FPSC FINANCIAL PLANNING STANDARDS COUNCIL®

Financial Planning Standards Council

Response to CSA Consultation Paper 81-408: Consultation on the Option of Discontinuing Embedded Commissions

Submitted June 9, 2017

FPSC FINANCIAL PLANNING STANDARDS COUNCIL

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FINANCIAL PLANNING STANDARDS COUNCIL

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Comments delivered by email to:

The Secretary
Ontario Securities Commission
20 Queen Street West
19th Floor, Box 55
Toronto, Ontario M5H 3S8
comments@osc.gov.on.ca

Me Anne-Marie Beaudoin
Corporate Secretary
Autorité des marchés financiers
800, square Victoria, 22e étage
C.P. 246, tour de la Bourse
Montréal, Québec H4Z 1G3
Consultation-en-cours@lautorite.qc.ca

Introduction

Financial Planning Standards Council (FPSC) is pleased to comment on Canadian Securities Administrators (CSA) Consultation Paper 81-408 – *Consultation on the Option of Discontinuing Embedded Commissions* ("the Consultation Paper").

FPSC is a national, not-for-profit standards-setting and certification body that develops, promotes and enforces professional standards for financial planning through CERTIFIED FINANCIAL PLANNER® certification. FPSC certifies and oversees approximately 17,000 CFP® professionals and approximately 2,000 FPSC Level 1® Certificants in Financial Planning across Canada. With FPSC's formal partnership with the Institut québécois de planification financière (IQPF), which is the only organization authorized to certify "Financial Planners" in Quebec, there are more than 23,500 "Financial Planners" in Canada who have met, and continue to meet, FPSC's unified financial planning standards.

General Comments

As an organization that represents the public interest, FPSC fully supports transparency and disclosure of fees and services, and views them as critically important to the protection and empowerment of consumers. We believe that for consumers to achieve their financial goals, they require all relevant facts so that they can make informed choices regarding whom they work with and what fee model meets their needs.

The CSA has made tremendous strides over the past few years in improving the transparency of costs associated with financial products and advice, especially through the Client Relationship Model-Phase 2 (CRM2) and Point of Sale (POS) reforms. FPSC believes these and other regulatory reforms have the potential to greatly enhance clients' awareness and understanding of the fees they pay for the services they receive.

In commenting on the Consultation Paper, we are mindful of the fact that that the CSA has not yet made the decision whether to discontinue embedded commissions, and that the goals of the Consultation Paper are to identify and understand the potential impacts such a change would have on the fund market, fund managers, dealers, advisors and ultimately the investors they serve. It is from this perspective that we have provided comments.

To help supplement our own views, and to provide additional information to the CSA regarding the potential issues and impacts such a change to compensation models may have, we conducted a survey of those we certify and oversee—CFP professionals and FPSC Level 1 certificants—to better understand the challenges of, and to gain insights from, the most highly qualified individuals who stand to be affected by this regulatory proposal.[1]

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[1] FPSC surveyed CFP professionals and FPSC Level 1 certificants on issues raised in the Consultation Paper. The survey was conducted online from May 17-24, 2017, and consisted of a combination of multiple choice, "yes/no" and open-ended survey questions. A total of 2,451 individuals responded to the survey. These respondents were representative of the overall population of CFP professionals and FPSC Level 1 certificants in terms of age and gender.

The results of this survey showed that there is overwhelming support for our position that there should be complete transparency and disclosure of costs and fees associated with investing and with the financial planning services offered. However, the results clearly indicate a considerable degree of confusion and concern about the implementation and potential impact of the CSA's proposal to eliminate the option of offering embedded commissions.

Accordingly, if the CSA ultimately elects to eliminate the option of embedded commissions as a compensation method for financial products and advice, then for the benefit of consumers and the industry that serves them, we would urge the CSA to first resolve the confusion and specific concerns that have been raised.

Issues to Consider

Uncertainty About Direct Pay Arrangements

As stated above, FPSC supports requiring full transparency and disclosure of all material facts so that consumers can make informed choices about the services being offered, and how they may pay for such services. An overwhelming majority of CFP professionals surveyed agree with us. Further, 80% of respondents to our survey did not see disclosure or transparency of costs or fees as a concern or as a threat to their business viability or success.

While fee and cost transparency are imperative, it is also important to ensure that consumers have options for how to structure their advisor or planner relationship, in a way that will meet their unique circumstances. For example, in some cases it may be more advantageous for a client to choose an Assets Under Management compensation model, whereas in other cases, clients may elect for the services of their advisor to be paid up front. Less direct arrangements may also make sense for clients with limited resources who are just beginning to use an advisor, and an option where the fees are paid ultimately out of the cost of the product may be appropriate, provided the client understands and supports such a model. FPSC believes it is essential that the CSA does not unnecessarily limit payment options or structures, but at the same time does ensure regulations that afford clients the opportunity to make an informed choice regarding fee and payment models that suit their particular needs.

In reviewing the comments from survey respondents, and in our conversations with industry groups, we note that there still exists much confusion as to what "direct pay" may actually mean in practice. Contrary to the CSA's intent, many have interpreted "direct pay" as requiring consumers to pay up front via a cheque for the types of financial services they access.

In our survey of CFP professionals and FPSC Level 1 certificants, we explained that "direct pay" arrangements might include the product manufacturer or fund manager facilitating payment to the dealer on the investor's behalf, as proposed by the CSA. We then asked if this would alleviate their concerns about consumers not getting access to advice because they may be unwilling to pay for the services up front. Among survey respondents who are primarily compensated through trailing commissions, more than 50% indicated acceptance of such an arrangement. The CSA should ensure advisors, planners and consumers are aware that this particular option is contemplated under this proposal, and work with fund manufacturers and managers to ensure such arrangements would be viable should the proposals go through.

It is imperative that the CSA make perfectly clear to consumers, advisors, planners and all industry participants all of the types and forms of compensation arrangements that would be permitted under this proposal, and should particularly focus on raising awareness of those options that would not require consumers to pay up front to access products, advice or planning.

Risk of Magnifying Asymmetrical Relationship

We do wish to raise a concern that was also noted by several of our survey respondents. That is, certain groups of investors—such as new investors, seniors or other vulnerable consumers—are less likely to be skilled at "negotiating" an appropriate compensation arrangement with their advisor, which could lead to potential overcharging or an increase in fees charged for mass-market clients than is currently being charged in direct pay arrangements. While we recognize the CSA has identified this concern within the Consultation Paper,[2] FPSC firmly believes that this risk must be effectively mitigated before proceeding.

We further note that a contributing factor to this risk is consumers not understanding that advisors can have varying degrees of qualifications, proficiency and capabilities. In the absence of robust rules around titles, designations and proficiency requirements, consumers may find it difficult to accurately assess the value of an advisor's advice or services when they are negotiating. Accordingly, we urge the CSA to continue its work to implement targeted reforms pertaining to titles, designations and proficiency requirements to assist in mitigating these concerns.

Importance of Mitigating Disruption for Investors

The discontinuation of embedded commissions would be a significant regulatory change, with the potential for disruption that would adversely impact some investors if not implemented effectively. Accordingly, if the CSA decides to move ahead with implementation, it is imperative that due consideration be given to various measures that may assist in alleviating disruption and unintended negative consequences.

Important to Provide an Adequate Transition Period

If the CSA decides to move forward with this proposal, providing industry participants with enough time to manage the transition to direct pay arrangements will be crucial to successful implementation and to reducing the possibility of adverse effects for investors. While the majority of those we certify indicated that a 36-month transition period would be sufficient to allow for necessary process, communications and client education to occur, depending on the details and scope of the final rule (if any), we suggest a longer transition period would be prudent to help avoid or minimize consumer harm.

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[2] CSA Consultation Paper 81-408 – *Consultation on the Option of Discontinuing Embedded Commissions* (pp.79-80). http://www.osc.gov.on.ca/documents/en/Securities-Category8/sn_20170110_81-408_consultation-discontinuing-embedded-commissions.pdf.

We feel that the CSA has accurately captured many of the most likely and substantial transition impacts in the Consultation Paper.[3] Nonetheless, for the CSA's reference, we have outlined some of the specific transition concerns among CFP professionals and FPSC Level 1 certificants in Appendix A.

CSA Should Weigh the Option of "Grandfathering"

To assist in the transition process, we believe that consideration could be given to various grandfathering provisions that may be available. We recognize that the CSA has already identified the possibility of allowing existing redemption schedules to be maintained until the redemption schedule is complete in the Consultation Paper.[4] Thought could similarly be given to other, potentially broader grandfathering measures so long as they ensure consumers are appropriately served and protected, and given options for transitioning to a different model.

Conclusion

FPSC would like to thank the CSA for the opportunity to provide comment. Should the CSA decide to proceed with the discontinuation of embedded commissions and transition to direct pay arrangements, then for the benefit of both consumers and industry participants, we would urge the CSA to identify ways to effectively address the confusion and concerns described in this submission before proceeding.

As with all major change, communication will be the key to successfully preparing the advisory community and consumers on the implications of these changes if enacted. We would be pleased to lend our counsel as your deliberations continue.

[3] CSA Consultation Paper 81-408 (p.77).
[4] CSA Consultation Paper 81-408 (p.82).

Appendix A – Overview of Survey Findings

This Appendix provides an overview of the survey results referenced throughout this submission. The results and comments received from CFP professionals and FPSC Level 1 certificants have been included for the CSA's information and reference only, and do not form part of FPSC's submission.

1. Challenges the Discontinuation of Embedded Commissions and Transition to Direct Pay Arrangements Would Create

FPSC asked survey respondents the following question to learn more about their major concerns with respect to implementation of this regulatory proposal:

> ***The CSA is considering eliminating embedded commissions as a method of compensation, and transitioning to direct pay arrangements. If this were to occur, what would be the most significant challenge(s) this change would create for your business?***

Given the significant number of responses to this open-ended question, we have summarized responses by theme.

Transition Challenges

Among respondents who are primarily compensated for their services today through trailing commissions, some of the most commonly cited challenges with transitioning to direct pay arrangements included:

- The volume of paperwork required to transition all existing clients to fee-based accounts;
- The need to adopt new billing/invoicing methods, collection processes, software, etc.;
- The ostensibly high costs to successfully transitioning, which some believed would require hiring staff to assist in completing the transition and managing ongoing tracking and collection of payments from clients;
- The time and effort required to educate clients on the change and negotiate and establish a new fee structure with potentially hundreds of clients;
- The time and effort required to successfully manage the transition, which may cause disruption and reduce time providing actual financial planning/advisory services for clients; and
- Potential direct costs to clients (such as tax consequences) resulting from liquidation of funds with embedded compensation.

Perceived Inability to Continue Servicing Small Clients

A number of respondents expressed belief that this regulatory change might impact their ability to serve small investors. The following were among the more commonly cited reasons for this:

- Small clients may have difficulty affording certain direct payment arrangements;
- Many dealers already have, or may raise annual minimums for fee-based accounts, pricing out small investors; and
- Fees could increase due to the costs associated with this transition, with these costs being passed on to these investors.

Perceived Unwillingness of Some Clients to Pay Directly

A number of respondents expressed concern that even though their clients understand how much they are paying for service, they may be less willing to pay should they have to do so more directly or "out of pocket". For some, this belief was anecdotally based on their previous experiences discussing fees and compensation arrangements with clients.

2. Direct Pay Arrangements

FPSC asked survey respondents the following questions regarding the CSA's proposed direct pay compensation arrangements:

> ***If the CSA discontinued embedded commissions, but allowed the advisor and client to negotiate a fee structure that was acceptable to both parties, which included the ability to have the dealer/advisor's payment facilitated directly by the product manufacturer either at the time of purchase and/or on an annual basis out of the value of the funds held:***
>
> - ***Would this be an acceptable model for compensation?***
> - ***What specific challenges would this cause?***

Acceptability of Direct Pay Arrangements

In total, 53.5% of all respondents indicated "Yes" to the question of whether this would be an acceptable model for compensation, with 28.0% indicating "No" (18.5% indicated "No opinion").

Among respondents who are primarily compensated through trailing commissions, 53.2% indicated "Yes", with 31.2% indicating "No" (15.6% indicated "No opinion").

Challenges

Most of the challenges identified in response to this question were similar or identical to those provided in response to the previous question, including:

- The time, costs and administrative work required to transition all clients to direct pay arrangements and to change established processes and systems;
- The perceived unwillingness of small clients to pay out of pocket as proposed; and
- The perceived inability to serve small clients in a cost-effective manner.

Support for Allowing Fund Manufacturer or Manager to Remit on Investor's Behalf

Although there was a degree of confusion and uncertainty as to how this would work in practice, many of the respondents who provided comments expressed support for allowing this form of direct pay arrangement. However, there were some potential issues identified by respondents, including:

- The potential complexity and/or difficulty of receiving payments from multiple manufacturers or managers, which could possibly result in advisors focusing on fewer products and limiting client choice;
- The potential for conflicts if not all product manufacturers or managers offered to facilitate direct payment arrangements;
- For clients with small portfolios, potential issues selecting which funds to redeem for payment, as a large redemption may require rebalancing the portfolio to meet regulatory requirements; and
- Tax concerns, which do not affect embedded compensation arrangements and which, if not resolved, could reduce the attractiveness or feasibility of this option.

3. Transition Considerations

FPSC asked survey respondents the following questions in relation to the contemplated transition period:

> ***In considering various transition options, the CSA suggests that a transition period of 36 months would provide sufficient time for representatives, dealers, and fund managers to make all the necessary changes to ensure a successful transition. For representatives and dealers, such changes would include things such as designing and implementing direct pay arrangements, meeting with clients to explain the upcoming changes and their associated impact, making necessary system, compliance, procedural and process changes, and coordinating with issuers to manage the associated client impact.***
>
> - ***Is a 36-month transition period sufficient from your perspective?***
> - ***Is there a specific, alternative transition period or methodology the CSA should consider?***

36-Month Transition Period

In total, 53.2% of all respondents indicated "Yes" to the question of whether a 36-month transition period would be sufficient, with 33.0% indicating "No" (13.8% indicated "No opinion").

Among respondents who are primarily compensated through trailing commissions, 43.7% indicated "Yes", with 44.4% indicating "No" (11.9% indicated "No opinion").

Alternative Transition Period

Respondents suggested a range of alternatives to the proposed 36-month transition period. Among respondents who are currently compensated through trailing commissions, the most commonly suggested alternative to a 36-month transition period was 5 years/60 months.

Grandfathering

Several individuals raised the idea of "grandfathering" for existing clients to assist in the transition to direct pay arrangements. Some of the specific suggestions included:

- Grandfathering existing accounts, with any new rule applying to accounts opened after the rule comes into force;
- Allowing clients to consent to having their account and current compensation arrangement grandfathered. To facilitate this, investors could be required to sign off on a disclosure form that outlines all payment options and costs in full detail; and
- Maintaining embedded commissions as a payment option for small accounts only, while requiring "large" accounts (e.g. above 250k in assets) to transition to direct pay arrangements.

Appendix B – List of All Survey Questions

The following is the complete list of questions that FPSC asked of CFP professionals and FPSC Level 1 certificants.

1. What is your age range?
   - Under 31
   - 31-40
   - 41-50
   - 51-60
   - 61-64
   - 65+

2. What is your gender?
   - Female
   - Male
   - Other

3. How long have you been a CFP professional or FPSC Level 1 certificant?
   - Less than 5 years
   - 5-10 years
   - 11-15 years
   - 16+ years

4. Indicate which of the following best describes your primary professional role?
   - I work directly with clients (client facing).
   - I work indirectly with clients (offer back office client services).
   - I work mostly in a supervisory capacity.
   - I am not involved with clients in any capacity.
   - I am retired.

5. In thinking about changes underway in the financial services industry, on a scale of 1 to 5, please rate each the following issues in terms of how much they concern you from a business standpoint, with 1 being “not concerning” and 5 being “very concerning”:

   Uncertainty regarding regulatory change
   1 2 3 4 5

   CRM2, fee disclosure and transparency
   1 2 3 4 5

   Robo-advisors and automation of investment advice
   1 2 3 4 5

   The costs of compliance
   1 2 3 4 5

Possible discontinuation of embedded commissions
1 2 3 4 5

Lack of consumer distinction between CFP professionals and other financial advisors
1 2 3 4 5

Lack of regulatory or legislative recognition for financial planners
1 2 3 4 5

Other (please specify)

6. What is the most common way that your clients pay you for the products you offer?
    - I do not sell products
    - Front-end load
    - Deferred Sales Charge
    - No load
    - Fee for Assets Under Management (AUM)
    - Other (please specify)

7. How do your clients generally pay for your services?
    - Trailing commissions
    - Fee for Assets Under Management (AUM)
    - Hourly fee
    - Flat or retainer fee
    - Not applicable
    - Other (please specify)

8. The CSA is considering eliminating embedded commissions as a method of compensation, and transitioning to direct pay arrangements. If this were to occur, what would be the most significant challenge(s) this change would create for your business?

If the CSA discontinued embedded commissions, but allowed the advisor and client to negotiate a fee structure that was acceptable to both parties, which included the ability to have the dealer/advisor's payment facilitated directly by the product manufacturer either at the time of purchase and/or on an annual basis out of the value of the funds held:

9. Would this be an acceptable model for compensation?
    - Yes
    - No
    - No opinion

10. What specific challenges would this cause?

In considering various transition options, the CSA suggests that a transition period of 36 months would provide sufficient time for representatives, dealers, and fund managers to make all the necessary changes to ensure a successful transition. For representatives and dealers, such changes would include things such as designing and implementing direct pay arrangements, meeting with clients to explain the upcoming changes and their associated impact, making necessary system, compliance, procedural and process changes, and coordinating with issuers to manage the associated client impact.

11. Is a 36-month transition period sufficient from your perspective?
    - Yes
    - No
    - No opinion

12. Is there a specific, alternative transition period or methodology the CSA should consider?