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VIA EMAIL

Ken Woodard
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July 20, 2018

Dear Mr. Woodard,

Re: MFDA Bulletin #0748-P – Discussion Paper on Expanding Cost Reporting

We are writing in response to the request for comments on MFDA Bulletin #0748-P *Discussion Paper on Expanding Cost Reporting* (the "Discussion Paper"). We appreciate the opportunity to comment on this important initiative.

Invesco Canada Ltd. is a wholly-owned subsidiary of Invesco, Ltd. Invesco is a leading independent global investment management company, dedicated to helping people worldwide get the most out of life. As of June 30, 2018, Invesco and its operating subsidiaries has assets under management of approximately $963 billion. Invesco operates in more than 20 countries in North America, Europe and Asia.

Invesco has generally been supportive of regulatory initiatives to enhance transparency and investor protection, and to reduce conflicts of interest. However, we have come to the view that disclosure is a rather ineffective way to address material (in the eye of the beholder) conflicts of interest. We have learned of the dangers of disclosure, including (1) that a registrant who discloses a conflict of interest is more likely to act in the conflicted capacity, having been protected by the disclosure, (2) that too much disclosure merely obfuscates the facts for the reader, and (3) that disclosure can be quite misleading if not placed in the proper context. We do not believe that more reporting is better, and further submit that our position is supported by recent investor education publications.[1] Further disclosure of cost reporting risks realizing each of these dangers. In the following pages we will explain why that is the case and then we will turn to answering the specific questions included at the end of the Discussion Paper.

[1] OSC Staff Notice 11-778, Behavioural Insights, states, "BE and BF studies have demonstrated that a number of traditional policy approaches were either inadequate or failed to solve the poor choices often being made by consumers. Even when traditional regulation successfully identified a problem, the research suggests that it frequently used ineffective measures (such as very detailed disclosure to correct these market flaws) to address them. Authorities had the right problem, wrong solution. Traditional policy and regulatory measures came to be seen frequently as ineffective, and often also as causing unintended consequences.

INVESCO CANADA VIEWS ON COST REPORTING PROPOSAL

While we are not in favour of further reporting at this time, we commend the MFDA for initiating this consultation and its commitment to share the results of the consultation with other regulators, including the Canadian Securities Administrators (the "CSA"). We have been concerned that in past CSA initiatives impacting the mutual fund industry the MFDA appeared to be consulted very late in the process and we are impressed that the MFDA has committed to doing just the opposite here. As such, should you find it useful after reading our comments, we would be pleased to meet with you in person to further discuss these matters.

In our experience, the MFDA has been a proactive regulator, genuinely seeking to understand the concerns of its members and their clients, which makes the present consultation no surprise. While we heard some firms express a desire to include management expense ratios in the Cost and Performance Reporting under CRM2, we believe the current initiative was likely instigated by The Investment Funds Institute of Canada ("IFIC"). We are not members of IFIC, having resigned from that organization some years ago because, among other things, we do not typically share their views. CRM3 is no different. Given the interaction between the MFDA and IFIC and IFIC's claim to speak for the industry, it is especially important for firms like ours to speak out forcefully when we disagree and when we fear the industry is headed down a decidedly bad path.

As you are well aware, the mutual fund industry has been the focus of Canada's regulatory community for over twenty years. From our perspective, it is clear that the mutual fund industry attracts more regulatory scrutiny than any other part of the retail wealth management landscape, including separately managed accounts offered by dealers, principal protected notes, segregated mutual funds, and basic advisor constructed portfolios. While much of this is beyond the jurisdiction of the MFDA, it would be inappropriate for the MFDA to ignore this background in proposing any sort of regulatory expansion.

Is This Necessary?

We believe, as a matter of principle, that regulators should not add to the burden of registrants just because they can. Rather, regulators are justified in adding to the "regulatory burden" where there is a clear need for a new or amended rule and where it makes sense to do so on a cost basis. In our view, CRM3 fails on both of these counts.

While the Discussion Paper does not offer an exhaustive list of items it believes should be disclosed, it does list several broad categories. The first such item is the "ongoing costs of owning investment funds". In other words, the Discussion Paper notes that "there are still costs associated with the ongoing management and operation of Investment Funds that are not required to be disclosed." It is not clear what costs are not required to be disclosed as National Instrument 81-106 sets out rather comprehensive disclosure rules and these are supplemented by the current requirements of National Instrument 31-103, National Instrument 81-101 and National Instrument 81-102. It only becomes clear what is being referred to when one looks at the disclosure examples provided.

The management expense ratio ("MER") is currently reported in the management report of fund performance and the fund facts document (and is widely available on virtually every free financial website that provides any information about mutual funds). As such, it cannot be said that this information is not required to be disclosed. While arguments have been made in the past that investors did not know about commissions that they paid, it would be rather difficult to make that argument with the MER as the sole reason an individual investor would not know the MER of the investment fund they own is because they have not looked. This brings to mind the old saying, "you can bring a horse to water but you can't make him drink it." It is not clear, therefore, how adding this

disclosure to the account statement, as posited, adds anything. Therefore, adding the MER to the account statement might be classified as "nice to have", not "necessary". As we will discuss later in this letter, the cost of implementing this suggests that the necessary cost-benefit is not present.

Later in the Discussion Paper, a suggestion is made to include the MER in the cost report, in which case it would be displayed in dollars. It is not clear to us why this is necessary. As we discuss later, providing this disclosure is likely to be costly and it will likely not add to an investor's understanding of whether they are getting value from their fund investment.[2] Put differently, the amounts paid to the fund company (which is what this discloses) will generally vary greatly when compared to the dollar profit or loss on the account annually as that is the nature of markets. This promotes short-term thinking which is generally viewed as anathema to good investment results. We note also that the temptation may be to compare dollar costs to dollar results but the account reporting does not in any way account for the timing of the deposits into the account, which is vital to a proper evaluation of this metric.[3] Continuing to compare based on percentages (whether an MER or a management fee rate) is appropriate as it provides a common basis for comparison with other products (and advisors) and is less likely to mislead.

The second item is transactional costs charged by Investment Funds. The only examples provided are redemption fees and short-term trading fees and, per CSA Staff Notice 81-330, the redemption fees will be disappearing over time. The reason we believe this disclosure is unnecessary is because this disclosure is already provided directly to the client. Under NI 31-103, the client would have reviewed these charges before purchasing the mutual fund and upon incurring these charges the investor would have received a trade confirmation or other direct correspondence. In fact, that disclosure is given to the client without the clutter of any other information, so one can reasonably assume they are more likely to appreciate the information.

The third item is the costs paid by clients directly to third parties for account administration. As these costs do not involve registrants, it is not clear what rationale supports a registrant reporting them. Regardless, this information is given to the client directly by the third party as part of the billing process.

Lastly, the Discussion Paper states that the MFDA is not proposing expanding cost reporting for other investments at this time as those investments generally have limited automated data. In other words, either the MFDA believes that it is not necessary for those investors to get the same information as mutual fund investors receive or it is simply too costly to do so, inherently applying a cost-benefit test. We note that exchange-traded funds ("ETFs") are investment funds and the costs of ownership are not well disclosed and are not part of this proposal. However, ETFs have bid/ask spreads, swap fees and other costs, none of which are transparent to the investor but all of which come with a cost that is hidden so well it cannot even be used by the investor to compare with another investment.

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[2] As an example, in Year 1, the fee-based account starts at $10,000 and the profit is $2,000. The "dollar MER" is $140. The next year, a down year for markets, the account actually rises by $100. The "dollar MER" is likely going to be close to that $140. So in Year 1 the client paid $140 for $2,000 and in year 2 the client paid $140 for $100, which appears to not have value. But if the markets were down, surely there was value in year 2?

[3] If the client added substantial money at the end of the year, the report just shows that substantial money was added, not when, and therefore the investor may incorrectly compare the profit/loss to the larger amount rather than the initial smaller amount.

Implementation Cost

The foregoing leads us to our second major issue with the Discussion Paper and that is the cost to implement these proposals. As mentioned above, the MFDA has decided not to propose expanding cost reporting for other investments because "…such investments generally have limited automated data available to registered firms." We were pleased to see this statement as it shows that the MFDA may well be the first securities regulator in Canada to refrain from proposing a rule on the basis of cost-benefit. As such, we do feel emboldened in making the following points.

Some costs are quantifiable and some are not. However, we ask you to consider all of the possible costs for each of the proposals.

1. Adding the MER to the account statement: Mutual funds in Canada generally have a financial year-end consistent with the end of a financial quarter, i.e. March 31, June 30, September 30, December 31. The most popular year end is December 31. The MER for a financial year ending December 31 is not due until March 31 of the following year, i.e. 90 days after year-end. We understand that annual account statements are typically sent to clients at the end of January. As such, that January statement would have an MER that is at least 13 months old for a December 31 fund. This is not helpful information. For the investment fund managers to alter processes to generate an MER earlier than that, in time to meet the annual statements, would require a structural change across the industry in the nature of the type of change that is used to justify refraining from addressing other investment products in the Discussion Paper. For clients who receive statements monthly or quarterly, this may be confusing disclosure since 3 of every 4 statements will have the same MER. In addition, the same investor might have a December 31 fund, a March 31 fund and a June 30 fund. This will lead to staggered reporting and become quite confusing, especially as explanatory notes would need to be added.

2. Adding a Personalized Cost of Owning Funds: In essence, this is the MER for each mutual fund held, dollarized based on the investor's circumstances. Unfortunately, it is not as simple as taking market value on a date and multiplying by the MER. This is not information that a fund company has available today and to produce it would be costly. We note that there are several models for operating expenses. Some firms charge a unitary management fee and they pay for the operating expenses of the funds. Some firms pay a fixed rate administration fee. In both cases, the calculation may appear simple as the rate can be translated to a daily percentage and that can be applied against the daily balance of the individual investor. We do not believe daily balances to this degree are currently calculated by fund companies, so this would require significant investment. However, those "easy" cases do not cover the industry. Many fund companies, including our own, operate on a cost recovery basis. While we accrue fund expenses daily based on estimates, there is typically a "true up" at year end, so we cannot accurately provide this information until the end of the year. We then have the same issues that the "easy" cases have. Furthermore, for all investment fund managers, the problem is compounded by the impact of investors subscribing for and redeeming mutual fund securities during the year, which further complicates the calculation.

3. Redemption Charges and Short-Term Trading Charges: Dealers are provided this information as these amounts are charged and, therefore, one would think that there is no expense for the fund company. Unfortunately, this is not the case. As with series suitability where the MFDA suggested to its Members that they get the investment fund managers to resolve this issue for them, we are already hearing from dealers who are saying that notwithstanding they have this information, they still expect us to provide it in

a one-stop shopping type of approach. While implementation costs have not been scoped out, this will not be an inexpensive build.

As set out above, all the information that is under consideration for disclosure in the Discussion Paper is already disclosed directly to mutual fund investors. Therefore, in assessing the benefits of this proposal as required by law, neither the MFDA nor the CSA should focus on the benefits of the information *per se*, but rather the incremental benefit of providing this information in one report once per year in addition to the other disclosures of this information. We believe that if assessed in that manner, the cost-benefit analysis will fail.

Confusion to Investors

Our final point is that these additional disclosures are confusing to investors. As we explained above, investors would, under this proposal, receive all possible cost information relating to owning a mutual fund but not an ETF. We are close to achieving a level playing field between ETFs and mutual funds with the ETF Facts Document and it would be a shame for that levelling to be so short-lived.

Adding MER disclosure to account statements or reports on cost is not necessary and, we believe, will lead to a misleading performance assessment. We have long been concerned with how performance information is presented in Canada. Mutual fund performance is reported net of fees because the fees are embedded in the product and such is required under NI 81-102. Interestingly, no other investment product is subject to rules governing how performance is disclosed and in our experience, many of those products disclose performance gross of fees (or, in some cases, on a non-annualized basis, thus making the investment return look better than it is). Thus, adding the MER might cause an investor to deduct the MER from the reported performance which is already net of MER and that is simply unfair.

We note that under the performance reporting requirements, all performance reported to the investor through the Performance Report is supposed to be net of fees and, therefore, our concern should not be an issue. However, other investments do not report costs in the manner that mutual funds already do, even before consideration of the proposals contained in the Discussion Paper. This is simply unfair and leads investors to believe that other investments perform better than mutual funds. Sometimes that is the case, but it is not a universal rule. To the extent the CSA and MFDA disagree with our position on MER reporting, we submit that the only fair way to show this information would be to disclose gross fund performance, MER, net fund performance. That would allow investors to compare their mutual fund's performance with the performance of non-mutual fund investments on an equivalent basis and allow investors to determine if they are getting value for the cost incurred. In our view, there is no way to justify the dollar reporting of fund expenses at an individual level.

INVESCO CANADA RESPONSES TO CONSULTATION QUESTIONS

1. <u>Should regulators consider expanding cost reporting for Investment Funds?</u>

   As noted above our response is no. Given the reforms enacted by the MFDA and the CSA over the last 8 years, no case has been made for further reforms in this area. It seems to us that the essence of this type of reporting is mitigation of conflicts of interest. However, no link has been established in the Discussion Paper between expanded reporting and mitigation of conflicts of interest. Other forms of investment are not subject to similar rules and this results in a negative connotation to retail clients regarding investment funds. We note that mutual funds subject to NI 81-102 are the only investment products that are subject to specific regulation that impacts how they can invest and be designed. The rationale for that is that

mutual funds are intended for the retail market and, therefore, additional protection is required for these investors. As additional reporting requirements are layered on, the investor's costs of investing increase without a commensurate financial benefit. This puts mutual funds especially in an increasingly worse competitive position with the inevitable result that the clients for whom these protections are intended will not avail themselves of those protections as they move to investment products that do not have these protections. For example, many dealers now offer their own "wrap" products through separate accounts. Because these are not mutual funds, there are no investment restrictions. Some dealers also offer a form of private money management, often through separate accounts or non-mutual fund investment pools, again without standard investment restrictions. It is not clear to us how this results in better protection for retail investors. Therefore, we do not believe that regulators should consider expanding cost reporting for investment funds.

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

   As alluded to in our response above, we do not believe that other investment products are subject to the same level of reporting as investment funds, especially mutual funds. Therefore, we believe that cost reporting should be expanded to those other products so that all investment products, including investment services, are treated evenly.

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?

   As discussed in earlier parts of this letter, we do not agree.

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

   Costs that are unique to the client should generally not be reported in the same report as costs that are similar to all investors as that detracts from any ability for an investor to compare and ascertain value.

Cost Reporting

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

   Account Statement Disclosure

   Figure 1 provides information that is confusing to an investor because it shows MER, book value and market value without any statement or discussion of how these interrelate and what they mean. For example, one might read the 1.49% MER (in the first line) and look at the market value of $5,110.10 and then incorrectly conclude that they should deduct 1.49% from that amount to see what they really have. There is no statement that the market value is the market value after the deduction of the expenses that comprise the MER. This could easily lead an investor to overestimate what they are paying. Similarly, we question whether investors properly understand what the book value is and the relationship between book value and MER.

   Figure 2 is more problematic because the inherent confusion over market value and the inclusion of expenses is repeated and the addition of the pie chart without really explaining what it means is not particularly helpful. Further, given what the portfolio management part of the pie chart comprises, the explanation provided is at odds with disclosure in the MRFP and

in the FFD that every fund is required to provide. Inclusion of the pie chart would make implementation of these proposals significantly more expensive. Given that magnified cost, it is incumbent upon the MFDA to establish why the incremental cost to create Figure 2, compared to Figure 1, is of commensurate value. The Discussion Paper declines to do that.

Cost and Compensation Reports

Figure 3 is confusing. It is not unrealistic to assume that an investor reading that report will believe they paid $1,343 rather than $726 for their investment. This could be addressed if the compensation section began with the statement "Of the $726 you paid directly or indirectly for your investment, we received directly or indirectly $617."

Figure 4, when looked at in relation to Figure 3, gives the impression that the cost of proprietary investments is about half the cost of third party investments based on the potential misbelief noted in the previous paragraph. It also makes it sound like the financial advisor does not get compensated at all whereas Figure 3 is somewhat clearer in that topic.

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

   It is not clear to us why the regulatory community believes that clients require such level of detail in cost information only for mutual funds and not for any other investment. In our view, the entire approach is riddled with problems. Primarily, lost in the reporting is that mutual fund returns are reported net of fees and expenses charged by the fund company. To mix costs that are netted from returns with costs that are not netted is misleading and leads a reader to add back all costs to figure out their "true" cost.

   The better way to report these costs to clients is the way they are currently reported, as we have set out above.

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

   As set out above, we believe it will be quite difficult to calculate the "ongoing cost of owning investment funds" per client by each fund company, with any precision and meaning or on a timely basis.

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

   Please see our response to Q.7 above and our letter generally.

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?

   Through the Fund Facts/Point of Sale Proposal and the implementation of CRM2 (which remains imperfect at many firms), we believe that an appropriate timeframe to implement these proposals is 2 years. Those who say otherwise either have no experience in the operational aspect of the mutual fund industry or have a simplistic business model that is shared only by very few competitors.

Thank you for the opportunity to comment on the Discussion Paper. We hope you have found our comments helpful. We would be pleased to discuss our comments with you and MFDA staff in person at your convenience.

Yours truly,

Invesco Canada Ltd.

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