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Canada-wide Ban on Unfair Mutual Fund Fees Coming Next Year: How to Protect Yourself Until Then

On June 1 next year, mutual funds that charge you a hefty fee if you sell your investment before a certain length of time will be banned everywhere in Canada – including Ontario.

The fees, called "Deferred Sales Charges" (DSCs), apply to certain mutual funds. They typically start at 6% of your investment if you sell in the first year after your purchase, falling by one percentage point each year. After about five to seven years, the fee drops to zero.

Here's the problem with DSCs. They take advantage of everyone's desire to avoid paying fees when making an investment – even though the fees are still there for most fund buyers, just postponed for a few years. And because advisors know this, they may recommend you buy mutual funds with DSCs that may not be suitable for you.

Nothing in life is free and you will likely end up paying later. Don't worry about your advisor – he or she will get paid by the fund company for selling you a DSC mutual fund at the time you buy it. With an early exit, your fee will subsidize the advisor's compensation.

The deferred sales charge creates real pressure on you to stay invested in the fund for years to avoid paying the fee, even if your fund is performing poorly or you need the money to cover unexpected expenses. For this reason, DSCs have long been recognized as being unfair to investors.

FAIR Canada is pleased to see that Ontario will be joining the rest of Canada in banning them and applauds all those involved in the decision to implement the ban next summer.

For "do-it-yourself" investors, you will be pleased to know that "trailing commissions" – paid by fund managers each year to discount brokers, in exchange for ongoing advice to clients – will also be banned next June. Trailing commissions are typically set at 1% of the value of your investment in the fund and have a real impact on your investment returns. The catch is that discount brokers don't actually provide advice, and so its not fair for them to receive any trailing commissions.

While the bans are very good news, its important to remember that they do not kick in for another year. Regulators determined the delay was needed to provide mutual fund firms enough time to change their business and compensation systems before the new requirements become the law.

This means you will not be protected from DSC fees on funds you buy (or have bought) before June 1, 2022. Since there could be a big push to sell DSC funds ahead of the ban, regulators have signaled that they will be watching for inappropriate sales of mutual funds with DSCs.

In the meantime, here are some things you can do to protect yourself from these unfair fees:

1. When buying a mutual fund, make sure you ask your advisor whether it is a DSC fund, or check the **Fund Facts** to see if DSCs apply. Any good advisor should steer you away from these types of mutual funds – or at least explain the pros and cons in detail.
2. If you did buy a mutual fund with DSCs and need to sell it before the five-to-seven-year period expires, ask your advisor or the fund company to waive the fee. Many will agree. And some have already set up policies around such types of fees being waived in financial hardship cases.
3. If you buy a mutual fund through a discount broker, check the Fund Facts to see if the fund comes with a trailing commission. You can also look for the letter that follows the name of the mutual fund (*e.g.,* “XYZ Canadian Equity Fund – Series A”). Funds with a trailing commission are usually Series A (advisor), and those without the commission are typically Series D (discount).
4. Take time to learn more about fees, since they will impact the returns on your investment, and they can be quite complicated. A good overview of these fees, along with a checklist of questions to ask before you invest, is available here: **MFDA Investor Bulletin – (Mutual Fund Fees)**.

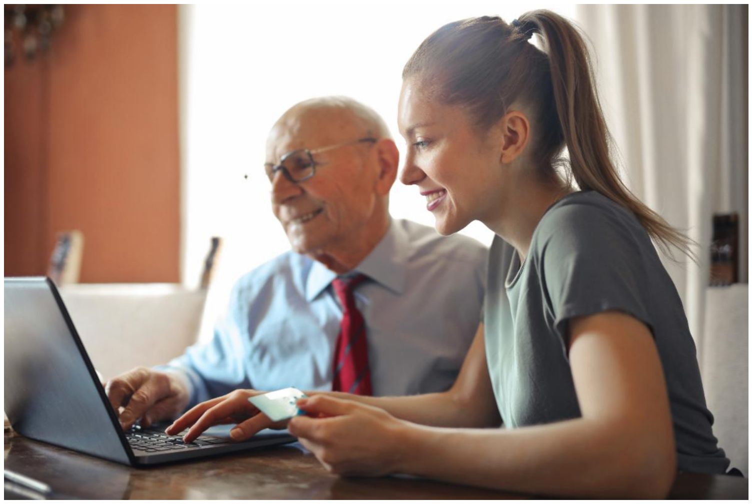
The bans on DSCs and trailing commissions for mutual funds bought from discount brokers, when they finally take effect, will be big wins for Canadian investors – certainly something to look forward to in 2022.

What is Canada Doing to Protect Vulnerable Investors?

Investor advocacy groups like FAIR Canada have been pushing regulators and the industry to do more to protect vulnerable Canadian investors. Several studies show that older Canadians are at an increased risk of losing money to fraud. Financial abuse is also the second most common form of elder abuse in Canada.

Vulnerable investors may be persons living in isolated, abusive, or neglectful situations which can make them more likely to be subject to undue influence, regardless of age. They also may be persons with diminished mental capacity due to health issues, developmental disability, brain injury or other cognitive impairment. Such vulnerabilities may be episodic, or long-term.

Several years ago, FAIR Canada worked with the Canadian Centre for Elder Law and published the report, **“Vulnerable Investors: Elder Abuse, Financial Exploitation, Undue Influence and Diminished Mental Capacity”.** In the report, we made several recommendations on how to identify potentially vulnerable investors and protect those who are more vulnerable. These recommendations may help you, or someone you know, when it comes to investing.



Last March, the Canadian Securities Administrators (CSA) proposed amendments to securities law to address issues of diminished mental capacity and financial exploitation of older and vulnerable clients. The final amendments, which we expect to be published this summer, will set the new ground rules for protecting and serving vulnerable investors.

We are pleased that the CSA incorporated two of FAIR Canada's core recommendations in its initial proposal. However, we urge the CSA to consider other recommendations FAIR Canada made, particularly the Legal Safe Harbour (pages 67 to 70 in the report).

The Legal Safe Harbour is helpful to address concerns advisors may have about exposing themselves to the risks of being sued or contravening privacy laws when they disclose personal information to a Trusted Contact Person (TCP). Without it, your advisor may be deterred from following through and speaking with a TCP, a provision meant to help protect vulnerable clients.

While we wait to see what the CSA publishes later this summer, there are things to do in the interim. Canadian firms can begin to take steps to ensure that vulnerable clients are identified and protected. Given that social isolation during the COVID-19 pandemic may increase vulnerability and the risk of financial exploitation, the need to act now is even greater.

We are glad to see the Mutual Fund Dealers Association (MFDA) provide helpful guidance on April 27, 2021, to its members on how to meet the needs of vulnerable clients. Its report can be found at: **Vulnerability and Financial Advice: A Broader Look at the Factors That May Increase the Risk of Client Vulnerability**.

We encourage you to speak to your advisor and explore what your firm can do to protect you or someone you know.

Social Media and Investment Advice

Social media platforms such as Instagram, TikTok, Reddit, Facebook and YouTube have been trending with investment advice. It is becoming common for millennial and Gen Z investors to look for investment advice on these platforms.

The Ontario Securities Commission (OSC) released **a research study** on April 21, 2021, called "Self-Directed Investors: Insights and

Experiences." The research shows that 13% of do-it-yourself investors consider posts on social media to be important sources of information.

While social media platforms can be beneficial, they are not monitored by securities regulators. These platforms can be exploited by investment scammers, who find it easy to create messages and investment statistics that look genuine and credible. In many cases, it is hard to tell fact from fiction in a short video or blog post that offers investment advice.

In Canada, anyone who offers investment advice must be registered with a securities regulator. When you invest with a firm that is registered, you are afforded protection because securities regulators will only register firms and individuals if they are properly qualified. Registered firms also have to comply with rules to ensure that clients are protected. If you have a complaint against a registered firm that was not addressed in a satisfactory way, you can go to OBSI (Ombudsman for Banking Services and Investments) to get an independent review.

Before you make an investment based on advice from social media platforms, make sure you:

1. Check the registration of the business or person offering investment advice or selling you an investment at **the Canadian Securities Administrators**.
2. Do your research about the investment being offered and the person/firm offering the advice. A Google search will be helpful.
3. Contact your financial advisor and/or securities regulator if you have any questions.

Know Your Rights – Client Focused Reforms (CFR)

As we mentioned last month, the client focused reforms are based on the idea that your interests should come first when you invest your money with a registered investment firm. Parts of the CFR will come into effect on June 30, while other parts come into effect at the end of December.

Beginning June 30, advisors will be legally required to tell you about their conflicts of interest. This includes telling you how much compensation/commission they receive when you invest in a specific product.

By December 31, investment advisors and the firms they work at will have to do the following:

- Know your client (KYC) – They must take reasonable steps to gather accurate information about you.
- Know your product (KYP) – They must take reasonable steps to understand the investments they recommend that you buy, sell or hold.
- Suitability determination: They must collect enough information about you to determine what investments are suitable for you and put your interests first.
- Relationship disclosure information (RDI): They must tell you about costs, limitations and restrictions relating to the investments they offer you.
- In addition, advisors will be prohibited from misleading you about their experience, qualifications or relationship with the firm/investment that is being offered to you.

You don’t have to wait until these rules take effect to protect yourself. You can contact your advisor and ask questions about your account and your investments.
For example:

- Are my investments suitable for me?
- How much am I paying you in fees and commissions?
- How are you managing any conflicts of interests in the advice you are giving me?
- Will I face any restrictions when I want to withdraw my investments?

For more information, check out the Canadian Securities Administrators' publication, **Questions to Ask when Choosing a Financial Advisor**.

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FAIR Canada
36 Toronto Street, Suite 850
Toronto, Ontario M5C 2C5
647-256-6690

Contact Us