July 20, 2018

Delivered By Email: kwoodard@mfda.ca

Ken Woodard
Director, Membership Services &
Communications
Mutual Fund Dealers Association of Canada
Toronto, ON M5H 3T9

Dear Mr. Woodard:

RE: Discussion Paper on Expanding Cost Reporting

The Investment Funds Institute of Canada ("IFIC" or "we") is writing to provide comments on behalf of our members on the MFDA's *Discussion Paper on Expanding Cost Reporting* (the "Paper").

IFIC supports a move to expanded cost reporting and we have shared this view publicly (IFIC press release issued on April 25, 2017)[1]. The industry has invested significant time and effort in providing enhanced disclosures under CRM2, and the next logical step in enhancing disclosure is to expand cost reporting. This will further enhance transparency to investors of the costs of owning investment funds.

This submission letter sets out material elements of expanding cost reporting. We propose a calculation methodology that provides a reasonable approximation of the ongoing indirect cost to a client of owning an investment fund. This approach is consistent with approaches currently in use in the industry. We also offer our preliminary assessment of the implementation issues, differences in approach required for exchange traded funds and our views on the required implementation timeline. Our responses to the specific questions posed by the MFDA are set out in Appendix A.

Calculation Methodology

The key element of expanding cost reporting is the methodology for calculating the ongoing cost, in dollars and cents, to a client account of owning investment funds. As we discuss in greater detail in the following section, the presentation of the ongoing cost of owning investment funds will be a reasonable approximation because of the process by which MERs are calculated[2].

While the calculation methodology must be agreed upon amongst all stakeholders based on a full assessment of the issues and available data points, we propose a methodology similar to the following:

[1] https://www.ific.ca/en/news/investment-funds-industry-ready-to-tackle-crm3/

[2] MERs take into account a number of items including fixed fees, variable expenses, accruals and adjustments, waivers and/or absorptions.

1.	1/365th of MER of the applicable series of each investment fund X daily market value of the applicable series of each investment fund in client account ($)	**=**	Daily ongoing cost of owning the applicable series of each investment fund ($)
2.	Sum of Daily ongoing cost of the applicable series of each investment fund over 12 month reporting period (or portion thereof)	**=**	Ongoing cost of owning the applicable series of each investment fund during the 12 month reporting period (or portion thereof)
3.	Sum of Ongoing cost of owning each investment fund in client account during the 12 month reporting period	**=**	Aggregate ongoing cost of owning investment funds in client account during the 12 month reporting period

The first step of the calculation results in the approximate daily cost to the client of holding each investment fund. The second step results in the cost of holding each investment fund for the 12 month reporting period. The final step in the calculation would add up the annual cost of holding each individual investment fund held by a client to produce the aggregate cost of owning all investment funds in that client's account. This aggregate value would then be presented in the annual report to clients.

The MER used in the calculation is the series MER published in the annual Management Report of Fund Performance ("MRFP") as further explained below. Using the daily market value of each investment fund to calculate the ongoing costs of owning the applicable series of each investment fund will take into account any market fluctuations and client initiated actions such as purchases, transfers and redemptions.

Use of the Series MER published in the annual MRFP to calculate the ongoing costs of owning an investment fund

Investment fund managers currently track fees and expenses of an investment fund at the fund and series level only. There has not been a need or requirement to track these fees and expenses at the individual investor level because the costs are borne directly by the investment fund. As a result, an expanded cost calculation methodology that requires fund managers to provide the actual cost at an individual investor level is a very difficult task that requires significant changes to existing fee and expense processes, technology and shareholder recordkeeping systems for investment funds. This is in stark contrast to the ability of investment fund managers to provide information on the payment of trailing commissions on an individual account basis. The key difference is that, in the case of trailing commissions, there is an actual payment from the investment fund manager to the dealer in respect of their client holdings which means this information must be tracked to make the payment.

It is also important to note that investment fund managers generally accrue management fees and expenses and charge them on a monthly basis but have the ability to make final adjustments, including waivers of fees and/or absorption of expenses, up to the investment fund's year end. In some instances, an investment fund manager will waive fees or absorb expenses to achieve a desired MER at the investment fund's year end. Therefore, final calculations of the annual MER, inclusive of any adjustments, waivers and/or absorptions only occur at year end. Estimating an interim MER can overstate the ongoing cost of owning an investment fund as the MER used will not reflect any adjustments, waivers and/or absorptions taken at year end.

Although the MER obtained from the annual MRFP is for the fund's most recently completed financial year, most mutual funds have a fairly stable MER year over year. Moreover, the MER published in the annual MRFP is obtained from the investment fund's audited annual financial statements and its use is an accepted method by which to calculate the ongoing costs of owning an investment fund.[3]

For these reasons, we would submit that the applicable series MER as provided in an investment fund's annual MRFP provides a reasonable approximation of the indirect cost of owning an investment fund.

ETF Specific Differences

A consistent calculation methodology must be used to calculate the full cost of owning an exchange traded fund (ETF). However, because ETFs trade on an exchange, it will be important to understand differences in the process, including the need for ETF managers to provide a net asset value per unit ("NAVPU") and the role of the dealer in calculating the ongoing cost of ownership. ETF providers will have to provide a NAVPU to enable dealers to calculate the indirect cost for their clients based on the number of units of the ETF each client holds. Although the market price of an ETF is readily available, the NAVPU is necessary because the MER is based on the net asset value of the ETF. It will also be necessary to identify a central repository through which key data elements, such as the NAVPU, can be made available to dealers in a readily useable format. Unlike conventional mutual funds, ETF providers do not have any information on the number of securities held by each ETF investor.

Statement Design

IFIC supports flexibility in statement design and presentation to make the expanded cost disclosure easy to understand. To that end, IFIC recommends that the minimum content requirements be prescribed with a flexible approach permitted for the implementation consistent with the approach taken for the CRM2 requirements.

IFIC has included a sample disclosure statement at Appendix B. The sample statement provides a client's total cost of investing at the top of the statement, followed by a breakdown of the indirect costs paid to the investment fund manager or investment fund and the direct fees and other compensation paid to the dealer. This sample provides the total cost of investing in investment funds in a simple and easy to follow format. Please also see our response to question 5 in Appendix A.

A flexible approach allows firms with different business models, such as fee based dealers or integrated firms, to develop different statements that meet the prescribed content requirements while meeting the needs of their clients.

Implementation Timeline

The timeline to transition to expanded cost disclosure should take into account implementation issues that will include, at a high level, the following:

- Establishing or identifying central repositories for new data elements
- Systems builds for investment fund managers, dealers and external service providers to accommodate new data elements and to verify the information to be provided
- Implementing monitoring processes for any external service providers retained by investment funds managers or dealers
- Industry collaboration on developing standards and implementing the technology changes, including testing, to existing processes, systems and service providers and related implementation timelines
- Developing the training program for staff within both investment fund managers and dealers

---

[3] See, for example, https://www.getsmarteraboutmoney.ca/calculators/mutual-fund-fee/

This work cannot begin until the regulatory requirements are finalized.

As a result, IFIC recommends that the implementation timeline for expanded cost reporting be at least 3 years:

- a minimum of 2 years following publication of the final rule to develop, test and implement systems required to calculate the ongoing indirect costs, in dollars and cents, of owning an investment fund and make it available to dealers.
- one additional year thereafter, to allow for the collection of data for a full year prior to the first reporting date.

This is a reasonable transition timeline which provides time to develop the technology plan and implementation timeline for industry service providers and industry members. By way of example, Fundserv currently operates on a 1-year implementation schedule where new system requirements are finalized in June and implemented in June of the following year. Prior to Fundserv implementation, industry stakeholders need to establish and agree upon the data requirements for the transmission of the cost information from investment fund managers to dealers.

Conclusion

IFIC thanks the MFDA for the opportunity to provide comments and input on the Paper. We hope our comments advance efforts to provide investors with a complete understanding of the full cost of owning retail investment funds.

We would be pleased to provide further information or answer any questions you may have. Please feel free to contact me by email mupadhyaya@ific.ca or by phone (416-309-2314).

Yours sincerely,

THE INVESTMENT FUNDS INSTITUTE OF CANADA

By: Minal Upadhyaya
Vice President, Policy & General Counsel

Enclosed: Appendix A - Responses to MFDA Implementation Questions
Appendix B - Sample Statement

APPENDIX A

Responses to MFDA Implementation Questions

Expanding Cost Reporting

1. Should regulators consider expanding cost reporting for Investment Funds?

IFIC is supportive of expanding cost reporting. CRM2 was an important first step in giving clients more information on how dealers are compensated and an opportunity for enhanced client discussions. Expanding cost reporting is the logical next step in making clients more aware of the total costs of investing in investment funds.

2. Should regulators consider expanding cost reporting for other investment products?

Yes. IFIC supports increased transparency to aid investors in their understanding of costs. IFIC has argued for and encourages a level playing field. Securities regulators should continue dialogue with other regulators to ensure there are consistent requirements for costs disclosure across all financial products.

Costs Considered for Expansion

3. Do you agree that the costs considered in this Discussion Paper (i.e. MER, short-term trading fees, redemption fees and client costs paid directly to third parties) should be disclosed to clients?

IFIC supports including the fees outlined in the Discussion Paper.

4. Are there any other costs that should be reported to clients?

No, the examples in the Paper outline the relevant costs that should be reported.

5. What are your views on the reporting examples provided in this Discussion Paper?

Figure 1: IFIC is supportive of providing clients with ongoing information of the costs of ownership for the investment funds that they hold. An important consideration in this context is the duplication of information that is provided or made available to clients. For example, the MER of an investment fund is included in the Fund Facts document provided at the time of sale and is available through the MRFP.

At a minimum, there should be flexibility for dealers on the presentation of this information. Any MER information will need to provide additional information to clients that the actual cost may be lower for a client if the client qualifies for householding programs, management fee reductions and rebates.

Figure 2: As set out in our letter, the minimum requirements should be prescribed and if dealers want to provide additional information such as that set out in Figure 2, they can do so. We note that Figure 2 focuses on fund-level requirements rather than on giving clients information about the total costs of owning an investment fund. Reporting the components of the MER as illustrated in Figure 2 will increase the size of the statement package which may have the adverse effect of reducing investor interest in reviewing all of the content.

Figure 3: IFIC supports a document similar to this figure. However, Figure 3 raises the issue of double counting because a client could add up the prominently displayed total cost figure with the total charges and compensation figure which could lead to an overstatement of the total cost. Specifically, one of the concerns noted by our members with Figure 3 is the separation of cost reporting from compensation reporting given the significant overlap between the two reports. For example, the amount of trailing commission is reported in both sections – in the

Cost Report, as part of the indirect cost of owning an investment fund, and in the Compensation Report, as a payment to the dealer. Other charges from the dealer, such as administration fees, are also reported in both sections. A client's natural tendency will be to add the totals of both sections together to determine their total costs, which will result in an overstatement of their total cost.

We suggest these two reports be combined into a single "Costs and Compensation Report" which breaks down all costs to the client, either direct or indirect, into two groupings: costs paid indirectly to the investment fund manager or investment fund; and costs or compensation paid to the dealer. The total of these groupings represents the full cost of investing to the client. IFIC's sample statement, which is provided at Appendix B, provides an example of this combined reporting.

Figure 4: IFIC supports integrated firms having the option of showing total costs of investing without a dealer/manager breakdown.

6. Are there better ways to report the costs of investing to clients?

IFIC's sample statement better explains the costs of investing to clients. We also recommend that dealer firms have flexibility to tailor their statements to their clientele. The regulatory framework should prescribe the minimum standards for disclosure, providing industry members with the flexibility to implement the new rules in a fashion that best suits their business models.

7. What challenges or issues do you foresee in obtaining and reporting expanded cost information to clients?

We expect there to be unforeseen and unexpected implementation issues that will arise as we move to expanded cost reporting. As with CRM2 implementation, we recommend that stakeholder committees, including both regulators and industry members, be established to resolve common issues collaboratively. IFIC will also continue to provide a forum for our members to address implementation issues as they arise.

8. Are there different challenges or issues to expanding cost reporting for investment dealers or other securities registrants?

Investment dealers have broader product shelves and may have different challenges or issues.

Implementation

9. Based on the cost reporting approaches detailed in this Discussion Paper, what would be a realistic timeframe for implementing expanded cost reports to clients?

See our discussion under Implementation Timeline

APPENDIX B

Liberty Financial

Annual Report of Costs & Compensation
For the period ended December 31, 2022

Jane Q Public
123 Main Street
Chatham, ON
Canada N3T 8A9

Your RRSP Account 12345678

Your Total Costs to invest during 2021: $796.99

This report provides a breakdown of your total costs to invest during the year. These costs are paid to us (Liberty Financial) for administrative costs and services, including financial advice, and indirectly, through the investment funds you invest in, to parties such as the investment fund companies that manage the investment funds you own.

	Cost ($)
Amounts you indirectly paid to Investment Fund Manager(s) and / or Investment Fund(s)	
Investment management fees and expenses ("MER")[1]	$671.78
Less: management fee rebates	$(44.79)
Less: trailing commissions paid to Liberty Financial[1]	$(298.57)
Net ongoing management fees & expenses	$328.42
Short-term trading fees paid on the sale of investments	$20.00
Redemption fees paid on the sale of deferred sales charge investments	$50.00
Net paid to Investment Fund Manager(s) and/or your Investment Fund(s)	**$398.42**
Amounts paid to Liberty Financial	
Trailing commissions received from investment fund manager(s)[1]	$298.57
Account administration and operating fees	$60.00
Front-end sales commissions	$25.00
Switch fees	$15.00
Net paid to Liberty Financial[2]	**$398.57**
Total costs to invest during 2021	**$796.99**

[1] Inclusive of Goods and Services Tax/Harmonized Sales Tax

[2] **Note re: total compensation received by Liberty Financial**

In addition to the amounts you paid to Liberty Financial shown above, Investment Fund Manager(s) paid Liberty Financial a total of $250.00 in deferred sales charge commissions related to the purchase(s) of investment funds. Accordingly, the total charges and compensation that Liberty Financial received to service your account during 2021 was $648.57.