AGF Investments Inc.
Toronto-Dominion Bank Tower
66 Wellington Street West, 31st Floor
Toronto, ON M5K 1E9

BY EMAIL: comments@osc.gov.on.ca;
consultation-en-cours@lautorite.qc.ca

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

Attention: The Secretary
Ontario Securities Commission
20 Queen Street West
22nd Floor, Box 55
Toronto, Ontario
M5H 3S8

Me Anne-Marie Beaudoin
Corporate Secretary
Autorité des marchés financiers
800, square Victoria, 22e étage
C.P. 246, tour de la Bourse
Montréal, Québec
H4Z 1G3

Dear Sirs/Mesdames:

RE: Client Focused Reforms – Proposed Amendments to National Instrument 31-103 and Companion Policy 31-103CP

AGF Investments Inc. ("**AGF**") is writing to provide comments in respect of the Canadian Securities Administrators' ("**CSA**") Client Focused Reforms: *Proposed Amendments to National Instrument 31-103 and Companion Policy 31-103CP*, as published on June 21, 2018 (referred to herein as the "**Proposed Amendments**" and/or the "**CFRs**").

AGF provides asset management services globally to institutions and individuals. AGF's products include a diversified family of mutual funds, exchange traded funds, mutual fund wrap programs and pooled funds. AGF also manages assets on behalf of institutional investors including pension plans, foundations and endowments. AGF is registered in the categories of Investment Fund Manager, Mutual Fund Dealer, Exempt Market Dealer, Portfolio Manager, and Commodity Trading Manager.

Although institutional clients may purchase AGF mutual funds directly from AGF, AGF predominantly distributes these funds through unaffiliated dealers for its retail investment fund business. As a result, AGF has direct experience with the challenges facing independent mutual fund manufacturers as they seek to offer their products on the shelves of third-party dealers to provide access to such products to Canadian investors. Further, due to AGF's experience with working with dealers of all sizes, AGF appreciates the consequences of the CFRs on dealers, advisers, and investors.

AGF appreciates the opportunity to provide feedback to the CSA on the matters raised in the Proposed Amendments. AGF's overarching concerns, along with additional specific feedback/recommendations regarding the CFRs, are articulated below.

OVERARCHING CONCERNS

A. *Regulatory Scope*

Alongside publishing the Proposed Amendments/CFRs on June 21, 2018, the CSA also published CSA Staff Notice 81-330: *Status Report on Consultation on Embedded Commissions and Next Steps* ("**CSA Notice 81-330**") (and subsequently published, on September 13, 2018, *Proposed Amendments to National Instrument 81-105 Mutual Fund Sales Practices and Related Consequential Amendments*). In recognizing the majority feedback of fund industry stakeholders, the CSA indicated in CSA Notice 81-330 that it would not be discontinuing embedded commissions. Instead, the CSA published that it would be addressing (through the CFRs) a policy change "*designed to implement enhanced conflict of interest mitigation rules and guidance for dealers and representatives requiring that all existing and reasonably foreseeable conflicts of interest, including conflicts arising from the payment of embedded commissions, either be addressed in the best interests of clients or avoided*".

AGF strongly asserts that the implication of the CSA referencing (in the CFRs) third party compensation – namely, embedded commissions – as inherently being a conflict of interest (and requiring such a high degree of justification for the use of embedded commissions by registrants), is that such action will have the ultimate impact of effectively imposing a ban on this method of compensation. There is no question that by establishing embedded commissions as de facto "conflicts of interest", this will no doubt create a deterrent for registrants to utilize this form of compensation, even where it may make best sense for the investor. Natural behaviour would dictate that when faced with a regulatory presumption of a "conflict of interest", registrants will undoubtedly feel unduly pressured to avoid what may otherwise be (but for being deemed by the regulators to be

fundamentally flawed) a beneficial option for investors. This, along with other "behavioral economics" considerations with respect to the topic of "effective disclosure", was recently addressed by a panel of experts at the IFIC Annual Leadership Conference on September 27, 2018.

It is AGF's position that embedded commissions are simply a form of payment for services, and such form of payment is ultimately just a choice of compensation model for investors to leverage to the extent that direct-payment arrangements are not suitable/preferable for them. Further, even if there is perhaps a perceived conflict associated with embedded commissions, the "risks" should only elevate to the need for commensurate regulatory reform when there is actual harm occurring (to investors) that warrants intervention, and such conflict should therefore not require anything more than appropriate and effective disclosure that ensures understanding. This assertion is further detailed in our responses below.

Further, AGF queries why the CSA would specifically isolate only embedded commissions as being the compensation model with potential conflicts of interest. AGF maintains that fee-based compensation arrangements also have possible conflicts of interest. In support of this argument, AGF references a 2017 Investment Industry Regulatory Organization of Canada Report[1], warning that "*a significant number of dealers provide additional incentives to representatives in the form of performance bonuses linked to fee based assets*", leading to clients potentially being moved to these accounts unnecessarily (clearly a potential conflict of interest).

To this end, we strongly urge the CSA to remove the inherent presumption of a conflict of interest associated with third party compensation (embedded commissions) from the Proposed Amendments. The CSA should not be positioned as the arbiters of dictating behaviours toward a compensation model that they have ultimately recognized does not need to be banned. This creates confusion and will invariably lead to registrants looking to avoid regulatory presumptions at the cost of investor preference. In fact, according to a Pollara Strategic Insights research survey published in July 2018[2] (the **2018 Pollara Survey**), the clear majority of investors with advisors continue to prefer that their advisor is paid through mutual fund fees – an increase from 53% last year to 59% in 2018. This begs the question as to why the CSA would desire to indirectly impact the use of a compensation model that is, in fact, favoured by investors. This outcome does not appear to be within the realm of investor protection.

In addition, within the Proposed Amendments, the CSA has indicated that the proposal to adopt a regulatory best interest standard has been abandoned in favour of a harmonized approach that "*infuses the client's best interest into the conflicts of interest*

[1] "Managing Conflicts in the Best Interest of the Client – Compensation-related Conflicts Review" (April 27, 2017) by the Investment Industry Regulatory Organization of Canada.

[2] "Canadian Mutual Fund Investors' Perceptions of Mutual Funds and the Mutual Funds Industry" (July 2018) by Pollara Strategic Insights. This research survey was commissioned by The Investment Funds Institute of Canada to provide an independent assessment to better understand Canadian mutual fund holders, to identify their attitudes, opinions, needs, expectations and behaviours and to track these over time.

and suitability reforms". While AGF understands and agrees with the principle of ensuring that client interests are upheld, AGF submits that the CSA has, in effect, inherently imposed such a best interest standard, notwithstanding the assertion that it will not be proceeding in that regard. The terms "best interest" and "putting the client's interest first" are not clearly differentiated in NI 31-103 or 31-103CP. As a result, it is not apparent that these are meant to be different standards. There is also concern that both of these terms may be tantamount to a fiduciary standard, and interpreted as such by the courts. ***It is therefore important that the CSA clearly identify in NI 31-103 that the inclusion of both "best interest" and "putting client's interests first" language is not equivalent to a fiduciary standard.***

B. *Value of Advice*

When it comes to working with an advisor, the 2018 Pollara Survey results showed that 86% of respondent investors work with an advisor for at least part of their investments, and half (51%) work with one advisor for all of their investments. What's more, 85% of the surveyed investors agreed that they "*would not want to handle my investment on my own*". In fact, given the trust investors place in their advisors, satisfaction with advisors scored very high (95%), and an overwhelming majority (78%) reported they are "*completely satisfied*" or "*satisfied*" with the advice provided.

As a strong proponent of the "value of advice" principles, AGF is genuinely concerned that the CSA is not conferring enough credibility to the overarching value that investors do place on advice received from their advisors. The findings from the 2018 Pollara Survey support previous research that demonstrates: *Canadians who work with an advisor build more savings over time and are better positioned to meet their long-term investing goals.* In fact, more than three-quarters (78%) of the surveyed investors specifically reported having better saving and investment habits because of their advisors.

The CFRs must ensure that all investors – particularly investors who may just be beginning their path toward long-term financial goals, and may have smaller asset-sized portfolios – are not displaced or delayed access to advice. The notion that smaller investors can be serviced through other means, namely online tools like robo-advice or self-directed platforms, until such a time that their wealth justifies – or meets the minimum requirements of – an advisor is misplaced. Not surprisingly, the 2018 Pollara Survey also found that usage of and interest in these types of online tools continues to be low, with most preferring to use the services of a human advisor.

Further, the Proposed Amendments place much emphasis on the belief that better investment outcomes for clients are most attainable through low cost products and lower fees. In effect, it would appear that the value of advice is being lost as a key driving investment principle.

When it comes to investing, cost is, in fact, only one element of the decision when selecting and allocating to investments and constructing a portfolio, and is not the sole determinant of investor success. As acknowledged by the CSA in the Proposed Amendments, other factors such as objective, performance, risk and investment

management capabilities must also be considered when selecting investments. This, combined with risk tolerance, investment time horizon, diversification and the client's objectives, are all factors considered when constructing an appropriate investment portfolio. It should not be overlooked that advisors' expertise plays a pivotal and valuable role in determining a portfolio that is suitable for, and positioned for, the investor's ultimate success.

The 2018 Pollara Survey findings suggest this is something investors clearly understand and appreciate. The vast majority (84%) of surveyed investors agreed that "*advice provided by my financial advisor is worth the fees*". This result clearly demonstrates that investors recognize the value of advice, and are willing to pay for it.

AGF recommends that the CSA explicitly recognize the value provided to investors by advisors, and that there is a cost to that advice. All references in the CFRs – whether overt or subtle – to the overemphasis on cost as the determining factor for consideration for investors in making their investment decisions should be removed altogether.

C. *Unintended Consequences*

There is no question that the know your product and suitability obligations under the CFRs will require representatives to develop a deeper understanding of investment products (including mutual funds) offered on a firm's shelf. Representatives will also require enhanced training, and firms will require additional resources. These aspects of the CFRs are accordingly not practical/feasible for many firms with a broad product shelf, will be extremely difficult to manage and will not aid in the betterment of investor outcomes. As a result, the onerous nature of the CFRs will have the unavoidable effect on dealer firms to (i) offer a much more limited suite of investment products (including mutual funds); (ii) restrict their product offerings to proprietary products only; and/or (iii) limit their shelf to low cost products. All of these consequences would undoubtedly reduce the diversity of investment products available for an investor. ***AGF submits that limiting investor choice is not in the best interest of investors. With the fundamental goals of preserving investor outcomes and protecting their best interests, AGF urges the CSA to consider and examine this negative unintended consequence carefully, and make adjustments to the CFRs in order to preserve the integrity of investor choice.***

AGF also submits that only dealers with scale will be able to afford the vastly increased costs to ensure compliance with the CFRs, particularly in relation to the know your product proposals. This would invariably result in a reduction of the small to medium sized dealers and consolidation in the industry. Further, the increased cost to registrants of compliance with the CFRs will inevitably be passed down to investors and result in the increased cost of advice for investors. As a result of the reduction of dealers and the increased cost of compliance on such dealers, investors, particularly those with small investments, will likely have less access to affordable and appropriate investment advice. Such consequences are evident from the reforms undertaken in the UK, and seem inconsistent with the best interests of investors. ***Moreover, it should be an essential objective of the CSA to uphold***

market efficiency as a key tenet of shielding investors from the unintended consequences of industry consolidation as a result of the steep costs associated with compliance.

SPECIFIC FEEDBACK AND ADDITIONAL RECOMMENDATIONS

A. *Know Your Product Requirements*

As referenced in our responses above, AGF implores the CSA to consider that there will predictably be a narrowing of dealers' product shelves as a consequence of the requirement to strictly comply with the CFRs. This is no more evident than in the CSA's expectation that advisors must have an in-depth understanding of each security on the registrant firm's shelf, and "*how the products compare to one another*". Registrant firms will no doubt need to narrow the range of products and services to offer to their clients to ensure that know your product expectations of representatives can be met. AGF does not believe that a narrowing of product shelves is the CSA's intended outcome; however, the CSA should fully expect that investors' choices will be limited as a result of product shelf contraction. This is obviously not in the best interest of investors.

In addition to the above-mentioned general concern with the know your products requirements, the following are some specific areas of the know your products parameters that AGF respectfully submits warrant further consideration by the CSA:

- The Proposed Amendments reference that "*a security cannot be approved based solely on…representations, information, documentation, analyses or reports received from issuers*". ***AGF does not understand why (under the already onerous requirement of issuers to provide full, true and plain disclosure with respect to securities) issuers' offering documentation cannot be relied upon (even solely relied upon) to meet the due diligence requirements for registrants. Further, AGF requests that the CSA amend the Proposed Amendments to harmonize the expectations of the product due diligence process (on a risk-based approached) with existing SRO guidance[3].***

- ***AGF proposes that know your product comparisons (in reference to the "similar securities available in the market" comparison requirements) must be contextual from an investor's perspective, which requires the representative to compare products that have the same fundamental features and attributes to make the comparison meaningful.*** For example in choosing a Canadian equity mutual fund, the comparison should be amongst similar Canadian equity mutual funds, and not include all available mutual funds on the firm's product shelf. The CSA should re-assess the requirements in this light.

- ***AGF also submits that the know your product obligations with respect to investments transferred in or purchased through client-directed trades should be***

[3] IIROC Notice 09-0087 *Best practices for product due diligence* expressly states (page 6) that: "*Dealer members are entitled to rely on factual information and disclosure documents provided by issuers or manufacturers of products under review, unless there are obvious reasons to question their validity…*".

made less onerous by requiring a <u>reasonable</u> level of diligence, without the full inquiry and on-going assessment requirement of a product on the registrant's product shelf.

B. *Disclosure Mitigation*

AGF is concerned with the CSA's proclamations with regard to the use of disclosure. The Proposed Amendments state that "*disclosure is not, in itself, sufficient to satisfy the obligation to address conflicts of interest in the best interest of the client*". AGF counters that disclosure of perceived conflicts of interest – particularly with respect to the use of third party compensation (notably, embedded commissions) – is <u>most certainly</u> an effective means of protecting investors.

AGF presumes that the above statement from the CSA is predicated on the CSA's assumption that investors may not be reviewing disclosure provided to them. As previously referenced (in a June 9, 2017 letter to the CSA, responding to the CSA's Consultation Paper 81-408), AGF again puts forth the findings of a 2017 Report from the Gandalf Group[4] (the "**<u>Gandalf Report</u>**"). Within the Gandalf Report, most investors said they read the details included in statements provided to them by advisors, financial institutions or fund providers about the fees and commissions they are charged: 53% said they read this information in <u>every</u> statement, and an additional 36% read that information occasionally. These percentages do not vary significantly between the advised and non-advised investors that were surveyed. To this end, AGF submits that the consumption of disclosure by investors does <u>not</u> appear to be an issue.

Further, AGF also contends that the CSA's statement with regard to disclosure is a significant, and unwarranted departure from the current acceptance of disclosure as an effective mitigant in some circumstances – for example, the inclusion of disclosure related to fees and conflicts in the relationship disclosure information.

AGF does acknowledge – and the Gandalf Report provides recognition – that while investors are fully informed (i.e. there <u>is</u> transparency) and they do in fact read disclosure, there may be an inherent gap in commensurate knowledge/understanding about their holdings (including the fees and commissions they are charged). This does not mean, however, that there is any issue with regard to transparency or disclosure. On the contrary, AGF submits that this simply means that disclosure can be *clarified* and *enhanced* to make it more "user-friendly", and that investors may need more tools to

[4] "<u>The Canadian Investors' Survey: An Opinion Research Study on Fees & Advisory Services</u>" (May 30, 2017) by The Gandalf Group. This third-party survey, as conducted by The Gandalf Group (a Toronto-based consultancy firm that specializes in survey research), was commissioned by AGF. Designed by The Gandalf Group, this recent survey of a core sample of 1299 Canadian investors investigated issues relating to individual investors, the advisory services industry, fund providers and regulators, including: (i) satisfaction with advice, fees, transparency and investment options; (ii) the role of advisors, and their strengths and weaknesses; (iii) the perception of fee disclosure, transparency and new reporting obligations; (iii) general awareness and assessments of various types of commissions and fees (notably trailing commissions), and (iv) investors' preferences for advisor compensation (i.e. fee-based or commission-based charges).

understand and *appreciate* applicable disclosure (including with regard to fees and commissions).

As a result, AGF requests that the CSA amend the Proposed Amendments to state explicitly that disclosure can be an effective mitigant in some circumstances. Registrants should be able to employ their professional judgment to determine which conflicts of interest cannot be properly addressed through disclosure alone, and implement appropriate controls for those conflicts.

Further, AGF encourages the CSA to recognize that the data shows that investors do read disclosure; and that focus should instead be given to providing investors with the appropriate tools to increase their knowledge to be able to understand and interpret additional information to benefit from added/enhanced disclosure.

C. *Alignment with Other Industry Advocates*

AGF is generally aligned with the Investment Funds Institute of Canada ("**IFIC**") response letter to the Proposed Amendments; and is most particularly in agreement with IFIC's responses in relation to the following specific substantive matters:

Companion Policy Guidance – AGF is in full agreement with IFIC's more detailed submission (and recommendations) concerning the premise that the Companion Policy should be viewed as guidance only, and should not impute mandatory requirements as to how to interpret the NI 31-103 rules. What is more, AGF stresses that even though the CSA may not think that the Companion Policy is prescriptive, and actually lends itself to interpretation, registrants will surely have a tendency to interpret the guidance too literally in order to mitigate their risk of being seen to be "non-compliant". It is therefore highly important that the CSA specifically reference the scalability in implementation of the CFRs more broadly, particularly as they apply to the know your client and know your product requirements. In addition, AGF requests that the Ontario Securities Commission make an express statement to the effect that Appendix E of the Proposed Amendments (*Ontario Local Matters*) should not be interpreted as guidance for which registrants would need to consider any compliance considerations.

Safe Harbour – AGF asserts (as IFIC has) that the Proposed Amendments do not provide a commensurate level of guidance with regard to the "client first" element of the suitability determination. AGF agrees with IFIC that this will predictably cause uncertainty for registrants in demonstrating compliance. IFIC's recommendation for the CSA to create a regulatory safe harbour (i.e. if a registrant meets its obligations under the specific suitability factors and manages material conflicts of interest in the best interests of the client, the registrant would be deemed to have put the client's interests first in the suitability determination) seems essential, reasonable and in-keeping with the approach taken by the United States Securities and Exchange Commission.

Permitted Clients – As addressed in the IFIC response letter, the CSA previously considered (in CSA Consultation Paper 33-404: *Proposals to Enhance the Obligations of Advisers, Dealers, and Representatives Toward their Clients*) an exemption from the enhanced

know your client and suitability requirements for a newly defined category of institutional clients. The CFRs do not envision a similar exemption. AGF agrees with IFIC's recommendation for the CSA to establish such an exemption for all permitted clients, including where the account is a managed account. AGF submits that a presumption needs to be ascribed to the Proposed Amendments that not all clients (particularly institutional clients) require or desire the same level of protections associated with the CFRs – particularly the know your client, suitability, and know your product obligations. Permitted clients are sophisticated in their understanding and appreciation of the unique attributes of investment products and capital markets, and would therefore not require the same level of enhanced requirements contemplated in the Proposed Amendments.

Transition Timeline – The scale and impact of the Proposed Amendments should not be discounted. To transition to the full scope of the CFRs will be a time-intensive and costly undertaking for the industry. AGF advocates for a reasonable and viable period of time for such a transition, and therefore concurs with IFIC's recommendation for a three-year transition period after adoption of the final rules.

AGF is also aligned with the Portfolio Management Association of Canada ("**PMAC**") response – notably with respect to the following considerations:

Portfolio Manager Registration Distinction – PMAC contends, and AGF agrees that the CFRs are insufficiently tailored to address the portfolio manager registration category. As noted by PMAC, portfolio managers are already subject to a stringent fiduciary duty to their clients. Further, regulating portfolio managers in the same way as other registrants (as currently contemplated under the Proposed Amendments) is duplicative and unnecessary. In accordance with PMAC's recommendation, the CSA should reassess the specific elements of the CFRs that are not essential to achieve the CSA's stated goals with respect to this category of registrant, and the CSA should instead defer to the professional judgement of portfolio managers on these topics.

Referral Fees – Separate Phase Consultation – Given that the topic of "referral fees reform" was only raised by the CSA for the first time in the June 21, 2018 publication of the Proposed Amendments (unlike the other reforms, which have been the subject of much industry consultation to-date), AGF subscribes to PMAC's proposal for the topic of referral fees to follow a separate work stream to allow for further data collection and consultation. This proposal would be akin to the approach that the CSA is taking with regard to proficiency requirements, and title reforms.

We thank the CSA for the opportunity to raise the above issues in relation to the CFRs. As always, AGF certainly promotes the necessary balance of truly benefitting investors while not unduly prejudicing the industry. At AGF, we believe in sound regulatory change that is grounded in the needs and preferences of all investors.

Yours very truly,

Mark Adams
Senior Vice President, General Counsel & Corporate Secretary
AGF Investments Inc.