

2. NBF Business Units

Before adopting any new regulatory initiatives, we would like to provide concrete examples of the impact of certain regulatory initiatives contained in the Discussion Paper on our business units.

² *ClearFacts.ca or jecomprends.ca is a website maintained by NBF. Its primary goal is to contribute to the financial education of Canadians.*

³ *Strategic Insight study (2012): "For many 'buy-and-hold' U.S. mutual fund investors, total shareholder costs over the lifetime of an investment have increased as a result of the transition to a fee-for-advice model. In total, the unbundling of fees has resulted in an increase in the total shareholder costs for many investors, with such an increase amplified due to tax considerations at times." A Perspective on the Evolution in Structure, Investor Demand, Distribution, Pricing, and Shareholders' Total Cost in the U.S. Mutual Fund Industry, page 5.*

Over the last few years, National Bank Financial, the full-service advisory unit, has experienced significant growth in fee-based accounts. The fees in these accounts are fully disclosed. This business unit has experienced two results:

1. Overall fees have been reduced in High Value accounts. This reduction is observed when calculated as a percentage of assets.
2. There has been no significant change in the fees charged to Lower Value accounts. Although over the last few years, the minimum portfolio size we accept in this business unit has been increased. This reflects our cost structure and our clients' willingness to pay the fee.

This example demonstrates that there was some form of cross subsidy between the different client segments i.e that High Value accounts were subsidizing Lower Value accounts.

National Bank Direct Brokerage Inc, offers a multitude of services for self-directed investors and a significant percentage of the assets held are mutual funds. It is important to understand that trailer fees not only pays for advice, but also for the operational costs of a discount broker such as the IT infrastructure, supervision, investor support services, periodic reporting, posting of distributions, CIPF coverage, upkeep of online tools and economic and market research. It is incorrect to assume that distributing a DIY class of mutual fund would not generate costs for a discount broker. Mutual funds are more costly to trade and to maintain than an equity or fixed income product. A regulatory initiative which would ban or limit trailer fees would have a significant impact on our business model and also on the end-user – the DIY investor.

3. UK Regulatory Initiatives

The UK experience in particular attracted our attention as it has already implemented several of the major changes discussed in the Discussion Paper. There are a few differences between Canada and the UK that need to be stated, as they are relevant to the lessons we can learn from them:

- The 2008 financial crisis in UK was deeper, lasted longer, and did greater damage than anything Canada experienced. Government bailouts of a number of the large high street banks created a profound lack of trust on the part of retail investors towards the financial industry.
- A series of scandals in the UK also highlighted the aggressive selling of inappropriate financial products to individuals and small businesses. The mis-selling of these financial products is seen as the direct result of the practice of paying advisors on a commission basis and increasingly seen as rewarding behaviour that is not in the best interests of the investor. There has been no

comparable situation in Canada, where the conduct of Canadian advisors is guided by more stringent rules and training.

- A few examples of mis-selling to consumers, small business, municipalities and hospital trust include: payment protection insurance, interest rate swaps, reverse mortgage, income drawdown, and other financial products. These have led to compensation of more than £10 billion from the financial industry and government, and not all claims have yet been settled.

The FSA has been the sole regulatory body in the UK and oversees all financial products. The FSA will be replaced in April 2013 and its duties will be assumed by the Prudential Regulation Authority and the Financial Conduct Authority. UK regulatory deficiencies have caused parliament to replace the regulatory body. The social and political environment in the UK appears to have created a situation where only draconian rules and regulations were deemed acceptable; this situation clearly does not exist in Canada.

Amongst other things, the Retail Directive Report (RDR, the document that articulates the new UK regulations) eliminates commission, and requires that all fees and payments be disclosed prior to a sale being made. Trailer fees will be abolished later this year. The financial industry's response, set out below, seems to demonstrate a clear trend which will greatly impact the investor with lower asset levels who is seeking advice:

- Some major banks have moved clients with investible assets of less than £100,000 to non-advisory service and have introduced new fees.
- Barclays has stopped offering investment and pension advice altogether. Instead it offers an online execution-only service.⁴
- Lloyds and HSBC have stopped providing advice to clients with less than £100,000 and £50,000 of investible assets respectively, and have terminated tied advisors, which are advisors that can recommend products from a specific sponsor.

The following example illustrates the approach to new business rules and fees introduced at four major high street financial institutions⁵ (HSBC, Lloyds, Nationwide and RBS): a 2.6% upfront fee for advice and more than 65 basis points annual ongoing costs (the portfolio size used in this example is £100,000). These fees exclude investment cost and/or product charges.

It is still too early to draw conclusions from the regulatory changes implemented in the UK, however the trend seems to demonstrate that the economics of the fee-for-advice

⁴ *The Telegraph, " Banks: New fees revealed for cost of investment advice", Emma Simons, January 10, 2013*

⁵ *The Telegraph, " Banks: New fees revealed for cost of investment advice", Emma Simons, January 10, 2013*

model would further limit the provision of advice to those with higher levels of assets, and an “advice-gap” would most seriously affect investors with lower net worth – arguably the individuals in our society with the greatest need for advice. In conclusion, we believe that it is paramount that the CSA understands the full impact of international regulatory initiatives before contemplating similar regulatory initiatives in Canada.

Conclusion

NBF would like to thank you for providing us with an opportunity to comment on this important issue. We look forward to our continued participation in any further public consultation on this topic and would be pleased to discuss our input in greater detail with you. We have expressed our main concerns and our objective is to find solutions that are relevant for, and serve the needs of the Canadian market. NBF and its employees are willing to take a leadership role in this issue participating in consultations with investors, industry participants and the CSA.

Yours truly,



Luc Paiement
Executive Vice-President, Wealth Management,
Co-President and Co-Chief Executive Officer National Bank Financial