BY ELECTRONIC MAIL: comments@osc.gov.on.ca, consultation-en-cours@lautorite.qc.ca

December 13, 2018

British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Ontario Securities Commission
Authorité 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

The Secretary
Ontario Securities Commission
20 Queen Street West, 22nd Floor
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
Montreal (Québec) H4Z 1G3

Dear Sirs / Madames:

RE: Proposed Amendments to National Instrument 81-105 Mutual Fund Sales Practices and Related Consequential Amendment (the "Proposed Amendments")

Thank you for the opportunity to provide comments to the Canadian Securities Administrators ("CSA") on the Proposed Amendments.

Fidelity Investments Canada ULC ("Fidelity") is Canada's 4th largest mutual fund company managing approximately $130 billion in mutual fund and institutional assets.

For over 70 years, including 31 years in Canada, Fidelity has put investors first by working hard to help them achieve their financial goals. We recognize that the CSA is also committed to improving outcomes for investors and we are pleased to work collaboratively with the CSA toward our shared commitment.

Please refer to Appendix “A” for our responses to certain of the questions set out in the Proposed Amendments.

GENERAL COMMENTS

Fidelity is very pleased with the CSA’s decision not to ban embedded commissions. We believe that now, more than ever, it is incumbent upon the regulators and the industry to find ways to preserve choice and protect access to financial advice. It is important to recognize that, globally, we have seen a shift in regulatory policy, i.e. a move from initiatives that reduce choice and access to ones that promote and protect them. This shift aligns well with the public policy objectives of the provincial and federal governments in an aging Canada. Retirement savings of Canadians and the health of the Canadian economy must remain of paramount concern.

We acknowledge that there are potential conflicts of interest in any model where fees are paid for financial advice, including fee-based compensation. We believe, however, that the CSA’s client focused reforms strike the right balance in achieving principles-based standards to addressing conflicts of interest.

In keeping with our belief in choice for investors, Fidelity believes that the deferred sales charge option (“DSC”) can be a viable and legitimate purchase option if used and regulated appropriately. The DSC option allows smaller investors to invest in mutual funds so that the full amount of their money is working. It also allows smaller asset advisors and new advisors to provide financial advice to investors who might otherwise not receive advice.

Emphasis on Costs

We refer the CSA to our previous submission dated October 19, 2018 on the CSA’s Client Focused Reforms – Proposed Amendments to National Instrument 31-103 and Companion Policy 31-103CP (the “Paper”).

Fidelity very much supports the philosophy that investors should understand the costs of the investments that they are buying and the impact of those costs on potential returns. However, we think the most important driver of investment success is performance. An emphasis on costs without the context of performance or a consideration of a number of other factors may not result in the best investor outcomes.

Based on what we consider a flawed reading of the Paper, some argue that the only, or most definitive driver, of a suitable product is cost. The Paper seems to suggest that it is <u>the</u> primary driver, based on the wording on page 191 of the Paper, which says "…*we expect the registrant to trade, or recommend, **the lowest cost security***…". This is unfortunately reinforced by language that repeats "lower cost" or "lowest cost" in Annex E – Ontario Local Matters of the Paper.

In our view, the correct reading of the Paper is that "cost" is one factor to be considered in a suitability assessment, not the sole factor.

We believe that this statement should be read in the context of the previous paragraphs on 191, which say "…*Registrants must assess the relative costs of **various options** available to clients at the firm when making a suitability determination*…" and "…*Registered individuals must put their client's interest first when selecting between **multiple suitable options***…"

Further, on page 185 of the Paper, the CSA provided guidance on when a security is suitable and includes the following factors:

- the general structure and features of the security
- conflicts of interest including compensation
- the parties involved – including the issuer's financial position, history, viability, qualifications, reputation, track record of the parties involved (including the fund manager)
- risks
- performance

We believe that a product suitability analysis should include all these factors.

We would urge the CSA to redraft the wording on page 191 of the Paper, which references the "lowest cost security", to consolidate the sections on pages 185 and 191 of the Paper and make it explicitly clear that cost is one factor and not the sole factor in the overall suitability analysis.

We would also urge the CSA to make it clear, once and for all, that the "lowest cost" does not mean that clients need to be driven to passive exchange traded funds ("ETFs") or index funds. We know the CSA is aware of the dangers of a market heavily skewed toward passive ETFs and index funds and the potential for considerable investor consequences if that does occur. A healthy balance between active and passive products, as well as ETFs and mutual funds and other types of securities is important for a healthy functioning marketplace. We refer you to a recent article in the Wall Street Journal in which John C. Bogle of Vanguard yet again sounded the alarm of a market dominated by passive index funds offered by a few large institutional investors. [1]

[1] John C. Bogle, "Bogle Sounds a Warning on Index Funds", Wall Street Journal, November 29, 2018.

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Lastly, Annex E – Ontario Local Matters of the Paper is intended to be a cost/benefit analysis as required by the Securities Act (Ontario). However, Annex E goes well beyond that by providing additional guidance to the Companion Policy to bolster the Ontario Securities Commission's agenda that lowest cost be the primary factor to be used in determining suitability. For example, on pages 254 and 255 of the Paper, the Ontario Securities Commission ("OSC") say that the client focused reforms will "…*result in improvements including a higher provision of* ***lower cost, better performing*** *securities to clients*", "…*result in better diversification of client portfolios and* ***lower portfolio costs***…" and "…*bundles of securities with similar portfolio risk attributes but l****ower cost and better return potential***". In our view, the cost/benefit analysis should not restate concerns which have been otherwise addressed in the consultation papers.

The DSC

We refer the CSA to our previous submission dated June 9, 2017 on Consultation Paper 81-408: *Consultation on the Option of Discontinuing Embedded Commissions*, wherein we described the benefits of the DSC option.

We believe that the DSC option, which was introduced in 1987 in Canada, should remain a legitimate purchase option. The DSC option provides two key benefits. First, it allows the modest investor the ability to invest 100% of his or her money in mutual funds to save for retirement. Second, it provides advisors with the ability to service investors with small amounts to invest. This is particularly important for advisors, both new and seasoned, who make a living servicing the modest investor.

In addition, there is sound evidence that the DSC option is helpful for many investors. The DSC option encourages self-control around retirement savings and investing for the long-term. In actuality, it may discourage bad investment behaviour like early withdrawals from registered savings and from investors falling prey to what is known as the "present bias". The present bias refers to households placing a disproportionately high weight on present consumption and low weight on the future.

In recent years, while arguments have been made that the DSC is missold or unsuitable for investors, significant improvements have been made. Suffice it to say, if the DSC option is used appropriately, there should be no reason why the CSA should eliminate a purchase option that continues to serve a meaningful purpose both for modest investors and newer advisors.

<u>CONCLUSION</u>

Thank you for allowing us to provide comments on the Proposed Amendments. We also thank you for considering our comments. We are, of course, always available to discuss our comments.

Yours very truly,

Fidelity Investments Canada ULC

"Rob Strickland"

Rob Strickland
President

c.c. Sian Burgess, SVP, Fund Oversight

APPENDIX "A"

RESPONSES TO SPECIFIC QUESTIONS

Regulatory Arbitrage

Question 11. *We understand that the elimination of the DSC option may give rise to the risk of regulatory arbitrage to similar non-securities financial products, such as segregated funds, where such purchase option and its associated dealer compensation are still available. Please provide your thoughts on controls and processes that registrants may consider using, and on specific measures or initiatives that the relevant regulators should undertake, to mitigate this risk.*

> One of the CSA's stated goals for this initiative is investor protection. We are concerned that the CSA is considering only the protection of investors who invest in mutual funds. We believe that it is imperative that like products be treated in a like manner, i.e. segregated insurance products. There is a broad social goal of protection for all investors. Other goals include the need to increase savings rates for retirement and the overall health of the Canadian economy. If the CSA drives investors to other less regulated and less transparent products, it will not accomplish its overarching goal of investor protection for all investors. It is equally important for the CSA to liaise with other regulators, like the CCIR, before the CSA proceeds with any policy initiative that will cause a difference in treatment among similar retail investors.

Modernization of NI 81-105

Question 12. *Given that NI 81-105 aims to restrict compensation arrangements that can conflict with registrants' fundamental obligations to their investor clients, and given that the proposed Client Focused Reforms introduce the requirement for registrants to address conflicts of interests, including conflicts arising from third-party compensation, in the best interests of clients or avoid them, should the modernization of NI 81-105 entail a consolidation of its requirements into the registrant conduct obligations of NI 31-103?*

Question 13. *NI 81-105 currently applies only to the distribution of prospectus qualified mutual funds. In our view, the conflicts arising from sales practices and compensation arrangements that are addressed by the provisions in NI 81-105 are not unique to the distribution of prospectus qualified mutual funds and also arise in the distribution of other investment products, either sold under a prospectus or a prospectus exemption. Are there other types of investment products that are not currently subject to NI 81-105, such as non-redeemable investment funds, certain labour-sponsored investment funds, structured notes and pooled funds that should also be subject to NI 81-105? If not, why should these investment products, their investment fund managers and the dealers that distribute them, remain outside the scope of NI 81-105?*

> Yes. Fidelity believes that NI 81-105 should be modernized to cover other competing retail products like separately managed accounts ("SMAs") and unified managed accounts ("UMAs"). We do not think it is necessary to consolidate it into the registrant conduct obligations of NI 31-103.

SMAs and UMAs are considered fee-based accounts and are becoming increasingly popular, particularly among the banks. They are not subject to the same disclosure requirements as mutual funds. They are also not transparent. There is little publication of the performance of these accounts, although investors do receive reporting after they buy these products. There is no Fund Facts and they are largely unregulated as far as disclosure is concerned. There is also no publicly available price information about these products. Investors may not be aware of the fact that a higher portion of the fee goes towards advisor compensation than the commissions on a mutual fund. Rather, SMAs and UMAs are typically pitched as cheaper and superior alternatives to mutual funds, which, in many cases, they are not. The CSA must, in our view, address the compensation conflicts associated with these products as well.