June 7, 2017

Dear Board of the Canadian Securities Administrators,

I am writing to challenge the CSA Consultation Paper 81-408 *Consultation on the Option of Discontinuing Embedded Commissions* which suggests that embedded commissions incent financial advisors in negative ways.

While I can see that embedded commissions appear to provide a misdirected incentive to people who aren't financial advisors or registered investment advisers, as a financial advisor I know first-hand that they allow me to provide the best service possible to my clients. Embedded commissions allow me to work with young people starting out in life, people who don't have a lot of money, and people who want to trust their financial advisor before they start working with them. The reason these people can afford to work with me is because my fee for working for them is paid out of the trailer on their investments, their mortgage, and a commission on the insurance products they choose to purchase -- not out of their pocket.

Following are some examples of when paying out of pocket holds people back from using a service:

1. Approximately 50% of Canadians don't have a will. http://www.advisor.ca/tax/estate-planning/48-of-canadians-have-no-will-survey-230734
Middle class Canadians (or "every day Canadians") think that having a will done by a lawyer is too expensive (despite it being the cheapest legal procedure they will pay for) and that belief holds them back from approaching lawyers to assist with their wills. Many of them choose holographic wills or will kits instead which could be done incorrectly and assets are distributed according to their wishes. Others don't get wills at all, leaving their families to divide up their assets after death.

2. Canadians with group dental benefits are more likely to go to the dentist than Canadians who have to pay for dental care out-of-pocket. http://www.hc-sc.gc.ca/hl-vs/pubs/oral-bucco/fact-fiche-oral-bucco-stat-eng.php

3. Most Canadians do not pay to get their income taxes done because they don't want to pay out-of-pocket. Those who do pay to have their taxes done either have complex income taxes and/or will be getting a refund.

4. When access to health care in Canada is compared to access to health care in the United States, more middle-class and lower-income Canadians have access than in the United States because they don't have to pay out-of-pocket. Because of this, Canadians have a longer life expectancy than Americans and Canadians with chronic health conditions (such as cystic fibrosis) have a significantly longer life expectancy than Americans with chronic health conditions.

5. Many Canadian women choose to dye their own hair instead of paying a hair stylist for it because of the out of pocket cost.

6. Many Canadians choose to do free exercise (such as running, riding their bike, walking, YouTube exercise videos) instead of joining a gym, exercise classes or hiring a personal trainer because they don't want to pay out of pocket. Even people who do pay to exercise still do some form of free or low cost exercise.

7. People with access to state-run elementary and post-secondary education programs are more likely to go to school than people who pay out of pocket.

Currently, all Canadians have an option to pay an hourly rate out of pocket to their financial advisor or registered investment adviser, yet most people choose not to pay their financial advisor or registered investment adviser that way. Paying an out of pocket fee-for-service can benefit some people such as some high net worth clients, but it doesn’t benefit most people. Canadians who can't afford to pay out of pocket, but still need advice, can afford to pay for the advice they receive through embedded commissions.

Recently I’ve been working with several 15 year olds to 25 year olds who have saved some money -- between $3,000 to $15,000. To them, that's a large sum of money, and all of them worked hard for it. All of them want to do the right thing with it, but they aren't sure what that is. With each of them, I spent 1.5 - 3 hours discussing how investing works before they decided to invest their money. I did it because I know that if I spend time with them when they are young, they will start proper saving and investing habits early and I will have a client for life. If they take my advice at their age, they will become wealthy and I will get paid for years to come.

If each of those young people had to pay me per hour to listen to me talk about investing, how much would they have been willing to spend? Trust is built by spending time together getting to know each other, how many of these young people would have paid me per hour to sit and talk about life? To ask questions about how the stock market works and if they should choose an RRSP or a TFSA or both?

The most crucial financial discussion I had in my lifetime occurred when I was 14 years old and my mom’s financial advisor came to our house, sold Mom some life insurance and showed me why I should invest $50/month in the stock market. I’ve invested in the stock market ever since and watched my savings grow through ups and downs. But I never would have paid him an hourly fee to listen to him.

Several years ago, a client of our office was tragically killed in an unexpected and sudden boating accident. This client started his life -- and his relationship with our office -- with nothing. When he became a client of our office, he was in his early 20s, newly married with a young child, a big mortgage and a dream of taking over his parents’ farm. He took advice from our office and purchased life insurance and set up RRSPs for him and his wife. He didn’t pay us an hourly rate for that advice (he couldn’t have afforded it with so many obligations) and he knew we were paid by commission from his investments and for selling him life insurance.

When members of our office heard that he passed away on a Friday evening, one of our staff went to the office the following Saturday morning and started the process of filing his life insurance claim and notifying the investment companies holding his RRSPs and other investments of his passing. We did this because the survivors needed money fast and there were lots of forms to prepare. Survivors of a deceased loved one are under pressure to make some major decisions, and often are too overwhelmed to complete the paperwork. Our office spent more than 50 hours over the next month or so helping settle the estate. His survivors didn’t pay us out of pocket for our time.

We didn't charge an hourly fee when his widow cried in our office. We didn't charge when his two kids phoned us periodically to ask what to do with their inheritance, or stopped by over lunch to talk about what they were going through. We didn't charge when we ran into them at the local gym and local grocery store and they asked questions about income taxes and how investing works.

Seven years after his death, his family is doing well. The other day, his widow came into our office to invest a settlement her family received for his death. The sum of settlement is well into the millions. She listened to our advice and did what we suggested. She didn't ask how much we were paid, although we've told her in the past how our pay is calculated (as we do with all of our clients). The embedded commission on this money is significant, yes. However, she knows we need to get paid. She knows we've invested many, many hours in her family when she had nothing to pay us. She trusts us because she's been working with our office for almost 20 years.

Can you imagine having to decide what to do with the multi-million dollar settlement you received from your husband's tragic death by taking advice from someone that you pay an hourly rate to and therefore don't spend time getting to know? An hourly fee-for-service incents the advisor to drag out the process of giving advice, and incents the client to limit the time they spend listening to the advice. That creates a lot of pressure for the client, and may mean a lot of questions remain unanswered.

Embedded commissions actually work in our clients' favour – it puts the pressure on us, not them, to answer all of their questions and to thoroughly explain our solutions, because we don't get paid until they invest their money through our office. Until they make the decision to invest with us, they can spend as much time as they want talking to us. Financial advisors and registered investment advisers have no choice but to take the time to answer their questions, because if we don't our clients will find someone who *will* take the time – even after knowing each other for years.

All Canadians with a consistent income, no matter how modest, have the ability to save enough money to retire sometime in their 60s to the lifestyle they've become accustomed to if they listen to our advice. To achieve retirement, you have to start setting money aside at a young age, and you have to invest in equities that provide a good return. You also have to decide if RRSPs or TFSAs or both are right for you. You have to understand how they fit with LIRAs and RESPs and what happens to all of those savings vehicles if you die or get divorced or lose your job.

A good adviser also needs to not let you give in to your fears. There's lots of misinformation and scare tactics out there about investing. The media is full of them. So is the local coffee shop. Your neighbour, the accountant at your gym, and the realtor who got rich in real estate all have investment tips for you. Their tips are compelling, but none of the people giving those tips are trained in how investing in the stock market works.

Our clients know they can phone us anytime they have questions about something they saw on the news. They know they can walk into our office anytime (often without an appointment) and ask how their investments are doing and how current oil prices or Trump's presidency are impacting their hard earned savings. They can email us or text us whenever they have a concern. They can ask questions for clarification. And if they don't understand something, they can ask again.

We listen, we respond, we provide relevant resources all without an out-of-pocket fee. And we repeat, if necessary.

I pay a fee-for-service to my mechanic. I just spent $1100 for new calipers and brake pads to be installed in my car. The fee *didn't* include the mechanic's time explaining what was wrong with my car and what my options were. It included the parts and the time working on my vehicle. My mechanic took the time to explain to me what was wrong and what my options were because if he didn't, he knew I'd get my car serviced somewhere else – and he also knew I wouldn't pay him to tell me what's wrong with my car.

I also pay a fee-for-service to my tax preparer. I spend $80/hour. This fee *doesn't* include advice, either. It includes the time it takes for my tax preparer to file my taxes. He might have suggestions for how much I should set aside for income taxes next year and that I can reduce my income tax bill by investing in RRSPs, but he won't help me pick my investments and savings vehicles, or complete the paperwork to set them up.

I also pay a fee-for-service to my bank. I pay $14.99/month in bank account fees. This fee *doesn't* include advice on whether I should get a savings account or a TFSA or a chequing account. I have to decide that myself.

I pay a fee-for-service to my gym of approximately $400/year. This fee gives me full 24 hour access to gym equipment and exercise classes, but it *doesn't* include advice. I could pay an hourly fee to a personal trainer for advice, but like most people I don't, because I don't want to pay for it. I'd rather take the chance that I'm using the equipment incorrectly and injury myself (because it won't happen to me) than pay for it. Besides, I can Google how to use the equipment (even though I don't Google it because it's too much work).

One reason the CSA suggests embedded commissions aren't good is because the CSA thinks that financial advisors and registered investment advisers are paid more of a commission for certain investments than we are for other investments. In the words of the CSA, embedded commissions can

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

This is only partly true.

All carriers pay us the same embedded commission for the same type of investment, so the commission we make isn't an incentive to choose one carrier over another, or even one fund manager over another. They have to pay us the same, or else all of us advisers would work with only the investment company that pays us the most.

Across all investment carriers, advisers are paid more to invest people's money in equities, real estate and balanced funds than we are paid to invest our client's money in bonds. But shouldn't we be? A financial advisor's job is to help people grow their net worth. Bonds don't keep up with inflation, and when outside of registered investments, are the least tax-efficient investments there are. Only equities surpass inflation, and are also more tax efficient than bonds (when non-registered) because they are taxed as capital gains and dividends. We should be encouraging our clients to invest in equities because that's where the long-term growth is.

Investing in equities is more work for my staff and I than investing in bonds, GICs and savings accounts. Our office has more compliance to do and we spend more time training our clients discussing how their investments work than we would if they were invested in bonds, GICs and savings accounts. We need to stay abreast of current news events and understand the impact of economic and political changes on the stock market so we can answer their questions. We need to be there for our clients when they have concerns about the market. None of that work needs to be done when people invest in bonds, GICs and savings accounts.

The CSA report also claims that embedded commissions can:

> *"Incent investment fund managers to rely more on payments to dealers than on the generation of performance to gather and preserve assets under management; this incentive can in turn lead to underperformance and drive up retail prices for investment products due to a competition between investment fund managers to offer attractive commissions to secure distribution."*

Embedded commissions don't incent fund managers to rely more on payments to dealers than on the generation of performance. This is because the embedded commission is paid on the amount of money in the fund which can only grow two ways: with increased returns and with people putting money into the fund. If the fund isn't managed well, the fund won't produce increased returns, and if the fund doesn't produce increased returns, people won't want to invest in it.

The CSA also claims that embedded commissions "inhibit the ability of investors to assess and manage the impact of dealer compensation costs on their investment returns". This doesn't need to be. If investment returns reported on a client statement show the returns *after* all fees are paid (the net return), then the client knows their returns. As long as the client gets the expected return, does it matter what the compensation is? A client is getting better value investing in a mutual fund earning 7% with a 2.5% MER than a GIC earning 2.5% recommended by an advisor he paid a $150 hourly fee to.

Another of CSA's concerns is that embedded commissions might "cause investors to pay (indirectly through fund management fees) dealer compensation that may not reflect the level of advice and service they may actually receive; the cost of the advice and service provided may exceed its benefit to investors".

It's true that the amount of advice received by clients might not perfectly reflect the amount they pay in embedded fees, but that's how it needs to be. Some clients need a lot of advice – such as the widow mentioned above, and my mom who found herself to be a single parent in her late 30s with no knowledge of how investing and insurance works, and the 18 year olds starting out in life. All of these clients get the advice they need because they don't worry about paying for advice out of pocket.

If embedded commissions are no longer an options for adviser compensation, clients won't get the advice they need because they won't pay their financial advisor a fee for service. We will see people's net worth decline in the coming decades. As people's net worth decline, they will become a liability to the government. Most people invest for retirement, and without enough retirement savings, they will be more reliant on programs like the Guaranteed Income Supplement, Old Age Security and Canada Pension Plan. This will cost tax payers billions of dollars in the future.

Finally, I must mention that I notice there are no financial advisors sitting on the Canadian Securities Administrators Board. As such, none of the CSA board members have any working knowledge of what registered investment advisers do on a day-to-day basis. Have you considered having at least one financial advisor or registered investment adviser on your board? It doesn't seem possible to me that you can make sound decisions about how I work with my clients without having done it yourself.

I did some research on the make-up of regulatory bodies in other industries. Physician in Saskatchewan answer to the Saskatchewan Medical Association (SMA), which has a board of directors and a representative assembly. The SMA requires that half of all people sitting on the board, the representative assembly and their committees be physicians. Shouldn't the CSA be held to similar standards? (For more information on requirements for being on the SMA board, RA or a committee, go here: http://www.sma.sk.ca/kaizen/content/files/Physician%20Health%20Program.pdf)

I trust that you will consider my words in making your final decision about removing embedded commissions as an option for payment. At this point, consumers can pay a fee for service if they want to, and they can also pay embedded commissions. Removing embedded commissions as an option will limit choice for consumers and will have a negative impact on their wealth in the years to come.

Sincerely,

Shannen Fisher, B.A. (Econ), CFP, CEA
Certified Financial Planner, Certified Executor Advisor and
Financial Advisor