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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
Superintendent of Securities, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Yukon Territory
Superintendent of Securities, Nunavut

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Re: Canadian Securities Administrators (CSA) Discussion Paper and Request for Comment 81-407: *Mutual Fund Fees* (Discussion Paper)

We are writing to provide comments on the CSA's Discussion Paper on mutual fund fees published on December 13, 2012.

Investors Group Inc. (Investors Group) is a diversified financial services company and one of Canada's largest managers and distributors of mutual funds, with assets under management of over $63 billion at March 31, 2013. Investors Group distributes its products through approximately 4,500 Consultants engaged with its subsidiaries that are for the most part Approved Persons with the Mutual Fund Dealers Association of Canada. We provide financial planning solutions to approximately a million Canadian households.

A leader in the investment industry, serving the financial needs of Canadians for over 85 years, and representing the collective experience of millions of interactions between investors and their advisors, Investors Group is uniquely positioned to provide a deep understanding of the subject matter presented in this Discussion Paper.

We believe many of the issues and potential actions discussed in the paper are the result of considering only a very limited perspective of the mutual fund industry. Any course of action taken based on this narrow view has the potential to be extremely detrimental to all participants in this industry, including and especially the individual Canadian investors we serve and regulators are to protect.

It is important to have the broadest and deepest understanding when changes are being considered that affect the fundamental way in which financial services are offered to the public, especially if the potential effects are as far reaching as here. We welcome the opportunity to add clarity and additional background to this discussion, and to raise several unintended consequences that potentially may result from this initiative.

1. General Comments

Many of the critical elements of the Discussion Paper are focused on the transaction of mutual fund purchases and how advisors are paid for the financial products and services they provide to the clients they serve. The paper concludes that the current environment leads to potential conflicts of interest, and considers changes that it believes would mitigate those conflicts.

At Investors Group we believe that building long-term relationships with clients is the best way to help individuals reach their financial goals at each stage of their lives. We see financial planning and advice as integral parts of reaching those targets. That advice is delivered through an advisor, who keeps clients focused on the realization of their long-term goals. That advice is not paid for directly by the client, but instead through compensation embedded within the fund's expenses. It is within this philosophy that we (and most of the industry) have structured our business practices and compensation to our advisors with our clients' long term interests in mind.

Independent research has demonstrated the significant value of delivering financial advice to the public, at all income and asset levels. Among other things, advised households (i) are twice as likely to save for retirement at all ages (ii) have significantly higher levels of investable assets at all ages (iii) improve their regular saving for retirement at all income levels (iv) rate themselves as more financially knowledgeable; and (v) are more comfortable making the financial decisions they need to make to plan for their future.

At one time, most mutual funds were purchased on a front end load basis, where clients would pay an up-front fee at the time of the sale, and there was no trailing commission. However, investors became increasingly reluctant to pay an initial sales charge, which reduced the net amount they invested. The marketplace evolved away from advisor compensation paid separately by the investor to a model where compensation was included in the cost of the product.

It is important to note that embedded compensation is not unique to mutual funds. Apart from the mutual fund industry, embedded compensation is the standard in approximately 45% of the average Canadian household's investments in deposits and segregated funds[1].

In an embedded compensation model, the up-front cost of providing planning advice is amortized over the life of the investment, despite the fact that much more time and effort is involved by the dealer and the advisor at the time of the initial investment. This model aligns the advisor's success with the client's (since a significant portion of the compensation is paid out over the life of the investment and will increase as the value of the client's portfolio goes up and decline if it decreases). Further, it provides a basis for the advisors to provide ongoing advice to clients, since they continue to receive revenue from the investments as long as the client remains with the advisor.

Most investors have preferred to pay indirectly for advice and even if they mature to the point of being willing to pay directly for such advice, time is no longer their ally in meeting their financial goals.

Although their intentions may have been good, countries that have banned embedded compensation, such as the United Kingdom and Australia, are beginning to experience unintended negative consequences, namely an "advice gap". A growing number of investors are unable to access the guidance they need to manage their investments[2] and meet their financial planning needs, either due to their smaller account size or their unwillingness to pay for such services. Given the strong correlation between financial advice and positive financial outcomes, this is a worrying development.

A large proportion of Canadians have access to financial advice through their mutual fund investments, with very positive outcomes compared to other countries.[3] As observed in other

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[1] These financial products represent approximately 40.7%, 4.0% and 25.5% of Canadians' household balance sheets respectively (see Investor Economics. *Household Balance Sheet 2012.*

[2] Deloitte LLP, *Bridging the Advice Gap: Delivering investment products in a post-RDR world.* November 2012.

[3] Based on *Canada's retirement-income provision: An international perspective* by Edward Whitehouse Retirees in Canada have well-above average income adequacy compared to other OECD countries (while Australia and the UK are well below average), and Canadian retirees derive a very large proportion of their income from accumulated capital, and little from public transfers when compared to the OECD average.

countries, wholesale changes to the current compensation model in Canada along the lines considered in the Discussion Paper would create and accelerate an "advice gap" here and, as a result, are ill advised.

The presentation of the issues in the Discussion Paper focused only and entirely on mutual funds which is, unfortunately, misleading and potentially tarnishes the mutual fund industry as a whole. It leaves the unfair and unfounded impression that the embedded compensation model is unique to the mutual fund industry, that market forces are not driving out sufficient innovation, that current regulations are lacking and that our clients are exposed to unmanageable conflicts that do not occur elsewhere. There is no support presented for these positions and indeed there is overwhelming evidence that the existing structures have served the public very well, and will continue to do so in the future.

2. Response to Specific Proposals

The Discussion Paper sets forth a series of topics for consideration. The following are our comments on each.

A. Tie Trailing Commissions to Advisors to Specific Services

This proposal arises from a misunderstanding that 100% of trailing commissions are paid for ongoing services provided by advisors. In fact, the compensation is paid to the dealer in connection with the distribution of the financial products and is generally the only source of revenue for mutual fund dealers. This revenue pays for a variety of dealer costs, including supervision, back office functions, client statement production, insurance and similar expenses – many of which, we note, have increased as a result of recent regulatory requirements – in addition to the cost of compensating advisors. The dealer, not the manufacturer, determines the level of service its advisors are to provide.

Of the industry average of two-thirds of the trailing commission actually paid to advisors by the dealer, there are two facets involved. First, they represent deferred compensation to advisors for the initial work done by them in providing advice to clients at the time of the original investment. Second, these payments are to compensate for the ongoing service provided by the advisor to the client. Because of this, the services provided by advisors to investors will vary depending on a number of factors, including the size of the portfolio and specific needs of the particular client including desired frequency of contact and updates.

B. Mandate a "Do It Yourself" Class for all Funds

"Do It Yourself"(DIY) investors currently have access to a growing selection of investment products that have no trailing commission, including mutual funds, and if there are unfulfilled investor needs, the market will respond, as it has always done. The idea of requiring all mutual funds to be available as a DIY class has no merit. Fund manufacturers should continue to be free to structure their offerings for the clients in their target market. If a manufacturer decides to focus only on investors who seek advice, they should be able to do so. Conversely, a manufacturer that decides

to provide products to suit a broader range of investors should be able to offer low cost products suited for clients at discount brokers who do not provide advice if they choose. Securities regulators have traditionally stayed away from interfering in commercial decisions such as this and should not begin here.

It appears that a major concern of the CSA underlying this proposal is that an investor using a discount broker may be paying a trailing commission without receiving the advice associated with it. If this is the case, the self regulatory organizations in Canada that have primary responsibility for overseeing dealers are well equipped to handle any issues in this regard and we understand that this is something that is already being looked at. In our view that is the appropriate process to review any concerns in this area and does not need to be addressed through this aspect of this proposal.

C. Unbundling Trailing Commission and Replacing Them with an Asset Based Fee

As fund managers rarely increase the trailing commission component of the MER, it is difficult to see how unbundling the trailing commission component of the MER would represent a step forward from the current model. Unlike other financial products with embedded ongoing compensation, the trailing commission component of mutual fund expenses is already fully disclosed and readily available to investors. This change in structure is unnecessary and would potentially be detrimental to investors, increase complexity for the client and add undo administrative process and costs.

D. Separate Series or Classes for No Load Funds

A number of Canadian fund sponsors (including Investors Group) already use this approach. However, the argument that unit holders choosing the no load option are cross-subsidizing those choosing the deferred sales charge (DSC) option is incorrect. Although DSCs have an up-front commission paid, they also are typically combined with a lower ongoing trailing commission compared to no load. Which pricing option (if any) proves to be costlier to the fund manager will depend on the details of the product. For example, it has been the experience of Investors Group that the DSC pricing option is usually less costly due to the longer holding period and lower trailing commission. We can therefore offer the DSC option with a lower MER than the No Load version of the same fund, providing a discounted cost to investors in return for a longer commitment from those investors. The DSC pricing option arose in response to investor demand and has important beneficial features (most notably aligning advisor and client interests) that the Discussion Paper ignores.

Having said this, we believe that the proposal that fund manufacturers should have separate series or classes for each purchase option has some merit. Doing so may bring increased clarity to investors as to the various purchase options available to them. However, we also believe that whether or not a fund manufacturer wishes to offer these separate series (and at a separate cost) should be market driven and not mandated by regulators. Furthermore, the administrative burden and associated costs of implementing this are not insignificant and would be borne by investors. We do not believe that the benefit of requiring separate series outweigh the costs.

E. Cap Commissions

Canadian securities regulators have traditionally refrained from regulating compensation and commissions and for a good reason. These issues are best left to the market and the competitive forces that operate to shape it. Freedom to compete is a cornerstone of the financial services sector in Canada and has served the public well. The goal should be on ensuring a wide range of consumer choice, which is what the market has done.

If capping was considered to avoid increased cost pressure, there is no evidence to suggest such action is necessary in the mutual fund industry in Canada. There is no trend toward increased cost among mutual funds or in the payment of compensation to dealers and advisors in Canada. In fact the only significant increase in the cost of MERs in Canada has been the introduction of GST in the 1990s and then HST in the last few years in Ontario and other provinces. Absent these government imposed costs to the investor, MERs have been trending downward through market pressures.

Further, capping commissions would undoubtedly have a host of unintended negative consequences, and introduce new (and potentially more damaging) sources of conflicting interests. It could encourage churning on the part of advisors to generate additional commissions, or could lead to "regulatory arbitrage", namely the movement to other similar investment vehicles, such as segregated funds, which are economically indistinguishable in many ways from mutual funds but which, as insurance products, are regulated under different rules. It is also likely that if compensation is capped, dealers and their advisors may be forced to look at "firing" clients due to the ongoing costs associated with maintaining, supervising and reporting on an account which make keeping them uneconomic.

F. Implement Additional Standards for Advisors

The question of whether the duties that advisors owe to their clients should be amended, specifically by adding a "best interest" standard, is extensively canvassed in CSA Consultation Paper 33-403: *The Standard of Conduct for Advisers and Dealers: Exploring the Appropriateness of Introducing a Statutory Best Interest Duty when Advice is Provided to Retail Clients*.

Advisors are already governed by a comprehensive set of obligations based on recommending only suitable investments for clients, coupled with the duty to act fairly, honestly and in good faith. The argument in favor of a "best interest" standard is that the current regulations are somehow inadequate, although the case has not been made as to how this step would improve the existing situation. Indeed our fear is that this new standard could only increase uncertainty and restrict the access of investors to affordable advice. For the same reasons as we give in this letter, this would be an unfortunate outcome for both clients and Canada. We would refer you to the comment letter we submitted on that paper.

In March of this year, the Ontario Securities Commission Investor Advisory Panel and the Investor Education Fund released the results of an investor survey which appears intended to support the need for a statutory best interest duty for advisors[4]. Upon a closer review, it is apparent that the survey lacks the qualities to provide useful and unbiased information.

The conclusion that investors agree that "a best interest duty is needed to protect retail investors" is based on responses to a single question in that regard. That question is preceded by a leading statement that "it is not clear whether the 'best interest duty' applies to financial advisors". There is no reference to the actual regulations already in place – and the suitability obligation and duty to act fairly, honestly and in good faith that they create – and no indication of increased cost or reduced access to financial advisors if a best interest duty were to be applied. This misleads respondents into believing current regulations are inadequate or non-existent, and that there would be no impact on their access to financial advisors to implement additional regulations.

Furthermore, the language used throughout the survey is misleading and biased against the mutual fund industry. For example:

- Rather than asking about "embedded fees", the survey asks about fees that are "hidden"; mutual fund fees are fully disclosed in Fund Facts and Simplified Prospectus, both of which are public documents that must be provided to investors.

- The survey includes a statement that mutual fund fees are "sometimes quite high"; the opinion of whether fees are high should be left to the respondent, and should not be part of the survey.

- It states that investors choosing stocks and bonds can "benefit from lots of available information", implying falsely that there is more fulsome disclosure on stocks and bonds purchases than there is on mutual funds, which is not the case.

We are very concerned about any reliance on this survey on the question of investors' views on the proposed statutory best interest standard.

G. Discontinue Practice of Having Manufacturers Set Compensation for Advisors

This proposal is based on a faulty premise that we believe is critical to clarify. Fund manufacturers do not set compensation for advisors. Mutual funds sponsors include provisions for the payment of commissions to dealers. Those dealers in turn enter into compensation arrangements with their advisors, which are dependent on a number of factors, including the competitive landscape with respect to other distributors as well as the costs that the dealer has in carrying on business. It is

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[4] "Strengthening Investor Protection in Ontario - Speaking with Ontarians", prepared by Ascentum, Inc. on behalf of the Ontario Securities Commission Investor Advisory Panel and the Investor Education Fund, January 2013.

important to note that the percentage of the compensation paid to dealers that is in turn paid to advisors is steadily going down. Much of this is due to the increased costs faced by dealers, particularly in complying with new or enhanced regulatory requirements.

The assumption behind this proposal appears to be that mandating a fee only model for advisor compensation would remove a source of potential conflict of interest through increased transparency. In fact, the information investors receive is actually reduced under a fee-based model because investors now must negotiate advisory fees with dealers directly and independently, with no frame of reference as to what is reasonable, or what others are paying for similar services. This contrasts starkly with the current structure where there is comprehensive public disclosure of all fees and commissions in the Simplified Prospectus, Fund Facts and Management Report on Fund Performance.

There is no cost advantage to investors either. For example, when all factors are taken into account, mutual fund fees in Canada are on average comparable to those in the United States, where fee-for-service is the dominant model[5]. Indeed for investors with lower asset levels, the all-in cost is significantly lower in an embedded compensation model than a fee for service model.

Fee for service accounts already exist in Canada, as do fund series designed to work in these structures (that is, funds that have lower or no trailing fee component). Advisors who want to provide financial advice through a fee-based service model are free to do so and to argue its merits. Further, fund manufacturers are able to structure their product offerings to address the needs of clients who prefer having a fee-based advisory relationship. Those investors who want to pay an additional fee for an advisory relationship currently have that option. Freedom of competition and market forces will continue to evolve the offerings to clients over time.

Investors who prefer to invest in a fund with all the fees included, fully disclosed, and widely available for comparison and public scrutiny, should not be deprived of the opportunity to do so. Ultimately the goal of this exercise should not be to limit freedom of choice for investors. We see no advantage to clients to support a proposal that eliminates one investment option in favour of an option that may not be as advantageous for them.

3. Conclusion

One of the troubling aspects of the Discussion Paper is that it appears to reflect some of the recent misinformed commentary in the public sphere and in the media suggesting that the current mutual fund sales process is somehow harmful, that the costs associated with mutual funds are excessive.

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[5] Investor Economics and Strategic Insight, *Monitoring Trends in Mutual Fund Cost of Ownership and Expense Ratios, A Canada-U.S. Perspective,* November 2012.

As noted in the course of this letter, although the paper presents the relationship between advisors and their clients as being fraught with conflicts of interest, no such evidence exists, and in fact there is and continues to be a close alignment in interests, which overwhelming evidence shows continues to serve the public well.

Singling out the mutual fund sector for distinctive treatment regarding embedded compensation in a larger financial services industry in Canada that is dominated by this model (as a response to investor preference) is unfair and ultimately inconsistent with the public interest.

We strongly support fair and unbiased disclosure to potential and existing investors for all financial products.

We thank you for the opportunity to provide comments on the Discussion Paper. Please feel free to contact David Cheop (david.cheop@investorsgroup.com) or myself, if you wish to discuss this further or require additional information.

Yours truly,

INVESTORS GROUP INC.

Murray J. Taylor

President and Chief Executive Officer