June 8, 2017

To:

British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumer Services Commission, New Brunswick
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Yukon
Superintendent of Securities, Nunavut

Dear Sirs/Madam:

I am writing in response to the request for comments on the Canadian Securities Administrators Consultation paper 81-408 released on or about the 10th of January, 2017.

Who am I?

I am an enigma in the industry. I have been licensed to sell mutual funds for over 35 years in Alberta and have been operating my own mutual fund dealer since 1996. My understanding is that there are few mutual fund dealers operating in Canada who's head office jurisdiction is in Alberta. Primarily though, I am an investor using my own capital as my primary source of income. For example, I was the largest public shareholder in Companies such as Executive Inn Group which went private in 2007, H. Paulin and Company in 2013 and Morgan Financial in 1996. I currently own in excess of 10% of the voting shares of a public company GVIC Communications Corp. I have also been active legally by dissenting shares in Morgan Financial, Municipal Bankers Corp. and Dundee Realty when they went private respectively. RBC was able to enter the insurance industry by taking over Westbury Canadian from under Morgan Financial without any fair value calculation to protect the shareholders and Dundee was taken private below the independent "fair value" calculated amount. So I do what I can to protect my interests when I feel I have been wronged.

Mutual Funds are a Great Product

Looking back over my career I find mutual funds to be a great product to use in advancing an individual's savings over time. If you can compound your money at 5% per year over a long period of time on your savings you will do well. Do it yourself investing in stock and bond securities when done right can advance your savings at a much faster pace but the individual has to be diligent and do their own research. Or simply investing in a good performing closed ended fund can do well for investors with lower fees; or obviously just investing with Berkshire Hathaway or Fairfax Financial has made many investors quite well off. I have found setting up regular savings of even small amounts can lead to much larger amounts over time and this has been relatively easy to do with mutual funds for amounts as low as $25 or $50 per month. Similar to what Investors Group has been preaching since the beginning of time.

A Little History

I cannot compete against the position taken by the Canadian Securities Administrators (CSA) since I do not have the time nor the energy to answer their questions in the format put forth in their paper 81-408. But what I can do is share my experience over time in the industry as a client, salesman, investor and MFDA licensed dealer.

I attended my first investment presentation in 1981 when the Dow was less than 1,000 points at the time. I was enthralled. I personally purchased a term certificate paying 20% along with a portion of my investments going into an equity mutual fund after paying the 9% upfront fee in September of 1981. I ended up leaving the Chartered Accounting firm I was articling with in 1982 and embarking on a "career" marketing primarily term certificates, term deposits and mutual funds. We had a branch right next to the Royal Bank and as rates declined mutual funds became more and more popular with investors willing to pay up to 9% on the front end for equity funds and 5% on bond funds even though RBC was offering mutual funds without these front end loads. No matter what is believed, investing is an emotional decision not a logical one.

In 1987 with the stock market collapse I was witness to my office manager being "strangled" in front of everyone by a small female client whom he had continued to leverage as the markets were moving higher. The manager was fine but shaken. I have taken a "no strangulation" policy within my firm where the use of leverage is not only frowned upon but forbidden entirely. I was also caught up in the dealer firm I was with filing for bankruptcy protection in 1987 and from that day on have never sold a term certificate nor term deposit. The mutual fund investors were unscathed as they "owned" the funds. I was able to join an independent dealer and carried on with the remaining clients I had.

DSC Funds

Mackenzie brought out the Industrial Horizon fund in 1987 which was the first fund available in Canada to be sold on a deferred sales charge (DSC) basis. It was a sister fund to the highly popular Industrial Growth fund. I think assets quickly hit $1 billion leaving the Industrial Growth Fund which had a 20 year history in its wake. I found the independent firm I was with conflicting as they heavily promoted the use of the DSC sales structure. For example at a conference in 1990 I would quickly get surrounded by salespeople with calculators espousing the financial virtues of transferring my client's assets to DSC funds from the front end version I was using. I wasn't buying it. DSC funds are never in a client's best interest. No client in their right mind would choose a DSC fund over a no front end load equivalent. I recently asked one of my "senior" representatives why they did not use DSC funds anymore. His answer was brisk and sharp – he just knew it was not right. If the regulator continues to let mutual funds sold on a DSC basis exist then they are doing a disservice to Canadians. Mutual funds are primarily sold not bought so this puts the onus in the regulators hands to make the right decision.

Lowering Fees

With front end fees at zero advisors still need to be compensated for selling mutual funds and also holding on to client's assets through turbulent times. When trailer fees first came out I was relieved that I could focus more on my existing clients than having to spend time gathering new clients. In 1993 my firm even placed advertisements in the Financial Post advertising the no front end load sales model which was hugely successful. One of my representatives was even "interviewed" by Barry Critchley. Of course we try to find the best mutual funds for our clients as we always risk clients redeeming primarily due to poor performance. As a dealer and investor I am also aware how higher fees directly affect the returns my clients achieve. Do I believe fees are too high? You bet. Thankfully most manufacturers are lowering their management expenses on larger accounts. I also believe representatives should lower their fees but my understanding is that it is dealers themselves that are balking at this. They need to make a spread on their sales. My firm is not like this as I charge representatives a flat fee irrespective of their assets under management. I believe a reasonable charge would be a service fee of .50 % on equity funds and .25% on balanced and bond type funds. The higher fee is necessary on equity funds because it is much more difficult to hold a client in these funds when turbulence hits.

CSA's position:

Mark Armstrong, supra note 184. At page 6, Armstrong states: "Although the direct effect of a price cap is to reduce prices, the indirect effect of reduced search lessens each firm's demand elasticity so much that prices on average go up. This formalizes a claim sometimes made informally, which is that imposing price controls on an oligopoly market could raise equilibrium prices. One intuition for such a claim is that a price cap acts as a focal point for tacit collusion."

This is ridiculous. One of the easiest ways to ascertain when someone does not know what they are talking about is when they try to talk "over your head". Anyone speaking like this in front of me I would immediately dismiss as an insult to my intelligence.

Robo Advisors

To actually believe active management does not outperform passive is only a current "sales pitch". It soon will pass. While my chances at doing better than the average person at tennis who only wins 50% of his matches depends on the day and my opponent, there will be obvious winners and losers amongst money managers as well. Of course the higher the fees the more difficult it would be to perform well. Back when you could list all mutual funds available in Canada on a single piece of paper, four mutual funds stood out: the Cundill Fund, the Industrial Growth Fund, the AGF Special Fund and the Templeton Growth Fund. Of course these funds were relatively small but each fund averaged roughly 10% per year between 1974 and 1984 when the markets were basically flat.

CSA's view:

…embedded commissions can incent dealers and their representatives to sell funds that compensate them the best or focus on only those funds that include an embedded commission rather than recommend a more suitable investment product; specifically, they can encourage a push for higher commission generating funds, such as higher-risk actively managed funds, which can impair investor outcomes.

If the regulator sees a world where passive investing will outperform active then I will definitely become a dinosaur in the industry. As stated previously, mutual funds are primarily sold not bought. Clients will and do prefer to pay a sales fee imbedded or otherwise to get advice. If I was to sell only passive low commission funds for free I would quickly look for other employment and the industry would also have difficulty retaining any quality salespeople.

My Fear of Unembedding Trailer Fees

I absolutely hate bank charges. The same $19 a month shows up on my statement every month unless I maintain a certain balance in my account. My fear is that if clients are charged monthly service fees outside of the fund they will be constantly reminded of the fees they are paying. When times are good there should be no problems but when the market fall which they will do then this charge might be enough to make the client redeem. As everyone knows, these redemptions primarily occur at the bottom of the market not the top. This would be a disservice to them.

Language is an Issue

While a fully informed client is preferred, the regulator must understand that investing in itself is a language that is not easily understood by the public, advisors, nor some manufacturers. I was at a recent investment conference in Banff hosted by the Franklin Templeton Group of funds. While I was interested in some speakers I had a difficult time understanding the alpha, beta and gamma that the fund manager was talking about as crucial for their fund to do well. He might as well have been speaking Spanish. I was more interested in seeing if one of my holdings, Ithaca Energy would do a compulsory buyout of the remaining shareholders. If I was right, the shares I could buy at $1.55 would be bought out soon at $1.95 based on Ithaca taking up 92% of the outstanding shares already.

Now I bring this up because this is relatively simple for me because I know the language and have been involved in a number of takeover deals in the past. I would say this fund manager is actually clueless on managing his fund which I would never recommend to any client. But the advisors in the room do not know this. At another conference put on by Mackenzie on the 24th of May I attended a presentation by their lead fixed income manager who did not even mention the yields on the bonds within his fund. To say that the emperor has no clothes on would be an understatement. At least he had on a good suit.

Investing is never easy but it is made all the more difficult by the fact that new funds are increasingly brought out as new funds without a track record are more exciting than older funds. And poorer performing fund tend to perform better than current 5 star funds due to a “reversion to the mean” but everyone goes off a fund’s current track record for comfort.

Direct Sales of Funds

If the regulator believes investors are better off with a direct sales model where the client buys directly from the manufacturer and more “aligned” I doubt this is the case. As an advisor and dealer I want the clients in funds that perform the best along with a high degree of security. That way my client is happier and will keep his investments with me, maybe invest more and likely will be a good source for referrals. Doing the opposite just means I am shooting myself in the foot eventually and risk losing the client forever.

Altamira went direct a number of years ago and gathered many assets due to their star manager Frank Mersch. Dare to say, the experience was likely not that good for clients who are attracted to better performing funds even though they rarely see the future risk they are assuming with the outperformance. Altamira, alas, had to sell themselves off while they still had some assets as redemptions became rampant. I would say the experience will be similar to any other firms that plan to or are currently selling direct now.

My Recommendation

Funds sold on a DSC basis are a bain of the industry. Getting rid of this sales practice would go a long way in lowering the administrative costs of dealers and manufacturers and obviously clients would be better off not being trapped in a product. If a client holds a front end fund today he or she is always free to move it should they believe the performance of the fund is lacking, or move the fund to another representative or dealer if they feel their account is not getting serviced properly.

Lowering trailer fees by having them negotiated between the representative and client should do away with conflicts and also improve the transparency of these fees/charges. I do not see much difference between having the fund companies charge trailer fees on a regular basis by selling client fund units and charging these amounts internally. I just do not think it is in the client's best interest to keep reminding them of the fees especially when the markets drop. Mutual funds are a great product and I have seen many financial "successes" over the past 35 years that may not have been possible had the client been given more incentive to redeem at the wrong time in the market cycle.

Dan Good

President

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