FAIR | Canadian Foundation *for* Advancement *of* Investor Rights

December 8, 2017

SENT VIA E-MAIL

Jeremy Rudin
Superintendent of Financial Institutions
Office of the Superintendent of Financial Institutions
255 Albert Street
Ottawa, Ontario
K1A 0H2

Lucie Tedesco
Commissioner
Financial Consumer Agency of Canada
427 Laurier Avenue West
6th Floor
Ottawa, Ontario
K1R 1B9

Dear Mr. Rudin and Ms. Tedesco:

Re: Reviews of Retail Sales Practices at Canada's Banks

FAIR Canada writes to the Office of the Superintendent of Financial Institutions and the Financial Consumer Agency of Canada to urge you to investigate certain retail sales practices and referred lending relationships relating to leveraged fund investing that, in our view, not only pose harm for many Canadians but also may pose widespread or systemic risks.

FAIR Canada is a national, charitable organization dedicated to putting investors first. As a voice for Canadian investors, FAIR Canada is committed to advocating for stronger investor protections in securities regulation. Visit www.faircanada.ca for more information.

FAIR Canada has long been concerned with improper sales practices in Canada's financial industry. Our concerns have included improper sales practices as a result of sale incentives and compensation structures that place the immediate financial interests of the firm and its representatives above those of its customers.

We also have raised concerns about the widespread inappropriate use of leverage to invest in mutual funds and the large role monetary and other incentives and hidden fees play in driving dealer firms and their representatives to recommend to retail clients borrowing from financial institutions in order to invest in mutual funds. We are concerned about how these relationships and incentives are not in the best interests of Canadian investors and financial consumers and can lead to substantial harm.[1] In addition, such relationships and incentives may lead to systemic risk to a financial institution or financial institutions that have a significant portfolio containing mortgages or other loans that have been used to purchase mutual funds. We have urged for the contractual relationships between financial institutions who are lenders and mutual fund manufacturers and dealer firms to be scrutinized.[2]

Specific issues that concern us include:

- The practice of investment fund companies having contractual arrangements with bank lenders to provide preferential rates on investment loans to investors who purchase their family of mutual funds in order to generate greater sales of their own funds.

- Registrants who actively promote the use of leveraged fund investing in order to generate increased commissions and assets under management.

- The ease by which registered representatives can recommend certain fund investments, including the use of a leveraged investment strategy, and at the same time process the loan application under a referral arrangement with a banking institution (often within the same day) from the registrant's office, all the while the client is under a mistaken belief that registered representatives have an obligation to put the client's best interests ahead of his or her own personal interests.

- Many Canadians have been convinced to borrow to invest by accessing their Home Equity Line of Credit (HELOC) which amounts to a second mortgage on their property.

- The troubling conclusion in a recent Canadian Securities Administrators' consultation document that:

> "Recommendations that clients borrow to invest in funds on a [Deferred Sales Charge] basis enable the dealer and their representatives to increase the total compensation they can earn from the investment. **Specifically they may receive a referral fee from the financial institution in connection with their client's loan** in addition to the 5% upfront commission (plus the ongoing trailing commission) they may receive from the investment fund manager on the purchase transaction."[3] (our emphasis)

We urge you, as part of your on-going reviews of bank retail sales practices, to examine the sales incentives and compensation structures at banks that also involve fees, commissions or payments (both monetary and otherwise) from or to mutual fund manufacturers, and dealer firms. We trust that your

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[1] We have been urging securities regulators to take steps to address the widespread inappropriate use of leverage Most recently, we have made recommendations in our submission on CSA Consultation Paper 81-408, http://faircanada.ca/wp-content/uploads/2017/06/170609-FAIR-Canada-submission-re-81-408_final.pdf and in earlier submissions, see footnote 1.

[2] Our most recent submission on recommending borrowing to invest and the relationships between dealer firm, mutual fund manufacturers and financial institutions can be found here: http://faircanada.ca/wp-content/uploads/2017/06/170609-FAIR-Canada-submission-re-81-408_final.pdf. See also https://faircanada.ca/fca_submissioncategory/borrowing-to-invest/.

[3] CSA Consultation Paper 81-408 regarding the option of discontinuing embedded commissions, at 104.

reviews of this issue would not be limited to only the top 6 banks as others are very actively engaged in promoting loans for the purpose of investing in mutual funds.

We would be pleased to discuss this issue or the foregoing request with you or members of your staff. Please fee free to contact either Frank Allen (Frank.Allen@faircanada.ca; 416-214-3443) or Marian Passmore (Marian.Passmore@faircanada.ca; 416-214-3441) regarding this issue.

Thank you for your consideration of this request.

Yours sincerely,

Frank Allen

Executive Director