THE INVESTMENT FUNDS INSTITUTE OF CANADA | L'INSTITUT DES FONDS D'INVESTISSEMENT DU CANADA

IFIC.CA

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November 17, 2017

Competition Bureau
50 Victoria Street, Gatineau QC K1A 0C9

Dear Sirs/Mesdames:

RE: Technology-led Innovation and Emerging Services in the Canadian Financial Services Sector—Draft Report for Public Consultation (the Draft Report)

The Investment Funds Institute of Canada (IFIC or we) is pleased to have this opportunity to provide the Competition Bureau (Bureau) with comments on the Draft Report. IFIC is the voice of Canada's investment funds industry and includes approximately 150 mutual fund and ETF managers, retail distributors of funds, and service organizations that work together in a co-operative forum to enhance the integrity and growth of the industry and serve the needs of investors. For 55 years, IFIC has championed the growth of Canada's domestic retail investment funds industry and its mission to help individual Canadians save for the future.

IFIC agrees with the Bureau that "competition is good for both businesses and consumers and that regulation should be minimally intrusive on market forces, allowing competition to drive innovation and improve outcomes for Canadians." (pg. 9) We further agree that to help consumers make purchasing decisions, complete and accurate information, presented in a manner that is clearly understood by consumers, is needed (pg. 11).

Our comments seek to address certain statements or assumptions in the section of the Draft Report entitled "Investment dealing and advice" which we believe could benefit from further information.

1. "Retail investors often find themselves without the ability to accurately compare the cost of advice, as embedded commissions are not readily determined from mutual fund marketing materials." (pg. 60)

   We believe that investors should know all the fees they pay and receive services commensurate with those fees.

   While trailing commissions are embedded with the mutual fund management fee, they are no longer hidden. The "embedded" commission has been made transparent by the combined effect of CRM2 and Point of Sale Fund Facts reforms. Dealers must provide their clients, annually, with a "Report on Charges and Other Compensation" which includes disclosure of the total amount of trailing commissions in dollars and cents.[1] The Fund Facts, delivered before the client's purchase, discloses whether compensation is paid by the fund manager to the dealer and the amount expressed as a percentage of the client's investment and in dollars per $1,000 invested.

[1] National Instrument 31-103, Registration Requirements, Exemptions and Ongoing Registrant Obligations, s.14.17(h)

2. "When two substantially similar funds are available and suitable for a client, for instance, the advisor may be incentivized to recommend the fund with the higher commission, acting on the lack of transparency." (pg. 60)

Research shows that there is very little variability among funds with respect to commissions. The percentage of equity and balanced funds that pay above-average trailer fees (higher than 1%) is only 4%. This is less than half (from 10%) the level of just one year ago. All indications are that this trend will continue and that it will be increasingly difficult for funds and fund companies paying higher than average trailers to find shelf space in distribution channels.

Further, research conducted by PricewaterhouseCoopers LLP concludes "there is no significant evidence that embedded commissions in Canada have been leading to conflicts of interest influencing financial advisors' behaviour." [2] Recent compliance reviews of mutual fund sales practices by the MFDA, IIROC and the AMF shows good industry compliance and little evidence that representatives are putting their interests ahead of their clients.

3. "However, despite regulation requiring such disclosure [of the cost paid for advice] at account opening, a recent mystery shopping exercise found that fees were discussed only about half the time and advisor compensation discussed only about a quarter of the time." (pg. 60)

The "mystery shopping exercise" was limited by the fact that none of the mystery shoppers got to the account opening stage when the cost disclosure is required to be made. In addition, the exercise occurred before the introduction of the CRM2 and Point of Sale disclosure requirements referred to in #1. This new information seems to be making a difference in investor understanding and awareness. In 2015, before the implementation of CRM2 and POS, 67% of mutual fund investors reported being familiar with the fees they pay their firm directly to operate and administer their account and the commissions that their firm receives from other companies. Fully 48% knew the amount of fees their firm received from other companies for the investments they hold. Early evidence subsequent to implementation of these disclosure reforms showed awareness of direct fees rose to 76% and awareness of indirect fees rose to 59%.[3]

Further, the 2017 Pollara survey of investors found that investor awareness that some of the fees they pay go to their dealer and advisor has risen considerably over the past three years. Among those who purchased a mutual fund through an advisor in the past year, awareness jumped from 72% in 2015 to 85% in 2017, while awareness by mutual fund investors generally rose from 69% in 2015 to 78% in 2017.[4]

4. "The difference between mutual funds with embedded commissions and those purchased directly can be significant. In 2015 data aggregator Morningstar found the typical advice portion of MERs on Canadian mutual funds to be around 100 basis points (1%)." (pg. 61)

This statement highlights that mutual funds purchased directly, and therefore without an advisor or advice, cost less than mutual funds purchased through an advisor, and we agree. The advice that is provided has a cost…and has value. Access to ongoing financial advice has been demonstrated to significantly increase household financial assets over unadvised households.

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[2] PricewaterhouseCoopers LLP, *Economic Impact Assessment of Banning Embedded Commissions in the Sale of Mutual Funds*, May 2017, (the "PwC Report"), p. 72
[3] British Columbia Securities Commission, *Investor Readiness for Better Investing 2016-2017 Panel Study: Part 2* (report prepared for the BCSC by INNOVATE Research Group (April 26, 2017)), p. 8.
[4] Pollara, Canadian Mutual Fund Investors' Perceptions of Mutual Funds and the Mutual Funds Industry. 2017

Academic research shows that while financial advisors (or anyone else) are not able to consistently beat relevant market benchmarks after fees on their investment choices, their advice generates significant net benefits to investors in terms of more disciplined savings behavior, overall higher asset values, more efficient tax planning and retirement confidence.[5] According to one study, a household receiving advice over 15 years accrues 3.9 times the value of investment assets of a comparable non-advised household.[6]

Also, it should be noted that the 100 basis points figure quoted is accurate for Canadian equity funds. The actual asset-weighted average for all long-term funds is closer to 78 basis points.[7]

5. "The following graph illustrates the difference in fees over time charged by a robo-advisor and a compensation-based advisor" (pgs. 61-62)

It is clear that if a robo-advisor does not provide and charge for advice then the fees paid by an investor will be less than where advice is provided. It is important to remember that in addition to looking at fees to determine which product provides the best value, an investor should also consider the *value* of advice, which has a very real impact on an investor's savings over time. As discussed in #4, the value of financial advice over the long term is well documented.[8]

6. "While robo-advisors can use technology and algorithms to meet these [KYC and KYP] requirements, they are subject to the same rigorous oversight as traditional advisors." (pg. 68)

IFIC fully supports the use of technology to make the investment process timely and user-friendly. IFIC also supports regulatory initiatives to reduce barriers to technological innovation. The way client information is collected, analyzed and used to make investment recommendations will frequently benefit from automation. However, KYC and KYP are cornerstones of investor protection. All registrants, whether human or automated, should be held to the same standards of investor protection. Any changes to these core principles should be undertaken as part of the current CSA consultations regarding a best interest standard of conduct, targeted reforms to strengthen the client advisor relationship[9] and the proposal to ban embedded commissions[10].

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Please feel free to contact me with any questions you may have, or to discuss our letter with you generally, by phone (416-309-2300) or by email at pbourque@ific.ca.

Yours sincerely,

THE INVESTMENT FUNDS INSTITUTE OF CANADA

By: Paul C. Bourque, Q.C.
President and CEO

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[5] The PwC Report, p.29

[6] Claude Montmarquette and Nathalie Viennot-Briot, "The Gamma Factor and the Value of Financial Advice", CIRANO Institute, August 2016, p.18-25

[7] Strategic Insight. Mutual Fund MERs and Cost to Customer in Canada: Measurement, Trends and Changing Perspectives. September, 2012. p. 5. See also, CSA consultation paper 81-408 – consultation on the option of discontinuing embedded commissions, footnote 228.

[8] Claude Montmarquette and Nathalie Viennot-Briot, "The Gamma Factor and the Value of Financial Advice", CIRANO Institute, August 2016, p.18-25

[9] CSA CP 33-404 – Proposals to Enhance the Obligations of Advisers, Dealers, and Representatives Toward Their Clients – April 28, 2016

[10] CSA CP 81-408 – Consultation on the Option of Discontinuing Embedded Commissions – January 10, 2017