

OSC Investor Advisory Panel  
c/o Ursula Menke, Chair  
Email: iap@osc.gov.on.ca

December 18, 2015

**VIA EMAIL**

Maureen Jensen  
Executive Director and Chief Administrative Officer  
Ontario Securities Commission  
20 Queen Street West  
Toronto, ON M5H 3S8

Dear Maureen:

**Re: Response to Research Paper: *A Dissection of Mutual Fund Fees, Flows, and Performance***

The Investor Advisory Panel is an initiative by the OSC to enable investor concerns and voices to be represented in its rule and policy making process. Given our mandate, we are pleased to provide our comments on a new piece of independent research commissioned by the Canadian Securities Administrators on mutual fund fees. The paper, *A Dissection of Mutual Fund Fees, Flows, and Performance*, written by Douglas Cumming, Sofia Johan, and Yelin Zhang, analyses Canadian mutual fund data on fund fee structures, fund flows, and fund performance. The goal of the paper is to produce reliable and concrete data on the relationship between specific types of mutual fund fees and flows, and how flows are related to fund performance.

The Panel would like to acknowledge and support the CSA in acting on its commitment to evidence-based policy-making. In particular, the findings of this research provide compelling evidence of a fundamental misalignment between the actions of commission-based advisors and the needs and interests of their clients. This can be clearly seen in the paper's key finding: *that mutual funds with trailer fees perform worse than other funds and, at the same time, attract higher inflows of cash from investors even when they perform badly.*

The findings of Cumming, Johan, and Zhang follow in a long line of reports that show how sales commissions and fee structures skew investment advice. It also highlights clearly the dire need in Ontario for a best interest standard whereby advisors are bound to act in the best interests of their clients at all times. As the research shows, this is not the case right now: rather, Cummings et al find that investors are paying the price for regulatory gap inaction because they are being put into poorly performing mutual funds with conflicted remuneration designed to ensure that their advisors get paid.

## **Specific recommendations:**

### *Eliminate conflicted remuneration*

The Panel urges the OSC to act on the findings of this research and produce meaningful reforms that would see investors come first in their relationship with advisors. To that end, we once again urge the OSC to prohibit the payment of embedded trailer commissions. As we've stated before, other jurisdictions have already moved to eliminate conflicted remuneration and the OSC needs to follow suit. In the UK, the FCA recently commissioned independent research that clearly indicated the absence of an advice gap and demonstrated less bias in advisor product recommendations. The same needs to happen here. In fact, we urge the OSC to eliminate all third-party embedded commissions and remuneration.

### *Introduce a best interest standard*

We also expect the OSC to consider the findings of this research in the context of their stated priority for 2016 - to "*Advance regulatory reforms that put the interests of investors first*" as a priority issue. *We also recognize the commitment to developing and evaluating regulatory provisions to create a best interest duty and to completing an analysis of approaches for doing so.*

A best interest standard would immediately require advisors to be the true agents of their clients, putting clients' interests first. This framework would go a long way towards correcting the misalignment so starkly presented in the research paper.

The broken state of advisor-client advice is particularly detrimental to Ontarians, who hold the largest share of fund assets relative to the rest of the country -- according to Investor Economics for example, Ontario investors own 46% of assets in Canada's long-term investment funds. At the same time, Ontario has the largest proportion of mutual fund assets and number of MFDA dealers.

Given its mandate, the OSC has an obligation to act in the interests of Ontario investors and to take the necessary steps to protect investors. A best interest standard is a basic first step in investor protection and it is long overdue. We support the immediate introduction of a best interest standard to protect Ontario investors who expect their advisors to place their interests first. And we reiterate our recommendation that Ontario be prepared to go it alone should other members of the CSA choose not to act in response to this research.