June 2017

CSA Consultation 81-408 on the

Option of Discontinuing Embedded Commissions

the co-operators®

A Better Place For You®

Introduction

On behalf of The Co-operators Group Ltd. (“The Co-operators”), we are pleased to provide comments on the CSA’s Consultation Paper 81-408: *Consultation on the Option of Discontinuing Embedded Commissions,* which seeks input on the option of discontinuing embedded commissions and the potential impacts of such a change on Canadian investors and market participants.

About The Co-operators

The Co-operators Group Limited (“The Co-operators”) is owned and governed by 44 co-operatives and credit union centrals across the country. As one of Canada’s most prominent financial services organizations we are proud to provide insurance and financial services to more than two million Canadians. We are even prouder that we provide financial security to Canadians in their communities while staying true to our co-operative values.

We have over $44.9 billion in assets under administration, employ 4,992 individuals and count 500 exclusive financial advisors in our network, while serving more than 350 credit unions with more than 5.5 million members. We provide coverage to 38,000 farms and 295,000 businesses and insure approximately 805,000 homes, 1.3 million vehicles and protect 629,000 lives.

As a co-operative, concern for the community is one of our founding principles. That is why, in 2016 alone, The Co-operators contributed over $7.5 million, which represents 4.1% of our pre-tax profit, to Canadian charities and community organizations across the country.

4,992 EMPLOYEES - 500+ ADVISORS

38,000 FARMS - 295,000 BUSINESS

805,000 HOMES - 1.3M VEHICLES - 629,000 LIVES

Financial security for Canadians and their communities is our core mission. Our customer base is primarily comprised of “mass market” investors. The insurance and financial products and services provided by The Co-operators are delivered primarily through our independently contracted, but exclusive, face-to-face advisor channel. All of our advisors sell (registered and non-registered) segregated funds, as well as TSFAs and RESPs. Through Credential Financial Inc., a member of our group of companies, some advisors also distribute mutual funds. We expect to expand this offering to all of our advisors in the future.

The CSA's paper identifies a number of important areas in which there are opportunities to significantly enhance outcomes for consumers which include conflicts of interest, limited investor awareness, and misalignment of fees with services received. We agree that consumers are best served when transactions are transparent, conflicts of interest are disclosed or eliminated, when consumers have the tools to understand the information provided to them, and when fees align with services provided.

It is our view that these shared goals are best addressed through increased choice and transparency. While we do not oppose the removal of embedded commissions, we do share the industry's concerns around unintended impacts on accessibility and affordability of financial advice for Canadians. We believe an environment with embedded commissions with clear disclosure would provide Canadians with the best option in terms of affordability and choice.

Investor Protection and Market Efficiency Issues

The CSA outlines three key investor protection and market efficiency issues raised by mutual fund fees. We agree that embedded commissions could present a conflict of interest that misalign the interests of investment fund managers, dealers and representatives with those of the investors. However, we believe this a disclosure, not a market issue. Emphasis should lie on helping advisors focus on finding good performing portfolios for low Management Expense Ratios. At The Co-operators, we achieve this goal by providing a well-rounded suite of segregated fund products and transparent fee disclosure. Some of our agencies also engage in third party mutual fund sales through Credential Asset Management (dealer) with the same commitment to fee transparency. We acknowledge, however, that this may differ in the mutual fund industry.

Regulatory Impact

Our foremost concern is that the discontinuance of embedded commissions could result in an "advice gap" in terms of face-to-face counsel. Mass and mid-market investors may be left with only self-service style information with limited capacity to take advantage of this guidance.

Financial literacy is a considerable challenge in Canada and this move would likely further compound the problem of all Canadians having access to financial advice. Based on our business model, we strongly believe that face-to-face advice leads to the uncovering of other needs, goals, objectives, risks and concerns that clients are unaware of and ultimately, to a discussion of how to close to those gaps.

The fund industry has pointed to the consequences of relevant regulatory reforms in other jurisdictions (such as the U.K. and Australia) as potential evidence of the likely impact of the discontinuation of embedded commissions in Canada. We understand it is the CSA's position that while the impacts of relevant reforms in other jurisdictions are informative and insightful, potential impacts from similar reforms in Canada might not be the same.

We do, however, remain concerned that the mass and middle-market will be underserved by a discontinuation of embedded commissions. The loss of embedded commissions will only serve to increase entry level costs for advice to the mass and middle markets. In the U.K., this change has also resulted in a reduction of the number of advisors in the business – with an estimated 11,000 advisors leaving the industry since 2008 according to the U.K.'s Institute of Financial Accounts. Those that remained focused on high-net clients.[1]

In addition, more restrictive educational standards further drove out advisors from the market. We do recognize and acknowledge that continuing education is absolutely critical to those working in the wealth and investment marketplace and it should be a mandatory requirement in all provincial jurisdictions both within the securities industry and the insurance industry.

The prospect of regulatory arbitrage across distribution channels, as well as products, to create an uneven playing field is another consideration. Unless all manufacturers and distributors move in the same direction for a level playing field, we worry a commission ban may unintentionally favour large banks. Banks have salaried staff and performance-based bonuses based on sales volumes, not per transaction, which can be a very significant portion of their income. As such, their mutual fund disclosure statements would not show a trailing commission as bonuses.

With respect to segregated funds in particular, the paper notes the similarity between segregated funds and other investment fund products – including the use of embedded commissions – and calls for a harmonized approach to regulating such products.

We agree that requirements for segregated and mutual funds should be such that consumers can easily compare products. As members of the Canadian Life and Health Insurance Association, we share their position with respect to the implementation timelines.

We are pleased that the CSA will coordinate with the Canadian Council of Insurance Regulators (CCIR) to address the potential for regulatory arbitrage between investment funds and segregated funds.

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[11] Leong, Melissa. "International expert warns against banning embedded advisor commissions." *Financial Post* 5 November 2017. Web 2 June 2017

Mitigation Measures

We have expressed our concerns regarding the affordability of advice to those in the mass or middle market if they are forced to pay “upfront” fees. In fact, a recent survey suggests that almost a quarter of respondents would be less likely to use an advisor if charged directly for advice.[2] Canadians deserve choices. Clients should have the option of either paying the fee upfront or having the fee withdrawn from their account on a “no-load” flat fee basis – transparency is the key.

Other Regulatory Initiatives

In terms of disclosure, while the Client Relationship Model Phase 2 (CRM2) initiative is a step in the right direction, more needs to be done. We are aware that other industry stakeholders have urged to allow full implementation to assess its results but we believe disclosure around fees paid to manufacturers could be stronger. Statements must show both the percentage and dollar amount for the management, dealer/MGA and advisor fees - and in the case of segregated funds, the insurance fee as well.

Conclusion

Thank you for the opportunity to provide our comments on the CSA’s Consultation Paper 81-408: *Consultation on the Option of Discontinuing Embedded Commissions.* We hope the consultation will result in a strengthened market, one where clients can take advantage of offerings through a payment schedule that they understand, have choice over, and can afford. We also believe informed choice will encourage better servicing of clients on an ongoing basis.

Please do not hesitate to contact our Director of Government Relations, Maya Milardovic, at 519-824-4400 or maya_milardovic@cooperators.ca should you have any questions or wish to arrange a follow-up meeting.

With best regards,

Rick McCombie
EVP Chief Client Officer
The Co-operators Group Ltd.

Kevin Daniel
Chief Operating Officer
Co-operators Life Insurance Company

[2] Hemeon, Jade. "Investors are fine with trailer fees, survey says." *Investor News* 31 May 2017 *Investment Executive.* Web 2 June 2017.