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The Gold Standard for Regulatory Strength and Transparency
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Embedded advisor compensation is an important option for Canadian investors, given the unique aspects of our market. It should be preserved alongside the option of paying separate fees for advice.

The most unique feature of our market is the availability of advice to everyone, including small investors who might otherwise not have access to professional investment services. Public surveys have shown that almost 60% of Canadian mutual fund investors first go to an advisor when they have under $25,000 to invest; more than 40% seek advice with less than $10,000. Average accounts are $35,598 for MFDA-licensed advisors and $67,078 in the IIROC channel. In jurisdictions such as the U.S., where fee-for-advice is the dominant structure, advisors have a declining interest in clients with smaller portfolios and some firms penalize their advisors for holding accounts below a certain size.

The total cost of owning a mutual fund in Canada is already fully disclosed and transparent in the Management Expense Ratio (MER). Embedded fees enable individual consumers to compare the total cost of owning various funds. In contrast, U.S. investors pay a misnamed "Total Expense Ratio" (TER), which does not incorporate the separate fee for advice that is typically paid directly to the advisor. There is no regulatory requirement in the U.S. to publicly disclose the advice fee. As a result, a U.S. investor knows what s/he is paying for advice but has no way of knowing whether the total costs (TER plus advice fee) are consistent with amounts paid by other clients of the same firm, and no way of comparing total costs against what other firms charge.

Another attribute is the strength of Canada's regulatory environment. Our disclosure regime is already superior to that of any other country, and it will soon be even stronger with recently announced changes to Fund Facts, as well as the full implementation of new Client Relationship Model rules, known as CRM2. Fund Facts will give fund purchasers a four-page summary of key information including costs, risks and fund holdings, all written in plain language. Under the new CRM2 requirements, investors will receive an annual statement that explains how their investments performed and what they paid to their dealer. This will equip investors to have much more robust discussions with their advisors about the costs and value of their services.

Banning embedded fees just as we embark on a new enhanced disclosure regime seems premature. A more prudent approach would be to complete the implementation of the new initiatives, and allow some time to determine whether they are meeting the intended public policy objectives.

Major public policy changes can have unintended consequences. Following the ban on embedded commissions in the U.K., a number of major banks and insurers cut their branch advice arms. Santander, AXA UK, HSBC, Barclays, Lloyds and the Royal Bank of Scotland are reportedly leaving the mass market because small accounts are not serviceable in a fee-for-service market. HSBC has withdrawn advice to customers investing less than £50,000–almost $80K Canadian. The move is causing significant layoffs: these banks have cut several thousand advisors from their staff in the past few months. As a result, smaller investors will experience an advice gap while fee-for-service advisors focus their attention on high net worth clients.

Without a doubt, embedded commissions facilitate smaller retail investors' access to advice on a more efficient basis than under a fee-for-service model. For people in Canada wishing to pay separate fees-for-advice, this option is already available and growing.

At the Ontario Securities Commission's recent roundtable, where I was pleased to serve as a panelist, we were asked whether Canadian retail investors would be willing to pay for advice under a fee-for-service model. The fact is that investors are paying for advice today—but it is done in a way that is efficient and convenient for both the investor and the advisor. The current structure allows those with small amounts of investments to access advice—which ultimately encourages savings and helps Canadians build wealth. This is a key public policy goal of our provincial and federal governments.

There is a legitimate concern that some investors are not sufficiently aware of the fees that they pay. A measured approach will afford us the opportunity to foster better understanding of the pricing structure with new disclosure requirements. At the same time, we will have the opportunity to observe the impacts of the commission ban in the U.K. and Australia. The insights we gain will enable us to assess the impact of these approaches on investors, in order to determine whether better and targeted disclosure is the best way to help them understand the cost of the products they buy.