



Mutual Fund Dealers Association of Canada
Association canadienne des courtiers de fonds mutuels

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MFDA Bulletin

Policy

For Distribution to Relevant Parties within your Firm

Discussion Paper on Expanding Cost Reporting

On December 15, 2015 the MFDA issued a consultation paper in respect of expanding the requirements under Rule 5.3.3 and the implications for doing so (see [Bulletin #0671-P](#): Report on Charges and Compensation - Consultation Regarding Cost Reporting for Investment Funds). The majority of comments received were in support of expanding cost reporting to include total costs paid by clients, including ongoing costs of owning investment funds. However, commenters suggested MFDA wait until Members issued Reports on Charges and Other Compensation to their clients before considering whether further amendments were necessary. In light of these comments, in 2017 MFDA performed a review of certain Members' Report on Charges and Other Compensation (see [Bulletin #740-C](#): CRM2 Report) and identified areas for potential policy development, such as expanding cost reporting.

Accordingly, to further promote discussion in respect of expanding cost reporting, MFDA is issuing another Discussion Paper on Expanding Cost Reporting. MFDA will be sharing the results of this consultation with other regulators. Interested parties are asked to provide comments by **July 20, 2018**. All comment letters received will be published to the MFDA website unless MFDA staff receive a request from the commenter asking that their letter not be made public. MFDA is also able to meet with Members, industry associations or investor advocates to discuss the contents of the Discussion Paper. To submit comments or request a meeting, please contact:

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DISCUSSION PAPER ON
EXPANDING COST REPORTING

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I. INTRODUCTION

A. Background

On December 3, 2014, MFDA Members approved MFDA Rule 5.3.3 (Report on Charges and Other Compensation) which requires Members to provide each client with an annual summary of charges paid by the client and compensation received by the Member. MFDA Rule 5.3.3 is consistent with changes to securities legislation, specifically National Instrument 31-103 (“NI31-103” and known as “CRM2 Amendments”), which came into effect on July 15, 2016.

At that time, MFDA received feedback from Members, Approved Persons and other stakeholders asking the MFDA to consider expanding the requirements under Rule 5.3.3 to require disclosure of other costs of owning Investment Funds¹ that are not paid to the Member. These costs include management fees, fund operating costs, redemption fees and short term trading fees. Accordingly, on December 15, 2015 the MFDA issued Bulletin #0671-P: Report on Charges and Compensation - Consultation Regarding Cost Reporting for Investment Funds (the “initial Consultation Paper”) in respect of expanding the requirements under Rule 5.3.3 and the implications for doing so.

The majority of comments received were in support of expanding cost reporting to include total costs paid by clients, including costs and compensation paid to other parties. However, most commenters advised that the CRM2 Amendments that were coming into effect would take considerable time and effort to implement. As a result, commenters suggested that the MFDA wait to determine the outcome of the CRM2 Amendments before proposing further changes. Additionally, commenters advised that any new proposal to expand cost reporting would require amendments to NI31-103 and therefore should be proposed by the Canadian Securities Administrators (“CSA”) and not the MFDA.

Collaboration with Other Securities Regulators

The purpose of the MFDA’s initial Consultation Paper was to promote further discussion on expanding cost reporting for Investment Funds. The MFDA recognizes that any proposal to expand cost reporting for Investment Funds would require the CSA to make amendments to NI31-103. However, as 96% of MFDA Members’ assets under administration are held in Investment Funds and 56% of households in Canada are serviced by MFDA Members, cost

¹ For purposes of this Discussion Paper, the definition of “Investment Fund” is that contained in the *Ontario Securities Act, R.S.O. 1990, c. S.5*.

transparency for retail mutual fund investors is of particular importance to us. The MFDA would like to advance the discussion to ensure mutual fund investors in Canada have a complete and accurate understanding of costs associated with their investments in order to make informed choices. We have consulted with staff from the CSA and the Investment Industry Regulatory Organization of Canada (“IIROC”) on this initiative and will be sharing the feedback from this consultation with them.

MFDA CRM2 Review of Integrated Members

In light of the feedback received from the initial Consultation Paper, the MFDA decided to review the Report on Charges and Other Compensation (“RCC”) of Members with fund affiliates that do not earn compensation directly from sales activity but rather earn compensation through internal transfer payments (“integrated Members”). As integrated Members earn a combined revenue stream for fund manufacturing and distribution activities, such firms may be in a better position to report on a total cost basis. In 2017 the MFDA review of integrated Members’ charges and compensation reports found the majority of integrated Members did not report total costs but rather estimated the amount of commissions that they would have received had they acted at arms’ length. However, a few integrated Members did disclose the total costs paid by clients to invest and hold mutual funds. Since our review, other Members have indicated their intention to report on a total cost basis. We are encouraged that some Members are disclosing total costs as it provides clients with more accurate information and a better understanding of costs associated with their investments.

B. Other Regulatory Initiatives

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

On January 10, 2017, CSA issued Consultation Paper 81-408: *Consultation on the Option of Discontinuing Embedded Commissions*. The purpose of CSA Consultation Paper 81-408 was to solicit feedback on the potential impact of banning the practice of investment fund managers remunerating dealers and their representatives for mutual fund sales through commissions, including sales and trailing commission (i.e. embedded commissions). The results of the CSA’s consultation could impact cost and compensation reporting requirements relating to embedded compensation but would not impact the determination of whether cost reporting should be expanded to include ongoing costs of investment fund ownership.

Canadian Council of Insurance Regulators (“CCIR”)

CCIR released a position paper that discusses moving to full Management Expense Ratio (“MER”) disclosure for segregated funds breaking out management fees, distribution costs and insurance components². The MFDA supports the effort to improve cost reporting for segregated funds and to harmonize regulatory requirements between mutual funds and segregated funds.

We note, however, that the proposed CCIR cost reporting requirements are to be placed on the product manufacturer. In the securities industry, individuals must act through a dealer or adviser (“registered firm”) to trade or advise in securities. Registered firms are currently required to report aggregated cost information to clients on an account basis through the RCC. Accordingly, the RCC could be expanded to provide additional aggregated cost information relating to the cost of owning investment funds.

The European Securities and Markets Authority (“ESMA”)

ESMA has introduced a number of pre-sale and post-sale disclosure requirements, including the presale disclosure of an estimate of the annual costs and their impact on performance, quarterly portfolio evaluations, and annual personalized costs and charges disclosure (also includes impact on performance). The disclosure is to include any management costs of an investment. The costs are to be represented as both a cash amount and as a percentage of assets. ESMA has created standardized report templates in an attempt to facilitate the transfer of cost information from product manufacturers to retail distributors.

NI31-103 section 14.1.1 already requires Investment Fund managers to report data to registered firms to assist them in complying with client reporting requirements. Standardized industry formats and facilities to report data between fund managers and registered firms exist today and could be developed further to allow for the exchange of additional cost data.

II. EXPANSION OF COST REPORTING FOR INVESTMENT FUNDS

A. Costs Considered for Expansion

There are costs associated with owning Investment Funds and other investment products that are not currently required to be disclosed under existing cost reporting requirements. As a result, cost reporting to the client is incomplete and this may prevent clients from fully understanding their total costs of investing. For purposes of this Discussion Paper, the MFDA considered costs in

² “Segregated Fund Working Group Position Paper.” *Canadian Council of Insurance Regulators*, December 2017, [https://www.ccir-ccrra.org/en/init/Segregated_Funds/Seg%20Funds%20Position%20Paper%20\(En\).pdf](https://www.ccir-ccrra.org/en/init/Segregated_Funds/Seg%20Funds%20Position%20Paper%20(En).pdf)

the following four areas that are not currently covered in the existing cost reporting requirements:

1. Ongoing costs of owning Investment Funds

For the purposes of this Discussion Paper, “Investment Funds” would include mutual funds, exchange traded funds, labour sponsored funds and commodity pools. When it comes to ongoing Investment Fund expenses, currently only trailing commissions are required to be reported by Members on the RCC. However, there are still costs associated with the ongoing management and operation of Investment Funds that are not required to be disclosed.

2. Transactional costs charged by Investment Funds

In addition to the ongoing cost of owning an Investment Fund, there are other costs to clients associated with transactions in Investment Funds that are usually charged by the fund manager. These costs include redemption fees and short term trading fees. As these types of charges are generally not paid to the registered firm, they are not currently required to be reported on the RCC.

3. Costs paid by clients directly to third parties for account administration

These costs include custodial or intermediary fees that are taken directly from a client’s account. As these costs are not charged by or paid to the registered firm, they are not required to be reported on the RCC.

4. Costs related to other investment products

MFDA has not proposed expanding cost reporting for other investments at this time as, unlike Investment Funds, such investments generally have limited automated data available to registered firms. Including them in cost reporting would require significant structural changes across the entire industry. Although this Discussion Paper proposes expanding cost reporting only for Investment Funds, MFDA welcomes feedback on whether additional cost disclosure should be considered with respect to other investment products.

B. Disclosure Examples

MFDA considered how to provide clients with cost information to allow them to understand i) the ongoing costs of each Investment Fund they own and ii) their total costs of investing. In order to

achieve these objectives, both the client account statement and RCC could be expanded to include additional cost information.

While there are different approaches that can be taken to expand cost reporting, we have provided examples in this Discussion Paper based on our understanding of MFDA Member business models and practices that can be integrated into existing reporting requirements. Examples contained in this document are meant to generate a detailed discussion on expanding cost reporting for Investment Funds to meet the objectives stated above. MFDA, however, is open to other proposals and encourages stakeholders to provide their views on alternatives to accomplishing these objectives.

Account Statement Disclosure

Disclosing the MER percentage on client account statements for each Investment Fund held would remind clients of their ongoing costs of Investment Fund ownership. Investment Fund MER generally represents the largest component of costs associated with owning an Investment Fund. Currently, clients are provided with MER information through the delivery of the Fund Facts document. However, clients receive this information for each fund separately and there is no mechanism for clients to receive regular MER reporting of all their Investment Fund holdings.

Figure 1 illustrates how the holdings section of an account statement could be expanded to include MER information where an account only holds Investment Funds. We would appreciate feedback on how expanded MER information could be disclosed in the “account holdings” section of the account statement where an account contains other types of securities or investment products.

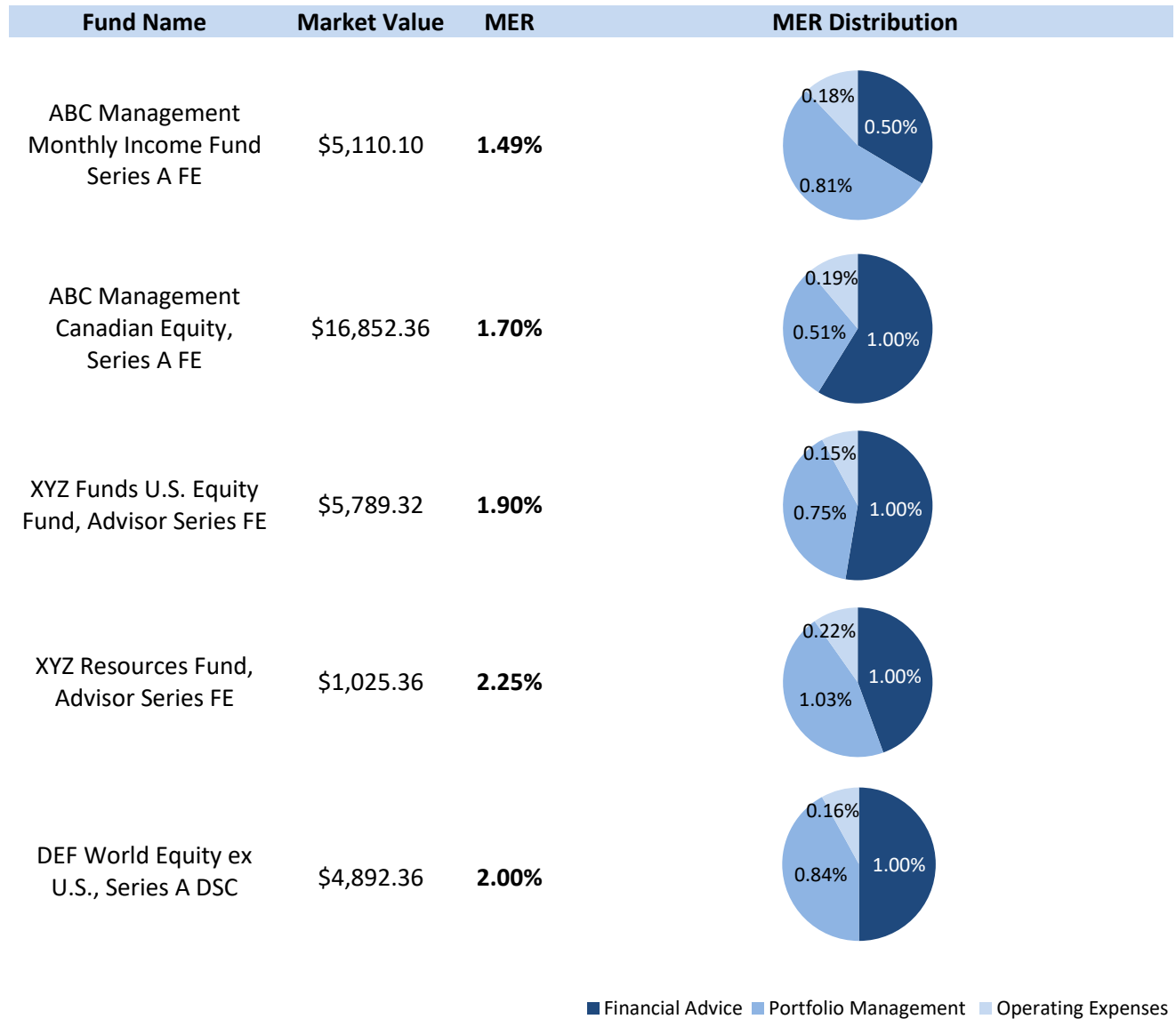
Figure 1:
Example Account Statement Holdings Section for an account holding Investment Funds

Fund Name	MER¹	Dec-31-17 Book Value	Dec-31-17 Units	Dec-31-17 Price	Dec-31-17 Market Value
ABC Management Monthly Income Fund, Series A FE	1.49%	\$5,111.12	413.4385	\$12.36	\$5,110.10
ABC Management Canadian Equity, Series A FE	1.70%	\$15,896.17	515.6781	\$32.68	\$16,852.36
XYZ Funds U.S. Equity Fund, Advisor Series FE	1.90%	\$5,698.26	135.9314	\$42.59	\$5,789.32
XYZ Resources Fund, Advisor Series FE	2.25%	\$1,005.06	45.6527	\$22.46	\$1,025.36
DEF World Equity ex U.S., Series A DSC	2.00%	\$5,032.56	247.3387	\$19.78	\$4,892.36
Totals:		\$32,743.17			\$33,669.50

1. The MER or Management Expense Ratio represents the total cost of portfolio management, fund operating expenses and financial advice. It is shown as a percentage of the Investment Fund’s average net assets for the year.

Figure 2 provides an alternative presentation of the MER information for each Investment Fund that could be issued with the account statement. The sample “Investment Fund Report” breaks down the MER into components for each Investment Fund held. While this example provides greater detail of the MER, it would be more difficult to implement and incorporate into existing account statement reporting.

**Figure 2:
Example Investment Fund Report**



Financial Advice is provided by your advisor at the registered firm. It includes a number of services including determining your goals and personal circumstances (also known as Know-Your-Client or KYC information) such as risk tolerance and time horizon, providing suitable advice based on those circumstances, planning services and reviewing progress with you on an ongoing basis.

Portfolio Management expenses cover services provided by the fund’s investment manager such as asset mix allocation, selection of individual investments and risk management.

Operating Expenses include valuation of your funds, custodial services, audit and legal expenses, record keeping, report issuance and tax reporting.

Report on Charges and Other Compensation Disclosure

As previously noted, there are various costs that are not required to be disclosed on the RCC currently. This includes i) transactional costs paid to Investment Funds and costs paid to other parties for account administration and ii) ongoing costs of owning Investment Funds.

i) Transactional and Operating costs paid to other parties

On the RCC, additional line items could be added to disclose costs paid to parties other than the registered firm relating to costs associated with trading in Investment Funds or account administration. This would include redemption fees and short term trading fees paid to an Investment Fund manager and account operating charges paid to others directly from client accounts. All costs paid by a client to trade or maintain an account that are reflected on the account statement should also be reported and aggregated on the RCC to provide clients with a complete picture of their total costs of investing.

ii) Ongoing cost of owning Investment Funds

Current RCC requirements are focused on compensation and amounts paid to registered firms. However, there are costs associated with the ongoing management and operation of Investment Funds that are not currently required to be disclosed on the RCC, including portfolio management fees and fund operating expenses.

iii) Considerations for collecting costs

There are challenges to collecting and displaying the cost of Investment Fund ownership considered in this Discussion Paper. Registered firms that only sell proprietary funds may be able to access the relevant cost data more easily, but this data is not readily available to registered firms who transact in third party funds. To be able to report actual Investment Fund costs to clients, registered firms would need reporting from Investment Fund managers (e.g. via Fundserv). Further development of registered firms' back office systems would also be required to receive, aggregate and report such costs.

iv) MFDA Considerations for displaying cost on the RCC

MFDA considered reporting costs by fund and by fund company. We looked at options including separate line items that name the fund company and detail the specific fee amounts, and a separate report that totals the costs by Investment Fund and by third parties. This level of reporting became increasingly cumbersome where multiple fund companies and third parties were involved and made the report difficult for clients to read and registered firms to produce.

MFDA also considered different MFDA Member business models and recommends that any proposal to expand cost reporting should be sufficiently flexible to reflect how compensation is paid or earned by registered firms and Investment Fund managers. For example, Figure 3 illustrates expanded cost reporting for a Member selling third party funds. This sample report contains a section with a breakdown of the total costs paid by the client for investing and a section with a breakdown of the total charges and compensation received by the Member. Figure 4 illustrates expanded cost reporting for an Integrated Member selling only proprietary funds. This sample report contains a combined cost and compensation section as the Member does not receive sales or trailing commissions.

Figure 3:

Example Cost Report and Compensation Report for a Member selling Third Party Funds

Cost Report

Costs you paid to invest in 2018: \$726.00

This report provides a breakdown of total costs you paid to invest. These costs are paid to us (*registered firm's name*) for administrative costs and services, such as financial advice, and to other parties such as investment fund companies who manage your investments. Costs paid to us are also reported in the Compensation Report.

Amounts You Paid

	Cost (\$)
Ongoing cost of owning Investment Funds paid to Investment Fund Companies ¹	\$556.00
Short term trading fees paid to Investment Fund Companies	\$20.00
Redemption fees on deferred sales charge investments paid to Investment Fund Companies	\$50.00
Administration and Account Operating Fees paid to us	\$100.00
Transaction Fees paid to us	\$0.00
Total costs	\$726.00

1. The ongoing cost of owning investment funds includes the amount you have paid for portfolio management, fund operating expenses and financial advice (e.g. commissions). Commissions paid to us are also reported in the Compensation Report.

Compensation Report

This report provides a breakdown of compensation we received for account administration and financial advice.

Amounts We Received

	Cost(\$)
Section 1: Amounts for general administration of your account	
Administration Fees	\$100.00
Sub-total of amounts for general administration	\$100.00
Section 2: Amounts for specific transactions	
Switch fees	\$0.00
Front-end sales commission	\$0.00
Sub-total of amounts for specific transactions	\$0.00
Section 3: Amounts we received from investment fund managers and third parties	
Commissions from deferred sales charge investments	\$250.00
Trailing commissions ²	\$267.00
Sub-total of amounts we received from others	\$517.00
Total charges and compensation we received to service your account	\$617.00

2. Investment funds pay investment fund managers a fee for managing their funds (ongoing costs of owning Investment Funds). The managers pay us ongoing trailing commissions for the services and advice we provide you. The amount of the trailing commission depends on the sales charge option you chose when you purchased the fund. You are not directly charged the trailing commission or the management fee. But, these fees affect you because they reduce the amount of the fund's return to you. Information about management fees and other charges to your investment funds is included in the prospectus or fund facts document for each fund.

Figure 4:

Example Report for an Integrated Member selling only Proprietary Funds

Cost and Compensation Report

Amounts you paid to us and our affiliates	Cost (\$)
Ongoing cost of owning Investment Funds ¹	\$539.00
Administration Fees	\$125.00
Short term trading fees	\$50.00
Total costs and compensation	\$714.00

1. The ongoing cost of owning Investment Funds includes the amount you have paid for portfolio management, fund operating expenses and financial advice.

III. REQUEST FOR FEEDBACK

We invite all stakeholders to provide their comments on this Discussion Paper. We have included some questions below to assist in the comments process.

Expanding Cost Reporting

1. Should regulators consider expanding cost reporting for Investment Funds?
2. Should regulators consider expanding cost reporting for other investment 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?
4. Are there any other costs that should be reported to clients?

Cost Reporting

5. What are your views on the reporting examples provided in this Discussion Paper?
6. Are there better ways to report the costs of investing to clients?
7. What challenges or issues do you foresee in obtaining and reporting expanded cost information to clients?

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

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?

IV. COMMENTS

Members and other interested parties are asked to provide comments by **July 20, 2018**. All comment letters received will be published to the MFDA website unless MFDA staff receive a request from the commenter asking that their letter not be made public. MFDA is also able to meet with Members, industry associations or investor advocates to discuss the contents of the Discussion Paper. To submit comments or request a meeting, please contact:

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