CFA Societies Canada

Canadian Advocacy Council
120 Adelaide Street West, Suite 2205
Toronto, ON M5H 1T1
+1 (416) 366 3658 tel
www.cfacanada.org

June 30, 2020

VIA EMAIL

The Secretary
Ontario Securities Commission
20 Queen Street West 22nd Floor
Toronto, Ontario M5H 3S8
comments@osc.gov.on.ca

Dear Sirs/Mesdames:

**Re: Ontario Securities Commission Notice and Request for Comment – Proposed Ontario Securities Commission Rule 81-502 *Restrictions on the Use of the Deferred Sales Charge Option for Mutual Funds* and Proposed Companion Policy 81-502 to Ontario Securities Commission Rule 81-502 *Restrictions on the Use of the Deferred Sales Charge Option for Mutual Funds* and Related Consequential Amendments (the "Proposed Rule")**

The Canadian Advocacy Council of CFA Societies Canada[1] (the "CAC") appreciates the opportunity to provide the following general comments on the Proposed Rule.

We understand from the Notice describing the Proposed Rule that its purpose is to address some investor protection issues that arise from the use of the deferred sales charge option ("DSC") in the sale of mutual fund securities. In particular, the Proposed Rule is intended to address the "lock-in" effect on investors concerned about fees resulting from the redemption schedule and reduce the potential for mis-selling. The proposals include new restrictions on the use of the DSC option that would be placed on dealers and manufacturers of mutual funds and only allow the DSC option for smaller accounts.

We agree with the statement in the Notice to the effect that there is an inherent conflict of interest when registrants accept upfront commissions when selling mutual funds under the DSC option. As holders of the CFA designation, we commit ourselves to maintaining the highest standards of ethical conduct and professionalism in dealing with clients and conflicts. Conflicts of interest, conflicts arising in an agency relationship and prioritizing the interests of the client ahead of oneself, are all ethical concepts

[1] The CAC is an advocacy council for CFA Societies Canada, representing the 12 CFA Institute Member Societies across Canada and over 18,000 Canadian CFA charterholders. The council includes investment professionals across Canada who review regulatory, legislative, and standard setting developments affecting investors, investment professionals, and the capital markets in Canada. Visit www.cfacanada.org to access the advocacy work of the CAC.
CFA Institute is the global association of investment professionals that sets the standard for professional excellence and credentials. The organization is a champion of ethical behavior in investment markets and a respected source of knowledge in the global financial community. Our aim is to create an environment where investors' interests come first, markets function at their best, and economies grow. There are more than 177,600 CFA charterholders worldwide in 164 markets. CFA Institute has nine offices worldwide and there are 158 local member societies. For more information, visit www.cfainstitute.org.

120 Adelaide Street West, Suite 2205
Toronto, ON M5H 1T1
+1 (416) 366 3658 tel
www.cfacanada.org

specifically addressed within our CFA Institute Code of Ethics and Standards of Professional Conduct[2] (the "**Code and Standards**").

While the OSC cannot currently implement a DSC ban as is the case in the rest of the country, we reiterate our prior comments that we would have preferred harmonization of the prohibition. The ability to put clients' interests first may often be in direct conflict with an adviser's compensation structure. The CAC views the current system of financial incentives associated with DSC products as driving sub-optimal behavior and inherently ridden with irresolvable conflicts. The financial industry and investors would benefit from a structure of economic incentives that promotes transparent, simple fee structures, full attribution of all costs to the end investor related to their financial advice, and a structure that promotes competition in the distribution of investment fund products to investors on the basis of product quality and value-for-advice rather than compensation to advisors.

The jurisdictions that are participating in the ban have indicated that during the transition period, dealers will be allowed to sell mutual funds with a DSC option and redemption fee schedules will run their course. Relief will be granted to dealers from the enhanced conflict of interest requirements that will take effect once the client focused reforms come into force. We query, if relief is necessary in all other jurisdictions, how dealers operating in Ontario will be able to meet the enhanced requirements, despite the guidance provided in the Notice to the effect that staff expects registered firms to address this conflict by complying with their policies and procedures, the Proposed Rule, and their suitability obligations. More specific guidance on this point would be helpful.

Barring the ability to ban DSCs in Ontario, we support the Proposed Rule and believe the suggested restrictions are incrementally positive for investors and the industry.

The 2018 proposed amendments to National Instrument 81-105 *Mutual Fund Sales Practices* solicited feedback as to whether there were other types of investment products (such as pooled funds) that should also be subject to that instrument, on the basis that the conflicts arising from sales practices and compensation arrangements are not unique to prospectus qualified funds.

We are generally of the view that payments which are substantively like those that are proposed to be restricted by the Proposed Rule should be similarly discontinued in an integrated fashion, to ensure consistent and fair competitive dynamics and investor choice. As we have noted previously, conflicts that arise from monetary or non-monetary benefits provided to dealers and representatives from product manufacturers also arise for other investment fund products, including those sold on a prospectus exempt basis. We are further aware of substantively similar compensation arrangements in products similar to securities-regulated products regulated via other channels (such as segregated funds regulated in the insurance channel) and would strongly support collaboration and harmonization across regulatory channels/verticals to

[2] https://www.cfainstitute.org/-/media/documents/code/code-ethics-standards/code-of-ethics-standards-professional-conduct.ashx

deliver uniform outcomes and protections to investors, who may not be aware of differences in regulatory coverage between products and advice.

The OSC should continue to work with other regulators, as well as their insurance counterparts, to review fees charged on the sale of segregated funds and the universal life portion of insurance policies to ease potential regulatory arbitrage opportunities. We would support a continuing review of these types of fees and products. Regulators may also wish to examine in more detail the compensation practices and benefits provided to scholarship plan dealers.

With respect to the specific restrictions in the Proposed Rule, a dealer would not be permitted to accept commissions from a member of the organization of a mutual fund if the dealer knows the balance in the client's account immediately after the distribution would be in excess of $50,000. We are unaware of any study or data to indicate that smaller investors can better mitigate or accept the conflict that will be prohibited for larger investors.

There may be a possibility that investors purposely or inadvertently exceed the cap if they open more than one account at a dealer (through a holdco, dealer nominee account, or otherwise). To the extent the dealer has the relevant information the cap should be per investor and not per account. Further guidance on the calculation of the limit, including clarification of intention that the cap is a hard cap, regardless of whether the account reached $50,000 through contributions or capital appreciation, would be helpful.

Although not specifically contemplated in the Proposed Rule, we believe staff should review the methodology used for calculating the fees payable to the investment fund manager on a redemption schedule. When charged as a percentage of the redemption amount, the amount received by the manager may be akin to a performance fee (which should be transparent and disclosed accordingly) to the extent the value of the securities has increased from the initial purchase price. We recognize, however, that instead basing redemption fees on the initial purchase price could require registrants to undertake costly system overhauls. We recommend that the OSC consider whether any additional investor disclosure with respect to the characterization and calculation of the DSC redemption fee would be beneficial.

Under the new client focused reforms, registrants will have an obligation to consider a reasonable range of alternative recommendations available to the registered individuals through the registered firm (which we recognize will vary among registrants and based on an individual's own licensing). For larger firms, we expect that many dealers will be required to make investors aware of alternative products that may be less costly, suggesting that the DSC business model may be likely to be phased out over time.

For sales that continue to be made under the DSC option, it will be important for investors to be informed and educated on the fact that the embedded fees represent both a conflict as it relates to the advice that the investor receives as well as a drag on performance.

CFA Societies Canada

Canadian Advocacy Council

120 Adelaide Street West, Suite 2205
Toronto, ON M5H 1T1

+1 (416) 366 3658 tel
www.cfacanada.org

**Concluding Remarks**

We thank you for the opportunity to provide these comments. We would be happy to address any questions you may have and appreciate the time you are taking to consider our points of view. Please feel free to contact us at cac@cfacanada.org on this or any other issue in future.

(Signed) *The Canadian Advocacy Council of*
*CFA Societies Canada*

**The Canadian Advocacy Council of**
**CFA Societies Canada**