PRIMERICA FINANCIAL SERVICES
RESPONSE TO CSA CONSULTATION PAPER 81-408:
CONSULTATION ON THE OPTION OF DISCONTINUING EMBEDDED COMMISSIONS

JUNE 9, 2017

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Superintendent of Securities, Northwest Territories
Superintendent of Securities, Yukon
Superintendent of Securities, Nunavut

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Dear Sirs / Madames:

Re: CSA Consultation Paper 81-408 – Consultation on the Option of Discontinuing Embedded Commissions ("Consultation Paper")

Primerica Financial Services ("Primerica") appreciates the opportunity to submit comments on the Canadian Securities Administrators' ("CSA") Consultation Paper 81-408 – Consultation on the Options of Discontinuing Embedded Commissions.

1. Executive Summary

Primerica has been serving Canadian investors since 1986, with a mission to help middle income families become financially independent. The majority of our accounts start out very small and as such contain an embedded fee structure that allows us to put some upfront compensation into the hands of our mutual funds representatives, without reducing our clients' initial investment. This approach is key to servicing our small investor client base. Built-in fees are a reflection of the pooling principle behind mutual funds, making advice affordable and readily available to all investors regardless of account size.

The gap between regulatory intent and regulatory impact of the CSA's proposed ban on embedded fees will disproportionately affect vulnerable consumers and their access to savings and advice. The assumption that technology, including robo-advice, can close the advice gap that will inevitably be left by disrupting the vast majority of Canadians' savings method is overly optimistic. While robo-advice will continue to make its way into the market, and technology will continue to evolve and create efficiencies in the industry, by no means will this alleviate the immediate impact that a ban on embedded commissions will create.

The impact of significant consumer protection initiatives such as CRM2 that have recently been introduced should have an opportunity to be fully assessed - both on investors and the industry - before embarking on additional reforms that attempt to address similar concerns of conflicts of interest. We have in fact already seen the positive impact of CRM2 on investors' knowledge and understanding of the fees they pay and the cost of their investments. The second phase of the British Columbia Securities Commission's ("BCSC") longitudinal study focused on this matter proves this point with empirical data.

We believe caution is warranted so that Canada does not end up with outcomes similar to the UK after the Retail Distribution Reforms ("RDR") were implemented. Many middle income families that previously had access to financial advice no longer have that available to them. As well, the real danger of regulatory arbitrage that could push the mass market to products and services that may not serve them as well as mutual funds needs to be seriously considered.

Regulatory reforms should not impose a one-size-fits-all solution to a diverse industry that has served both investors' needs and our economy well to date. Nor should changes create an un-level playing field, advantaging one type of service delivery model over another. Targeted reforms and rules around the use of built-in fees along with improved transparency and meaningful disclosure are the best means to improve investment outcomes for Canadians.

2. About Primerica

Primerica is a leading distributor of basic savings and protection products to middle-income households throughout Canada. Our Canadian corporate group includes a mutual fund dealer ("PFSL Investments Canada Ltd."), a mutual fund manager ("PFSL Fund Management Ltd.") and a life insurance company ("Primerica Life Insurance Company of Canada"). Primerica has been serving Canadians since 1986. PFSL Investments has the largest salesforce of any independent mutual fund dealer in the country, with over 6,000 licensed mutual funds representatives ("representatives")[1]. It administers over $9 billion of client investments, the majority of which serve the savings needs of middle-income Canadians. Our life

[1] We have used the terms "representative" (which is how we refer to our advisors) and "advisor" (which is how the industry and the public refer to mutual funds representatives) interchangeably

insurance company contracts with 11,000 licensed life insurance agents, protecting Canadian families with over $100 billion of term life insurance in-force. As well, this company manages a segregated fund product with $3.2 billion of assets under management.

Our mutual fund dealer has an open shelf, offering funds from well-known managers. In addition, we offer a proprietary suite of mutual funds. All funds are vetted to ensure they meet the needs of the clients we serve. Over 85% of our assets under administration ("AUA") are in registered accounts. Our investment products and principles help middle-income Canadians establish a long-term savings plan for retirement, education and other needs. We work with middle-income Canadians to help them avoid the pitfalls of saving and investing: starting late, not saving enough, neglecting tax-advantaged opportunities, and buying and selling at the wrong times. We believe that we play a significant role in our clients setting and achieving their financial objectives by instilling a savings culture, and as a result, they are better prepared for their retirement and other life events. We do this with our advisors conducting face to face meetings at their kitchen table. Our advisors take a holistic approach to their clients' financial situation; it is far more than just making fund purchase and sale recommendations.

While the comments that follow to a great extent are specific to our business, we have reviewed comment letters by the Investment Funds Institute of Canada ("IFIC") and the Federation of Mutual Fund Dealers and concur with the points made in those letters.

3. The Success of Mutual Funds – And Mutual Fund Investors

Mutual funds make it possible for people of more modest means to participate in a professionally managed, well-diversified investment plan with the potential for superior returns – something that at one time only the wealthy could access. Mutual funds have successfully served investors for many years. From 1990 to 2017 amounts invested increased significantly from $100 billion to $1.4 trillion[2]. Mutual funds are purchased through a variety of channels, including direct from fund firms, discount brokerages, banks and independent advisors.

The 11th annual Pollara[3] survey of mutual fund investors in Canada, commissioned by IFIC, found that mutual funds continue to attain significantly more confidence (86%) than other investment vehicles such as stocks, GICs, bonds, and ETFs.

- According to the same study, retirement is the dominant motivation for people who purchase mutual funds.
- Eighty-eight per cent of respondents agree that they received a better return on their investments than they would have without an advisor.
- The study also found that in 2016, nine out of ten mutual funds were purchased through a financial advisor, compared to eight out of ten in 2011.

[2] IFIC INDUSTRY OVERVIEW, IFIC Industry Statistics, April 2017

[3] Pollara IFIC Survey, 11th Annual Pollara – Investment Funds Institute of Canada (IFIC) Mutual Fund Holder Survey: Confidence in Mutual Funds and Advisors Remains Very High, September 23, 2016

On May 23, 2017, the MFDA released its "MFDA Client Research Report: A Detailed Look into Members Advisors and Clients"[4] ("MFDA Research Report") which demonstrated the importance of mutual funds and the advisory sales channel to the middle income market. (Note that this does not include mutual funds sold through other channels). 80% of the 15.8 million Canadian households had $100,000 or less financial wealth which includes financial investments. Of those households, 8.9 million are represented though the MFDA channel, and 83% of those have $100,000 or less financial wealth. 27% of these households are represented through the independent advisory channel – firms such as ours – and 89% of the households in this channel have $250,000 or less financial wealth. From this data we can see that changes in regulation have the potential to disproportionately impact middle market investors.

4. Mutual Funds Are Highly Regulated

Mutual funds and their distribution are highly regulated through the rules and regulations of provincial and territorial securities commissions and self-regulatory organizations ("SRO"), the Mutual Fund Dealers Association of Canada ("MFDA") and Investment Industry Regulatory Organization of Canada ("IIROC"). Financial advisors are subject to licensing and market conduct regulations and oversight by regulators. Current CSA, MFDA and IIROC rules already contain significant provisions to protect investors. Existing regulations for the disclosure and management of conflicts in the distribution of mutual funds are extensive. A blanket ban on certain compensation models is not needed and could lead to unintended negative consequences for investors and the marketplace. We believe that specific changes would be more effective in curbing potential conflicts of interest and enhancing investor protection.

5. The Value of Advice

Independent studies have demonstrated the value that financial advisors bring to their clients. We have provided examples of these in Appendix 2. We believe that Primerica clients in particular have benefitted from the work of our representatives and the educational approach they use.

Advisors in the mutual fund industry take the time to understand their clients' entire financial situation. Much more than simply picking funds, advisor recommendations take into account financial goals, debt, spending, available income, cash flow, and tax saving opportunities. Just knowing where to start can be a challenge for many people. Advisors help clients overcome their inertia, identify better opportunities to save money and get a savings plan underway. Then, the ongoing discipline that Advisors bring to the relationship contributes significantly to their clients' success. Having someone follow up to ensure the savings plan is on track means the plan has a much higher probability of success. As we have seen over the past decade, markets can be volatile. Advisors help clients make better choices for their situation during times of significant market turbulence – buying into the market at the right times and not selling at the wrong times are particularly important. Basic dollar cost averaging principles can make a marked difference in both account values and client behaviour. Finally, advisors can help clients and their families through significant changes in their lives, often at a time when they are emotionally least able to make good financial decisions.

[4] Compliance Bulletin #0721-C - MFDA Client Research Report, May 23, 2017

We mentioned that Primerica's clients in particular have benefitted from the work of our representatives. Our clients are largely in the middle income market, with small amounts to invest, at the start of their relationship with us. We do not impose minimum account sizes as we wish to foster a long-term investment relationship. In Canada, two factors are impacting middle income families when considering the importance of financial advice to them relative to those with a higher net worth. First, with Canadians living longer and at the same time having more responsibility for their financial well-being, the need for financial advice by middle income families has never been greater. Second, the ability and willingness of the financial services industry to provide advice to middle income Canadians is declining rapidly. Firms that have been unable to take advantage of economies of scale have chosen to impose minimum account sizes, some as high as $250,000, putting these out of reach of the average investor. Appendix 2 provides references to research on the impact of this trend.

The Consultation Paper notes that the impact of discontinuing embedded compensation on low to middle income households would be that some dealers may choose not to service these families (page 62). The Consultation Paper also recognized that some low to middle income investors will not be able to afford personal financial advice and that these investors will need to utilise online tools. "Some investors may be pushed into online advice relationships, other more simplified forms of advice, or the online/discount brokerage channel even though these services may not meet all their needs and even though they may prefer, but can no longer afford, face-to-face advice" (page 65).

The Consultation Paper suggests that emerging technologies such as Robo-advice is one way that the advice gap will be filled in the event of a decline of traditional advisory services. Certainly Robo-advice has its place in the market and it will continue to grow over time. However, it does have its limitations. It cannot effectively assess a family's entire financial situation. It is less effective at prompting individuals to invest the way we encourage or "nudge" them. Without this sort of personal interaction, many middle income clients may not even begin a basic savings and investing plan. The ongoing discipline that an advisor helps bring to an investor is significantly reduced with a Robo-advisor. The implications of significant life events may not be properly assessed using a Robo-advisor. We believe it is highly likely that investors will not be as successful, as measured by their total wealth accumulation, if the opportunity to obtain personal advice is removed.

Further, our markets are not ready for Robo-advice to take over significant portions of mutual funds sales.

- Investors surveyed by Pollara in 2016[5] overwhelmingly favoured purchasing mutual funds through an advisor. To quote Pollara, "Purchases of mutual funds on-line or through customer service representatives have never made significant inroads into the market and are currently just one-half of what they were in 2011". Generally speaking, most investors would not be comfortable buying investment products on-line or through automated advice, with comfort with on-line purchasing at 37% and with automated advice at 17%. While these numbers will change over time, drastic regulatory changes that will impact distribution of mutual funds will have a negative effect on investors.

[5] Pollara 11th Annual IFIC Investor Survey, http://www.pollara.com/11th-annual-pollara-investment-funds-institute-canada-ific-mutual-fund-holder-survey-confidence-mutual-funds-advisors-remains-high/, September 2016

- Speaking at a G20 conference in January, Mark Carney, the Governor of the Bank of England cautioned that the Robo-advice channel could pose systemic risk in financial markets if not properly monitored by regulators. Specifically, he said the technology used by Robo-advisor firms created a risk of moving significant numbers of clients towards certain assets at the same time, creating volatility and increasing asset prices in the short term. [6]

While the embedded compensation model may have imperfections, it has been a significant factor in the success of middle income Canadians in accumulating assets in well diversified and highly regulated products. Banning embedded commissions puts at risk the ability of middle income Canadians to continue to accumulate wealth at this rate. We believe that it is not only a disservice to the investing public, such a change has the potential for serious public policy consequences. High net worth investors will always have plenty of advisors willing to serve them. We believe middle income investors should have the same opportunity.

6. The Core of Our Business – Serving the Middle-Income Market

Our company was founded on providing advice and products that meet the needs of the middle income market. That focus continues today. While other companies are abandoning this market, it continues to be the core of our business. Our advisors use an educational approach with our clients, focusing on fundamentals to achieve a solid financial foundation. We believe the only way to do this effectively is with personal service. Our representatives provide this service in our clients' homes.

We are able to continue to serve the middle income market with personal advice in the face of due to several factors:

- A large client base over which costs are spread achieving economies of scale;
- the use of client-name accounts;
- a significant and continuing investment in technology;
- a compensation model with some up-front incentive while not charging clients up-front fees (see "Embedded Compensation – Serving Small Investors" below); and
- representatives that are growing their businesses (See "Renewing and Expanding the Number of Advisors" below).

Economies of scale, account structure and technology investments enable us to maintain a reasonable cost per account. The compensation model and growth of new Primerica representatives provides the incentive to provide personal advice and service to these clients.

Middle income Canadians should have the opportunity and choice to work with an advisor and it is our desire to continue to provide this service through our representatives.

7. Compensation and Conflicts

The Consultation Paper asserts that the mutual fund sales industry, which includes the related financial advice, has significant conflicts of interest that compromise the objectivity of the advice given to

[6] Bank of Canada, Governor Carney Speech to G20, https://www.moneymarketing.co.uk/carney-warns-systemic-risks-robo-advice-fintech-boom/, January 2017]

investors, and increases the cost of advice and products sold to investors. It also suggests that embedded commissions preclude the need for fund managers to strive to achieve superior performance of their funds. We disagree with these assertions.

We understand the concerns expressed around perceived and potential conflicts of interest with compensation flowing from fund manufacturers to those making fund recommendations rather than from individuals purchasing the products. We agree it is important for investors to understand the flow of compensation. However, initiatives such as the very clear disclosure requirements of CRM2 have assisted clients in understanding fees paid to advisors. We do not believe that fund manufacturers paying dealers necessarily results in a negative impact on investor results. We have taken a number of internal steps to ensure that advisor and client interests remain aligned in the current embedded compensation environment.

As previously mentioned, we have a relatively open product shelf. While it is not possible for us to have every fund in Canada available to our clients, the number of funds available through our dealer is in the thousands. Generally speaking, the compensation paid by fund manufacturers is similar for similar products. There is no additional compensation to our representatives for recommending our proprietary funds over third party funds, or one third party fund over another. There are funds in the market that offer higher than average trailer fees. Our practice has been to not allow these funds on the product shelf as it would be very difficult to demonstrate that a fund recommendation by our representative was not influenced by the higher compensation. At the same time, the number of funds in the market with a higher trailer fee has been declining over the past three years.

While the conflict of having fund managers pay compensation still exists, its ability to influence behaviour becomes moot when there is a variety of fund managers and funds to choose from, and no compensation or incentives to representatives from recommending one fund over another. If representatives were not already looking to maximize client returns (and we believe most actually were) then once compensation conflicts are substantially removed, maximizing investor outcomes clearly becomes paramount when representative make recommendations. With the focus on fund performance, fund managers must strive for superior returns or they will lose assets. We have seen this in the market in general, and in funds flows to fund managers and funds in our own book of business in particular.

The Consultation Paper concentrates on the potential misalignment of interests between advisors and investors. It does not give credit for the significant alignment of interests between these groups. Ultimately investors expect to be successful and grow their savings. If investors are not achieving these results, then it is the advisor that will be held accountable. Advisors in this situation will be at risk of losing their clients. Often clients are well-known to their advisors and the personal nature of these relationships provides advisors an additional incentive to have good performance. Finally, as investors succeed, so do their advisors, through asset growth, client retention, additional amounts from their clients to invest, and referrals to new clients. To suggest there is not a significant alignment of interests between clients and their advisors, or to ignore it, is simply wrong.

8. Embedded Compensation – Serving Small Investors

We appreciate the CSA including in the Consultation Paper that commissions and ongoing asset based fees would continue to be allowed, and that fund managers would be allowed to redeem mutual fund units for these fees and remit the proceeds to dealers. It would need to be made clear to the investor the amounts they were paying and whom was being paid. We understand the intent is to remove the conflict of interest of manufacturers paying dealers and their advisors. Banning embedded commissions, however, would eliminate one compensation model that, up until recently, has been popular in the independent advisory channel: the Deferred Sales Charge ("DSC") model.

Although it has its critics, and does result in a small number of complaints from time to time, the DSC model works well, particularly for those with smaller amounts to invest. A lot of work goes into an advisor/client relationship, particularly up front when an advisor is getting to know a new client and their personal and financial situation, explaining his or her services to clients, educating the client on financial concepts, making recommendations for the way forward, and completing all of the documentation required to satisfy regulatory and dealer requirements. Without up-front compensation it may not be economically feasible to work with individuals that have modest amounts to invest. We believe the unintended consequence of a compensation ban is that smaller investors – which are the majority of Canadian households - will face significant increases in the cost of financial advice or simply be ignored altogether, an outcome which has significant public policy implications. There is already evidence in the marketplace of both of these outcomes when looking at the offerings of non-DSC based investment dealers.

The benefit of the DSC model is that it provides some up-front compensation to advisors while not reducing the amount available for clients to invest. The up-front compensation is financed by the fund manager and paid for through a reduced trailer fee. As an example, on a $10,000 initial trade, the compensation from fund manager to the dealer in the industry is generally 5% or $500. The dealer keeps in the range of 20% of this for its operation, 20% will go to the Branch Manager supervisor, and the remaining $300 will go to the advisor, out of which must be paid expenses such as office rent, supplies, travel, tax and similar costs. Without up-front compensation, there is generally a 1% trailer fee which provides a total of $100 of compensation to the dealer, Branch Manager and advisor spread over the first year. There is far less incentive to take on this client without the up-front compensation.

It is by no means certain that investors will incur a deferred sales charge. The DSC model works for investors when they are investing for the long term, particularly in RRSP accounts. Rebalancing can occur within a fund company's offerings without cost, and an annual 10% unit withdrawal free of deferred sales charges is usually available to enable investors to meet liquidity or systematic withdrawal requirements. Our firm's experience is that while deferred sales charges are incurred, the amount of these charges relative to the fund amounts being redeemed are relatively small on both an absolute dollar and percentage basis. The vast majority of redemptions at our dealer do not incur a deferred sales charge.

The MFDA Research Report[7] found that 42% of funds $100,000 and under had a DSC load, 6% had a Low Load, and 32% of funds between $100,000 and $250,000 had a DSC load while 6% had a low load. Clearly this model that provides some up front compensation while not reducing the amount to invest has a significant place in the market.

We have heard the argument that the DSC model is already in decline and that it no longer has a place in the market, and so it should not be a factor when considering whether to ban embedded compensation. The problem with this position is that it does not take into account firms that have made a business decision to focus on higher net worth investors.

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[7] Compliance Bulletin #0721-C - MFDA Client Research Report, May 23, 2017

The Consultation Paper notes on Page 48 a public announcement by Investors Group in 2016 regarding their decision to discontinue the use of the DSC fee structure. It should be noted that the Dealer's 2016 decision was followed this year with their announcement that they will focus their business on high net worth clients, significantly downsizing their advisors and support staff. In an Investment Executive article, their CEO was quoted as follows: "We're moving more up-market". "We were probably working too hard for the smaller clients and now we're working for the right ones. We don't want to walk away from our smaller clients but they don't need that level of sophistication at that stage of their lives vs somebody who has accumulated significant wealth and needs to know that their retirement is going to fund the rest of their lives." While we respect their business decision, far from supporting the CSA's view that DSC is no longer relevant, it supports our case that it is very relevant for the very investors that mutual funds were designed to serve: those with more modest amounts to invest.

9. Renewing and Expanding the Number of Advisors

When considering the case for embedded commissions and DSC in particular, one significant point is rarely raised – the recruiting and development of new advisors. Our business model is based on bringing in new representatives and helping them to be competent and productive. They come from all walks of life and a wide variety of diverse backgrounds. Over half of the representatives entering our business are women. We are attracting millennials who are looking for an alternative to a job with a large corporation (which are becoming scarcer). Not only does this help renew an aging financial advisor force in Canada with an average age in the 50's, it helps Canadians of all backgrounds access much needed financial advice and products. Financial advisors are likely to serve their communities. Our mutual funds representatives reflect the face of Canadians and we are proud of our diversity.

Our representatives also have broad coverage of smaller, rural and remote communities. Just the distances involved in serving investors in these communities makes it difficult to obtain advisory services even now. A ban on embedded compensation would disproportionately disadvantage middle income Canadians in these areas.

Developing new advisors and servicing smaller accounts is complementary. A new advisor, under the supervision of someone more experienced, is more likely to put in the effort on a smaller account in order to gain experience and build the foundation of a book of business. Established advisors are far less likely to put in the effort to do this. Still, new advisors need to be compensated for their efforts. The DSC model works well for all concerned. The investors, who do not have large sums of money to begin with, are not put in a position of needing a significant percentage of the amount they have to invest to pay for advice; they are provided with the advice and the products that they need, and the advisors are compensated for their efforts. What is at stake is not only the ability to serve smaller investors, but the environment to attract new advisors and renew a rapidly aging advisory force.

10. Disproportionately Impacting Certain Business Models

We believe the proposal to ban the use of commissions will lead to a less competitive marketplace, as a ban would impact some business models significantly more than others. Financial advice and product sales to consumers can be provided through various channels, including face-to-face meetings, over the phone, and through the internet or other digital media. The Consultation Paper divided the distribution channels into the following categories: branch delivery, online/discount brokers, full-service brokers, financial planners/advisors and private wealth management (page 33).

Our concern is that banning embedded commissions results in favouring certain types of business models over others. This should not be the consequences of regulation, whether intended or not. Instead, every effort should be made to target the issues that have been identified – in this case conflicts – while allowing services valued by investors to continue. We understand and support rules and regulations in the financial service sector to protect the investing public, but believe they should target specific conduct rather than negatively impact broad sectors that are generally functioning well and providing a useful service to the investing public.

11. Canada's Financial Services Regulations Serve Investors Well

We believe that the current regulatory environment in Canada is serving investors well. Regulators in some other jurisdictions such as Australia and the United Kingdom determined it necessary to strengthen rules on compensation. However, this was in response to specific regulatory gaps or events that do not exist in Canada. Canada has robust regulation over the sale of mutual funds through CSA rules and the Self-Regulatory Organizations (IIROC and MFDA). It does not appear that a similar level of regulation existed in jurisdictions where it was determined that drastic action was required to protect the investing public. In its Financial Advice Market Review ("FAMR")[8], published in March 2016, the FCA reported that up to 16 million people could be trapped in a "financial advice gap" and that they need advice but can't afford it. The regulators acknowledge that the problem may stem from a ban in 2013 which stopped financial advisors from offering advice to customers and being paid by commissions from the product providers. They are considering ways to reverse the negative consequences on investors of decisions.

Mutual fund failures and harm to investors from funds themselves is virtually non-existent. While there are complaints as evidenced by the matters investigated by the Ombudsman for Banking, Savings and Investments and IIROC and MFDA cases, these are extraordinarily few in number as compared to the tens of thousands of advisors, millions of investors and tens of millions of fund positions. Using this model, investor have accumulated a significant percentage of the $1.4 trillion in mutual funds - savings which quite possibly would not have existed without funds and advisors.

12. Alternative Recommendations

Rather than an outright ban on embedded commissions, we believe there are a number of measures than can be implemented that will reduce the potential for conflicts of interest when product recommendations are being made to clients. We have already implemented some of these in our business and our clients are benefitting from them. The key concept behind many of these is looking at what drives advisor behaviour. When the compensation to the individual making the recommendation is the same for like products it will not drive a recommendation towards a certain product or products. The following recommendations will help reduce this impact of this conflict of interest.

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[8] FAMR progress report, [Financial Advice Market Review (FAMR),](#) March 2016

Cap Trailer Fees

Some mutual funds and fund companies carry a higher trailer fee, in some cases 25 basis points higher than generally available in the industry for a given asset category. This difference is high enough to potentially influence recommendations to investors, and, at a minimum, results in the perception of a conflict of interest. The industry is moving away from these higher trailer fees on its own. Elimination of the remaining higher trailer fee funds will remove that conflict.

We note that some fund categories carry a significantly different trailer fee than others, for example equity funds as compared to fixed income funds. While this sets the potential for conflicted recommendations, client circumstances are significantly different between individuals investing in these types of funds. As a result, we believe know your client requirements will overcome these conflicts.

Deferred Sales Charge Restrictions

We make extensive use of the DSC model. As noted earlier, it works particularly well for investors with lower amounts to invest and to support new entrants into the industry. Investor protection can be enhanced through the implementation of certain restrictions. The Paper notes the decline in the DSC model but to us it is unclear what is driving this – a decision to no longer offer the DSC option, or a move into higher net worth markets where clients can be effectively served with other compensation models. It is likely that both of these factors have had an impact.

Following are some suggested restrictions on the use of DSC:

- Once a DSC schedule has been completed on an account, the amount invested through a dealer is not put into a new DSC schedule at that dealer. A fee model with a 0% front end commission is to be used. This achieves several things. It removes the incentive to churn accounts, unnecessarily moving investors to other products solely to generate a commission for the advisor. The advisor is still being paid a trailer fee to provide service as needed. It limits the amount of time that an investor can be subject to a deferred sales charge, reducing the potential for investor “surprises” resulting in potential complaints. It recognizes and provides compensation for the often extensive up-front work required of advisors to establish a relationship with new clients to get to point of making recommendations.

- Limit DSC on older ages. Seniors are potentially more vulnerable to abusive practices. Their ability to save and make up for fees is usually limited. They may be required to use a significant portion of their savings on short notice to meet medical or other unanticipated events. Deferred sales charges would reduce the amount available and may lead to a complaint. We recommend limiting the use of DSC fees at ages which are appropriate to largely reduce the potential for these fees to be incurred. We note, however, that funds generally provide an annual withdrawal free of charge of 10% of the assets invested. Our experience has shown that for those investors relying on their funds for ongoing income, this provides them with sufficient money to meet their needs without incurring fees.

- Limit the use of DSC to an individual’s time horizon. The DSC period would not be longer than the individual’s time horizon when they would expect to require their money. This would significantly reduce the potential for DSC fees to be incurred.

- Enhanced disclosure. While there is already significant disclosure of DSC fees in Fund Facts and other documents, given the potential for such a fee to actually be incurred, it may be warranted to provide a separate disclosure of the DSC schedule to clients, and to have it acknowledged by them in writing or some other positive action such as a computer check box. Focussing on this important item should reduce the potential for surprises at a later date should deferred sales charges be incurred.

Enhanced Disclosure

The Consultation Paper discounts the effectiveness of disclosure in informing and educating investors. We believe that the validity of this comment depends on the nature of the disclosure. We recognize that mutual fund costs and compensation are complex subjects. Prospectuses, Annual Information Forms, Management Reports of Fund Performance and the like are challenging to read for the average retail investor. However, disclosure is changing. The Fund Facts document was a significant improvement in providing concise, clear disclosure. CRM2, with its one-page disclosure of the actual amount of fees paid by fund managers to dealers and fees paid directly to dealers, and the individual investment returns, was a further improvement. This disclosure is new, and we believe it is very effective in showing investors what they are paying, whom is being paid, and the returns on their investments.

A research study released by the Gandalf Group, "The Canadian Investors' Survey – An Opinion Research Study on Fees & Advisory Services"[9], found a high percentage of investors were reading at least some of the disclosure statements or reports provided to them (page 13). For those with assets less than $50,000, 46% read the statements or reports every time they received them, and 40% read them only some times when they received them. The combined percentages were higher for investors with greater amounts invested. This indicates that investors are paying attention to the disclosure documents they receive, and improved disclosure has an excellent chance of being reviewed by them.

The original intent in CRM2, among other things, was to show investors the flow of funds from fund managers to dealers – really to help address the conflict situation that is the subject of the Consultation Paper. IFIC recently announced support for CRM3, full disclosure of the actual amount of all costs incurred by investors. We support this initiative. As CRM3 is developed, its focus should be on simple disclosure of exactly what investor are paying, and clearly setting out the flow of funds that would be considered a conflict of interest. Combined with the existing CRM2 disclosure, this will give investors the information they need to assess potential conflicts of interest that that may exist with their advisor, dealer and/or fund manager. Provided prominently on one or two sheets of paper we believe it will be effective disclosure.

The longitudinal study commissioned by the British Columbia Securities Commission ("BCSC"), conducted by Innovative Research Group, recently completed the second phase of their research "Investor Readiness for Better Investing"[10]. The study examines BC investors who hold securities and

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[9] The Gandalf Group. *The Canadian Investors' Survey: An Opinion Research Study on Fees & Advisory Services*, On behalf of AGF Investment Inc., 2017. Survey conducted April 7, 2017 to May 5, 2, 017

[10] British Columbia Securities Commission (BCSC), Investor Readiness for Better Investing (Part 2), April 26, 2017

invest through an advisor, to understand and explain the effect of the CRM2 annual reports on the knowledge, attitudes, and behaviour of investors. The results were encouraging:

- Most people think their CRM2 reports were easy to understand (62%) and provided the information they need to understand fees associated with their investments (67%).

- Since the first part of the panel study, investors are more aware of the fees, both direct and indirect, after receiving their CRM2 reports (76% and 59% compared to 67% and 48% in November). Investors with small portfolios became substantially more aware of direct fees (up to 61% from 31% in November).

- Investors had slightly more knowledge that fees impact returns and that products can have different fees; those with small portfolios (<$50k) were much more likely to agree that fees can be negotiable (47%) and that similar products can have different fees (71%) than before receiving their CRM2 reports (32% and 49%).

Disclosure can also be improved on subsequent purchases. Key pieces of information can be provided succinctly to investors at the point of sale and during the course of the relationship with the investor.

13. Significant Change Warrants Careful Consideration

We support changes that strengthen client protection and increase investor knowledge; a ban on embedded compensation goes far beyond that. As noted earlier, such a ban has the potential of eliminating the ability of those with lesser amounts to invest to obtain tailored advice. We believe this result is a far worse outcome than the conflicts, real or perceived, in the current system.

We are pleased that the CSA is undertaking a multi-year research project to measure the impact of CRM2 and Point of Sale changes. Industry and regulators worked together for several years to bring forward these initiatives to improve the transparency and client knowledge of costs and their investment performance. Implementing this disclosure came at considerable cost and effort on the part of industry. Fundamentally changing the compensation structure before we know the actual impact of the CRM2 and POS will not allow industry and the regulator to determine what worked well and which aspect of the disclosure needs to be improved. We believe that before the CSA makes any decision on compensation models, we must wait until the research on CRM2 and POS is finished and the data analyzed.

Conflicts of interest also exist in fee arrangements. The banning of embedded compensation will not eliminate conflicts from the relationship that advisors, dealers and managers have in relationships with their clients. The objective of regulation should be to minimize the potential for conflicts to cause harm, either through targeted elimination or informing investors, while allowing the arrangements to continue where there is a significant alignment of interests.

Substantial rules to deal with conflict of interest situations already exist. IIROC Rule 29.1 requires that dealers and their representatives observe high standards of ethics and conduct in the transaction of their business and not engage in any business conduct or practice unbecoming or detrimental to the public interest. MFDA Rule 2.1.4 requires that material conflicts of interest must be addressed by the exercise of responsible business judgment influenced only by the interests of the client. It is important that existing rules be taken into consideration before introducing new regulations.

A targeted approach to managing conflicts of interest is most efficient, and we firmly believe that improved transparency through enhanced meaningful disclosure, and investor education are the answers to improving and managing conflicts of interest.

Conclusion

We support the CSA's intent to reduce the impact of conflicts of interest that may be harmful to investors. However, it is clear that mutual funds investors today benefit from the advice that comes with mutual funds in the advisory channel. There is no empirical evidence of harm to investors as a result of the current compensation structure. Enhanced transparency, choice for investors, and targeted rules and reforms to curb conflicts will go a long way to further improve investor experience for Canadians. We firmly believe that a one-size-fits-all ban on compensation for one financial savings vehicle is not necessary nor helpful to investors and harms far more than benefits investors. While a broad ban of embedded commissions may eliminate some (but not all) conflicts, it will also cause significant harm to investors with smaller amounts to invest by reducing or eliminating access to advice leading to significantly reduced savings. Not just a regulatory issue, this is a public policy issue that will impact Canadians' ability to care for themselves as they age and put additional pressure on governments already straining to support an aging population.

The CSA should not underestimate the potential harm from a ban of embedded compensation. To a great extent, the existing $1.4 trillion now invested in mutual funds was reached using this model. While the industry is changing, one of the reasons that investors are able to migrate to other platforms and fee structures is that they have accumulated significant wealth in mutual funds. New and small savers on the other hand may never take the step into the investment spectrum, leaving swaths of the mass market out of saving and investing.

The mutual fund product and the independent advice channel are highly regulated and provide significant investor protection. They were built for the investor with modest amounts to invest. We believe it is incumbent on industry and its regulators to ensure that it continues to serve this segment of the market well, with real choice to help them achieve their financial goals.

We appreciate the opportunity to comment on this important issue, and look forward to participating in any further public discussion on this topic. Should you have any questions or wish to discuss these comments, please feel free to contact us.

Sincerely,

[redacted]

John A. Adams, CPA, CA
Chief Executive Officer

APPENDIX I – Responses to Consultation Questions

<table>
<tr><th>CSA questions</th><th>Primerica response</th></tr>
<tr><td>1. Do you agree with the issues described in this Part (Part 2. A)? Why or why not?</td><td>We disagree with several assertions made in this Part:

1. “Embedded commissions raise conflicts of interest that misalign the interests of investment fund managers, dealers and representatives with those of investors”:

While we don’t disagree that embedded commissions could raise conflicts of interest, we believe that these can be managed through targeted reforms. In 2016 the MFDA conducted a review to assess compliance with certain sections of National Instrument 81-105 (Mutual Fund Sales Practices) and to identify any compensation or incentive practices that might lead to mis-selling or unsuitable advice. While they identified a small number of instances where there was concern about incentives and compensation practices related to mutual funds sales, the MFDA expressed a need to extend 81-105 requirements to investment products beyond mutual funds. Lack of similar regulation is creating compensation and potential sales biases. Banning embedded fees on mutual funds, without even considering extending existing regulations to other investment products and referral arrangements, is a dis-service to investors.

2. “Embedded commissions reduce investor awareness, understanding and control of dealer compensation costs”:

We believe that recent gains in disclosure are going a long way in increasing investor awareness, facilitating a more meaningful dialogue between investors and their advisors and empowering investors in choosing the best fee structure to suit their particular needs. The second part of a longitudinal study conducted by the BCSC found significant improvements in investor awareness of fees as a result of the recent implementation of CRM2. Specifically, since the first part of the panel study which was conducted pre-CRM2, “investors are more aware of the fees after receiving their CRM2 reports (76% and 59% compared to 67% and 48% in November). Investors with small portfolios became substantially more aware of direct fees (up to 61% from 31% in November).” According to the study, those with small portfolios (<$50k) were much more likely to agree that fees can be negotiable (47%) and that similar products can have different fees (71%) than before receiving their CRM2 reports (32% and 49%). These are early but encouraging results. We support IFIC’s position that enhancing simplified and meaningful disclosure through CRM3 will improve investor knowledge and outcomes even more.

3. “Embedded commissions paid generally do not align with the services provided to investors”:

We disagree with the assertion that benefits derived from advice are intangible.</td></tr>
</table>

	In Canada, advice is readily available because of the foundational principles of mutual funds – shared costs, risks and rewards – extend to advisor services. The latest research released by the Center for Interuniversity Research and Analysis of Organizations ("CIRANO") in 2016, The Gamma Factor and the Value of Financial Advice, provides ample empirical evidence that advice and by extension fees for advice provide value for investors. The study found that, for identical households, those with an advisor for 4 years or less will have 69% more assets and 290% more with an advisor for 15 years or more.
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.	The majority of mutual funds in Canada are currently sold with embedded commissions. This compensation method allows for economies of scale, enabling Dealers to compensate advisors upfront for serving even the smallest investors while also paying for operational costs of processing a transaction. The benefit to the investor is that the DSC model provides some up-front compensation for the advice that they receive without reducing the amount available to invest. The up-front compensation is financed by the fund manager and paid for through a reduced trailer fee. It is important to consider real numbers, rather than having this discussion in the abstract, to understand the potential impact of an embedded commission ban on services to small investors. As an example, on a $10,000 initial trade, generally in the industry the compensation from fund manager to dealers is 5% or $500. The dealer keeps in the range of 20% of this to offset its operational costs, with another 20% paid to the Branch Manager supervisor to offset their effort and costs, and the remaining $300 paid to the advisor. The advisor has to cover expenses such as office rent, supplies, travel and similar costs. Without up-front compensation, there is generally a 1% trailer fee which in this case would provide a total of $100 of compensation to the dealer, Branch Manager and advisor spread over the first year. This would leave no incentive to take on and serve small investors. The embedded commission structure allows Dealers such as PFSL, to compensate representatives upfront for providing service and advice to all clients regardless of size of account, while making use of efficiencies and economies of scale to offset Dealer costs. The DSC model works for our investors as they are often investing for the long term, particularly in RRSP accounts. Over 85% of our funds are in registered accounts with long term savings goals. Fund switches are generally allowed within a fund company's offerings, and an annual 10% withdrawal is usually available to enable investors to meet income requirements, both without incurring deferred sales charges. Our firm's experience is that while there are deferred sales charges being incurred, the amount of these charges relative to the fund amounts being redeemed are relatively small on both an absolute dollar and percentage basis. Within this context, we strongly believe that the embedded fee structure is appropriate and serves investors and the industry well.

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?	We strongly believe securities regulators need to mandate consistent rules across all financial products. We remain committed to the principles of timely, simple disclosure to investors to ensure that investors are well equipped to make well informed decisions about all the financial products they are purchasing. If embedded compensation is only prohibited for mutual funds, it would encourage some to sell products which allow embedded commissions. In their recent compliance reviews, the MFDA found that products and services that are not subject to 81-105 or parallel regulation were sold with high fees and little scrutiny. Our understanding is that the MFDA is raising this issue with CSA regulators and we strongly encourage the CSA to review conflicts of interests inherent in less regulated products and services and to level the regulatory landscape for all investment products in a measured, targeted manner. It should also be noted that only a handful ofinternational jurisdictions that reviewed a potential ban on embedded fees proceeded with this approach and all of those who banned embedded fees did so across a wide range of financial products and not just only on mutual funds.
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. The current rules and regulations governing these payments are providing necessary protections and can be enhanced further through targeted reforms and meaningful disclosure. For low to middle income investors purchasing mutual funds, embedded fees provide optimal means to gain access to capital markets. 81-105 provides ample regulatory guidance and investor protection measures on mutual funds sales. Newly implemented disclosures are also helping to improve mutual funds sales practices and investor knowledge which will further curb real or perceived conflicts of interest. As well, a move to a full cost disclosure regime, or CRM3, will ensure that all costs and fees related to a mutual fund are well understood and fully transparent. Similar measure can be extended to other investment funds and securities.
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.	While we don't believe that this approach would fully mitigate the impact of a ban on embedded commissions, it may reduce some investor aversion to paying upfront fees for investment services. This approach is not optimal for investors as they will lose a portion of their investable assets upfront and may have potential tax consequences. However, in the event of an embedded fee ban, it would be important to allow the described practice.
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?	We continue to believe the proposal to ban embedded commissions in their entirety is not needed and will not improve the financial well-being of the majority of Canadians who are small investors in the middle income market. Prohibiting embedded commissions and requiring clients to negotiate fees will possibly result in worse investor outcomes as most investors will have a harder time understanding the net impact of different types of fees on their account performance. An outright ban on embedded fees will also reduce service and the availability of advice to these clients, resulting in less savings and worse investment outcomes. CRM2 became fully implemented in Canada in 2016 which increased the transparency of fees that mutual fund investors pay. The mutual funds industry wants to move to further enhance transparency by moving to a full cost disclosure regime, or CRM3. The effect of CRM2 on investor awareness and behaviour is already being noted through a longitudinal study conducted by the BCSC. It is paramount that regulators take an evidence based approach to regulatory reform on such an important structural issue. We strongly believe that the three-part study by the BCSC, with two parts already

	completed, should form part of the evidence considered before imposing a sweeping ban on embedded compensation. There is no evidence that embedded commissions are leading to substantial harm to investors and their investments. Conflicts and potential of harm can be mitigated through improved disclosure, transparency and targeted reforms. For example, banning DSC on sales to seniors may be an appropriate step.

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?	Rather than banning embedded commissions outright, we recommend that following regulatory initiative, which we believe will be more effective and less disruptive in addressing the concerns expressed by regulators. Please also see “Alternative Recommendations” section of our letter for more detailed explanation for our recommendations:
	
	• Cap trailer fees to ensure that higher trailer fees for the same essential services don’t distort sales recommendations
	• Improved point of sale and ongoing disclosure, including a separate DSC schedule
	• Limit the use of DSC as follows:
	    o Once a DSC schedule has been completed on an account, the amount invested through the same dealer automatically goes into 0% front end commission
	    o Limit the use of DSC for senior investors
	    o Limit the use of DSC to an individual’s time horizon in order to reduce the incurrence of DSC charges

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?	Embedded fees allow the mass market to access capital markets efficiently and cost effectively. A blanket ban on embedded fees will result in loss of access and service for those with small accounts while increasing the overall cost in the system as result of loss of some economies of scale that exist in today’s environment. • Investors with small accounts may not receive any advice while the overall cost of operation and compliance may need to be shouldered by smaller numbers of investors, therefore increasing overall cost of advice and service. • Investors surveyed by Pollara in 2016 overwhelmingly favoured purchasing mutual funds through an advisor. To quote Pollara, “Purchases of mutual funds on-line or through customer service representatives have never made significant inroads into the market and are currently just one-half of what they were in 2011”. Generally speaking, most investors would not be comfortable buying investment products on-line or through automated advice with comfort with on-line purchasing at 37% and with automated advice at 17%. While these numbers will change over time, drastic regulatory changes that will impact distribution of mutual funds will have a negative effect on investors. • Discretionary advice may increase in the higher income brackets as many firms that are moving toward wealth management may find it more lucrative to work in a fee based environment. However, for the mass market that is unlikely to be the case as discretionary advice will remain unaffordable for most. It is difficult to compare to other jurisdictions as the market and the circumstances are different in Canada. For example, in Australia, the

	mandatory nature of their national retirement savings program creates a different market and environment. • While a ban may push growth of the online discount brokerage channel, it is unlikely that the majority of the mass market will avail itself of this channel as their preference remains face-to-face advice as this stage.
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?	We believe banning embedded compensation will require many firms to fundamentally restructure their businesses, resulting in higher minimum account balances beyond the reach of thousands of middle income households, reduced access to financial professionals, reduced investor choices, and ultimately, lost opportunities to accumulate significant retirement savings for millions of Canadians in the low to middle income market. When firms provide a client with a product, there are other fixed costs associated with the sale of the products such as marketing expenses, compliance costs, customer-service call centres, online portfolio analytical tools, software applications available to advisors' representatives, and educational material. For smaller-size accounts typical of middle income investors the profitability of these accounts may not cover these other fixed costs. Primerica can serve small investors without sacrificing service because of economies of scale, significant investments in back-office technology to create efficiencies and a compensation structure that allows us to provide our advisors with some upfront compensation without directly charging our clients. The current compensation model allows those with modest means to participate in the financial markets through the use of a financial advisor. Research conducted by the Pierre Lortie from the University of Calgary School of Public Policy concluded that "in absence of bundling, the unavoidable consequence is that a combination of lower aggregate costs per investor and higher expected fee income will motivate financial firms (and the financial advisors in their employ) to target higher-net-worth investors and shun less wealthy households." • Lower net worth individuals will be impacted the most as many firms will implement minimum account sizes, precluding advice based services to this group. Rural and remote clients may also be impacted as without upfront compensation it may be less attractive to serve investors face to face if distance is involved. Finally, while millennials and younger generations may be more comfortable with technology and online based advice, various research reports point to the fact that the vast majority and especially those older are not comfortable investing without face to face advice. • We believe that the CSA's definition of advice gap is too narrow and does not capture the true value of face to face advice. • Loss of face-to-face advice at this point in time will translate to a general advice gap as the vast majority of mutual funds in Canada are sold through advisors, mainly with embedded compensation. Majority of Canadian investors still express concerns about investing through online methods. • Face-to-face advice and sales of mutual funds through advisors will be impacted the most. This also constitutes the vast majority of mutual funds sales in Canada. • We believe that CRM2 is already providing positive results in terms of improving client knowledge and understanding of fees they pay and compensation their advisors receive. We believe that before embarking on a

• 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?	wholesale ban on a widespread compensation method that will further increase cost on the industry and therefore on investors, we need to wait and evaluate the impact of CRM2, of other possible targeted reforms and consider a move to CRM3. • We have provided alternative approaches to mitigating concerns expressed by the CSA, both in our letter and in response to question 13, that don't involve a ban on embedded commissions. • Online advice will not be taken up by the majority of investors. Currently the vast majority (9 out of 10) of mutual funds are sold through an advisor. It would be naïve to assume that all of these sales could shift to fee based and online sales. Further, online channels do not offer the same "nudge" factor as a real life advisor. Nor would it address the "gamma factor" of value of advice as expressed by experts such as the CIRANO center. • Regulatory arbitrage could shift investors to seek advice through other channels that may not be impacted to the same extent by the proposed changes. However, the vast majority of Canadians still trust mutual funds as their preferred investment vehicle and the majority of investors buy their mutual funds through an advisor. The IFIC Pollara Poll has found year after year strong trust among investors and their advisors. We would not anticipate that all those disenfranchised by upfront and direct fees, or high minimum account sizes, would move to a different investment vehicle or outlet. Further, it is unclear how conflicts and high cost of ownership for investors would be addressed in these alternate channels. Limited shelf spaces focused on proprietary products, generally higher MERs in alternate investment vehicles such as segregated funds, should all be carefully considered when evaluating the ability of alternate providers to step in to close an inevitable advice gap in the event of an embedded fee ban on mutual funds.
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: Will the industry continue to transition away from embedded commissions if the CSA does not move forward with the proposal?	Over the past few years, many firms have chosen to change their compensation model for their advisors, and more companies will probably follow this trend. Some firms have made a business decision to change how they compensate their advisors. Each business model is unique and services a particular segment of the market. Regulating how firms compensate their advisors would choose winners and losers in the marketplace and negatively impact a competitive marketplace. It should be noted that firms that have changed their compensation away from embedded fees, have also limited their services to higher net-worth clients and larger accounts. While that is a legitimate business decision for some, we don't believe that a regulatory ban on certain types of compensation is the right public policy decision. Over time, technology assisted advice and distribution, along with more transparency will influence and change compensation structures in the industry. However, getting there should not be forced through a one-size-fits all regulatory rule.
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	Fee-based financial advice requires individuals to pay up front, usually out of their pocket, for advice. Many Canadians are not willing to pay upfront for financial advice. To operate a profitable business many fee-based advisors require minimum account thresholds before they engage with an individual – most thresholds are set between \$100,000 and \$250,000.

limiting the use of fee-based series by dealers? Potential impact on competition and market structure	Those identified as the mass-market in this Consultation Paper would not meet the required account minimums to work with a fee-based advisor. Banning embedded commissions would result in a significant portion of the mass-market not qualifying for personalised financial advice.
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?	We have reviewed and are in agreement with the response provided by IFIC.
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?	The Consultation Paper acknowledges that a transition to direct pay arrangements will likely require significant effort by industry. In the limited time available, we have had preliminary discussions with a few fund managers, specifically to process fee transactions on client-name business. Some already have the ability to process such transactions, but in some cases are doing so only on large dollar accounts. Other firms do not have this capability, and would have to build it at considerable cost, or no longer sell into this market. It is not clear whether an industry-wide solution would be available for fee-based, client-name accounts. While much more work would need to be done to assess the impact, the operational challenges of implementing such a system portends to increase cost, reduce investor choice, and eliminate service to large segments of the market.
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 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?	Banning embedded compensation will not eliminate all conflicts of interest. IIROC recently published a review of compensation and conflicts and noticed that many dealers are providing additional incentives to representatives in the form of performance bonuses linked to fee-based assets. IIROC expressed concern that clients may be moved into fee-based accounts, whether or not such accounts are consistent with the customers' best interest especially for those who are "buy and hold" clients and who will be paying ongoing fees without receiving a comparable level of continuous service. So conflicts are not restricted to embedded fee structures. Firms will continue to need controls and oversight of their advisors regardless of the compensation model.
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 banning embedded compensation will require firms to fundamentally restructure their businesses by establishing and collecting several types of fees from each client for services that are currently covered by the embedded fee model. Banning embedded compensation will not improve our firms' ability to service individuals and families with smaller amounts to invest. Embedded commissions allow Dealers to compensate their advisors who serve small clients upfront for their services. Further, larger pools of small investors allow for economies of scale for Dealers, therefore pooling the costs of services and operations. Banning embedded compensation challenges these business efficiencies.
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	Developing new advisors and servicing smaller accounts is complementary. A new advisor, under the supervision of someone more experienced, is more likely to put in the effort on a smaller account in order to gain experience and build the foundation of a book of business. Established advisors are far less likely to put in the effort to do this. Still, new advisors need to be compensated for their efforts. The DSC model works well for all concerned. The investors, who do not have large sums of money to begin with, are not put in a position of needing a significant percentage of the amount they have to invest to pay for advice, they are provided with the advice and the products that they

Relative attractiveness of careers in competing financial service business lines?	need, and the advisors are compensated for their efforts. What is at stake is not only the ability to serve smaller investors, but the environment to attract new advisors and renew a rapidly aging advisory force.
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?	Given that the mass majority of the current mutual funds sales are on an embedded fee basis, we don't believe that a blanket ban on the same can be mitigated in any meaningful way as it will cause a significant structural disruption of the industry. Instead, we would propose alternate approaches to addressing the concerns expressed by the CSA (see Question 13). With regards to a level playing field, this cannot be accomplished other than by imposing the same compensation ban on all other investment vehicles. We believe this to be beyond the purview of the CSA.
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?	We are supportive of the IFIC response to this question.
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 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?	Economies of scale works both ways. While lower net worth investors may pay lower fees for essentially similar services due to lower amounts that they invest, therefore arguably being cross-subsidized by higher net worth accounts, higher net worth clients also benefit from the mass market participating as more participants paying for the same infrastructure reduces the cost for all participants. The current system functions well for investors, advisors and companies alike.

APPENDIX II – Additional Supporting Research

Value of Professional Financial Advice

- Most consumers are unable to make optimal financial choices by themselves (Campbell 2016).
- An experimental study on unadvised investment decision making[11] found that 75 per cent of investment decisions were suboptimal and that 98.6 per cent of respondents failed to make all five investment choices optimally (Chater et al. 2012).
- While poor financial decision-making cuts across socioeconomic categories, it is most pronounced among the poorest, oldest, youngest, least financially literate, and least educated consumers (Fischer and Gerhardt, 2007; Guiso and Jappelli, 2008; Kimball and Shumway, 2010; Klapper et al., 2013; Lusardi and Mitchell, 2007; Lusardi and Tufano, 2009).
- The latest findings of a longitudinal study by the CIRANO Institute found that for comparable households those with a financial advisor gain 69% more value for their investment assets. The additional value reaches 290% for a household with an advisor for 15 years or more (3.9 times the value of assets of the equivalent non-advised household). (Montmarquette and Viennot-Briot, 2016). Moreover, households that began to work with an advisor over the course of the study, did significantly better than households that did not (Montmarquette and Viennot-Briot, 2016).
- Low income individuals are observed to be highly responsive to advice with their financial behaviour improving more than that of high income households (Tang 2010).

Technical Expertise

- Advised portfolios are better diversified and have more tax effective investments (Kramer 2012; Shapira and Venezia 2001; Mayer 2011; Winchester 2011).
- Gerthardt and Hackethal (2009)[12] conclude that advisors promote appropriate asset allocation, a significant corrective function given the consensus that strategic asset allocation is “far more important than the subsequent (tactical) decision of which specific securities to pick in a particular asset class” (Chater et al. 2010, p. 56).
- Given that inefficient asset allocation costs tens of billions of dollars annually, this also has broader implications for economic welfare (Rehberg 2009, p. 3).

Behavioural Biases

- Persistent behavioural biases cause cognitive failures that impede decision-making competence (Lunn & Lyons, 2010).
- Indeed, individuals consistently make financial choices that are not in their best interest (Agarwal and Mazumder 2013; Campbell 2016).

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[11] Chater et al (2012) surveyed and conducted online experiments with 6,000 consumers from eight European Union Member States, half of whom had purchased bonds, stocks and shares, personal pensions, investment funds, mutual funds, ETFs, or life insurance products within the last five years. Other deposit products such as current accounts, savings accounts and tax-free savings account were excluded.

[12] This study used data from the accounts of 65,000 German bank customers to match 7,000 advised clients with a “non-advised twin” who, based on demographic and account information, was just as likely to have met with a financial advisor but had not, thereby addressing the potential problems of self-selection and endogeneity and allowing the authors to conduct a strong test of whether financial advisors influence investment activities and outcomes rather than vice versa.

- The United Kingdom's Financial Conduct Authority (FCA) (2013) notes that these cognitive failures are particularly severe when it comes to financial decisions. They manifest in common investment mistakes such as undervaluing asset allocation; holding losing stocks too long; and selling profitable stocks too soon (Kahneman and Tversky 2000; Kahneman 2011).
- Behavioural biases are often exacerbated when making unadvised investment decisions. Chater et al. (2010), for example, observed that individuals placed in this situation were "disproportionately averse to uncertainty, ambiguity, and product complexity" (Chater et al. 2010, p.8).
- Many biases can be overcome with experience and education (Latif et al. 2015, p.12). As such, financial professionals are less likely to commit common investor mistakes (Dhar and Zhu, 2006; Feng and Seasholes, 2005; Shapira and Venezia, 2001).
- In times of financial volatility or crisis (at the global or personal level) investors are prone to panic and poor decision-making (Haslem 2010). For example, imprudent decisions in the wake of the 2007 economic downturn cost investors an estimated $8 billion (Winchester et al. 2011).
- According to advisors, making emotional decisions is the number-one investor mistake and preventing clients from making these decisions is critical to success (Global Survey of Financial Advisors 2016, p.3, 13).
- Advisors have proven effective at tempering rash decision making (Haslem 2010).
- Investors working with a financial planner at the time of the economic downturn were "92 per cent more likely to maintain optimal portfolio composition" (Finke 2009, p. 180).
- Advised investors also avoid "the impulse to behave myopically" as they are twice as likely to make optimal long-term decisions and 1.5 times more likely to adhere to them than unadvised investors (Winchester 2011, p. 21).

The Nudge Factor

- The ability of advisors to encourage and instill positive financial behaviours such as goal setting and saving is known as the nudge factor (Chang 2005; Mayer 2011; Thaler and Sustein, 2009).
- Consumers who have received financial advice exhibit more positive financial behaviours than those who have not (Prelec and Loewenstien, 1998). For instance, advisors increase enrollment in automatic saving plans (Gerthardt and Hackethal 2009). Advised investors are also more likely to have a higher savings rate than that of comparable non-advised investors (The Investment Funds Institute of Canada 2012).
- A survey of advised investors in Canada found that more than 80 per cent of respondents credit their advisor for their ameliorated savings and investment habits (Pollara 2015).
- There are also broader economic welfare implications. The Conference Board of Canada (2014) estimates that if 10 per cent of unadvised Canadians obtained financial advice and increased their saving rates to match those of advised investors, household income and economic output would increase in the long term (p. 32).

Barriers to Access

- Income and net worth are positively correlated with seeking advice with affluent households using financial advice and products more than lower income households (Bluethgen, 2008; Finke and Langdon, 2012; Tang and Lachance, 2012).
- Higher financial literacy is also associated with accessing financial advice (Alessie et al 2007; Christelis et al., 2010; Lusardi and Mitchell 2008).

Individual-level Barriers

- Lack of knowledge or misconceptions about financial products and services also impede access as "households tend to avoid strategies for which they feel unqualified" (Campbell 2006, p. 1553).
- Financial advice is commonly perceived as unaffordable. Although the vast majority of financial advisors in Canada offer advice with no upfront cost, a 2013 survey of middle income Canadian households[13] found that 11% of respondents said they could afford financial advice services; 55% said they could not; and 34% said they did not know the cost of such services (Union des consommateurs 2013, p.83). The study concluded that "the impression of not having the means to pay for such services, and the feeling of not having sufficient assets to justify them" is a significant barrier to access (p.93).
- Winchester (2015) also identifies the opinion that financial advice is only for those with extra money to invest as a barrier. A study of low-income households[14] in Toronto found that 58.7 per cent of respondents did not have a savings account and only 1.6 per cent had an investment account. Respondents cited the following reasons for not saving: bank fees; no point in saving; weak interest rates; and lack of information (Latif et al 2015, 14).

Institutional-level Barriers

- Institutional factors also impact access to financial advice (Iannicola and Parker 2010). Han et al. (2007) describe the institutional effect as follows:

> "Asset accumulation is influenced by institutional arrangements that involve explicit connections, rules, incentives and subsidies. These institutional arrangements lead to different levels of access and incentives to accumulate assets for different segments of the population and may explain a significant part of the variance in personal saving and investment patterns" (p. 4).

- Business models, for example, often prioritize some consumer groups over others. The nature of the financial advice market is such that wealthy clients "produce a greater revenue on a per capita, per engagement or per hour basis" (Financial Planet 2012).
- Consequently, some firms may target high income earners to the exclusion of middle and low income consumers. This occurs directly and indirectly. A minimum account balance may be required to work with an advisor or it may be factored into firm referral practices (Iannicola and Parker 2010, p.39; Union des consommateurs 2013).
- Hackethal et al (2011), for example, found that financial advisors were less likely to be matched with younger, less experienced and less wealthy investors.
- Institutional level barriers in the form of regulations, or their application can also restrict access to financial advice. Competitive financial systems with market-based regulations are associated with lower barriers to access. The FCA's (2013) research on vulnerability in the financial service industry found that "inaccurate interpretation or overzealous implementation of rules" can prevent firms from meeting the needs of vulnerable customers" (p. 6).

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[13] 77.5 % of respondents had a gross annual income of over $30,000 and 53.2% over $40,000

[14] Low-income was defined as below $22,000 for households without children to support or below $44,000 for households with children to support.

Vulnerable Consumers

- Lack of access to financial advice both signals and perpetuates vulnerability (Thorensen 2008, p. 26).
- Poor decisions are costlier for some consumers than for others. Tight margins in low and middle income households mean that financial mistakes can have disproportionate consequences (Betrand et al. 2004; Cartwright 2008). Consider Cowell and Gardiner's (1999) finding that a £1 loss for a consumer with an income half the national average was equivalent to a loss of £2.50 suffered by a consumer with the national average income.
- Consumers are most vulnerable when individual-level and institutional-level barriers coincide (Financial Conduct Authority, 2015, p. 21).

Abandoning Smaller Investors

- Countries where financial advice has been unbundled from financial products, either as a result of market forces or regulatory fiat, have seen the opening of a large "advice gap" and an increase in the total cost of the services for a large proportion of retail customers. A significant number of middle income individuals who need the advice but do not own enough financial assets to make the provision of regulated financial advice an economic business proposition under a fee-for-advice pricing policy were effectively denied access to affordable financial advice. (Lortie 2016)
- After the UK decision was made to unbundle fees, the number of financial advisors fell from more than 40,000 in 2011 to just over 31,000, and has not recovered. Large banks, meanwhile, cancelled their financial advice services for clients that had only modest assets. The opening of investment accounts worth less than 100,000 pounds fell by half. (Lortie 2016)
- In March 2016 the Financial Conduct Authority issued a report on the UK's Financial Advice Market in light of concerns expressed about an advice gap and found that the implementation of their reforms has had positive results for the wealthy, stating that, although the changes have raised standards of professionalism and enhanced consumer protection, this high level of advice is "primarily accessible and affordable only for the more affluent in society." (FAMR 2016)
- The report states that before the reforms, the economies of scale at firms made it possible to serve consumers with "lower levels of affluence." However, post-reforms, most businesses have implemented portfolio minimums of more than £100,000 because the cost to provide advice and service an account has increased significantly. (FAMR 2016)
- To help individuals pay for up-front fees the UK government introduced rules to allow consumers to withdraw money from their pension to pay for financial advice. Customers are allowed to only withdraw £500 three times over their lifetime and no more than once per tax year. According to the government's analysis, face-to-face advice costs £150 per hour on average which leaves the consumer with roughly 10 hours of face-to-face investment advice over the course of their lifetime. (FAMR 2017)

Banning Commissions

- A review of financial advice services in Canada concludes that while advice is provided "based on and in view of closing a sale," it is nonetheless "efficient" (Union des consommateurs, 2013, p. 61).
- Commissions themselves have also been found to incentivize information provision and customer service (Inderst and Ottaviani 2012, p. 245).
- There is little to suggest that any alternative to a commission-based compensation model would reduce the provision of biased advice or improve consumer outcomes. No compensation scheme would be "behaviourally neutral" (Lortie 2016).

- Research shows that financial advisors on salary tend to promote proprietary funds (Gil- Bazo and Martinez, 2004; Synovate, 2011; ISA, 2014).
- Advisors with flat incentives have also been observed to be “less honest and transparent than expected” (Chater et al., 2012, p. 379). In fact, when advisor-client interests were aligned, incentivized advisors were found to “outperform advisors with flat incentives” (Chater et al., 2012, p. 379).
- Behavioural biases value short-term gains and perceive immediate losses as less desirable than future losses. Consequently, upfront costs increase the perceived (immediate) cost of financial advice and diminish its perceived (long-term) value. Chater et al.’s, (2012) experiment on advised investment decision-making found that twenty to thirty per cent of subjects were “excessively averse to an up-front fee” (p. 10).
- Recent Canadian data indicates that only 48 per cent of investors who use an advisor believe that they would continue to do so if they were required to pay a separate fee (Pollara, 2015).
- Banning commissions also has supply-side implications. Providing modest investors with low-cost advice can be a viable business model, if there is a sufficient volume of demand. When demand falls, providing financial advice at the same price is no longer possible. In the United Kingdom, following a ban on commissions in 2012, banks began to limit access to financial advice to clients with investment assets of more than 100,000 pounds (Lortie, 2016, p.23). The result of depressed demand and supply resulted in a 50 per cent decline in the number of new investment accounts under 100,000 pounds by 2014 (GfK NOP Ltd., 2014; Lortie, 2016, p.23).
- Similar outcomes in the Canadian context would be disastrous given that 79 per cent of all current investors are in the middle market and the vast majority (85 per cent) of investors enter the market with less than $25,000 in financial assets (Pollara, 2015).

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