April 12th 2013

BY ELECTRONIC MAIL: comments@osc.gov.on.ca consultation-en-cours@lautorite.qc.ca

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
Superintendent of Securities, Newfoundland and Labrador
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Yukon Territory
Superintendent of Securities, Nunavut

The Secretary
Ontario Securities Commission
20 Queen Street West, Suite 1903, Box 55
Toronto, ON 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 / Mesdames:

RE: Canadian Securities Administrators Discussion Paper and Request for Comment 81-407 *Mutual Fund Fees*

The Federation of Mutual Fund Dealers (the "Federation") is an Association of Canadian mutual fund dealers and affiliates whose members, since 1996, have been working to be the voice of independent mutual fund dealers. We currently represent dealer firms with over

$114 billion of assets under administration and 17,000 licensed advisors that provide financial services to over 3.5 million Canadians and their families. A list of our members can be found at www.fmfd.ca.

The Federation is writing to provide comments with respect to the above captioned Discussion Paper (the "Paper").

While we understand that investor protection and fostering confidence in capital markets are key priorities for regulators, we feel strongly that this Paper is premature and serves only as a distraction, for regulators who have yet to be able to assess the impact of recently implemented policies whose transition dates span into 2016, and a distraction for industry who are reeling from working to implement the requirements that new policies require.

That said, we would like to ask the following questions:

1. What is the real problem or problems that we are trying to solve? It is not clear to us what, if any problem(s) the Canadian Securities Administrators ("CSA") is trying to solve in the release of this Paper.
    a. Which rules aren't working, which are missing, why do we need new ones – can we adequately enforce what we have?
    b. And what is the problem given the ample recent evidence, that investors are well served by advisors today?
2. Why now? It is not clear to us why regulators feel there is a need for more regulations at this time. Why not:
    a. Assess the impact of what has recently been put into place and what is pending e.g. CRM stage 2 whose transition periods range from 2014 to 2016 before introducing new regulation;
    b. Determine whether or not there is a need for new regulation;
    c. With dealer costs already running at 5 times the rate of inflation, understand that dealers cannot continue to bear the burden of regulatory bloat; and
    d. Acknowledge to the industry what the industry already knows, that the Canadian financial system, and not just banking, but the investment system/industry is the envy of the world.
3. Why was the methodology presented so shallow for such an impactful proposal?
    a. Only 52 interviews and a sample of 2,000
    b. No scholastic or academic research – objective or independent
    c. Sources were vague, and
    d. There was no presentation of a break-down of MERs, the cost of manufacturing, distribution, regulation, etc.
4. Why was the methodology not sufficient in terms of product scope and a level playing field?
    a. There was no discussion of regulatory arbitrage – a topic brought up time and time again by commenters in the past.

    b. Why doesn't it include all products that charge investors an investment management fee and an advisory fee so there can be an adequate marketplace comparison?
5. Why does the research not address unintended consequences, which have also been brought up in previous submissions, and the results of similar initiatives in other jurisdictions?
    a. The significant negative impact on small investors
    b. The tax consequences – tax shift, HST, churning, arbitrage
    c. The problematic experiences in the U.S. and Australia after similarly poorly conceived regulations
6. Why does the Paper fail, once again, to address the cost/benefit of the proposal and suggested changes?
    a. How specifically will the topics addressed enhance investor outcomes, net of the increased regulatory burdens?
    b. Did the CSA receive an exemption from the statutory requirement (in Ontario at least) to provide a cost/benefit analysis with this Paper?

As consumers we wonder on occasion when buying from a department store what the mark-up was, what the store paid for the item and what rebates or incentives they might receive from the manufacturers of goods. Why one manufacturer is more prominently displayed than another? Are their name brands the same as a private label product that might be cheaper?

When looking at cars we wonder what the relationship is between the dealer and retailer, the retailer and the salesperson or "auto consultant." We wonder why they might have a bias towards purchase or lease, why they would recommend an extended warranty. We wonder if there is a financial incentive from the manufacturer in terms of bonuses or rebates. We wonder if there is planned obsolescence in the car and how much the manufacturer or dealer expects to make from us in terms of replacement parts and labour throughout the cycle of car ownership.

When we go to a doctor, we would like to know what is in it for him/her if we come back in three months for a reassessment, choose the brand name prescription they recommend or visit the specialist they refer us to.

Nevertheless, we don't expect government/regulators to mandate to these vendors/service providers that information beyond what we pay, be disclosed. In our current sociopolitical environment it comes down to their struggle to be competitive and a client's responsibility to themselves to invest what we deem to be a prudent amount of time in research and comparative shopping.

What is the problem that we are trying to solve? It is not clear to use what, if any, problem the CSA is trying to solve in the release of this Paper.

There already seems to be more disclosure of compensation in this industry than in others and we are concerned about the inordinate amount of attention the mutual fund industry is receiving from the Canadian Securities Administrators (the "CSA"). While we concede that

mutual funds may be "the cornerstone investment for many Canadian investors" we would argue that the mutual fund industry has seen few problems, certainly nothing systemic that might suggest a complete overhaul of the current remuneration structure. Other jurisdictions that have gone down this road were in fact experiencing problems that included significant issues in their industry that unbundling was, in part, supposed to address. Canada does not have any preexisting problems and this paper unfortunately does not address any product outside of mutual funds.

The paper suggests that there are other investment funds and comparable securities products whose fee structure may raise investor protection and fairness issues for investors and we are disappointed that the scope of this paper did not encompass all products at this time. We would therefore submit that no changes to the current regime be implemented unless and until your review is expanded to include other products.

We agree that the CSA needs to "consider the unique features of the Canadian market as we examine what, if any, changes could or should be made." While we appreciate that other markets around the world may contribute their experiences for consideration, Canadian laws, regulations, tax structure and banking system all differ, significantly is some cases and to the benefit of Canadians and this should be acknowledged.

We understand that the CSA welcomes comments from investors but we are curious as to how investors generally will be made aware of this paper and what percentage of investors the CSA expects will understand its contents and be moved to comment. We do not believe for example, that the recent survey conducted by the Ontario Securities Commission's Investor Advisory Panel captured adequate investor representation e.g. 52 face-to-face interviews and 2000 surveyed given that the population of Ontario is 12.8 million.

We are also concerned that the paper raises the question of Canadian mutual fund fees being "amongst the highest in the world" and then goes on to say that the "Canadian mutual fund industry and other commentators have challenged these studies saying that they provide inaccurate comparisons", yet you provide no conclusion. What was the purpose of including this ongoing debate? We would argue that the studies performed by Investor Economics and Strategic Insight[1] should be considered more seriously as they shows that fees are not higher in Canada. They are in fact either lower or comparable.

Why was the methodology presented so shallow for such an impactful proposal? And why was the methodology not sufficient in terms of product scope and a level playing field?

The paper contains an abundance of 'perceived, potential, maybes and could-be's' but there is an absence of directly related research and proof – empirical evidence - that these conflicts really exist and in any material quantity to warrant a complete overhaul of the mutual fund fee structure in Canada; and we have concerns with some of the research presented in the paper, in particular where it reports "various years" or "various surveys" for example.

[1] Monitoring Trends in Mutual Fund Cost of Ownership and Expense Ratios A Canada – U.S. Perspective https://www.ific.ca/Content/Document.aspx?id=7476&LangType=1033

There is no discussion of the fundamental cost of manufacturing which should include a breakdown of fees by fund class, and the paper implies that equity funds are all profit; and there is no acknowledgement that it is the fund manufacturers that set the commission and trailer structure for the advisor community. As well, we disagree with the comment regarding trailing commission rates where you say rates “vary depending on the dealer firm distributing the mutual fund”. Commissions do not vary from dealer to dealer. A different series may reflect a different commission but commissions for the same series do not vary by dealer.

We ask ‘what the real problem is that you are trying to solve’ because it is not clear to us what and where the actual problem is. The paper is rife with suppositions but none of them concrete. Are there existing rules that are not adequately enforced? Are there existing rules that need to be stricter? Is the advisor, dealer or mutual fund manager unfairly gaining from the current rules? Are investors truly incapable of making appropriate decision within the current regime? Clients may have been asked ‘do you know what fees you pay?’ but did anyone ask, more importantly, ‘do you know where to find the information regarding the fees you pay?’ Do we, in fact, need new rules, or should we be asking different questions?

We would also the CSA to consider the unintended consequences of unbundling trailer fees, for example:

- does it become taxable?
- does it attract HST/GST?
- does it shift expenses to advisors?
- does it create an environment which would encourage churning[2]?
- does it mean less advice for Canadians? and
- does it create more product arbitrage than currently exists?

The trend regarding compensation of distributors – dealers and advisors – has been away from front end loads whether deferred sales charge or front and load to 0% front end load and trailing commissions (asset based compensation over time). However, most of the work performed by the distributors is still at the front end of the transaction – risk profiling, portfolio asset allocation strategies, new client application form, know your client information gathering, account opening including the provision of and discussion of the myriad of disclosure forms which include fees paid, suitability research, supervision over the process, etc.

The trailing commission is paid to the Dealer which in turn shares it with advisors using different payment models, and it is paid for dealer services, advisor services, as well as advisor advice – not as a service fee but as compensation for many services provided and advice provided, at the outset of the relationship with the client and for ongoing services – many of which serve only a regulatory requirement and are in addition to the services an advisor would normally provide to a client.

Although the commission has remained steady and is standardized by product type, the advisor’s share of this commission is decreasing, mostly due to the fact that Dealers have had

[2] Although rules exist prohibiting churning, regulators should be encouraged not to create an environment that might make it attractive and viable to some registrants.

to take on more responsibility for compliance, supervision, and system/IT costs to support – all costs that have been created and allocated by the same regulators who are now discussing the compensation model.

A review of the history i.e. 9% front end load charge in the 1980's (92% of funds invested) moving to deferred sales charge (5% front end commission plus trailing commission) to 0% front end load plus higher trailers has pushed the compensation out over a significant length of time regardless of the fact that this time and service is largely provided at the front end, but, as we have stated above, is ongoing.

Why now? It is not clear to us why regulators feel there is a need for more regulations at this time.

As we stated in our recent submission to the CSA regarding the Best Interests Paper, we are concerned about the over-regulation of the securities industry in Canada and in particular the over regulation of the mutual fund channel of distribution. From the introduction of the Mutual Fund Dealers Association, an SRO not founded by the industry for the industry but by enforcement regulators who pursued an enforcement regime of regulating mutual fund dealers and their advisors, to other impactful events such as the changes to business indicated by NI 31-103, CRM, and CRM 2 - the cost and performance requirement measures, layer upon layer of requirements have been placed on this channel with no assessment of duplication or concern for the detrimental effects this has had on manufacturers, distributors, advisors or the investing public.

We absolutely agree that the investing public should be treated fairly and has a right to know what fees are attached to their investment(s); however, if, as an unintended consequence, the investing public is harmed or goes without investment advice, then the regulatory regime is counterproductive. We would strongly encourage the CSA, before it considers introducing changes to the existing compensation structures in Canada, to analyze all applicable Rules, Policies, Acts, etc., that apply, remove redundant, dated and unnecessary regulations, and also assess the impact of pending policies will have once implemented.

We find that the broad brush of 'investor protection' lacks any specific objectives against which each new proposed regulation can be measured in terms of its effectiveness in creating the change or obtaining the intended objective. With so many rules being proposed and imposed towards the broad objective of investor protection, and with the lack of time given to measure the impact of one regulation before another is imposed we contend that the CSA will never be in a position to determine the impact or success of any new regulation. Further, how can rules be tweaked or unintended consequences be corrected when we simply will not be in a position to point to the change or isolate the regulation that created problems in the first place?

Why does the Paper fail, once again, to address the cost/benefit of the proposal and suggested changes?

The Ontario Securities Act, at paragraph 7 of subsection 143.2(2) (http://www.e-laws.gov.on.ca/html/statutes/french/elaws_statutes_90s05_f.htm#s143p2s2) requires "A

description of the anticipated costs and benefits of the proposed rule." While we understand that the CSA has issued a "Discussion Paper", should you move forward with this initiative, we would encourage you to conduct a fulsome analysis. Although the Act's language requires a "description", we would contend that the only way to adequately provide such a description of the anticipated costs and ultimate benefits would be to perform (as other jurisdictions do) a full analysis. We feel it is important to make mention of this requirement as such an analysis has not been attached to any recent policy proposals. Last year's 'cost and performance reporting proposals' for example contained only a slim statement that you were confident the benefits outweighed the costs. It is imperative to keep in mind that all costs are ultimately borne by the investor. Note that:

- Technology costs will increase as dealers and manufacturers transition their systems from built-in commissions and trailers to accommodate an up-front fee-for-service model.
- Compliance costs will increase exponentially as compliance staff at the dealer change their disclosure requirements, monitoring and supervisory regimes in order to consider how advisors are representing the services they provide against fees.
- This will be an opportunity that dealers and advisors will take advantage of in order to ensure their clients understand just how much the full spectrum of compliance costs them – the client. We believe this will lead to dissatisfaction with the industry and will diminish the investing public's confidence in capital markets as they realize that a significant portion of the costs are due to information they are required to receive in compliance with regulation but that they do not want, and some services their advisor is required to provide but does not want. Clients demand choice but they are not afforded it here.

Why does the research not address unintended consequences, which have also been brought up in previous submissions, as well as the results of similar initiatives in other jurisdictions?

It is essential that the impact of proposed policies across all channels of distribution be assessed to ensure that the imposition of the policy does not disadvantage one channel over another which could lead to, among other things, further regulatory arbitrage. We say 'further' because it exists today where, for example, advisors move assets from the mutual fund channel to insurance (segregated funds) in order to avoid the overly onerous compliance regime in the mutual fund dealer channel in favour of one with little or no regulation, higher remuneration, more benefits to the advisor, and less cost to run their business. Has the CSA surveyed segregated fund clients?

Segregated fund fees to clients were historically higher than mutual funds, however several segregated fund manufacturers have now synchronized their fees with mutual funds so as to avoid some related suitability challenges. In addition, there are substantial benefits that can be provided to segregated fund advisors by insurance companies which are prohibited in the mutual fund distribution channel. We believe this move to segregated funds to be a demonstrable existing and future consequence and not in the best interests of the investing public.

In most jurisdictions where the securities regulator has rule making authority, the regulator, in order to solve this issue, should remove the exemption for segregated funds thereby including segregated funds in the definition of 'securities' which would stymie the above consequence. This would be in the client's best interests.

Our primary concern is for the investors who will be disenfranchised should fees be unbundled and a fee-for-service model be imposed. Although some investors may say they do not know how their advisor is compensated and what they pay in fees, what they tend not to say is that they prefer not to 'see' the fee. When provided with a choice the average investor would prefer an imbedded fee rather than pay an upfront fee for service. As well, the embedded fee model actually provides an advantage to consumers, they are provided with an "all in" net return that they can easily understand and easily compare between funds. No adding, subtracting, what about this fee, that fee, etc. This is very attractive to investors.

Knowing what fees are paid is one thing, but has the CSA surveyed the investing public's appetite for a fee-based model i.e. upfront fee only model? Have you researched the psychology behind this? We would argue that it is the general experience of our members that while clients may want to know what fees they pay and/or where to find that information, they prefer an embedded fee model.

The small and arguably unsophisticated and perhaps financially illiterate investor will not be able to afford the fees associated with investing and advisors will not be able to service accounts under a certain amount. This watermark will vary from firm to firm; however, it will be there. This particular 'unintended consequence' should not be acceptable to anyone.

Thank you for the opportunity to comment on this paper. We understand that the OSC will be holding a round table discussion on this topic on June 7th and we would very much appreciate the opportunity to participate in that discussion. We look forward to hearing from you in this regard.

Regards,

Federation of Mutual Fund Dealers

Sandra L. Kegie
Executive Director