Safeguarding Access to Financial Advice for Canada's Middle Class

by Paul C. Bourque, Q.C.,

President and CEO

The Investment Funds Institute of Canada

to the

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"We should always be looking for ways to improve investor protection, and to foster fair, efficient and competitive capital markets. What we should avoid is introducing measures that add to the regulatory burden without providing proportionate improvements in investor outcomes."

CHECK AGAINST DELIVERY

Remarks by Paul C. Bourque, Q.C., President and CEO, IFIC
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Check Against Delivery

Joni Mitchell famously sang: "You don't know what you've got 'til it's gone." It's important for regulators – and for all of us – to spend some time now thinking about what we have and whether we are prepared to let it go. Because the potential impact of recent regulatory proposals will permanently alter the landscape for retirement savings in Canada – and not necessarily for the better.

So let's start off by talking about what we've got right now.

The growth of investment funds in this country is a uniquely Canadian success story. The combination of public policy, regulatory policy and competitive market forces has made access to advice, and to a wide range of investment products, available to all of us. Even those of us who are of modest means, and early stage investors, can obtain financial advice at a reasonable cost through a variety of purchase options in a well-regulated financial market.

Today, folks from all walks of life, from coast to coast to coast, are building financial security with more than 1.4 trillion dollars in mutual funds.

At the end of last year, Canadians had more than one-third of their total financial wealth in mutual funds – more than in stocks and bonds and more than in deposits.

What has led to this success? Why are so many Canadians investing in mutual funds?

First and foremost is the widespread access to equity markets that mutual funds provide. Mutual funds were the first product to give modest investors with small amounts of money the opportunity to lift themselves up by building their wealth in an affordable, professionally managed, diversified basket of investments.

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This opportunity was a giant step for the majority of citizens who, until that time, had been generally limited to Canada Savings Bonds, with no exposure to equity market returns. Access to stock market returns is critical, especially in a period of low interest rates.

The opportunity that funds provide for us to build our savings at a reasonable cost lines up perfectly with a critically important public policy objective: to encourage us to be self-sufficient in our retirement years.

We need to grow our retirement savings so that our money lasts throughout our lifetime – and with the decline in defined benefit pension plans, and people living longer than ever, that growth is more important than ever.

We Canadians are a diverse bunch, and the funds industry has continually evolved to meet our needs. We can choose from well-balanced funds with a range of risk levels and mandates that suit our personal goals or beliefs, such as socially responsible funds, global funds, exchange-traded funds, or funds that focus on different sectors or geographic areas.

The industry is a strong promoter of government-sponsored savings initiatives, such as RRSPs and TFSAs and the take-up of these programs has been high.

For all of these reasons, Canadians hold more investment funds as a percentage of total financial assets than any other country in the OECD.

Advice has played a pivotal role in encouraging all of us to save and plan our financial futures, to participate more in government savings plans and to save at higher rates than we otherwise would have.

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Advice helps build the knowledge and confidence investors need to become informed investors. Research shows that advice provides significant benefits to investors in terms of more disciplined savings behavior, overall higher asset values, more efficient tax planning and retirement confidence.

Research also shows that long-term client-advisor relationships build trust, encourage appropriate risk-taking and facilitate greater stock market participation.

Investors with advice accumulate as much as 3.9 times more financial assets over the long-term than comparable investors who do not have advice.

Canada has close to 100,000 registered advisors to assist us and offer advice on mutual funds.

Most of us pay for advice through the fees that are bundled in the management expense ratio. Ninety percent of mutual funds are purchased through an advisor, and about 80% are purchased using an embedded commission arrangement.

Research tells us that investors are less likely to seek financial advice if they have to pay for it up front.

- Pollara found that half of all mutual fund owners who currently use an advisor say they would not continue to do so if they were required to pay a higher, separate fee.
- The Gandalf Group reported that 25% of investors would be less likely to seek advice if embedded commissions were banned.
- A study of retail investors from eight European countries observed that between 26 to 30 per cent of investors were unwilling to pay upfront for advice.

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Evidence from the U.S., where the use of embedded fees has been on the decline for many years, shows that the total cost to average investors, through advice channels, has increased. In the U.K, the lack of transparency makes the total cost of ownership difficult to assess; however, there is evidence showing that investors are paying more.

Higher fees are an additional disincentive to seek advice.

In Canada, market forces have steadily improved investor outcomes. In recent years, the downward pressure on investment fund fees has intensified. Since early 2016, more than 30 fund companies have reduced fund pricing. These firms account for almost 70% of total mutual fund assets. Asset-weighted management expense ratios for long-term mutual funds have dropped 8½% since 2005.

Trailer fees are also dropping. Today, 97% of long-term mutual fund trailer fees are 1% or less.

The industry is actively exploring and developing new technologies to improve services to investors. Many IFIC members are teaming up with robo-advisors to find the right balance between automated portfolio matching and the qualitative services that advisors provide. These qualitative services cause investors to make more intelligent financial planning decisions, leading them to earn higher rates of return.

The industry's success at helping all of us increase our retirement savings has been decades in the making. It could soon be significantly undermined by two regulatory changes that are under consideration.

The first is a statutory best interest standard of conduct for registered representatives, which is being considered by regulators in Ontario and New Brunswick.

Four other regulators – from British Columbia, Alberta, Manitoba and Quebec – have decided not to pursue a best interest standard of conduct. They believe the best way to improve the advisor/investor relationship is to pursue a set of targeted reforms that were put forward by all of the regulators at the same time that the best interest standard was issued for comment.

We agree with all the regulators that the industry must put the interests of the investor ahead of the interests of the firm or advisor, where those interests may conflict.

We also agree with the four regulators who have decided not to proceed with a statutory best interest standard because it is unclear what the proposed standard would add to the rules of conduct that advisors are already obliged to follow. And it is unclear how a single overarching standard could be implemented with the variety of business models and categories of registration permitted in Canada.

The new rule would create uncertainty for investors and the industry, and cause firms to offer fewer products and withdraw from some types of advice, similar to what is occurring in the U.K. and the U.S.

The second and perhaps more significant regulatory change being contemplated is whether to prohibit embedded commissions and transition investors to pay directly through a fee-for-service arrangement. With about 80% of us choosing the embedded fee option, this proposal promises to be one of the most transformational, costly and disruptive regulatory initiatives ever proposed.

It is important therefore that we all understand the costs, benefits and possible unintended consequences of such a transition.

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Banning embedded commissions will have long-term negative impacts on the ability of Canadians to plan and save, leaving them with substantially lower levels of assets to fund their retirements. A recent study by PricewaterhouseCoopers estimates that the ban would result in individual Canadian investors accumulating, on average, $240,000 less in retirement savings than those with access to advice. This would create pressure on our social safety net, particularly as the population continues to age.

Last Friday, IFIC submitted a brief to the regulators proposing a made-in-Canada alternative to prohibiting embedded commissions that would address many of the concerns that the regulators have identified, while protecting choice and access to advice for Canada's mass market investors.

Canadian regulators have put the onus on the industry to propose an alternative to banning embedded commissions that addresses the regulators' concerns based on new research and insights into investor behavior and the economic impact of a ban.

I believe IFIC's submission meets that challenge.

No system is perfect. We should always be looking for ways to improve investor protection, and to foster fair, efficient and competitive capital markets. What we should avoid is introducing measures that add to the regulatory burden without providing proportionate improvements in investor outcomes.

Preservation of access to the financial advice investors want, at a price they can afford, should be a litmus test for any regulatory intervention in the marketplace. Options that fail to meet that test must only be considered with evidence of overwhelming public benefit.

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It would be unacceptable for the regulators to introduce changes in the name of investor protection only to find that the changes ultimately made financial advice unaffordable or worse – unavailable – for the majority of us.

IFIC will continue to work with regulators across the country as they deliberate these transformational changes.

At the end of the day, the industry will comply with whatever rules the regulators put in place. But once these decisions are taken, governments may find that they have to continue to intervene with new rules and programs to address an advice gap for large numbers of everyday people, as we are seeing in the U.K. But as the U.K. has also discovered – you can't turn back the hands of time.

We should take a lesson from their experience because, unlike Joni Mitchell's refrain, we know what've we've got – it is a uniquely Canadian success story – and we should not be prepared to let that go.

Thank you.