Via Email

December 13, 2018

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
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Re: Proposed Amendments to National Instrument 81-105 *Mutual Fund Sales Practices* and related consequential amendments

TD Wealth appreciates the opportunity to comment on the Canadian Securities Administrators ("CSA") proposed amendments to National Instrument 81-105 *Mutual Funds Sales Practices* ("NI 81-105") and related consequential amendments that seek to prohibit: (i) the payment of trailing commissions to, and the solicitation and acceptance of trailing commissions by, dealers who do not make a suitability determination in connection with the distribution of securities of a prospectus qualified mutual fund (the "OEO Proposal"); and (ii) all forms of the deferred sales charge ("DSC") option and their associated upfront commissions in respect of the purchase of securities of a prospectus qualified mutual fund (the "DSC Proposal", and together with the OEO Proposal, collectively, the "Proposals").

We welcome the opportunity to share our experience as a leading Order Execution Only ("OEO") dealer in Canada with the CSA as it considers how the Canadian mutual fund fee structure might be improved in light of concerns identified in the Proposals. We believe the issue of how self-directed retail investors are able to access mutual funds of their choice is an important matter with complex and wide-ranging elements that deserves further discussion and consultation. We support the principles of investor protection and fairness, and we also believe that Canadian investors are best served by a fee structure that furthers investor choice alongside these principles.

OEO Proposal's unintended consequences to smaller retail investors

TD Wealth believes that the interests of investors are best served by providing them with choice as to how they want to invest and choice as to what investment products they want to invest in. Mutual funds, in particular, have enabled investors, with minimal investment, to access capital markets. Accordingly, mutual funds have become the most widely-held investment vehicle, accounting for 31% of Canadians' financial wealth, held by 33% (4.9 million) of Canadian households.[1] TD Wealth is concerned that the OEO Proposal may threaten to reduce this level of investor participation in capital markets by eliminating the fee arrangement that enables this level of participation.

While we recognize the investor protection and market efficiency concerns with respect to embedded commissions raised by the CSA, there is, however, complexity in achieving the desired regulatory outcomes. The proposed prohibition of embedded dealer compensation in mutual fund products held on an OEO platform would be, in our opinion, detrimental to smaller retail investors, as it would have negative unintended consequences, as described below.

a. ***TD Direct Investing provides valuable ongoing services that warrant the payment of an appropriate trailer fee***

It is important to stress that trailing commissions are not exclusively used to compensate dealers for providing investment advice. In fact, a dealer may use trailing commission to pay for an array of services it provides to clients in relation to mutual fund investments. These services are unrelated to the provision of investment advice. Some examples of the services that trailing commissions support include: product information and research, including product-shelf management, tax documentation, continuous disclosure, portfolio monitoring, trade execution, account maintenance, and custody services. All these services benefit investors.

Where regulatory initiatives, such as the OEO Proposal, seek to align the payment of fees by investors with the provision of services to them, we recommend the focus be on requiring clear disclosure about the purpose of, and the services provided in relation to, those fees.

Through the direct investing channel, investors have access to many of the services, resources, and information ordinarily provided through an advisor; in other words, there is an array of services beyond order-taking. However, we are concerned that the absence of a suitability determination has contributed to a misperception that there is a lack of service in this channel. In light of the CSA's comments regarding OEO dealers in the direct investing channel and other dealers who are not required to make suitability determinations, we wish to provide some clarity on the services that are in fact provided by TD Direct Investing. To help individual investors make informed investment decisions, TD Direct Investing provides investors with a wide array of tools, information and resources, including:

[1] Investment Fund Industry of Canada (IFIC) statistics as of 2015.

- Third party mutual fund analyst research;
- Online tools which help investors find suitable mutual fund investment tailored to their personal goals and investment preferences;
- Performance and risk analysis for individual funds and related benchmarks;
- Detailed reporting on individual fund holdings and fundamental data;
- Custody and safekeeping;
- Webcasts featuring experts in portfolio strategy, economics, and market analysis;
- Monitoring tools which help clients monitor and track actual/prospective mutual fund investments (i.e. price events, analysts rating changes, and news developments);
- Real-time market data, historical sector/fund performance, and fund commentary from independent industry experts;
- Dedicated call centre mutual fund specialists assisting clients with specific fund-related questions to help clients navigate through the thousands of choices available to them; and
- Delivery of over 4,000 free educational seminars annually, as part of our commitment to increase financial literacy and help investors gain confidence while investing.

Accordingly, measures seeking to limit or eliminate trailing commission levels in the direct investing channel based on the OEO rationale (that no suitability determination is made) would not be reflective of the levels of service provided.

A potential unintended consequence of the OEO Proposal is the reduction in the scale of services currently provided by TD Direct Investing to do-it-yourself investors. This would result in, at best, fewer investor resources, less information and support, as well as a possible reduction in the mutual fund products that may be made available through this channel.

TD Wealth submits that its D-Series mutual funds, with reduced commissions tailored to the direct investing channel, provide a cost-effective way to continue to offer TD mutual funds, investor resources and services to do-it-yourself investors on its direct investing channel. Many of our D-Series mutual funds have a nominal trailer of 0.25% and no upfront commission. Moreover, given the cost to provide access and services to investors, D-Series mutual funds provide a value proposition to investors relative to other investment products.

b. Alternative fee arrangements would reduce access for small investors

Mutual funds offer the average retail investor entry to a pooled vehicle managed by professional money managers and administrators. Due to economies of scale, embedded commissions preserve investor choice in the form of access to the TD Direct Investing OEO platform; they provide smaller investors with access to mutual fund investing at very low investment minimums, and at a comparatively low cost. TD Wealth is concerned that the OEO Proposal, if implemented, will compromise this access. Retail investors would be required to enter into alternative fee arrangements in order to continue to invest in mutual funds on OEO platforms. Such fee arrangements may be cost-prohibitive for smaller accounts.

Alternative fee arrangements are generally not economical for smaller account sizes, largely due to the significant operational costs required to administer them. Moreover, under a number of alternative fee arrangements, certain economies of scale are lost when fees are calculated for each account, rather than across investors at the fund level. Additionally, investors will incur the added cost and complexity of incurring taxable gains or losses realized by redeeming units to pay for such fees. In contrast, the current fee structure, where trailer fees are paid by fund managers out of the revenue generated from the mutual funds, provides a simple and easy to administer, "all-in" cost to investors that works for fund managers, dealers and investors alike.

c. ***Transaction fees would negatively impact investors' ability to invest frequently in small increments***

We are concerned that that the industry may be required to move towards implementing a transactional fee structure as a result of the OEO Proposal. A transactional fee structure would be problematic to TD Direct Investing clients, as a vast number of them who hold mutual funds would be subject to higher fees than they are currently paying. As mutual funds have low trading frequencies and a substantial portion of mutual fund assets are 'transferred in', any transactional fee would, unavoidably, be much higher than the standard trading fee TD Direct Investing currently charges its clients, to make it economically viable to offer mutual funds on this platform.

Moreover, certain benefits that TD Direct Investing clients enjoy would be compromised with the introduction of a transactional fee. An example of one such benefit is the availability of systematic contribution plans, which facilitate regular savings and ensures client dollars are invested immediately. Low-fee barriers to transact encourages investors to save regularly and helps them to meet their long-term financial goals. A transactional fee model will create a barrier to regular savings, causing small-dollar investors to reconsider their investment frequency. This would disadvantage investors who currently make smaller frequent investments, as these regular contributions compound over time, resulting in greater savings, as compared to an investor who invests a larger sum of money twice-annually in no-trailer mutual funds, but with high fixed transaction fees. Lastly, investors may be further disadvantaged by having to wait until the transactional cost of reinvestment is justified, as oppose to reinvesting any cash dividends they may receive immediately.

d. ***Alternative fee arrangements may not be readily adopted due to operational complexity considerations and the size of investments required***

As expressed above, TD Wealth's primary concern with the OEO Proposal is the potential negative impact it will have on smaller retail investors who wish to have continued access to investing in mutual funds on an OEO platform. In addition, we would like to share with the CSA our reservations as to the commercial viability of pursuing alternative fee arrangements for the OEO platform given the operational complexity and the investment required.

If the CSA implements the ban as proposed, it is not self-evident that OEO platforms will invest in building the necessary infrastructure on the platform to support an alternative fee arrangement given the nature and size of the mutual fund holdings on the provider's platform. This may result in OEO platforms removing mutual funds from their product shelves. Currently, TD Direct Investing does not have a product-based fee-engine that can accommodate an alternative fee model for mutual fund investors on its platform. This would involve the creation and implementation of a completely new fee-based engine, requiring a significant investment in technology and operations. In addition, the complexity of operationalizing a new model would result in much longer implementation timeframes, prolonging the final solution for clients.

Further, as a practical matter, under the OEO Proposal, dealers may face challenges with respect to the collection of fees from clients. Having to collect fees directly typically results in a negative client experience, and has proven to be a significant client irritant, especially when clients are inactive and/or do not hold sufficient cash in their accounts. This potential step dealers may be required to take, as part of the OEO Proposal, will eliminate the experience smaller retail investors are accustomed to under the current fee structure. Notably, a substantial proportion of clients who hold mutual funds have less than $200 in their accounts, with most of those funds held in registered accounts. Accordingly, it would likely be a very challenging task to cover account fees for those accounts.

e. Transition period

Implementation of the Proposals, specifically the OEO Proposal, will impact TD Direct Investing's systems as well as internal policies and procedures. The systems necessary to enhance our capabilities to implement the Proposals, the redesign of our operations and the development of new compliance procedures will demand extensive resources. Projects and initiatives of this scope and scale involve resources that are scheduled on a multi-year basis. This project will require careful planning, including an enterprise-wide reprioritization of projects and initiatives that are already underway. Developing new functionality in legacy systems and processes is costly and time consuming and, in some cases, may not be technologically feasible, potentially resulting in the need to transition to entirely new systems.

Given the scope and significance of the Proposals, should they be adopted in their current form, a longer transition period, with an opportunity for meaningful consultation with securities regulators and self-regulatory organizations ("SROs"), is necessary. To effectively operationalize the required changes, registrants will need to see the final rules, including related SRO rules, before commencing implementation in order to ensure alignment of technical and logistical specifications with the new regulatory requirements. With respect to the proposed implementation schedule and transition period, we recommend that the CSA commence the transition period for implementation of the Proposals only <u>after</u> all related SRO rules are published in final form, including any related guidance.

As tax considerations are a key part of any discussion of mutual funds, their fees and structuring, the CSA should also consider, from an investors' perspective, the tax implications associated with paying fees outside a mutual fund product, should they choose to move forward with the Proposals. We would be pleased to provide the CSA with further background on this topic should the CSA find it helpful.

<u>DSC Proposal</u>

We appreciate the investor protection and conflict of interest concerns raised by the CSA and are supportive of the DSC Proposal.

TD Wealth does not currently recommend DSC products in our distribution channels and has concluded that it does not require DSC option products to continue to meet the needs of our clients. Consequently, should the DSC Proposal come into effect, TD Wealth will allow redemption schedules on existing DSC holdings to simply run their course.

<u>Recommendations</u>

While we support regulatory efforts that seek to address potential conflicts of interest between firms, advisors and investors, we believe that the OEO Proposal could have significant negative unintended consequences, as discussed above, that would harm smaller retail investors. As an alternative to the OEO Proposal, we recommend that the CSA consider the following:

1. *D-Series* - A standard, low commission option such as D-Series should be offered to investors on OEO platforms as this series allows "do-it-yourself" investors to continue to access online trading platforms at a low cost.

2. *Continued investor reliance on prescribed investment disclosure documents* - Investors should be given the freedom to make their own investment decisions, provided they have access to all relevant information and disclosure. It is TD Direct Investing's continued commitment to provide investors with clear disclosure and transparency of fees that are charged on products offered on its platform. In our view, regulatory initiatives, such as the prescribed pre-trade fund facts disclosure document and the client relationship model initiatives, provide increased disclosure and transparency with respect to fees (including embedded commissions such as trailer fees) to investors at each stage of their investment.

TD Wealth's Response to the Specific Questions of the CSA Relating to the Proposed Amendments

In the attached Appendix, we have provided responses to questions 6, 7, 8, 9(a) and (b), 10 and 13 from Annex A of the Proposals.

We appreciate the opportunity to provide comments on the Proposals. We recognize the importance of collaboration between industry members and regulators to advance the interests of Canadian investors through a mutual fund fee structure that is fair and transparent. However, we also believe that deliberation and care must be taken in modifying the current Proposals to protect investor choice, minimize unintended consequences and to ensure the vibrancy of Canadian capital markets.

We welcome the opportunity to provide additional detailed commentary through in-person discussions with CSA staff.

Sincerely,

[redacted]

Group Head, Wealth Management and TD Insurance

APPENDIX

TD Wealth's Response to the Specific Questions of the CSA Relating to the Proposed Amendments

6. *Would fund organizations encounter any issues, including any operational challenges, in confirming whether a participating dealer has made a suitability determination, and is thus eligible to be paid a trailing commission in compliance with subsection 3.2(4) of NI 81-105? If so, please explain.*

   TD Asset Management ("TDAM") anticipates significant issues in confirming whether a participating dealer has made a suitability determination and is thus eligible to be paid a trailing commission. In particular, TDAM lacks clear visibility as to whether an account sits on an OEO platform and has no visibility as to whether a client is a permitted client which has waived the suitability obligations. Moreover, integrated dealers often use the same dealer code for both advice channel orders and OEO orders.

7. *Are there any transitional issues for fund organizations and participating dealers with implementing the Proposed Amendments within the proposed 1-year transition period? If so, please provide details of the relevant operational, technological, systems, compensation arrangements or other significant business changes required, and the minimum amount of time reasonably required to operationalize those changes and comply with the Proposed Amendments.*

   As more fully described under "Transition period" above, TD Direct Investing will require a significant amount of time to create, test, and implement a new product-based fee-engine. This would require a significant investment in technology and operations. In addition, the complexity of operationalizing a new model would result in a long implementation timeframe, prolonging the final solution for investors.

8. *With the implementation of the Proposed Amendments, would the required changes to the disclosure in the simplified prospectus and fund facts documents within the proposed 1-year transition period necessitate amendments outside of a mutual fund's prospectus renewal period? Would these changes be considered to be material changes under NI 81-106?*

   We do not anticipate that the Proposals, if implemented, would necessitate amendments outside of a mutual fund's prospectus renewal period. Furthermore, as the Proposals relate to the elimination of a fee structure, the Proposals would not constitute a material change under NI 81-106.

9. *(a) Switching a client from a class or series of securities of a mutual fund that pays a trailing commission to one that does not pay a trailing commission would trigger the delivery requirement for the fund facts document. As a transitional measure, should there be an exemption from the fund facts document delivery requirement for such switches? Such an exemption would mean that the investor would not have the right of withdrawal from the purchase, however, the investor would continue to have a right of action for rescission or for damages if there is a misrepresentation in the prospectus of the mutual fund, including any documents incorporated by reference into the prospectus, such as the fund facts document. In some jurisdictions, investors have a right of rescission with delivery of the trade confirmation for the purchase of mutual fund securities and this right would remain unchanged with such an exemption.*

   TD Wealth is of the view that an exemption from the delivery requirement for the fund facts document should be embedded in the CSA's final rule with respect to switches from a class or series of securities of a mutual fund that pays a trailing commission to a more appropriate class or series.

(b) *Are there any other types of exemptions from CSA or SRO rules that we should consider to facilitate switches to trailing commission-free classes or series of mutual funds? If so, please describe.*

The CSA should consider ongoing exemptions for switches from one class or series of securities into another class or series of securities of the same mutual fund to facilitate investor transfer of assets between accounts (commission-based to fee-based and vice versa) and between dealers (OEO to full-service and vice versa). Under these conditions, the trade confirmation and fund facts pre-trade delivery requirement should be waived to permit for a reasonable operational switch.

10. *At this time, the CSA is allowing redemption schedules on existing DSC holdings as of the effective date of the Proposed Amendments to run their course until their scheduled expiry, and fund organizations to continue charging redemption fees on those existing holdings that are redeemed prior to the expiry of the applicable redemption schedule. Should the CSA propose amendments to require existing DSC holdings as of the effective date of the Proposed Amendments to be converted to the front-end load option or other sales charge option? If so, are there any transitional issues for fund organizations and participating dealers with converting existing DSC holdings to another sales charge option? What would be an appropriate transition period?*

If the DSC Proposal is implemented, the CSA, as of the effective date of the Proposals, should continue to allow redemption schedules on existing DSC holdings to run their course until their scheduled expiry date. We also agree that fund organizations should be permitted to continue to charge redemption fees on those existing holdings that are redeemed prior to the expiry of the applicable redemption schedule.

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?*

TDAM believes that the imposition of NI 81-105 is not warranted for investment products such as pooled funds, as they are sold under a prospectus exemption and are used by portfolio managers for their managed account clients or purchased by institutional or accredited investors and do not involve third party dealers for the purposes of distribution. The proposed amendments to National Instrument 31-103 - *Registration Requirements, Exemptions and Ongoing Obligations,* in our view, address regulatory concerns surrounding conflicts of interest for such investment products.