From: Jonathan Hunt [redacted]
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To: comments <comments@osc.gov.on.ca>
Subject: Request for comment with regards to embedded commissions

The following are some thoughts I have gathered with regards to the banning of embedded commissions and the effect this will have on both the industry and investors alike.

Due to widely varied Industry experience, I believe I have developed a somewhat more nuanced perspective than most. As an industry participant for over 30 years, I have worked as multiple award-winning advisor, as both a Branch and Provincial Manager for an MFDA firm, as an industry pioneer who built and ran Canada's first Internet-based online trading system, as software provider of secure communications technology to both public and private mutual fund dealers and now as a consultant. I am also a financial consumer.

Reflecting back on three decades of working with clients, advisors and their firms, I am struck most of all by the effect of properly balanced incentive in the advisor/client relationship. In my experience, it has been the incentive that has done more than anything to generate and/or maintain wealth - that is, when the incentive has been properly aligned. Accordingly, it is the optimization of incentive that the CSA should ideally look to balance that will ensure the continuation of Canada's wealth growth.

Our countries wealth has been built in large part thanks to the efforts of independent financial services professionals. With the wealth they have helped generate has come peace, stability, tolerance, education, artistic culture and a whole host of other benefits. Despite the fact that the compensation system might not have been the cheapest or ideal, it worked. As a nation, we are idealized by the world. The wealth we have grown is an integral part of that. So to radically change the recipe or formula that lead to our world class success should be looked upon with skepticism.

I refer to the question of generation of wealth, (particularly with clients where there was none before), as to whether the banning of embedded commissions will ultimately end up generating more wealth for Canadians as a whole? As mentioned, along with the freedom that wealth brings, come a whole host of other beneficial attributes which help our society as a whole. So if the CSA gets the decision right, the benefits will cascade for years or even generations to come. Destroying the source of our success however, may see the opposite also come true.

A few examples from my history that have led to my opinion...

I was first licensed to sell mutual funds back in 1985. Back in the mid-1980's, the mutual fund business was a sales industry above all. Back then, there was no option for DSC, no fee-based options, and no no-load mutual funds. At that stage, there was only a non-negotiable 9% front-end load if you wanted to purchase investment funds.

Although confining, the approach generally worked well. As discussed above, the incentive of just having paid 9% off the top meant both that investors were in for the long term and advisors were well paid for their sales efforts. It was expensive, but a mostly balanced approach to sales compensation that worked - as long as there was relative stability in the markets that is.

A 9% fixed commission environment was far from ideal however. Apart from being very expensive for the consumer, the lack of ongoing compensation meant that sales reps spent all of their time chasing new money - as opposed to helping their clients increase their wealth on an ongoing basis. When the crash of

1987 hit, this became apparent as about 80% of reps went out of business due to a complete dearth of new investments.

After 5 years of stagnancy, the industry managed to mature to a quasi-professional nascent financial planning industry with the help of Mackenzie Financial and their Industrial Horizon Fund. They saw the need to professionalize the industry (and no doubt maintain distribution). The Horizon Fund ushered in the DSC age and in doing so enabled the meager subsistence the industry needed to sustain itself through tough times.

Once again, we see targeted incentive guide the market and a result literally millions of Canadians benefited from basic financial planning. Our nation today is wealthier as a whole because of it.

About 4 years into my career as a mutual fund salesperson, I was suddenly thrust into a management position due to the untimely passing of the branch manager. Over the following 18 months, we were able to grow our branch advisor base to over 50 reps while we took our branch assets up to $80M from $5M through the use of technology, training, and aggressive marketing.

Looking back, of great significance during that period was the role that incentive played in generating new wealth that was simply not there before.

More junior advisors started selling savings plans with restrictions. United Financial had an innovative savings program called the Own and Loan which enabled some level of front end loading of commissions to the advisor - not unlike how an insurance policy commission works today.

The upfront commission payment was backed by the need for the clients to retain their money in the funds for a number of years or suffer a significant penalty. In principle, what the product did was enable the time an advisor needed to deal with someone who had no savings whatsoever. In a sense, it created the incentive for both the advisor (to write up the client) and the saver (not to spend their money).

And it worked incredibly well. In fact, I cannot recollect one instance over all of the years of a client who actually cashed in early and suffered the penalty. All people who had no money before, created a little nest egg. But none of that would have been without the incentive built into the product. You could say that it was the well-balanced incentive that helped turn a poor person into one with some long term savings.

Now perhaps the members of the CSA board reviewing this submission would never personally invest in such an onerous back end loaded product. Perhaps the relatively small amounts of money that we're talking about ($50-$100/m) seem insignificant. But to a middle aged worker who has never had any stability in their financial affairs, any help from anyone - even with only limited financial knowledge, along with the ongoing encouragement, was truly a life changing decision.

This is of fundamental importance to our society. Because along with wealth comes a myriad of other benefits - social and otherwise. Wealth brings with it a share of pride. It enables dignity while inspiring hope. So to bring this to the working poor was highly beneficial to both the client and community as a whole. Incentive, properly balanced with a relationship is ideal. A properly compensated financial planner is like a coach. And everybody, even Wayne Gretzky, can use a coach. So in forming policy, we need to be looking at how we can grow more coaches, not less - particularly in light of record levels of Canadian debt and the likelihood of significant financial turbulence down the road.

Which brings us to culture and the need for ensuring proper service for the coveted incentive.

As a general rule, in dealing with and providing services to well over a thousand independent advisors, it is clear that the vast majority of them put their client's first and deal with them in a highly ethical manner.

What is also evident however, is that there is no industry-wide commitment to servicing those accounts in return for the trailer fees that are paid annually. The majority of advisors and firms provide little in the way of meaningful ongoing service to anything other than their most important accounts. This is unfair to clients rich and poor that today have little choice but to continue to pay on going management fees and this is particularly where the CSA can and should seek to incent action through policy.

Yes, once again, incentivization can come to the rescue.

Case in point...

About 7 years ago, I went through a particularly vicious divorce and ended up with a fair settlement that resulted from the sale of our nearly paid off house. At the time, my investment account was midranged and as a result I received no ongoing support from the investment firm I had the account with. Instead of seeking out help, I really did nothing and as a result slowly saw my saving dwindle as I refused to deal with leaky business matters head on.

The reality of the situation is that any objective financial professional could have pointed out what was clearly going on but not necessarily recognized by myself at the time. The reason that I have not heard from that rep for 7 years now is that he is under no obligation to do so. The account is not so big that it warrants attention from his perspective, but he's happy enough to collect the trailer fees on it every month.

As a consumer, if I am going to pay ongoing trailer fees out of my investment portfolio, I have a right to some guidance along with it. I don't think that anyone would dispute that. The onus for delivering such annual advice should be on him, not me. (In practice, this might be enforced in a similar manner to the annual KYC obligation registrants have).

So the simple answer to the complex question the CSA is faced with is to tweak the existing system by obligating advisors to annually sit down with their clients or to forfeit the year's annual compensation that is generated from the trailer fees.

There is no need however to upset the whole system that is the backbone of our successful society in the hope that it might, maybe become better. The policy world is littered with unintended consequences so why take the chance by removing consumer choice of compensation and thereby favoring a centralized big bank environment (with their culture of moving employees around, specifically so they do not form long-term bonds with their customers).

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