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June 9, 2017

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

The Secretary
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Me Anne-Marie Beaudoin
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Dear Sirs/Mesdames:

Re: Canadian Securities Administrators ("CSA") Consultation Paper 81-408: Consultation On The Option Of Discontinuing Embedded Commissions (the "Paper")

Thank you for the opportunity to provide comments to the CSA on the Paper.

Fidelity Investments Canada ULC ("**Fidelity", "we**" or "**us**") is the 4th largest fund management company in Canada. We manage approximately $137 billion in mutual funds and institutional assets and offer approximately 200 mutual funds and pooled funds to Canadian investors. Millions of Canadian investors entrust us with their hard-earned savings and we take their trust and financial future very seriously. That is why we are committed to always putting them first in everything we do.

For over 70 years, including 30 years in Canada, Fidelity has put investors first by working hard to help them achieve their financial goals. We recognize that the CSA is also committed to improving outcomes for investors, and we are pleased to work collaboratively with the CSA toward our shared commitment.

Overview

Our detailed response to the Paper is attached to this letter in Appendices A and B. In Appendix A, as requested in the Paper, our comments cover new empirical evidence. We believe that the CSA will find this information valuable to its evidence-based policy development process. Specifically, this section addresses the following topics:

1. The Modest Investor
2. The Importance of Preserving Investor Choice
3. The Importance of Financial Advice
4. The Importance of Enforcing Existing Rules Around Conflicts of Interest
5. Global Trends
6. Robo-Advisors
7. Passive and Active Investment Strategies
8. Deferred Sales Charges
9. Proposed Options

Appendix B provides specific answers to the questions posed in the Paper.

Regulatory Goals and Public Policy

Fidelity shares the goal of the CSA and its regulators to strengthen investor protection and to foster fair and efficient capital markets. To achieve this regulatory goal, regulatory measures must be carefully designed in a balanced and principled manner so that they:

1. Protect access to financial advice for Canadian investors
2. Preserve choice in how Canadian investors can access financial advice according to their unique needs
3. Maintain or enhance competition in the marketplace

A growing body of empirical evidence continues to prove that financial advice helps Canadian investors save and be better prepared for retirement. We believe in the value of advice. Canadian investors – especially modest investors – should have access to financial advice and they deserve a fair chance to save for their future.

The current Canadian regulatory system has come a long way toward achieving this goal, and we applaud the work of the CSA and its regulators who have helped make meaningful differences for Canadian investors. We believe improvements can be made and we are pleased to propose potential improvements in this letter for the CSA's consideration.

While Fidelity supports many balanced and carefully crafted measures, we do not support the proposal to ban embedded commissions. Independent research suggests that the ban would exacerbate the problems the CSA seeks to resolve through this regulatory measure.

Compensation alternatives offered in the Paper will create new and different conflicts of interest which could potentially put Canadian investors' savings at greater risk. Most importantly, a ban of embedded commissions will reduce access to financial advice and limit the choice of investments that middle-class Canadian investors count on for their retirement security. That outcome would be misaligned with the public policy objectives of provincial and federal governments in an aging Canada.

Given the highly consequential public policy implications, we believe the debate on whether or not to ban embedded commissions must include provincial and federal governments. They need to understand the potential policy risks and impacts on the retirement savings of Canadians and the health of the Canadian economy. While the CSA plays a meaningful and critical role in protecting investors, we believe that it is one part of the overall picture and cannot act in isolation. We believe that the inclusion of the governments in the debate will ensure that regulatory policies are not only balanced and principled, but in support of public policy objectives.

Effective Changes Already Implemented by the CSA have had a Meaningful Impact

The CSA should be credited for the volume of regulatory measures it has implemented in recent years to raise investor awareness and strengthen investor protection. These measures have been balanced and they are achieving clear and positive outcomes for Canadian investors.

Among many regulatory changes in the last few years, CRM 2 and the point of sale regimes have simplified disclosure and made a meaningful difference in accessibility and transparency of fees on mutual funds and other securities products. Recent research by the British Columbia Securities Commission ("**BCSC**") confirms that since the introduction of CRM 2, investors are more aware of fees and the performance of their investments. In particular, investors with small portfolios have become substantially more aware of direct fees. We believe that the third phase of this important research will show even greater awareness of fees by investors and how their investments are performing toward their retirement goals.

Leading up to the implementation of the final phase of CRM 2, financial advisors were proactively having clear and explicit conversations with Canadian investors about the cost of advice. We have also seen a meaningful increase in the sale of F-series mutual funds, increased price competition and a focus on investments in stronger performing funds.

Furthermore, recent media coverage around other regulatory proposals, such as the best interest duty and targeted reforms, as well as compliance reports from the CSA, its regulators and self-regulatory organizations ("**SROs**") relating to sales practices, have raised public awareness, particularly related to the fees Canadian investors pay and how mutual funds are sold and operate. This is a positive outcome that complements recent regulatory measures and is improving financial literacy of Canadian investors.

Taken altogether, we believe that the CSA has and will achieve its objectives to improve the Canadian mutual fund industry and financial advice. Thanks to the balanced leadership of the CSA, Canada is in an enviable position leading the world in investor protection and it enjoys an accessible financial advice system for all Canadian investors.

We thank you for the opportunity to comment on the Paper. As always, we are committed to working with you to put investors first and are willing to meet with you to discuss any of our comments.

Yours truly,

"Rob Strickland"

Robert S. Strickland
President

c.c. Sian Burgess, Senior Vice-President, Fund Oversight

APPENDIX A – Fidelity's Comments

1. The Modest Investor

5.2 million (33%) Canadians save through mutual funds. 76% of investors have less than $50,000 in investable assets. Approximately 4.5 million households (22% of Canadians) save through the embedded fee option.[1] 80% of Canadian mutual fund investors have chosen embedded commissions as an accessible payment option to obtain advice and save toward their financial goals. These modest investors will be most impacted if they cannot purchase mutual funds through the accessible payment option. The impact of a ban on the modest investor must be considered and analyzed.

It is now clear that an advice gap emerged in the United Kingdom ("**U.K.**") after the Retail Distribution Review ("**RDR**"). Given many similarities between the U.K. and Canada, the risk that an advice gap will emerge in Canada is real, significant and should not be taken lightly. The impact on retirement savings rates in Canada as a result of a ban is also likely to be significant. Canadian investors save through mutual funds more than any other country to meet their retirement needs. The risk of impacting retirement savings is therefore greater in Canada than anywhere else. Consequently, the proposal to ban embedded commissions must be taken very seriously, thoroughly examined, and supported by a strong body of empirical evidence to ensure that Canadian investors' retirement savings are protected.

To date, however, we have only seen conjecture by the CSA, with no solid empirical evidence, that modest investors will not be harmed by a ban.[2] Until we know with reasonable certainty, corroborated by a strong body of empirical evidence that an advice gap will not emerge, we believe it would be ill-advised and irresponsible to move forward with a ban on embedded commissions.

The Paper even acknowledges that the structure of the Canadian marketplace will change potentially for the worse in a world where embedded commissions are banned. According to the Paper, the modest investor will be served increasingly by the Canadian banks and less so by the independent fund managers and dealers. Although the banks do service a high number of modest investors, it is clear from the Mutual Fund Dealer's Association's ("**MFDA**") recent research report that independent MFDA advisors play a key role in servicing a significant share of the modest investor segment.[3] We believe that a balanced and principled marketplace with healthy competition must be protected. This will ensure that modest investors who have chosen independent advice according to their unique needs can continue to save toward their retirement goals.

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[1] The Investment Funds Institute of Canada, "IFIC CEO Responds to Release of CSA Consultation Paper on Embedded Commissions", *The Investment Funds Institute of Canada* (January 10, 2017).
[2] Canadian Securities Administrators, "CSA Consultation Paper 81-408 – Consultation on the Option of Discontinuing Embedded Commissions", *Canadian Securities Administrators* (January 10, 2017) at 63.
[3] Mutual Fund Dealers' Association, "MFDA Client Research Report: A Detailed Look into Members, Advisors and Clients", *Mutual Fund Dealers' Association* (May 19, 2017).

The recent MFDA research report also highlights the importance of the deferred sales charge ("**DSC**") option in allowing smaller asset advisors to continue to provide financial advice. Surely, it is incumbent upon the CSA and its members to foster competition in the financial advice industry. This must include the smaller MFDA dealer firms and financial advisors who serve the modest investor and offer independent financial advice and choice of products.

We do know that modest investors are costly to serve relative to the assets they invest and the fees they generate for dealers and financial advisors. In the Canadian marketplace, there are many dealers that have high asset thresholds before a client is taken onboard. These thresholds can be $100,000 or even as high as $250,000. Yet the majority of households with investable assets have less than $100,000. One study by Pricemetrix demonstrated that the number of small households (defined as less than $25,000 in assets) had a significant negative effect on the future production of financial advisors.[4] It found that advisors actually pay a penalty in terms of decreased future revenue for the small households they keep on their books. The study went on to quantify this impact. Another Pricemetrix study found that diversifying away from small households dramatically improves production.[5]

We were struck by a recent article written by the Honourable Joe Oliver and we recommend that the CSA take his comments into consideration.[6] Given his background, the Hon. Oliver is uniquely placed to understand both the securities regulatory regime and the broader public policy issues impacting Canada. He was a former President of the Investment Dealers' Association and a former executive director of the Ontario Securities Commission ("**OSC**"). Eventually, he went on to be a Member of Parliament and the Federal Minister of Finance discharged with, among others, the responsibility of strengthening retirement security of Canadians. Here is what the Honourable Joe Oliver said in his recent article:

> Banning embedded fees to ensure that advisers face no financial conflict of interest, so as to protect financially unsophisticated retail clients, means clients will have to start paying upfront for advice. Many will instead forgo the advice entirely. This is just one of many unintended consequences that could come from banning embedded fees. Others include a fall in savings and returns and, most critically, undermining the competitive structure of the securities industry, shrinking the weakening independent brokerage sector even further.
>
> Still, we have to resist the temptation to try to protect everyone from everything that may pose a risk, regardless of the cost, the limits on freedom of choice and the unintended consequences.
>
> What policy-makers must rigorously avoid is creating an advice gap between the wealthy who will pay for advice and the smaller, less sophisticated investors who, more often, will not, hurting the very people who most need protection. That would also burden the retirement system and reduce liquidity in the markets.

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[4] Pricemetrix, "Moneyball for Advisors", *Insights: Volume 7* (October 2012) at 6 online: https://www.pricemetrix.com/cms/wp-content/uploads/PriceMetrix_Insights_Moneyball-for-Advisors_English.pdf.
[5] PriceMetrix, "Small Household Metrics", *Insights: Volume 1* (June 2010).
[6] Joe Oliver, "Joe Oliver: Banning embedded mutual fund fees will only hurt the investors we should be helping", *Financial Post* (April 17, 2017), online: http://business.financialpost.com/fp-comment/joe-oliver-banning-embedded-mutual-fund-fees-will-only-hurt-the-investors-we-should-be-helping

A lot is at stake in determining the right balance. We had better be careful.[7]

2. The Importance of Preserving Investor Choice

We believe that investors should be entitled to decide how they wish to pay for financial advice and save toward their retirement according to their unique needs. Considering the diversity of the needs of Canadian investors, as a matter of principle, less choice is rarely a good option and more choice is almost always a better option. That is why Fidelity would support a regime in which financial advisors are required to offer both embedded and unembedded fee options. Financial advisors would explain the implications of various options to their clients so that they can choose for themselves, instead of being limited by regulatory fiat to fewer choices that may not be suitable.

Fidelity regularly consults with a cross-section of dealers to understand the needs of Canadian investors. According to our consultations, dealers tell us about 50% of their investors say that they prefer the embedded fee. This preference has been validated in a recent study released on May 30, 2017. Given the choice of paying directly or indirectly, 55% of Canadian investors say they prefer to pay indirectly.[8] These investors are interested in the bottom line – how their account performed and how much they have saved toward their retirement. Anecdotally, some investors tell their dealers that they do not want to see the fees because they know they need financial advice and do not want to be deterred by seeing the cost. This is consistent with a recent U.S. study by J.D. Power. This study found that investors do not want to switch to a fee-based payment model in their retirement accounts. In response to a question about willingness to switch, only 8% of commission-paying investors favour the switch, 33% say they probably will, 40% lean toward disagreement, and 19% adamantly refuse.[9] These studies demonstrate that investors in both Canada and the U.S. need choice that is suitable to their needs. A majority of investors in Canada actually prefer the embedded fee as an accessible payment option.

The Paper acknowledges that the CSA expects that a ban on embedded fees will hurt independent financial dealers and advisors. It also says a ban will result in an increased number of modest investors being served by the banks. Clearly there is an important role for the banks in providing financial advice. But a healthy, competitive industry which the CSA and its regulators are mandated to uphold thrives on the availability and choice of independent or captive products. Canadian investors should continue to benefit from competition and have this choice for their retirement security. The reduction of potentially thousands of independent financial advisors raises an additional public policy risk relating to jobs and local economies. Many, if not most, independent financial advisors are small business owners and employers in the communities – often small communities – in which they work. Beyond providing financial advice and helping Canadian investors better prepare

[7] *Ibid*.
[8] The Gandalf Group, "The Canadian Investors' Survey: An Opinion Research Study on Fees & Advisory Services", *The Gandalf Group* (May 30, 2017) at 21, online: http://www.gandalfgroup.ca/downloads/2017/Investors%20Survey%20Report%20May%202017%20Release.pdf
[9] Michael Foy, "Insights: Fiduciary Roulette", *J.D. Power* (2017), online: http://www.jdpower.com/resource/wealth-management-fiduciary-roulette

for retirement, they employ thousands of Canadians and support local economies through their supply chain. Competition must be maintained to preserve choice for Canadian investors who benefit from independent advice and products for their retirement security.

The banks are under increasing scrutiny in Canada for alleged misselling and compensation conflicts of interest. On April 27, 2017, the Investment Industry Regulatory Organization of Canada ("**IIROC**") published findings related to compensation-related conflicts of interest.[10] IIROC found that in some cases advisors were paid higher commissions to offer proprietary products over independent third-party products. IIROC also found an increase in the use of fee-based and managed accounts and that those account types had their own conflicts of interest. In other cases, the offering of a fee-based account for some clients was found to be "unsuitable" where it resulted in an increase in fees to investors. This report highlights that there are conflicts of interest for any payment associated with fee-based accounts.

We have also seen an increased trend toward servicing high net worth investors in bank brokerages and other dealers, leaving the modest investor to bank branches (sometimes with fewer and lower-quality services, likely due to the cost of service). Even Investors Group ("**IG**"), who was built at the kitchen tables of modest investors, has recently announced that it will increase its focus on high net worth investors.[11]

The independent dealers service the truly modest investors on the frontlines. They play an important role in serving those who are just starting to save, new Canadians, those with disability savings plans or registered education plans, and other vulnerable groups that stand to benefit most from advice. The independent channel must be protected and fostered because modest Canadian investors with $500, $5,000 or $50,000 must have access to advice. And choice must exist for high-net worth Canadian investors as well. Forcing all Canadian investors to a bank may mean that they will be offered only bank products and be exposed to other conflicts of interest. That may be fine from your perspective, but you shut Canadians out of the choice of a range of fund products and services that may provide for their needs in different and potentially better ways.

The Australian Securities & Investments Commission ("**ASIC**") recently released a report on major financial institutions which charge advice fees without providing advice. ASIC found that some customers did not have an advisor assigned to them, but they were charged a fee for ongoing advice. This has resulted in 27,000 bank customers receiving $23.7 million (AUD) of fee refunds and compensation. ASIC estimates that by the time the review is fully complete, fee refunds and compensation may increase by $154 million (AUD) plus interest to over 175,000 additional customers.[12] All of the major Australian banks were implicated

[10] Investment Industry Regulatory Organization of Canada, "Notice 17-0093 - *Managing Conflicts in the Best Interest of the Client – Compensation-related Conflicts Review*", *Investment Industry Regulatory Organization of Canada* (April 27, 2017), online: http://docs.iiroc.ca/DisplayDocument.aspx?DocumentID=5365CB5BE384477F8FC08C2B9450424A&Language=en

[11] Geoff Kirbyson, "IGM downsizing, focusing on HNW clients", *Investment Executive* (May 5, 2017), online: http://www.investmentexecutive.com/-/igm-downsizing-focusing-on-hnw-clients

[12] Australian Securities & Investments Commission, "Report 499: Financial advice: Fees for no service", *Australian Securities & Investments Commission* (October 2016) at 7, online: http://download.asic.gov.au/media/4054607/rep499-published-27-october-2016.pdf

and are paying these refunds and compensation.[13]As a result of these conflicts of interest issues that are harming Australian investors, ASIC stated that they will soon release a new policy around product misselling of proprietary products within the banks.

The point here is not that the banks should not serve the modest investor in Canada, but simply that they are not the main and only solution. Canadian investors deserve healthy and robust competition in the marketplace. The independent advice channel must be protected so that Canadian investors can continue to have choice in how they access financial advice and prepare for retirement.

3. The Importance of Financial Advice

We know that financial advice improves outcomes for Canadian investors and that investors have positive views about the value of financial advice that their financial advisors provide in respect of their retirement goals.

According to one study[14], 97% of Canadians are satisfied with the financial advice they receive from their financial advisor.[15] 82% credit their advisor with helping them to achieve better savings and investment habits.[16] In a study released on May 30, 2017, these results were confirmed. This study says that 94% of Canadians were satisfied with their financial advisor providing *unbiased* advice.[17] Our own study also found that 94% of Canadian retirees who benefited from working with a financial advisor reported being financially prepared.[18]

Several studies indicate that when confronted with an upfront fee or an ongoing hourly fee, investors are unwilling to pay for financial advice. A 2011 study found that the willingness to pay upfront for advice depends on the level of wealth, formal education and financial knowledge of the investor.[19] In fact, only 16% of Canadian investors say that they would be either absolutely certain or very likely to continue using their financial advisor if they had to pay a direct fee that was higher than their current embedded fee.[20] Less than one-quarter (24%) say that they would be less likely to seek out advice if embedded commissions were banned.[21]

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[13] *Ibid* at 4.
[14] Pollara Inc., "Canadian Mutual Fund Investors' Perceptions of Mutual Funds and the Mutual Fund Industry", *Pollara Inc.* (2016) at 5, online: https://www.ific.ca/wp-content/uploads/2016/09/IFIC-Pollara-Investor-Survey-September-2016.pdf/15057/
[15] *Ibid* at 19.
[16] *Ibid* at 20.
[17] *Supra* note 8 at 10.
[18] Fidelity Investments Canada, "Retirement 20/20: The right advice can bring your future into focus", *Fidelity Investments Canada* (June 2017) at 8.
[19] Michael S. Finke, Sandra J. Huston and Danielle D. Winchester, "Financial Advice: Who Pays", *Association for Financial Counselling and Planning Education* (2011), online: http://files.eric.ed.gov/fulltext/EJ941908.pdf
[20] Pollara Inc., "Canadian Mutual Fund Investors' Perceptions of Mutual Funds and the Mutual Fund Industry", *Pollara Inc*. (2013) at 29, online: https://www.ific.ca/wp-content/uploads/2013/09/IFIC-Pollara-Investor-Survey-2013.pdf/4625/
[21] *Supra* note 8 at 23.

This is consistent with studies conducted in both Australia and the U.K. In a 2010 study, ASIC found that Australian investors were unlikely to be willing to pay for the true cost of financial advice.[22] Similarly, in the U.K., several studies show that financial consumers are reluctant to pay upfront for advice. 27% of survey respondents said that they would stop taking advice if charged directly for an advisor's time.[23]

We think Canadians have good reason to be happy with financial advice that they receive. One study shows definitively that Canadian investors who access financial advisors for 15 years or more accumulate 3.9 times more in savings than comparable investors without advice.[24] This study is consistent with other international studies, all of which are reviewed in the PricewaterhouseCoopers ("**PwC**") paper submitted by the Investments Funds Institute of Canada in their submission to the CSA.

Based on research, we expect two major consequences if there is a ban on embedded commissions in Canada: A decline in the number of Canadians receiving financial advice and a significant decline in the amount of savings. According to the PwC paper:

> …those who could potentially be deprived of access to financial advice following the ban on embedded commissions would accumulate on average $240,000 less in savings prior to retirement than those with access to advice.[25]

4. Importance of Enforcing Existing Rules Around Conflicts of Interest

We agree with the CSA and its regulators that there are conflicts of interest in our industry that need to be addressed. However, there are conflicts that exist in any model where fees are paid for financial advice. Eliminating embedded commissions in favour of other payment models will not eliminate and is likely to lead to other conflicts of interest altogether.

The industry has moved aggressively toward fee-based accounts driven by changing market conditions. Just a few years ago, sales of fee-based series were in the neighbourhood of 2% of gross sales in the industry. We estimate that this figure has risen sharply to 40%. At the same time, redemption rates for fee-based series have been significantly higher than for front load and deferred load assets (in the neighbourhood of 20%). These redemption rates may be further evidence that Canadian investors may eventually be unwilling to pay upfront fees and stay invested for their retirement. A Strategic Insight study confirms that redemption rates are higher in fee-based accounts, as there is greater turnover, and for

[22] Australian Securities & Investments Commission, "Report 224: Access to financial advice in Australia", *Australian Securities & Investments Commission* (December 2010) at 49, online: http://download.asic.gov.au/media/1343546/rep224.pdf

[23] Deloitte, "Bridging the advice gap: Delivering investment products in a post-RDR world", *Deloitte* (2012) at 7, online: https://www2.deloitte.com/content/dam/Deloitte/uk/Documents/financial-services/deloitte-uk-fs-rdr-bridging-the-advice-gap.pdf

[24] Claude Montmarquette and Nathalie Viennot-Briot, "The Gamma Factor and the Value of Financial Advice", *Cirano* (August 2016) at 24, online: https://www.cirano.qc.ca/files/publications/2016s-35.pdf

[25] PwC, "Economic Impact Assessment of Banning Embedded Commissions in the Sale of Mutual Funds", *PwC* (June 2017) at iv.

some investors they can be more expensive.[26] There is plenty of evidence that this is also true in Canada.

There are already rules in place to address compensation-related conflicts of interest. National Instrument 81-105 - *Mutual Fund Sales Practices* ("**NI 81-105**") was introduced in 1998. The conflicts covered by NI 81-105 had their genesis in the 1995 report of Glorianne Stromberg, who was hired by the OSC to study conflicts of interest in the industry.[27] Until recently, there has been little focus on this powerful regulatory tool and yet many of the compensation-related conflicts that the CSA takes issue with are already dealt with in NI 81-105. It is simply a matter of enforcing this rule.

Although we think NI 81-105 is a powerful tool as it is currently stands, we do think there is at least one area that should be modernized. The sales practices rule should apply to all competing products. We have seen a big move away from mutual funds to managed accounts, particularly at the banks. They are not subject to the same disclosure requirements as mutual funds. They are also not transparent – there is little publication of the performance of separately managed accounts, although investors do receive reporting after they buy these products. There is no Fund Facts and they are largely unregulated as far as disclosure is concerned. There is also no publicly available price information about these products, or that they may be available with different pricing depending on the client and their asset levels.

In its recent report on its targeted review of compensation-related conflicts of interest, IIROC endorsed the CSA's proposals for targeted reforms and guidance on conflicts of interest. [28] IIROC also identified three significant areas of concern: (i) excessive reliance on disclosure or poor disclosure of conflicts of interest; (ii) a lack of oversight of compensation models (particularly for proprietary products and fee-based accounts) and the conflicts they create; and (iii) a shift toward fee-based accounts without appropriate supervision and monitoring. In addition, IIROC found that the use of fee-based accounts could be unsuitable for some investors.[29]

Interestingly, the Securities and Exchange Commission ("**SEC**") is also looking at this issue. In their Examination Priorities for 2017, the SEC said that it would, as part of its mandate to protect retail investors, be reviewing share class selection. [30] The SEC will review conflicts that advisors may have in receiving higher compensation to sell certain share classes that have higher loads and distribution fees. Therefore, the issue of conflicts in compensation models is a focus for U.S. regulators as well.

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[26] Strategic Insight, “A Perspective on the Evolution in Structure, Investor Demand, Distribution, Pricing, and Shareholders’ Total Costs in the U.S. Mutual Fund Industry” *Strategic Insight* (November 2012) at 5; Staff of the U.S. Securities and Exchange Commission, “Study on Investment Advisers and Broker-Dealers”, *U.S. Securities and Exchange Commission* (January 2011) at 152.

[27] Glorianne Stromberg, “Regulatory Strategies for the Mid-90s - Recommendations for Regulating Investment Funds in Canada”, *Canadian Securities Administrators* (January 1995).

[28] *Supra* note 10.

[29] *Ibid*.

[30] Office of Compliance Inspections and Examinations, “Examination Priorities for 2017”, *U.S. Securities and Exchange Commission* (January 2017), online: https://www.sec.gov/about/offices/ocie/national-examination-program-priorities-2017.pdf

5. Global Trends

A. There is a Global Trend to Protect Access and Choice

We often hear that the banning of embedded commissions is a "global trend" and that if Canada does not ban embedded commissions, we will fall behind the rest of the world. This is not true. Schedule 1 to this letter shows the countries that have banned embedded commissions compared to some of those which have examined and decided to keep embedded commissions. It is evident that the global trend is ***not*** to ban embedded commissions. In the diagram, we illustrate 4 countries that have decided to ban after an active debate, versus 17 that have not. As you are aware, and as the regulators in both the U.K. and Australia have said to us in-person, the ban in those jurisdictions occurred after serious scandals in those countries. Both regulators commented to us that they find it interesting that Canada has not had similar widespread scandals.

Even here in Canada, other than Ontario and New Brunswick, the CSA jurisdictions have decided to abandon the pursuit of a best interest standard and have shifted their focus to the implementation of certain targeted reforms. Suffice it to say, we believe that the global trend is shifting away from regulatory action that would limit choice and access to advice in favour of protecting them.

B. Misunderstandings About Australia and the U.K.

There are many myths about the impact of the RDR in the U.K. and the Future of Financial Advice reforms in Australia. We have visited both countries on a fact finding mission in preparation for this comment letter and have had meetings with our Fidelity colleagues, industry associations and the regulators in both jurisdictions. In addition, we have reviewed and studied many papers and regulatory guidance coming from those jurisdictions. We think the representations made in Canada about the impact of these reforms have been overstated and misunderstood.

(i) United Kingdom

Some in Canada say that an advice gap did not emerge in the U.K. post-RDR. We have also heard that the advice gap only emerged because of the professionalization of financial advisors in the U.K. Both of these statements are untrue.

In March of 2016, the Financial Conduct Authority **("FCA")** published its Financial Advice Market Review ("**FAMR**") Final Report.[31] As a result of the advice gap that had emerged, this report was commissioned by the U.K. government to find solutions to fix this advice gap. The report identifies increased standards and professionalism as well as the move to fee-based advice as the two causes of the advice gap:

[31] Financial Conduct Authority and HM Treasury, "Financial Advice Market Review – Final Report", *Financial Conduct Authority* (March 2016), online: https://www.fca.org.uk/publication/corporate/famr-final-report.pdf

> These changes have highlighted concerns that there is an "advice gap". The Economic Secretary to the Treasury and the Board of the FCA shared this concern and so launched FAMR as a joint FCA/HMT Review. FAMR's Call for Input defined the advice gap as situations in which consumers are unable to get advice and guidance…[32]
>
> …respondents also highlighted that a number of issues with the UK's financial advice market remain following the RDR. Some suggested that, despite the benefits of removing 'commission bias', the move from paying for advice via commission to paying adviser fees has contributed to many people not being able to get the advice they want and need at a price they are willing to pay.[33]

The report states that up to 17 million people could be trapped in the U.K.'s advice gap. In addition, it clearly shows that there are 25% fewer financial advisors in the U.K. post-RDR. The report also notes that two-thirds of investment products in the U.K. are bought without professional advice which is up one-third from 2007. An FCA survey of advice showed that over the previous two years, the number of firms who ask for a minimum portfolio of more than £100,000 has more than doubled, from around 13% in 2013 to 32% in 2015. A further survey indicated that 45% of firms very rarely advise customers on retirement income options, if those customers have small funds (i.e. less than £30,000 to invest). Further, the report cited a 2016 survey that indicated that 69% of financial advisors had turned away potential clients over the previous 12 months for reasons of affordability.[34]

Three working groups were struck by the FCA to address three of the recommendations in this report. One of the working groups dealt with addressing advice and guidance – how best to find advice and guidance for those that had fallen into the advice gap. The group then expanded its mandate to try to come up with a definition for advice along with guidance. This working group reported to the U.K. Treasury and the FCA in March of 2017. It is very clear that the Treasury of the U.K. has recognized that advice is too expensive for many post-RDR. The working group found that it costs between **£1,000 and £2,000** for advice (either based on an hourly rate or based on an unembedded commission structure) which is unaffordable for someone who only has **£50,000** to invest (which is more than the average modest investor has in investable assets in the U.K.). The focus now is on how to get financial advice for the modest investor and how to ensure that the modest investor can access financial products.[35]

Let us dispel the myth that no advice gap emerged in the U.K. post-RDR. The U.K. government is clearly very concerned about the advice gap and is looking for concrete ways to address this very serious public policy issue.

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[32] *Ibid* at 6.
[33] *Ibid* at 17.
[34] *Ibid*.
[35] Financial Advice Working Group, "Consumer explanations of 'advice' and 'guidance'", *HM Treasury* and *Financial Conduct Authority* (March 2017), online: https://www.fca.org.uk/publication/research/fawg-consumer-explanations-advice-guidance.pdf

(ii) Australia

Australia has a very different market structure. A very high proportion of investable assets are invested through mandatory superannuation funds ($2.2T with another $0.5T in other investments). Currently, 9.5% of employment income must be contributed to a superannuation fund. The contributions occur at significantly advantageous tax rates (15% tax on contribution and no tax on withdrawal). The highest marginal tax rate in Australia is in the neighbourhood of 47%. Currently, Australians can invest up to $35,000 per year into their "supers". In addition, the regulators require providers of superannuation funds to offer a low cost series – generally between 70 – 80 basis points.

As a result, for very good tax and pricing reasons, the vast majority of investments by Australians are made into these superannuation funds. And of those who invest, a high proportion does not have financial advice. According to one report, an in-depth study of Australians' appetite to obtain financial advice, 14.5 million Australians are unadvised, the majority of whom will need and want assistance with their investment decisions. [36] Non-advised adults collectively hold 70% of the total wealth in circulation. 4.3 million Australians intend to conduct financial activity without the help of an advisor in the next two years. 80% of Australians do not currently use or intend to use a financial planner. In discussions with an Australian industry association and ASIC, both expressed concern about the need for more financial advice for Australians.

Most investments "default" into the default option within their superannuation funds. In other words, Australians are not making a conscious financial choice in their supers and are not receiving the much needed financial advice.

There are only 16,000 financial advisors in Australia. It is difficult to tell if this number has declined because financial advisors were required to be registered only two years ago. Bank financial advisors are unregistered to this day. However, recent findings relating to misselling in Australian banks is causing the regulators to consider registration among other strong measures to address misselling in the banks. As already stated, ASIC recently released a report on the charging of advice fees without providing advice at major financial institutions.[37]

Another interesting fact is that the best interest duty in Australia does not apply to stock brokers. Lastly, insurance commissions are likely to be capped rather than banned for insurance investment products. Capping is obviously seen as a viable alternative to a ban in Australia.

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[36] Investment Trends, "2015 Direct Client Report", *Investment Trends* (2015), online: http://www.investmenttrends.com.au/our-work/key-industryreports-australia

[37] *Supra* note 12.

C. United States

Partly as a result of the potential fiduciary rule from the Department of Labor, and partly as a need to address conflicts of interest, there are structural changes occurring to the offering of mutual funds in the U.S.

Today, investors who buy class A shares of a mutual fund pay a sales charge that may range from 2.25% to 5.75%. This payment is "bundled" in with the cost of the fund's total MER, as is true in Canada.

However, recently, the industry has started to launch "clean shares". These shares charge a fee to manage and operate a mutual fund. They do not include payments to broker-dealers or retirement plan platforms. They do not include compensation to brokers for providing advice or 12b-1 fees. These are similar to our series F securities. If investors want advice, they will pay for advice separately. These shares are being launched in order to address the perception of conflicted advice. Firms that want to continue to receive commissions are likely to sell clean shares plus a commission that is the same across all competing products.

At the same time, the mutual fund industry is introducing new "T shares". These also are intended to address conflicts of interest because these shares provide one uniform price across the board. So, advisors will not be tempted to choose a fund with higher compensation over one with less compensation. T shares will generally charge a 2.5% front load along with a 12b-1 fee.

In both cases, the U.S. market is evolving to address the issues of transparency and conflicts of interest. It is interesting that clean shares already exist in Canada similar to our series F securities. T shares are a bundled offering, like A shares with a mandate to have level fees so that the potential conflict of differing compensation is eliminated.

Unfortunately, the CSA seems to have rejected the notion of level fees without a real debate about its merits. However, it is clear that the U.S. thinks that both of these models address conflicts of interest and, in fact, would meet the standard under the fiduciary duty rule.

D. Sweden

In 2016, Sweden decided not to proceed with a ban on embedded commissions. One of the reasons was the importance of maintaining healthy competition in the Swedish market. Sweden's fund market looks surprisingly similar to Canada in terms of structure, bank dominance, investor behavior, and more. The Swedish Competition Authority published a report in 2013 that aided in Sweden's decision not to move forward with a ban (in spite of the securities regulators' strong recommendation to do so).[38] The question posed by the report was what would the consequences of a commission ban mean for competition in the Swedish financial services market. The report stated the following:

[38] John Söderström, Diego Gomez Ruales et al., "Competition on the financial services market – Deposits, mortgages and funds", *The Swedish Competition Authority* (June 2013), online: http://www.konkurrensverket.se/globalassets/english/publications-and-decisions/competition-on-the-financial-services-market---deposits-mortgages-and-funds.pdf

> The primary purpose of a ban on commission should be to ensure that the advice received by the consumer is adapted to their individual needs. However, the question is whether a ban on commission would in reality have the desired effect and thereby achieve the purpose of such a ban….it is probably that other factors that can give the advisor direct incentive to prioritize high-price products would remain…. A possible consequence of a ban on commission for financial advice is that the banks and insurance companies' hold on the fund market would be tightened as the consumer, who is often in need of advice, would probably be more likely to forgo financial advice….. A development of this kind would likely result in a number of small and medium-sized fund companies having problems with profitability and, in the long term, disappearing from the markets.[39]

In the final announcement by Sweden's Minister for Financial Markets and Consumer Affairs, announcing that Sweden would not ban embedded commissions, all of the issues that are of concern in Canada were outlined – the importance of access to advice, competitiveness, a level playing field among competing products and access to and choice of a broad range of funds.

E. Other Countries

Other countries like New Zealand, Singapore, Hong Kong, Germany, Switzerland and Ireland have had robust debates on this issue. They have all determined that a ban would not produce the best outcome for their country. We think that it makes sense to consider the alternatives as those countries have. A ban is not the only viable option for Canada.

6. Robo-Advisors

Fidelity is supportive of the concept of robo-advisors. However, we question whether they will solve the potential advice gap that may emerge. It appears that many millennials and more modest investors want broad personal financial advice. That kind of advice might include advice beyond strict investments. It is not clear that robo-advisors are the ultimate answer for these investors and would-be investors.

In its recent 2017 research, Ipsos Reid surveyed 2,006 Canadians of which 488 were millennials (35 years or younger). That research found that 81% of millennials do not currently use a robo-advisor. Among those millenials who are not using a robo-advisor, 27% said that they were unlikely to start using one, 63% were neutral, and only 9% were likely to start using a robo-advisor. The top reason why? They wanted to communicate with a financial advisor face-to face. Secondly, they wanted to be able to communicate with an actual person, not just automated software. Lastly, they wanted a financial advisor to keep an eye on their portfolio.[40]

Robo-advisors provide asset allocation services – no more and no less. And for that they charge fees in the area of 60 to 70 basis points. Robo-advisors generally do not provide education to investors or offer behavior modification ("the gamma factor"). They do not help

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[39] *Ibid* at 179.

[40] Ipsos, "The Canadians & Financial Advice Report 2017", *Ipsos* (2017).

them with their personal circumstances or provide many of the other services investors receive from financial advisors such as estate planning, financial planning or even succession planning. They also do not help investors with managing their emotions, fostering savings discipline and staying invested, especially in down markets. There are tangible and intangible benefits of having a financial advisor. For less than an additional 30 basis points, investors receive a whole host of services from financial advisors, in addition to the benefits of financial advice already outlined.

Robo-advisors are not yet gaining traction in a meaningful way in any jurisdiction. Although robo-advisors exist in marketplaces like the U.K. and Australia, they have had very little take up. Even the largest robo-advisors in those markets have not reached profitability after many years. This is also true in Canada. A recent study found that only 7% of Canadians are likely to trust recommendations from robo-advisors.[41] It is only the more sophisticated investor that is, in small numbers, gravitating to robo-advisors. In the U.S., there is slightly more take up, but it is because financial advisors are using robo-advisors to help them to service their clients.

While there will be a growing market for robo-advisors, they will not solve the advice gap in Canada. There are still many investors who prefer face-to-face interactions and would not entrust their monies to automated devices. Robo-advisors may offer a platform that is a lower-cost alternative for investors, but they lack the full capabilities that traditionally come with face-to-face advice and mutual fund investments.

7. Passive and Active Investment Strategies

Fidelity supports the choice of either active or passive products in the Canadian marketplace. We think allowing mutual fund registered advisors to sell passive investment products makes sense. However, there are overtones in the Paper and in regulatory pronouncements that passive solutions are better than active solutions because they are cheaper and perform better. This is not a balanced representation. There is an important place for both options and investors should continue to have the choice of either option without regulatory intervention.

Fidelity has funds that have outperformed their passive comparators over long and short time frames. For example, Fidelity Canadian Disciplined Equity Fund (Series F) has significantly outperformed the iShares Core S&P/TSX Capped Composite ETF when you look at growth of $10,000 over 10 years inclusive of costs. In fact, this fund outperformed its ETF comparator 100% of all 10 year rolling periods from March 1, 2006 to October 31, 2016. Investors should not be deterred from seeking improved returns over the index. Obviously, excess returns from active management can create a powerful wealth compounding effect and better prepare Canadian investors for retirement.

[41] HSCB Bank Canada, “Global study on trust & tech: Canadians twice as likely to trust a robot to perform open heart surgery than to open a bank account for them”, *HSBC* (May 24, 2017), online: http://www.about.hsbc.ca/~/media/canada/en/news-and-media/170524-trust-in-tech-news-release-en.pdf

There are other benefits of active investment strategies as well. The Canadian market is concentrated in a few sectors compared to international markets. Passive investors are exposed to this concentration risk. Active management can also help manage downside risk. Picking stocks in an active context that limit downside risk can enhance growth potential for Canadian investors.

The Investment Executive recently brought to the industry's attention a Dalbar study that showed that over a 15 year period (from January 1, 2001 to December 31, 2016), the average active investor outperformed the passive investor for periods of more than five years.[42] A key driver was the behaviour of investors. Passive investments were found to be more vulnerable to investor behaviour (e.g., poor market timing, increased redemptions, etc.) The report states, "The evidence shows … active investments offer greater preservation."[43]

Another recent article cited Morningstar statistics that showed the average hold periods for the top 10 ETFs in the U.S., in days, not years**.**[44] The article notes that "the largest fund, SPY, has an average holding period that lasts about as long as an episode of Hardcore History."[45] In actual fact, this fund is the SPDR S&P 500 ETF which has an average holding period of 15.4 days. There is plenty of research that shows that short holding periods do not amount to solid long term returns for individual investors.

Clearly there is a role for both active and passive options. There will be market periods when active outperforms passive and vice versa. And there will always be active funds that outperform. We think investors should continue to have this choice, free from regulatory intervention.

8. Deferred Sales Charges

Retirement savings in mutual funds were very small before the DSC was introduced in 1987 in Canada. Since that time, investments in mutual funds have grown dramatically because the DSC made mutual funds available to the average Canadian.

There is much debate around the ongoing viability of the DSC option to purchase mutual funds. It has become popular to argue that the DSC option should be banned. However, the DSC option provides two key benefits. First, it allows modest investors the ability to invest 100% of their money in mutual funds. Second, it allows advisors the ability to service investors with small amounts to invest. This is particularly important for advisors, both new and seasoned, who make a living servicing the modest investor.

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[42] Jade Hemeon, "Active investment strategies outperform passive ones in the long run: Dalbar", *Investment Executive* (March 16, 2017), online: http://www.investmentexecutive.com/-/active-investment-strategies-outperform-passive-ones-in-the-long-run-dalbar
[43] *Ibid*.
[44] Ben Carlson, "Passive Aggressive Investing", *A Wealth of Common Sense* (May 7, 2017), online: http://awealthofcommonsense.com/2017/05/passive-aggressive-investing/
[45] *Ibid*.

The MFDA recently released a report which studied the potential impact of a ban on embedded commissions.[46] It used real data from its members. The report concludes that a ban is most likely to impact non-bank dealers and will have the most impact on smaller asset advisors who are more reliant on DSC. Approximately 56% of advisors with non-bank firms rely on DSC to finance their operations.[47] It also points out that most of these advisors are dually licensed (mutual funds/insurance products) and so the outcome may be that these advisors simply sell competing products that continue to have embedded commissions.

Many bank dealers as well as large dealers like IG have announced that they will no longer offer DSC. While eliminating the DSC for IG clients, it is interesting to note that features of the DSC will continue to exist. The amendment to the IG fund prospectus states that after September 30, 2016, IG Consultants may receive a sales bonus of up to 2.50% of the amount invested. Further, if the Consultant has been with IG for less than four years, he or she "may receive an additional amount of up to 40% to help establish their practice." So while IG, a large and profitable organization, can afford to help these smaller advisors get established in the absence of the DSC, there is clearly a recognition that in lieu of a DSC, some kind of financial assistance is needed for newer advisors. It is unlikely that smaller dealers will be able to afford this kind of subsidization.

Arguments are made that the DSC is missold or is unsuitable for investors. And while that may have been true in the past, we see that the MFDA has made this issue a priority in its exams and bulletins. We believe that this issue has improved consistently and dramatically. If the main issue around DSC is misselling, as investor advocates and regulators alike claim, then we believe ongoing vigilance by dealers, UDPs, compliance officers and regulators is critical. It is important not to throw out a structure that serves a meaningful purpose both for modest investors and newer advisors.

There is evidence that the DSC is actually helpful for some investors. In a 2015 study by Argento, Bryant and Sabelhaus, the authors found that U.S. households under the age of 55 make $0.40 of taxable withdrawals from retirement accounts for every $1.00 of contributions, in spite of tax penalties imposed.[48] This is a major offset for flows and has significant potential implications for retirement security. It also indicates that there is a real issue with self-control around retirement savings.

A 2015 study entitled "Self Control and Commitment: Can Decreasing the Liquidity of a Savings Account Increase Deposits?" is also instructive.[49] This paper studied illiquid financial accounts versus liquid financial accounts. It found that U.S. households have a behavioural bias known as a "present bias". U.S. households place a disproportionately high weight on present consumption and low weight on the future. The authors of the study

[46] *Supra* note 3.
[47] *Ibid* at 19.
[48] Robert Argento, Victoria L. Bryant and John Sabelhaus, "Early Withdrawals from Retirement Accounts During the Great Recession", *2015 Contemporary Economic Policy* 33 (1): 1-16.
[49] John Beshears et al., "Self Control and Commitment: Can Decreasing the Liquidity of a Savings Account Increase Deposits?", *NBER Working Paper Series, No. 21474* (September 6, 2015), online: http://faculty.som.yale.edu/jameschoi/commitment.pdf

point out that in many countries, policy makers address this present bias in various ways, including mandating completely illiquid accounts (until a particular point in time, like retirement) or penalties for early withdrawals. The preference by policy makers around the world is to mandate completely illiquid accounts to address the present bias issue. But the second preference is to offer a partially illiquid account with a penalty to discourage present bias. However, this study argues that for social policy purposes, having a completely illiquid account is most useful for retirement savings, but does not take into account the need to address emergencies like loss of jobs, in which case, people do withdraw money from their retirement accounts.

In addition, this study found that for accounts that prohibit early withdrawal, investments into those accounts actually increase compared to accounts with no penalty or a modest penalty for withdrawal. The paper hypothesizes that investors who are aware of self-control problems are motivated to use accounts with penalties in order to ensure savings are retained.

In the context of DSC, this purchase option may actually be playing an important behavioral role in retirement savings in Canada. It helps people exercise the self-control needed to stay with their savings program.

The last point we would like to make about DSC is simply that it is widely used for smaller registered investments like TFSAs, RESPs and RDSPs. We have heard from advisors that the elimination of the DSC could and likely will have an impact on savings in these vehicles. These are longer term vehicles in any event and in most cases they are suitable retirement products.

9. Options

While Fidelity does have significant concerns with the proposal to ban embedded commissions, we do support options to continue to improve and enhance investor protection.

We would support the following:

1. Create standardized distribution commissions by asset class (i.e. equity, fixed income and balanced). In our view, a level fee eliminates the conflict of differing payments to advisors and neutralizes the conflict of interest. This is a model that is used in the U.S. and is being enhanced through T shares as described above.

2. Offer investors the choice of embedded or other alternative fee structures and explain the implications of each choice in a way that is clear.

3. Provide a list of minimum services that investors must receive in return for the trailing commission.

4. Implement certain targeted reforms under CP 33-404.

5. Enforce NI 81-105 immediately and vigorously, and amend it to apply to managed accounts like separately managed accounts and unified managed accounts.
6. Introduce CRM 3 disclosure to include management fees charged by fund managers.
7. Do not allow full trailing commission series to be sold on discount brokerage platforms.
8. Standardize naming conventions for fund series.
9. Provide further guidance and continue enhanced regulatory scrutiny on the sale of DSC funds.
10. Improve financial literacy and continue to measure other disclosure and regulatory initiatives such as CRM 2 and POS.
11. Roll out similar rules to all competing investment products, including insurance and bank products that are now not governed by comparable rules.

10. Conclusion

It is Fidelity's view that a ban on embedded commissions would not be good for Canadian investors for all of the reasons we have outlined in this letter. We think the Paper fails to take into account the real risk that retirement savings will decline in Canada as a result of a ban. This is understandable. The CSA has the job of investor protection, but not necessarily the public policy goal of protecting or enhancing retirement savings for Canadian investors. It is incumbent upon Canadian policy makers to weigh in on this debate as they have in other countries. In many countries, policy makers have simply decided that they will not risk retirement savings in their countries. They have looked to other measures to address the very same issues that we are facing in Canada. It is clear that the global trend is NOT to ban embedded commissions.

It is also important not to risk the health of financial advice in Canada. It is clear that financial advisors have made a meaningful difference to savings rates in Canada. In fact, as stated above, having advice for 15 years or more increases household assets by 3.9 times compared to households without a financial advisor.[50] The reduction in the number of advisors will not only lead to millions of Canadians being unprepared or underprepared for retirement, but also leave thousands of Canadians unemployed or underemployed.

Most importantly, we think that investors should continue to have meaningful choice. Once embedded and unembedded models are explained to investors, 50% or more want the embedded model for very good personal reasons. It is not up to the CSA to remove choice from the Canadian investor when at least half of those investors want this choice.

[50] *Supra* note 24.

SCHEDULE 1

Global Trend

After careful examination of the potential impact, 17 out of 21 jurisdictions have committed to protect choice and access for their investors

Protected Choice & Access					Banned Choice & Access	
Sweden	United States	Japan	India		Australia	Netherlands
Denmark	South Korea	Switzerland	Ireland	Israel		
New Zealand	Hong Kong	Italy	Germany		South Africa	United Kingdom
France	European Union *	Belgium	Singapore			

* The EU's MIFID II reforms only apply to commissions paid to independent financial advisors, who represent only 11% of the European market

APPENDIX B – Fidelity's Answers to Questions Posed in the Consultation Paper

CSA CONSULTATION PAPER 81-408 – CONSULTATION ON THE OPTION OF DISCONTINUING EMBEDDED COMMISSIONS January 10, 2017		
	SUMMARY OF CONSULTATION QUESTIONS	FIDELITY COMMENTS
	Part 2	
1.	Do you agree with the issues described in Part 2? Why or why not?	No. We state our reasons below. **<u>The embedded commissions model aligns the interests of the fund manager and dealers/advisors</u>** We believe that the Paper fails to acknowledge that in many circumstances dealer/advisor interests are in fact aligned with the interests of their clients. We take issue with the CSA's finding that embedded commissions reduce a fund manager's focus on performance. Our evidence suggests the opposite – when performance wanes, sales drop and redemptions increase. In addition, approximately 96% of mutual fund managers pay standard trailing commissions. Therefore, it is hard for us to believe that embedded commissions encourage recommendations that are biased toward higher compensation – this practice has become more evident in a fee-based world. The embedded commission model represents only one of many compensation models, and we acknowledge that all models contain conflicts of interest. In the absence of any compelling evidence which says otherwise, we cannot understand why the CSA believes that prohibiting one compensation model over others will address this issue. **<u>The embedded commissions model limits investor awareness, understanding and control of dealer compensation costs</u>** We believe that POS and CRM2 have played and continue to play a significant role in enhancing investors' awareness of costs and compensation. In fact, early evidence from the BCSC research on CRM2 confirms that investors are more aware of fees and the performance of their investments. We believe that the CSA did not give ample weight to

		these initiatives in the Paper, which seems to be a departure from the CSA's previous views on these topics. In terms of disclosure, Canada has led the way in comparison to other developed countries, and the CSA has been applauded for its focus on consumer education initiatives by the U.K. and Australia. In hindsight, we believe that other jurisdictions which have banned embedded commissions would have pursued disclosure initiatives first as an alternative to proceeding with a ban. Canada is in an enviable position and we believe that the CSA should wait and see how these initiatives play out over time in order to determine if additional regulatory action is warranted. We are confident that any CSA measures taken to assess POS and CRM2 will show an improvement in investor understanding of securities products and dealer compensation costs. **The embedded commissions model does not align with the services provided to investors** We believe that the CSA did not provide compelling evidence to support this conclusion. While choice is available, the embedded commission model facilitates affordable and accessible financial advice. Research shows that Canadian investors who access financial advisors for 15 years or more accumulate 3.9 times more in savings than comparable investors without advice. We find it again surprising that the CSA can come to a conclusion in light of POS, CRM2 and compelling facts that suggest otherwise. In addition, investors have different needs and expectations regarding the level of services they should receive. For example, someone who has $15,000 to invest may not require the same level of services of someone who has $250,000 to invest may require. However, as investors move through the cycle of life, their needs change. Nevertheless, if clarity of services is what the CSA seeks, we do not object. Of course, it will be important to have a strong industry dialogue around exactly what the services should be and how they should be measured.
2.	Are there other significant issues or harms related to embedded commissions? Please provide data to support your argument where possible.	Yes. One of the CSA's stated goals for this initiative is investor protection. We are concerned that the CSA is considering only the protection of investors who invest in mutual funds. While regulatory arbitrage was briefly acknowledged throughout the Paper, we believe that it is imperative that like products be treated in a like manner – e.g. segregated insurance products and managed accounts. There is a broad social goal of

		protection for all investors. Other goals include the need to increase savings rates for retirement and the overall health of the Canadian economy. If the CSA drives investors to other less regulated and transparent products, it will not accomplish its overarching goal of investor protection for all investors. It is equally important for the CSA to liaise with other regulators, like the CCIR, before the CSA proceeds with any policy initiative that will cause irreparable harm to investors.
3.	Are there significant benefits to embedded commissions such as access to advice, efficiency and cost effectiveness of business models, and heightened competition that may outweigh the issues or harms of embedded commissions in some or all circumstances? Please provide data to support your argument where possible.	Yes, there are significant benefits to the embedded commission model. As discussed in the main body of our letter, the embedded commission model serves a large percentage of the mass market households that invest in mutual funds today. As you know, approximately 80% of Canadian mutual fund investors do not pay a direct fee for advice and more than half of Canadians prefer to pay for advice through the embedded commission model. If the CSA proceeds with a ban in Canada, an advice gap will develop – similar to the advice gap that developed in the U.K. post-RDR. If Investors will be forced to pay upfront fees, which we know many of them will not want to do – only 16% of Canadian investors would be certain or very likely to use a financial advisor if they had to pay a direct fee that was higher than their current embedded fee. As a result, many investors will choose to forego investment advice entirely. This is not a good result. The U.K. experience post-RDR should not be misunderstood. It is clear from the FCA's Financial Advice Market Review – Final Report, which was published in March 2016, that an advice gap developed in the U.K. – because of the move to fee-based advice and increased professionalism standards. The FCA's report was commissioned by the U.K. government because of the advice gap that developed and was aimed at finding solutions to fix it. The report states that up to 17 million people could be trapped in the U.K.'s advice gap. In addition, it shows that there are 25% fewer financial advisors in the U.K. post-RDR. The report also notes that two-thirds of investment products in the U.K. are bought without professional advice which is up one-third from 2007. An FCA's survey of advice showed that over the previous two years, the number of firms who ask for a minimum portfolio of more than £100,000 has more than doubled, from around 13% in 2013 to 32% in 2015. A further survey

		indicated that 45% of firms very rarely advise customers on retirement income options, if those customers have small funds (i.e. less than £30,000 to invest). Further, the report cited a 2016 survey that indicated that 69% of financial advisors had turned away potential clients over the previous 12 months for reasons of affordability. The embedded commission model has enabled millions of middle-class Canadians, who otherwise could not afford upfront fees or who are unwilling to pay upfront fees, to access financial advice and save for retirement through mutual funds. The CSA needs to recognize this fact. The overarching goal of the CSA should be to foster healthy competition in the marketplace and protect investors, not inhibit competition and harm investors.
	Part 3	
4.	For each of the following investment products, whether sold under a prospectus or in the exempt market under a prospectus exemption: • mutual fund • non-redeemable investment fund • structured note should the product be subject to the discontinuation of embedded commissions? If not: a. What would be the policy rationale for excluding it? b. What would be the risk of regulatory arbitrage occurring in the exempt market if embedded commissions were discontinued for the product only when sold under prospectus?	Yes. See our response to question 2 above.
5.	Are there specific types of mutual funds, non-redeemable investment funds or structured notes that should not be subject to the discontinuation of embedded commissions? Why?	No.
6.	Are there other types of investment products that should be subject to the discontinuation of embedded commissions? Why?	See our response to question 2 above.
7.	Do you agree with the discontinuation of all payments made by persons or companies other than the investor in connection with the purchase or continued ownership of an investment fund security or structured note? Why or why not?	No. We do not believe that the Paper went far enough to prohibit other types of payments, including internal transfer payments of proprietary fund sales at the banks, which may not be tied to the purchase or continued ownership of a fund security. While certain of the banks have made it clear in their disclosure documents that the internal transfer payment paid between affiliated companies is a trailing commission, others have not. If the internal transfer payment is being paid out of an

		MER, then it should be prohibited. In addition, the Paper did not address the compensation related conflicts associated with separately managed accounts ("SMA") or unified management accounts ("UMA"). SMAs and UMAs are increasingly becoming popular among the banks. While SMAs and UMAs are considered fee-based accounts, investors may not be aware of the fact that a higher portion of the fee goes towards advisor compensation than the trailing commission on a mutual fund. Rather, SMAs and UMAs are being pitched as a cheaper and superior alternative to mutual funds, which in many cases they are not. Therefore, the CSA must address the compensation conflicts associated with these products as well.
8.	Are there other fees or payments that we should consider discontinuing in connection with the purchase or continued ownership of an investment fund security or structured note, including: a. the payment of money and the provision of non-monetary benefits by investment fund managers to dealers and representatives in connection with marketing and educational practices under Part 5 of NI 81-105; b. referral fees; and c. underwriting commissions Why? What is the risk and magnitude of regulatory arbitrage through these types of fees and commissions?	Yes. See our response to question 7 above. Fidelity does not believe that the payment of money and the provision of non-monetary benefits in connection with marketing and educational practices under Part 5 of NI 81-105 should be discontinued. Marketing and educational practices that currently constitute an acceptable primary purpose are beneficial to advisors and investors. Investors expect a wide range of information in order to make informed investment and financial planning decisions. It is therefore equally important to help equip advisors with the tools they need to appropriately engage their client base. If the CSA were to discontinue these benefits, the CSA would be denying investors and advisors access to important education and information in what is otherwise permissible areas. In addition, the costs associated with marketing and educational practices which are supported in part by fund managers could ultimately shift to retail investors. This would not be ideal. Fidelity believes that NI 81-105 is a useful and principled regulatory tool, if enforced appropriately. Many of the conflicts associated with accessible payment options would be mitigated if NI 81-105 was simply enforced. We would, however, urge the CSA to enhance NI 81-105 to cover other types of retail investment products, including managed accounts and insurance products.
9.	If payments and non-monetary benefits to dealers and representatives for marketing and educational practices under Part 5 of NI 81-105 are	See our response to question 8 above.

	maintained further to the discontinuation of embedded commissions, should we change the scope of those payments and benefits in any way? If so, why?	
10.	With respect to internal transfer payments: a. How effective is NI 81-105 in regulating payments within integrated financial service providers such that there is a level playing field for proprietary funds and third party funds? b. Should internal transfer payments to dealers within integrated financial service providers that are tied to an investor's purchase or continued ownership of an investment fund security or structured note be discontinued? Why or why not? To what extent do integrated financial service providers directly or indirectly provide internal transfer payments to their affiliated dealers and their representatives to incent the distribution of their products? c. Are there types of internal transfer payments that are not tied to an investor's purchase or continued ownership of an investment fund security or structured note that should be discontinued?	See our response to questions 7 and 8 above. We believe that NI 81-105 has not been effective at regulating internal transfer payments within the banks such that there is a level playing field among proprietary and third-party funds. There is a misconception across industry participants that internal transfer payments from affiliates are different from trailing commissions, even if the payment is not directly tied to activity in a client's account. However, they are not much different at all. For example, in MFDA Bulletin #0654 – P, the MFDA considered the reporting of internal transfer payments received from affiliates in the context of the implementation of CRM2. The MFDA opined that members who receive transfer payments instead of commission revenue must make a reasonable estimate of what it would have received if it earned commission revenue and report it. These payments are undoubtedly connected to registrable activities. The MFDA's consideration of this issue can be viewed as an explicit acknowledgement by a regulator that internal transfer payments received from affiliates are generally akin to trailing commissions.
11.	If we were to discontinue embedded commissions, please comment on whether we should allow investment fund managers or structured note issuers to facilitate investors' payment of dealer compensation by collecting it from the investor's investment and remitting it to the dealer on the investor's behalf.	Yes, fund managers should be allowed to facilitate investors' payment of dealer compensation by collecting it from the investor's investment and remitting it to the dealer on the investor's behalf.
	Part 4	
	Addressing the issues	
12.	Based on a consideration of the data and evidence provided in this Part, would a proposal to discontinue embedded commissions address the three key investor protection and market efficiency issues discussed in Part 2?	See our response to question 1 above. No. We believe that banning embedded commissions would have more negative impacts on investors and industry participants than positive ones – loss of jobs, savings rates will be jeopardized, and the middle-class and Canadian economy will suffer as a result. We believe that the conflicts associated with the embedded commission model can be appropriately managed as opposed to avoided. The goal of the CSA should be to foster choice and broaden access to financial advice. Mass market households

		should be able to decide how they want to access and pay for financial advice. Research has shown that in an unembedded world, the cost of advice generally increases. Mass market households simply cannot afford and are generally unwilling to pay upfront fees. Therefore, the CSA should be taking measures to enable choice and access to advice as opposed to taking measures, which could eliminate them.
13.	Are there other ways in which the CSA could address these issues that could be introduced in conjunction with, or separate from, the discontinuation of embedded commissions?	We believe that there are other ways in which the CSA could address these issues, while preserving choice and access to advice. See our response to question 8 above. In the absence of a ban, we have seen: 1) A significant rise in fee-based sales; 2) A reduction in mutual fund costs through healthy competition; 3) Innovative technology enhancements; 4) Simplified pricing models like Fidelity's Preferred Program; and 5) Increased investor awareness of the costs associated with mutual fund investments. We believe that these initiatives could address some of the issues without the need for further regulatory action. In addition, there are recent global trends that the CSA should take note of. Based on our research, a number of countries around the world have not banned embedded commissions. For example, Sweden most recently came out in opposition of a ban because of, among other things, the disproportionate harm to small investors. The U.S. administration recently directed the Department of Labor to review the Fiduciary Duty Rule to determine whether it may adversely affect the ability of Americans to gain access to retirement information and financial advice. Also, the U.S. administration released an executive order outlining the core principles for regulating the U.S. financial system – one such principle being to "empower Americans to make independent financial decisions and informed choices in the marketplace, save for retirement, and build financial wealth". Even here in Canada, other than in Ontario and New Brunswick, the CSA jurisdictions have decided to abandon the pursuit of a best interest standard and have shifted their focus to the implementation

		of certain targeted reforms set out in CP 33-304. Suffice it to say, we believe that the global trend is shifting away from regulatory action that would limit choice and access to advice in favour of preserving them.
14.	Are there other conflicts of interest that could emerge following a transition to direct pay arrangements that would not be addressed in the current securities regulation framework?	As indicated in our response to question 1, all compensation models have conflicts. In December of 2016, the CSA and SROs published staff notices, which shed light on many of the inappropriate sales practices, including proprietary sales practices at the banks and other large integrated financial services firms. In the cases of fee-based accounts, individual advisors may be paid more compensation with respect to fee-based programs in comparison to the compensation they would receive from trailing commissions on a mutual fund. Investors may not be aware of these practices or may not have knowledge of what their account fee pays for. In addition, whether such fee-based account fee is charged hourly, flat or based on a percentage of total assets, many retail investors are generally not in a position to negotiate or understand if the account fee is appropriate. Even if the fee was dependent on the level of services required, it is more likely that the investor will be given a menu of options with stated prices to choose from. It would be impractical to expect advisors to calibrate their fee to the level of services provided. For example, the banks generally charge minimum fees to service fee-based accounts. The fees are tiered and based on total assets often with little to no room to deviate from. As a result, retail investors are often placed in a natural conflict position based on information asymmetry. Overall, we believe that fee-based platforms generally incentivize advisors to recommend products that focus on maximizing their compensation rather than focusing on meeting the investor's investment objectives. In spite of the existence of conflicts in fee-based scenarios, no jurisdiction, including Canada, has proposed to eliminate direct fee arrangements. Rather, the CSA believes that because a fee-based world is transparent, it is sufficient for these conflicts to exist. However, we believe that the CSA should not prohibit one compensation model in favour of another – that is not the role of the regulators. Rather, the CSA and SROs should focus

		on enforcing current conflict of interest and sales practices rules to ensure that compensation programs are designed in such a way that there is no financial motivation to bias an advisor to sell one product over another.
	Change in investor experience and outcomes	
15.	What effect do you think the removal of embedded commissions will have on investor experience and outcomes? In particular: • Will investors receive advice and financial services that are more aligned with the fees they pay? • What effect will the proposal have on the growth of automated advice? Is this likely to be beneficial to investors? • Is discretionary advice likely to increase in Canada as we have seen in the other markets that have transitioned away from embedded commissions and, if so, would this shift be positive or negative for investors? • What effect will the proposal have on the growth of the online/discount brokerage channel and cost of fund products offered in this channel? Is this likely to be beneficial to investors? • What effect will the proposal have on the cost and scope of advice provided to specific investor segments?	If the CSA proceeds with a ban, Fidelity does not believe that the outcomes and experiences for all investors will be positive. A ban will undoubtedly lead to negative consequences for mass market households. We saw no compelling evidence in the Paper that suggests a misalignment of interests regarding advice and services received in exchange for fees paid. There is also no compelling evidence that suggests that embedded commissions in Canada have led to an abuse of investors by advisors. Our dealer community has told us that CRM2 is doing a good job in explaining advice and services received in exchange for fees paid. With respect to automated advice channels, while we appreciate the growth of robo-advisors and acknowledge a place for them in the marketplace, we believe that they are not the main solution to solving the advice gap. It has become apparent in foreign jurisdictions where robo-advisors have grown that they have limitations that inhibit them from effectively serving all types of investors – which is the opposite of what the regulators had predicted. In Canada, where robo-advisors are relatively new, they are generally only attracting higher net worth investors and do not offer complete financial services. In addition, there are still many investors who prefer face-to-face interactions and do not entrust their monies to automated devices. While robo-advisors may offer a platform that is a lower-cost alternative for some investors, they lack the full capabilities that traditionally come with face-to-face advice and mutual fund investments. In terms of the discretionary advice channel, we believe any increase in their use will be marginal. We note that many retail investors today simply cannot access this channel because of the premiums and liability involved. If the CSA proceeds with a ban, it is difficult for us to envisage how retail investors will access this channel if they cannot access it now. See our response to question 14 above with respect to the effect that the

		proposal will have on the cost and scope of advice provided to specific investor segments. Prohibiting accessible payment options will cause irreparable harm to investors and the mutual fund industry. As we have seen play out in the U.K. and Australia, the predictable consequences of a ban are: (i) higher cost of advice; (ii) less access to advice; (iii) fewer advisors to service investors; and (iv) lower savings available at retirement.
16.	What types of payment arrangements are likely to result if this proposal is adopted? In particular: • Would the payment arrangements offered by dealers to investors differ based on investor segment? If so, how and why?	See our response to question 14 above.
17.	Do you think this proposal will lead to an advice gap? In particular: • Which segments of the market are likely to be affected? Please consider segmentation by wealth, geography (size and location of community e.g. remote, small, medium, large), age, technological sophistication, the level of fund ownership across households, etc. • Do you agree with our definition of an advice gap? • Should we differentiate between an advice gap for face-to-face advice and an advice gap generally? • What types of advice or services currently provided today would be most affected by the proposal? • Are there any potential interactions between this proposal, existing reforms such as CRM2 and other potential reforms such as CSA CP 33-404 that may affect the size of any potential advice gap? • How could a potential advice gap, face-to-face advice gap or financial service gap be mitigated? • Do you think that online advice could mitigate an advice gap? If so, how? • Do you think that the significant market share of deposit-taker owned and insurer-owned dealers in fund distribution in Canada will affect the size or likelihood of an advice gap to develop?	Yes, the proposal will lead to an advice gap. See our response to question 3 above. The segment of the market most likely to be impacted is the segment that the CSA should most closely protect – those with less than $100,000 to invest. 5.2 million (33%) Canadians save through mutual funds. 76% of investors have less than $50,000 in investable assets. Approximately 4.5 million households (22% of Canadians) save through the embedded fee model. Currently, 80% of Canadian mutual fund investors who purchase their mutual funds through a financial advisor choose embedded commissions as an accessible payment option to get advice and save toward their financial goals. Retail investors need and value financial advice. We expect that a ban will drastically limit retail investors' access to financial advice as investors will no longer seek advice as they will perceive the costs to be too high. Mutual funds allow small investors to access professional money management because the services are subsidized by larger investors in the funds who pay higher fees. Similarly, smaller investors are serviced by advisors because, in total, their fees from smaller and larger investors allow them to be able to afford to service small investors. However, if the CSA proceeds with a ban, it will not be economic for advisors to service smaller investors in many cases. The risk of an advice gap developing in Canada is real and should not be taken lightly.

		As discussed in the main body of our letter, we know that modest investors are costly to serve relative to the assets they invest and the fees they generate for dealers and financial advisors. In the Canadian marketplace, there are many dealers that have high asset thresholds before a client is taken onboard. These thresholds can be $100,000 or even as high as $250,000. Yet the majority of households with investable assets have less than $100,000. One study by Pricemetrix demonstrated that the number of small households (defined as less than $25,000 in assets) had a significant negative effect on the future production of financial advisors. It found that advisors actually pay a penalty in terms of decreased future revenue for the small households they keep on their books. The study went on to quantify this impact. Another Pricemetrix study found that diversifying away from small households dramatically improves production. We believe it is important for the CSA to understand the true cost of advice and the amount of time it takes to service a small versus large investor. While no compensation model is perfect, the embedded commission model in Canada has worked well for retail investors. Canada is in a very different position than other jurisdictions that have banned embedded commissions. The real issue, we believe, has to do with the lack of regulatory enforcement of existing conflict and sales practices rules. In our view, if the CSA and SROs would focus on enforcing these rules, we would find ourselves in a much different position. Also, POS and CRM2 have done a good job in helping retail investors understand the costs associated with securities investments and how advisors are paid. Unlike other jurisdictions, the CSA has worked hard over recent years to enhance disclosure initiatives. Therefore, we feel that these initiatives should be given the time to play out and then be assessed to determine if additional regulatory measures are needed.
	Industry change independent of regulatory response to discontinue embedded commissions	
18.	Given some of the changes we have seen in the industry over the past few years (fee reductions, introduction of DIY series, streamlining of fund series, automatic fee reductions increasing access to fee-based options etc.), what is the likelihood that the fund industry will transition away from embedded commissions without regulatory action? In particular:	We believe that it is unlikely that the fund industry will transition away from accessible payment options in the absence of regulatory action. However, we do think that modest investors will continue with the embedded fee model while more affluent investors will move more and more to fee-based accounts. See our observations stated in question 13 above.

	• Will the industry continue to transition away from embedded commissions if the CSA does not move forward with the proposal?	In recent years, Fidelity has seen a significant increase in series F sales and more recently a spike in series F redemption rates. We expect that this phenomenon equally applies across the fund industry as a whole. Fidelity redemption rates in series F are on average 50% higher than our embedded commission series. We believe that this spike in redemptions may, in part, be attributable to advisors feeling that they need to justify their fee with account activity. In almost all circumstances, though, research has shown that frequent trading is almost always detrimental to long-term results. Fidelity advocates for choice, and having accessible payment options will, in our view, remain the best option for mass market households to access advice and professional money management. We will, however, in the absence of a ban, continue to see markets evolve in a way that preserves choice and allows all investor segments the ability to choose how they wish to access and pay for financial advice.
19.	How accurate is Figure 8 regarding the purchase options available to fund investors by channel, account size and firm type? In particular: • Do you see payment options and business models evolving at present? • How are they likely to change over time if the CSA were to choose not to move forward with the proposal?	We believe that this question would more appropriately be responded to by dealers.
20.	We note that the distribution of fee-based series is still relatively limited in Canada versus other markets. Are there obstacles (structural, operational, regulatory, investor demand, etc.) specific to Canada limiting the use of fee-based series by dealers?	From a fund manager's perspective, we do not believe there would be obstacles specific to Canada in limiting the use of fee-based series by dealers. We note, however, that there are dealers who are set up exclusively to transact using the embedded commission model. Therefore, we suspect that these dealers will have significant infrastructure costs in order to limit their shelf to fee-based offerings.
	Potential impact on competition and market structure	
21.	Please describe how discontinuing embedded commissions will affect competition and market structure and whether you agree with the analysis set out in Part 4? In particular: • Do you think the proposal will have an impact on the level of industry consolidation or integration? What about with	We do not agree with the analysis set out in Part 4. Many of our responses to this question are dealt with in preceding questions.

	respect to the concentration of mass-market investor assets held in investment products managed by deposit-taker owned firms? • What are the likely impacts on investor outcomes and market efficiency of any potential consolidation? • What opportunities and what challenges do you think the proposal would introduce for specific industry stakeholder groups? o Independent dealers? o Independent fund manufacturers? o Integrated financial service providers? o Mutual fund dealers? o IIROC dealers? o Online/discount brokers? • What is the likelihood and magnitude of regulatory arbitrage across similar financial products such as segregated funds and deposit-taker products? • What would be the impact on dually-licensed mutual fund dealers and insurance agents? • Will the proposal lead new, lower-cost entrants to the market? Why and how? • Does the interaction between this proposal and the proposals set out in CSA CP 33-404 change your responses to the questions above and, if so, how? • Will a transition away from embedded commissions reduce fund series and fee complexity, as we have contemplated? • Do integrated financial service providers have an advantage in terms of their ability to cross-sell and cross-subsidize across business lines? If so, how? • What are the potential effects on competition of the rise in online advice? Are these effects likely to be large and positive?	According to the Conference Board of Canada, the Canadian mutual fund industry has an economic footprint of $17 billion in GDP, contributes $7 billion in tax revenue and supports 192,600 jobs across Canada. After the U.K. banned embedded commissions, it saw a significantly negative impact on jobs and investors. The number of financial advisors fell by 9,000 (22%) from 40,000 to 31,000. As many of these advisors were small business owners, which directly and indirectly supported additional jobs, the total impact on jobs is estimated to be much higher. Likewise, if Canada were to proceed with a ban, Fidelity anticipates that the number of advisors will be significantly reduced, by as much as 20,000, with the most devastating impact to small investors who rely on these advisors. In addition, another significant negative impact in the U.K. was a dramatic decrease in the percentage of opening of new accounts by middle-class citizens. The U.K. saw a 50% drop in new accounts being opened because middle-class citizens who relied on embedded commissions as an accessible payment option could not afford or simply chose not to pay upfront fees. In Australia, upfront fees increased by 22%. In Canada, we also anticipate that a ban will result in higher upfront fees for advice, which will in turn result in fewer middle-class Canadians accessing advice and saving for retirement. Fidelity estimates that there will be a 20% to 30% decline in middle-class Canadians receiving advice. That translates to 1.5 million "orphaned" households, which could pose a significant challenge in an aging population. We disagree with the CSA's view that the solution to the advice gap will be the banks and robo-advisors. We do not believe it is the role of the CSA to favour one distribution model over another. The CSA's role is to regulate. In order to have a healthy securities industry, all stakeholders need to co-exist. When Sweden decided against a ban, it reasoned: 1) Firms with their own distribution would be in a more favoured position; 2) The potential negative effects on smaller, independent asset managers were not desirable; 3) A ban could lead to the unfavourable outcome of concentration of asset management with the banks; and

		4) There was a likelihood of the development of an advice gap, similar to what happened in the U.K. We believe that Sweden's recent decision is an example of a jurisdiction that was concerned with the negative consequences of a ban on competition, small investors and the resultant concentration of ownership among the banks. Finally, approximately 85% of financial advisors licensed with the MFDA are dually licensed as insurance salespeople. And similarly, of IIROC advisors, 63% are dually licensed. We are concerned that with the regulation of fees for mutual funds and the unbelievable increase in compliance burdens faced by these advisors, they will feel that their only option is to sell less regulated, transparent and unsuitable products to their clients. This is not a good result.
22.	What impact will the proposal have on back office service processes at the investment fund manager or at the fund dealer? In particular: • Is there any specific operational or technological impact that we should take into consideration?	If the CSA proceeds with a ban, Fidelity would need to decommission and reconcile all existing holdings that have embedded commissions with its dealers, as the ban would impact transfer agency, accounting systems, finance, FundServ, etc. In addition, depending on what the grandfathering rules would be, there could be substantial conversion efforts and enhancements to systems if Fidelity had to convert all ISC/DSC series to series F at an inopportune time. We note that transitioning to a fee-based world will put pressure on dealers to consolidate client billing from across their nominee and client name businesses. For smaller planners, this will be an issue, and is one reason for why Fidelity launched its redemption of units ("ROU") program. Operationally, fund managers will need to spend more time launching and administering their ROU programs to accommodate dealers. Alternatively, we believe FundServ will need to work on an industry enhancement to make it easier for fund managers to collect and remit redeemed units (and the corresponding sales tax) to dealers.
23.	The payment of embedded commissions requires the dealer and the investment fund manager to implement controls and oversight (with associated compliance costs) in order to mitigate the inherent conflicts	Generally, mutual fund managers do not monitor advisor conflicts with respect to embedded commissions – that is a dealer responsibility. Fidelity's systems have controls in place that do not permit inappropriate

	of interest today. • Would the transition to direct pay arrangements alleviate the need for some of these controls and oversight? • To what extent, if any, does the use of direct pay arrangements by representatives today (e.g. when a representative provides services under a fee-based arrangement) alleviate the need for some of these controls and oversight?	switches between certain series, or switches that would trigger new DSC schedules for existing units.
24.	Embedded commissions, especially trailing commissions, provide a steady source of revenue for dealers and their representatives. If embedded commissions were discontinued, would dealers be able to compensate for the loss of this revenue with direct pay arrangements?	We believe that smaller independent dealers who transact exclusively using the embedded commission model would be most harmed by a ban. We suspect that these dealers would be unable to compensate for the loss of revenue with direct pay arrangements – not only because of significant infrastructure changes, but primarily because their clients will most likely fall into the advice gap and would be unwilling to pay upfront fees for financial advice. Therefore, these dealers may be forced to consolidate or shut down.
25.	Aside from commission grids and salaries, what other approaches to representative compensation might dealers use if we were to discontinue embedded commissions? How are these approaches likely to change over time?	Fidelity believes that the real issue is that current conflict and sales practices rules have not been enforced appropriately. We encourage the CSA and SROs to take strong regulatory action against sales practices that do not meet current standards. We believe that it is important for the CSA and SROs to set out exactly what sales practices and incentives are permissible and those that are not. More recently, IIROC released Notice 17-0093 on April 27, 2017, which set out the detailed findings and analysis regarding their compensation review. Of particular note, IIROC found a bias on the part of most dealers towards fee-based accounts over commission-based accounts – i.e. most dealers provide the highest possible grid payout to their advisors for fee-based revenue. IIROC is concerned that investors may be moved into fee-based accounts, whether or not such accounts are consistent with the investor's best interest. Most IIROC dealers said they believe that fee-based accounts align registrant interests with client interests better than commission-based accounts. However, IIROC acknowledged that while this may be true in some cases, there are other cases such as "buy and hold" where this may not be true. As previously mentioned, we believe that all compensation programs should be designed in a way that removes any financial motivation to bias an advisor to recommend one

		product over another.
26.	What impact will the proposal have on representatives in the industry? In particular, what impact will the proposal have on the: • career path; • attractiveness of the job; • typical profile of individuals attracted to the career; • recruitment; and • relative attractiveness of careers in competing financial service business lines?	See our response to question 21 above.
	Part 5	
27.	How practicable are the mitigation measures discussed and how effective would these measures be at assuring: • access to advice for investors, • choice of payment arrangements for all investor segments, and • a level playing field amongst competing investment products?	Not practicable at all. See our response to question 21 above.
28.	What other measures should the CSA consider to mitigate the above unintended consequences?	We strongly urge the CSA not to proceed with a ban. We offer, however, the following measures the CSA could consider to mitigate the conflicts associated with the embedded commission model: 1) Create standardized distribution commissions by asset class (i.e. equity, fixed income and balanced). In our view, a level fee eliminates and neutralizes the conflict of differing payments to advisors; 2) Offer investors the choice of embedded or other alternative fee structures and explain the implications of each choice in a clear way; 3) Provide a list of minimum services that investors must receive in return for the trailing commission; 4) Implement certain targeted reforms under CP 33-404; 5) Enforce NI 81-105 immediately and vigorously, and amend it to apply to managed accounts like separately managed accounts and unified managed accounts; 6) Introduce CRM3 disclosure to include management fees charged by fund managers;

		7) Do not allow full trailing commission series to be sold on discount brokerage platforms; 8) Standardize naming conventions for fund series; 9) Provide further guidance and continue enhanced regulatory scrutiny on the sale of DSC funds; 10) Improve financial literacy and continue to measure other disclosure and regulatory initiatives such as POS and CRM2; and 11) Roll out similar rules to all competing investment products, including insurance and bank products that are now not governed by comparable rules.
29.	Other than the potential impacts we have identified in Part 4, what other potential unintended consequences, including operational impacts and tax consequences, may arise for fund industry stakeholders and investors further to the discontinuation of embedded commissions? In particular: • Would there be a negative tax impact to investors associated with their payment of dealer compensation under direct pay arrangements? In particular, would the investor's payment of dealer compensation through periodic fund redemptions facilitated by the investment fund manager attract tax consequences? Please explain. • To the extent a transition to direct pay arrangements results in the rationalization of fund series, could this rationalization attract negative tax consequences for investors? • What, if any, measures, regulatory or otherwise, could assist in mitigating potential operational and tax impacts?	Fidelity does not object to compensating dealers through periodic fund redemptions facilitated by the fund manager. An ROU in non-registered accounts would result in a disposition for tax purposes, and the investor would be subject to tax on capital gains or incur a capital loss. Unitholders may not be able to deduct the dealer compensation fee if the CRA takes the view that the dealer compensation does not meet the specific requirements in Section 20(1)(bb) of the *Income Tax Act* (Canada), which the fees must be: 1) reasonable; 2) represent fees for advice provided to investors regarding their purchase/sale of specific securities or includes the provision of administration or management services in respect of the securities; and 3) paid by the investor to the dealer whose principal business is advising others regarding the purchase/sale of specific securities or includes the provision of administration or management services in respect of the securities.
30.	With respect to the loss of a form of cross-subsidy from high net worth investors to lower-wealth investors in a fund further to a transition to direct pay arrangements, • to what extent (please quantify where possible) would the loss of this cross-subsidy increase the cost of providing advice and services to lower-wealth fund investors under direct pay arrangements?; • does the existence of this form of cross-subsidy suggest that	Cross-subsidization is an inherent part of the mutual fund structure. While Fidelity's two-series structure avoids many of the issues associated with cross-subsidization, the vast majority of the mutual fund industry uses a combined series structure. Fidelity is an advocate for different series for each purchase option and particularly the reduction in fees for front-end investors. There is little doubt that Fidelity's front-end purchase option is cheaper for the fund manager and we have chosen to pass on those savings to our investors. While we acknowledge that cross-

	high net worth fund investors may be indirectly paying fees that are not aligned with the services they are receiving (i.e. do the fees they pay exceed the actual cost of the services and advice they receive?); and • what measures may mitigate the potential effects on dealers, representatives and investors from the loss of the cross-subsidy?	subsidization is a standard practice, we did not see any sufficient evidence in the Paper to suggest that this practice is a problem. In our view, to the extent that valuable advice and professional money management is being provided to investors, we do not object to this practice.
31.	What measures could fund industry participants proactively take to mitigate the unintended consequences that may stem from the discontinuation of embedded commissions?	See our response to question 28 above. As previously mentioned in our response letter, Fidelity does not believe that a ban is an appropriate solution to lessen the conflicts that may stem from the embedded commission model.
32.	For each transition option, please tell us how your business (investment fund manager or dealer) would have to operationally change or restructure in terms of systems and processes and the related cost implications. Where possible, please provide data on the estimated costs. • Are there unique costs or challenges to specific businesses? • What transition period would be appropriate? • Should existing redemption schedules for DSC and low-load purchase options be maintained until the redemption schedule is completed, or discontinued at the Transition Date?	See our response to questions 20 and 22 above. From a fund manager perspective, we expect there to be significant upfront operational and structural challenges in order to successfully transition to a direct pay model – e.g. investor mailings, prospectus filings, data conversion efforts, etc. We also expect, however, that dealers will face even more significant operational and structural challenges – to the point where smaller independent dealers may be forced to consolidate or shut down.
33.	Which transition option would you prefer? Why? Are there alternative transition options that we should consider?	Should the CSA decide to proceed with a ban, Fidelity would prefer if the CSA adopted a transition period of at least 60 months. We would, in addition, propose that investors currently in DSC funds be grandfathered until their DSC schedules mature. If no grandfathering provision is permitted, we question who would absorb DSC fees, if applicable.
34.	As discussed in Appendix B, the CSA did not retain the option of capping embedded commissions, either as a stand-alone solution to the key issues discussed in Part 2 or as an interim step toward an eventual discontinuation of embedded commissions. Should the CSA further consider using a fee cap as a transition measure? Why?	We question why the CSA would consider a fee cap as an appropriate transition measure, but not consider a cap as an appropriate measure to help mitigate the conflicts associated with the embedded commission model.
	Part 6	
35.	Please explain whether you think each of the initiatives discussed above will, either alone or in combination: • address the three investor protection and market efficiency	Yes. We believe that POS and CRM2 will address many of the issues identified in Part 2. Both these initiatives have, in combination, increased transparency on the fees and costs associated with mutual fund and other

	issues and their sub-issues identified in Part 2; and • address or not address any additional harms or issues that you have identified.	securities investments. Recent research by the BCSC confirms that CRM2 is accomplishing what the BCSC has hoped to accomplish – an increased awareness of fees and the performance of investments. If the goal of the CSA is to ensure that investors have a better awareness of costs and fees, we believe this would be better accomplished through proper disclosure and literacy initiatives as opposed to an outright ban. Unlike those jurisdictions that banned embedded commissions, the CSA is in a unique position and should give POS and CRM2 the time to run their course and be assessed to determine if appropriate regulatory measures are needed. Of course, Fidelity acknowledges that disclosure initiatives alone may not entirely address the investor protection issues identified in Part 2. However, we believe that the CSA has many regulatory tools that they should use – i.e. enforce NI 81-105 and current conflict rules, implement certain targeted reforms in CP 33-404 and continue with their sales practices compliance reviews. If these tools are used and enforced appropriately in combination with disclosure and financial literacy initiatives, the CSA will likely find a reduction in inappropriate sales practices. This will undoubtedly lead to better conflict management and would allow the Canadian marketplace to evolve in a positive way that preserves choice for investors and allows all compensation models to co-exist.
36.	Are there alternative options or measures, whether regulatory or market-led, that could successfully address the three investor protection and market efficiency issues and their sub-issues identified in Part 2. If so, please explain.	See our response to question 28 above.