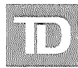 **Bank Financial Group**

April 17, 2013

British Columbia Securities Commission
Alberta Securities Commission
Saskatchewan Securities 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
Superintendent of Securities, Nunavut

The Secretary
Ontario Securities Commission
20 Queen Street West
19th Floor, Box 55
Toronto, Ontario M5H 3S8
Fax: 416-593-2318
Email: comments@osc.gov.on.ca

Me Anne-Marie Beaudoin
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Autorité des marchés financiers
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C.P. 246, tour de la Bourse
Montréal, Québec H4Z 1G3
Fax: 514-864-6381
Email: consultation-en-cours@lautorite.qc.ca

Dear Sirs and Mesdames:

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

TD Bank Group appreciates the opportunity to comment on the Canadian Securities Administrators ("CSA") Discussion Paper and Request for Comment 81-407 – Mutual Fund Fees, published on December 13, 2012 (the "Fees Paper").

We welcome the opportunity to work with the CSA to consider how the Canadian mutual fund fee structure might be improved in light of the concerns identified in the Fees Paper. We believe

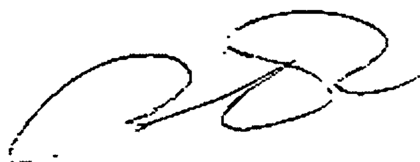
the issue of mutual fund fees is an important matter with complex and wide ranging elements that deserves further discussion and consultation. We support the principles of investor protection and fairness, and we also believe that Canadian investors are best served by a fee structure that furthers competition and investor choice alongside these principles.

TD is a strong proponent of consumer-focused regulation and developments that enhance disclosure and transparency, such as the CSA Point of Sale project ("POS") and the Client Relationship Model project ("CRM"). We believe these initiatives represent significant improvements to the transparency of mutual fund fees for investors, and will go a long way to improving investors' understanding of their investments and their relationships with their advisors.

We believe the CRM and POS initiatives – currently in their very early stages of implementation – will appropriately address many of the concerns raised in the Fees Paper. We urge the CSA to first assess the results from implementation of CRM and POS before proceeding with additional regulatory reform. We also note that the new UK regime referenced in the Fees Paper came into force early this year. We encourage the CSA to assess the outcomes of these new UK regulations, together with the pending developments in Australia, as it proceeds with its analysis of Canada's mutual fund fee structure. As we elaborate in the Appendix, proceeding with additional regulatory reform at this time may result in a number of unintended consequences, particularly for investors with small portfolios.

TD recognizes the importance of collaboration between industry members and regulators to advance the interests of Canadian investors through a mutual fund fee structure that is fair and transparent. We welcome the opportunity for a follow up discussion to explore these issues

Yours truly,



Mike Pedersen
Group Head, Wealth Management, Insurance and Corporate Shared Services
TD Bank Group

APPENDIX

In this Appendix, we discuss the structure of Canadian mutual fund fees in light of the concerns identified in the Fees Paper. We make two interrelated points: in most cases, clear disclosure mitigates potential conflicts of interest; and a mutual fund fee structure based on the principles of investor protection and fairness as well as competition and investor choice, produces fair and beneficial outcomes for investors.

It is important to state upfront that our views are based on the following premises:

- Competition generally produces the best outcome for consumers in all markets, including the mutual fund industry. Regulation should only be implemented if the ultimate result is superior to the one governed by market forces.

- In cases where industry regulation is required to serve a public interest, especially as it pertains to market failures, the response should focus on enhancing transparency through clear disclosure. POS and CRM are excellent examples of this approach.

- Protecting consumer interests is not about creating more rules, but about creating more effective ones. As such we should monitor current regulatory initiatives to determine their impact on investors, as well as industry players, before adding more rules and regulations (and potentially more complexity) into the market.

I. CURRENT REGULATORY INITIATIVES

The POS and CRM initiatives mandate increased disclosure by both mutual fund manufacturers and advisors[1], in order to provide investors with the information required to make better informed investment decisions.

Our organization believes these current policy projects will appreciably improve investors' understanding of investment costs by providing investors with the clear and useful information they require to make informed investment decisions and understand their relationships with their advisors.

The POS and CRM initiatives are to be implemented over time, in phases, and both projects are currently in their early stages of implementation. We feel that additional reforms at this time may have the unintended consequence of overburdening and confusing investors, potentially undermining the effectiveness of these recent initiatives. As such, we urge the CSA to fully assess the benefits resulting from implementation of the POS and CRM projects and to conduct a full cost-benefit analysis of the effectiveness of these projects before determining alternative regulatory reforms in this area.

[1] We adopt the definitions of the terms, "advisor" and "mutual fund manufacturer" as set forth in the Fees Paper for purposes of our comment letter. We also use "mutual fund manufacturer", "fund manufacturer", and "manufacturer" interchangeably.

We also note that the new UK regime referenced in the Fees Paper came into force early this year, which provides a timely opportunity to assess the implications of new reforms while the Canadian reforms continue to be implemented. We encourage the CSA to assess the outcomes of these new UK regulations, together with the pending developments in Australia, as it proceeds with its analysis of these issues.

II. CONFLICTS OF INTEREST

In the Fees Paper, the CSA highlights the potential for conflicts of interest as one of the most significant issues arising from the mutual fund fee structure in Canada. The implication is that these conflicts, in particular, may call for additional regulatory controls beyond those currently in place or being implemented.

In certain instances, a conflict of interest is so materially egregious or harmful, that regulatory measures above and beyond disclosure are required. However, in most instances, clear disclosure appropriately mitigates conflicts of interest. In our view, the conflicts identified in the Fees Paper can be appropriately mitigated through measures that focus on clear disclosure, similar to the initiatives the CSA has recently mandated and is currently in the process of implementing, through the POS and CRM projects.

The Canadian regulatory regime governing mutual fund conflicts of interest is robust and consistent with the paradigm we set forth above. For example, mutual fund manufacturers are subject to various provisions of Canadian securities legislation, National Instrument 81-107 – *Independent Review Committee for Investment Funds* and National Instrument 81-105 – *Mutual Fund Sales Practices,* which regulate conflicts. Particularly egregious conflicts, such as insider trading and certain sales practices are prohibited, including certain practices relating to trailing commissions.[2] National Instrument 31-103 – *Registration Requirements, Exemptions and Ongoing Registrant Obligations* takes the same approach for advisors.

III. COMPETITION AND REGULATION

Competition generally produces the best outcomes for consumers in all markets. This includes the Canadian mutual fund market, where competition has produced enhanced investor choice, access to advice and innovation, and a trend toward lower fee mutual fund choices, each of which are fair and beneficial to investors.

However, we also recognize that there are important public interest considerations (i.e. market failures) that may be effectively addressed through regulation. In order to prevent an outcome where regulation unduly limits competition, regulation should only be implemented if the ultimate result is superior to one governed by market forces. In a 2007 study examining the way regulation affects competition in self-regulated professions, the Competition Bureau summarizes this regulation versus competition balance as follows:

[2] All mutual fund sales practices involving manufacturer conflicts of interest are also subject to oversight by the relevant fund's independent review committee.

> ...[C]ompetition in a free market system protects both consumers and service providers better than any other alternative. The only time it is desirable to supplant competition by regulation is when markets are not functioning as well as they should be and when the benefits of regulation demonstrably outweigh the benefits of competition alone. But even then, regulation will be most effective when it imposes minimal restraints on competition.[3]

The Fees Paper indicates that the fundamental market failure mutual fund fee models produce is conflicts of interest, which may not be effectively mitigated due to information asymmetry. If information asymmetry is the source of the market failures which are at issue, we consider the appropriate regulatory response to be one focused on enhancing transparency through clear disclosure. At TD, we are committed to transparency through clear disclosure. We likewise strive to improve investors' understanding of disclosure through improved financial literacy.

A mutual fund market that encourages both competition and investor protection provides investors with an array of fee structures and investors may select the option that works best for their individual circumstances and needs, including, the amount and type of service they require, regardless of the size of their portfolio.

We are concerned that many of the regulatory options the CSA outlines may make it more difficult for investors with smaller investment portfolios to readily access advice. We note that Canada's mutual fund structure, through competition, has encouraged innovation in response to investor demand. In the Fees Paper, the CSA outlines the evolution of sales charges in Canada since 1980. Examining this data, we note that the variety of fee structures we see today, embedded commissions among them, illustrates how the marketplace produces innovation in response to investor demand and market acceptance.

IV. REGULATORY OPTIONS

To this point, we have argued that regulation should only be implemented if the ultimate result is superior to the one governed by market forces. And in the cases where it is required, the response should focus on enhancing transparency through clear disclosure. Taking this as our key premise, we examine each of the regulatory options the CSA outlines in the Fees Paper.

1. Advisors are required to specify services provided in exchange for trailing commissions

We agree with the CSA's general premise that trailing commissions should be clearly aligned with services provided to investors. In this regard, it is important to point out that advisor firms do not use trailing commissions exclusively for the compensation of advisors. In fact, an advisor firm may retain more than half of the trailing commission to pay for an array of services apart from the provision of investment advice. Some examples of the other services trailing commissions support include product information and research, tax documentation, continuous disclosure, portfolio monitoring, trade execution, account maintenance, and custody services. All of these services, of which the provision of investment advice is one component, benefit the fund and its investors.

[3] Competition Bureau, *Self-regulated professions: Balancing competition and regulation,* (2007) at p. v.

Accordingly, we suggest that any regulatory initiatives seeking to further align the payment of trailing commissions with services provided (to enhance investor understanding of the array of services trailing commissions support) focus on providing clear disclosure of the function and uses of trailing commissions.

In our view, measures that focus on mandating a minimum level of service, and which require advisors and their firms to record and monitor the nature, extent and frequency of the services provided, present practical limitations and are likely to negatively impact investors without providing corresponding benefits. For example, advisors currently service investors at an account or total relationship level rather than at a product level, and mutual funds may represent only a portion of a much larger service offering. To prescribe a minimum level of service and to require advisors to record and monitor such service for only the mutual fund component of an investor's investment portfolio is both impractical and administratively burdensome.

2. A standard class for "Do It Yourself" ("DIY") investors with no or reduced trailing commissions

In light of the CSA's observations regarding fee levels in the direct investing channel, we wish to provide some clarity on the services provided in this channel. We are concerned that, generally speaking, some conflate the absence of an advisor with a lack of service in the direct investing channel. At TD, the direct investing channel provides a wide array of tools, information and resources, similar to the breadth of resources advisors might access to advise their clients, to help individual investors make informed investment decisions, including:

- Third party mutual fund analyst research
- Online screeners which help investors find suitable mutual fund investments tailored to their personal goals and investment preferences
- Performance and risk analysis for individual funds and related benchmarks
- Detailed reporting on individual fund holdings and fundamental data
- Webcasts featuring experts in portfolio strategy, economics, and market analysis
- Monitoring tools which help clients monitor and track actual/prospective mutual fund investments (price events, analyst rating changes, and news developments)
- Real-time market data, historical sector/ fund performance, and fund commentary from independent industry experts
- Dedicated call centre mutual fund specialists assisting clients with specific fund-related questions and to help navigate through the thousands of choices available to clients
- Delivery of over 4,000 free educational seminars annually as part of our commitment to increase financial literacy and help investors gain confidence while investing
- A large network of 'Investor Centres' in Canada, where clients, or the general public, can walk-in to participate in a group seminar or get personal assistance.

Essentially, through the direct investing channel, investors have direct access to many of the services, resources, and information ordinarily provided through an advisor – an array of services beyond order-taking. Accordingly, measures seeking to limit trailing commission levels in the direct investing channel based on the execution-only rationale would not be reflective of the

levels of service actually provided. A potential response could be a reduction in the scale of services currently received by investors, which means less information and support for them. Another response might be an increase in minimum account sizes required for mutual fund investments through the direct investing channel, which disadvantages investors with smaller investment portfolios.

3. Trailing commission component of management fees to be unbundled and charged/ disclosed as a separate asset-based fee

We question the benefit of unbundling the trailing commission component of management fees as a separate asset-based fund fee, in light of existing and impending disclosure requirements that enhance transparency of fund distribution costs. We note that Item 9 of Part A of Form 81-101F1 – *Contents of Simplified Prospectus*, already mandates prospectus disclosure of the rates or ranges of trailers that may be charged to investors out of the fund's assets.

Although we do not generally oppose unbundling the trailing commission component of management fees, we require additional information as to how the CSA might proceed with such reform. The CSA discusses unbundling trailing commissions as a separate expense charged to the fund, and suggests either requiring security holder consent or the review and consent of the fund's independent review committee ("IRC") in the event of an increase in the commission. We believe IRC consent, in appropriate circumstances, is a preferred approach to security holder consent. Not only does IRC consent serve as a proxy for security holder consent, it is also more efficient and less costly than requiring security holder consent. Requiring security holder consent, on the other hand, is administratively burdensome and unduly favours investor control over manufacturer control over fund costs. In the example set forth in the Fees Paper, a mutual fund manufacturer determines to increase its trailing commissions whilst simultaneously compressing margins, resulting in no change to the overall management fee. To require that a mutual fund manufacturer hold a security holder vote in these circumstances is unduly costly and burdensome given that there is no net adverse impact upon investors' financial interest. Further, we do not believe that IRC consent would be appropriate in these circumstances given the lack of any harm to investors.

4. A separate series or class of funds for each purchase option

We believe creating a separate series or class for each available purchase option would introduce a tremendous administrative burden for mutual fund manufacturers and increase complexity for distributors and investors, without necessarily providing significant corresponding benefits.

The investor level cross-subsidization with which the CSA is concerned assumes a bottom-up method of determining management fees. By charging the same management fee on DSC and low-load units as is charged on their front-end load or no-load counterparts, the practice that mutual fund manufacturers are actually engaging in is margin compression, not cross-subsidization between investors who use different purchase options within a fund class or series. That is, the manufacturer is accepting a lower margin on DSC and low-load units, as opposed to having front-end load and no-load investors subsidize the DSC investors' financing costs. Accordingly, any separation would likely result in unchanged MERs on the front-end load and

no-load series or classes, and an increase in the MERs for the DSC and low-load series or classes. The result would be increased costs for investors.

At TD, the CSA's proposal would mean a substantial proliferation of fund series or classes. For example, creating a new series or class for all purchase options would require the creation of more than 300 fund series or classes, and would present significant additional administrative and regulatory costs, such as those associated with preparing more than 600 new Fund Facts in English and French and providing additional disclosures in the financial statements and management reports of fund performance for more than 300 new series and classes. At worst, this would lead to higher costs to investors through increased management expense ratios ("MERs"). At best, manufacturers will compress margins so as to produce no change to MERs in spite of increased administrative costs, with no commensurate benefit to investors.

5. Cap Commissions

We are concerned about regulatory action that would limit the operation of the marketplace in determining appropriate pricing of products and services in the mutual fund industry.

We caution that capping commissions may result in unintended consequences, such as reduced investor choice. As noted above in our response to potential regulatory option #2, a general cap on trailing commissions may cause advisors to re-examine their lines of business and the clients they service in light of changed economics, thus resulting in a reduction in the scale of products provided to investors. Similarly a cap that limits aggregate sales charges through automatic conversion to a commission-free series when the limit is reached would be administratively unwieldy and costly, particularly when multiple purchases, redemptions and switches are taken into account. Both caps would likely impact investors with smaller mutual fund portfolios most significantly, potentially making access to advice more difficult as advisors would be incented to service clients meeting larger portfolio thresholds.

In addition to reduced investor choice, we believe that a cap on aggregate sales charges may present worrisome challenges for the advisor-client relationship within the mutual fund industry generally, as it may be necessary for advisors to reduce the level of service provided to a client commensurate with revenues.

6. Implement additional standards or duties for advisors

We provided our views relating to the introduction of a statutory fiduciary standard in our comment letter of February 22, 2013 on CSA Consultation Paper 33-403: *The Standard of Conduct for Advisors and Dealers: Exploring the Appropriateness of Introducing a Statutory Best Interest Duty When Advice is Provided to Retail Clients* (the "Comment Letter"). We fully support the comments set out in the Comment Letter, and we reiterate in particular, our view that the CSA should fully assess the benefits resulting from implementation of the CRM before proceeding further with the fiduciary duty initiative. We do not believe the introduction of a statutory fiduciary duty is the best vehicle to materially advance investor protection as it may negatively impact investors' ability to achieve their financial objectives, but agree that there may

be alternative opportunities to improve the current regime. We hope that our analysis of the topic in the Comment Letter will provide the CSA with guidance regarding the issues involved.

7. Discontinue the practice of advisor compensation being set by mutual fund manufacturers

As mentioned throughout our comment letter, we believe that regulation is most effective when it imposes minimal restrictions on competition. We believe a more appropriate response is to provide investors with clear disclosure and full transparency of advisor compensation thereby mitigating conflicts while promoting the benefits of competition.

The current level of embedded fees may provide substantial benefits to Canadian investors, particularly investors with smaller portfolios. Investors with lower levels of wealth generally benefit from embedded commissions over fee for service models, as embedded commission structures provide investors with access to advice at a lower cost due to economies of scale. Hence, absent commission-based models, investors seeking advice-based services for small investments could be required to pay higher annual fees, which may increase the costs of advice. This is reflected in the U.S. experience and U.K. indications from RDR (as defined below). A Strategic Insight study examining the evolution of financial advisor compensation in the U.S. finds:

> With unbundled fees for advice typically rising as investor account sizes decrease (due to the lack of economies of scale in servicing such smaller accounts), many middle-income mutual fund investors are faced with the reality of significantly higher ongoing costs for financial advice – or even the complete lack of an advice option – within the continued transition to a fee-for-advice culture in the U.S.[4]

Another report indicates that the fee for service model "would end up doubling the annual costs as compared to charging [trailing] fees through the mutual fund. [...] Over a lifetime of investment, such higher costs could add up to a penalty, in some instances of 20-30% of the account's current value."[5] Investors with lower levels of wealth would be disproportionately affected by these high costs, and may as a result, have only limited access to advice or be denied access altogether.

The reason smaller account sizes are generally uneconomical for fee-based advisors, is largely due to the significant operational costs required to administer a fee-for-service-model.[6] In order

[4] Strategic Insight, *A Perspective on the Evolution in Structure, Investor Demand, Distribution, Pricing, and Shareholders' Total Costs in the U.S. Mutual Funds Industry* (November 2012) at p. 6.

[5] Strategic Insight, *Rule 12b-1: Looking Back, Looking Forward, in the Context of a $12 Trillion Mutual Fund Industry* (June 2007) at p. 3.

[6] For example, currently, most advisors lack the operational infrastructure to facilitate fee payments through a fee-for-service model. Due to an aversion toward an hourly or flat commission, we assume that most investors will elect to pay for their advisory fees based on a percentage of assets invested. In order to pay fees in this fashion, investors are provided several inconvenient payment options, among them: i) infusing cash into their accounts (an impractical/potentially tax-adverse option for RSPs, RIFs, and TFSAs, which do not allow this practice beyond specific limits), ii) redeeming fund units to raise cash, and iii) using cash from an alternative source or account. The costs required to support this infrastructure would be significant.

to offset these costs, fee-based accounts often require minimum assets or minimum fees and are therefore designed for investors with larger portfolios. In contrast, the current system which makes a variety of mutual fund fee models available to investors, when coupled with clear disclosure, provides increased investor choice and democratizes access to advice.

Evaluation of the experience of other jurisdictions that have recently moved to ban embedded commissions may provide additional informative guidance on the potential impacts of a fee-only model. We note, however, that sufficient time for the full effects of such changes is required in order to undertake a meaningful analysis. This provides an excellent opportunity to assess the implications of these new regulations before undertaking a major Canadian regulatory change.

Although the UK has only recently implemented their Retail Distribution Review ("RDR") and its full effects are not yet known, early data surveying independent financial advisers ("IFA") points to an expected increase in the costs of advice, with "90 percent of respondents [indicating] the expected IFA remuneration to be as it currently stands or higher following RDR."[7]

As noted above, these costs are likely to bear disproportionately on investors with small investment portfolios, for whom the fee for service model is not suited. The likely result will be orphaned investors, investors who either choose to cease using financial advisors or lack access to them by virtue of their small accounts. In fact, early evidence from the RDR's implementation is already pointing to such an effect: some estimates indicate that up to 5.5 million investors (or 11% of current investors) will be orphaned,[8] with less wealthy investors likely to be overrepresented amongst those orphaned.[9]

Moreover, the fee for service model does not necessarily enhance fee transparency relative to an embedded system of compensation. Currently, investors may easily compare shareholder costs through a fund's MER, which is consistently reported across funds. In contrast, in a fee-only system where fees are unbundled, the total cost to shareholders may be more difficult to determine. Similarly, the wide array of pricing models that would result from a fee-only system would make it difficult for investors to compare the costs of investing across firms, particularly if advisors seek to replace the loss of revenue currently received through trailing commission with an alternative service charge(s). In both instances, transparency is reduced. Indeed, evidence from the U.S. experience actually points to reduced transparency of cost information in the fee for service structure, for these very reasons.[10]

It is instructive to note that many of these limitations were identified and considered by the OSC in its *Fair Dealing Model Concept Paper* of January 2004.[11] The major shortcomings identified at that time included: costs to the industry, costs to advisors, reduced access to advice for clients with smaller accounts, unwillingness of consumers to pay for investment and financial planning

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[7] BDO United Kingdom, *RDR Could Result in Higher Consumer Costs: Research into Adviser Charging* (February 2012).

[8] Deloitte, *Bridging the Advice Gap: Delivering investment products in a post-RDR world* (November 2012) at p. 1.

[9] *Ibid* at p. 5. Those with less than £50,000 are half as likely to continue using financial advisers compared to those with more than £50,000.

[10] *Supra,* note 5.

[11] Ontario Securities Commission, *The Fair Dealing Model* (January 2004).

advice, loss of payment convenience.[12] These remain significant considerations today, as evidenced by the data emerging from other jurisdictions in which the fee for service model is either prevalent or mandated. We urge the CSA to continue to monitor the effects in these other jurisdictions, as well as, the effects of the CRM and POS initiatives in Canada, to determine whether a ban on embedded commissions is a laudable and necessary regulatory response.

CONCLUSION

Transparency and disclosure are the foundations of investor protection and fairness. Investors are best served when they understand their options, and have access to a broad array of services, tools and products to advance their unique goals and objectives.

Canada's competitive landscape has served investors well – bringing about greater choice, access to advice and innovation. Regulators also play a key role. As we have stated, POS and CRM represent significant improvements to the transparency of mutual fund fees for investors. We urge the CSA to proceed with caution with further regulatory action affecting the mutual fund fee structure. Specifically, it would be prudent for the CSA to assess the effects of fully implementing the recent POS and CRM projects, as well as evidence emerging from other jurisdictions, to ensure any contemplated changes do not have unintended consequences for investors. We are most concerned that some of the regulatory options would disproportionately affect investors with small portfolios.

Additionally, we ask the CSA to consider how investors may be benefited by a mutual fund fee system, which balances investor protection and fairness alongside competition and choice.

TD recognizes that our success depends on the success of our clients. Simply put, we cannot advance our own interests without advancing their own. As such we recognize the importance of collaboration between TD and industry regulators, working together to advance the interests of Canadian investors. We welcome the opportunity to a follow up discussion with you to explore the issues and review potential responses.

[12] *Ibid.*