PMAC
PORTFOLIO MANAGEMENT ASSOCIATION OF CANADA
Advancing Standards™

VIA E-MAIL: comments@osc.gov.on.ca

July 3, 2020

The Secretary
Ontario Securities Commission
20 Queen Street West
22nd Floor
Toronto, Ontario
M5H 3S8

Re: OSC 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*

Background

The Portfolio Management Association of Canada (**PMAC**) is pleased to have the opportunity to submit the following comments regarding OSC 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* (the **Proposed Rule**)(the **Consultation**).

PMAC represents over 285 investment management firms registered to do business in Canada as portfolio managers. PMAC's members encompass both large and small firms managing total assets in excess of $2.8 trillion for institutional and private client portfolios. Of note, close to 70% of PMAC's members are registered as investment fund managers (**IFM**s), managing both mutual funds and non-reporting investment funds (pooled funds).

We support Ontario's decision to ban trailing commissions, which aligns with the policy decision in other Canadian Securities Administrators (**CSA**) jurisdictions.

However, with respect to the Consultation on the use of deferred sales charges (**DSCs**), given the lack of harmonization with other CSA jurisdictions, which have implemented a complete ban on the use of DSCs, PMAC does not believe it will be practical for firms to implement the Proposed Rule in Ontario alone, and ultimately, we do not believe the proposed changes will significantly improve investor outcomes. Moreover, as discussed below, there are unintended consequences associated with the Proposed Rule which may, in fact, cause investor harm.

KEY RECOMMENDATION

> **PMAC recommends that Ontario reconsider the decision to deviate from other Canadian jurisdictions and instead, harmonize the DSC ban across Canada.**

General Comments

The reasons in support of discontinuing the use of DSCs are outlined in CSA Consultation Paper 81-408 – *Consultation on the Option of Discontinuing Embedded Commissions*, and include investor protection and market efficiency issues. All CSA jurisdictions other than Ontario determined that discontinuing the DSC option was the appropriate response to these concerns, and published the changes in *Multilateral CSA Notice of Amendments to National Instrument 81-105 Mutual Fund Sales Practices, Changes to Companion Policy 81-105CP to National Instrument 81-105 Mutual Fund Sales Practices* and *Changes to Companion Policy 81-101CP to National Instrument 81-101 Mutual Fund Prospectus Disclosure relating to Prohibition of Deferred Sales Charges for Investment Funds* (**CSA Multilateral Notice**).

In terms of the impact on the industry, the absence of a harmonized solution to regulate the use of DSCs will ultimately raise costs to investors and regulatory burden for Ontario IFMs and will not be an optimal long-term solution in the best interests of Canadian investors. Based on member feedback, the lack of national application and other aspects of the Proposed Rule make it costly, difficult to implement and burdensome to monitor, thereby increasing market inefficiency.

We have set out responses to the questions included in Annex D of the Consultation in this submission.

PMAC Member Feedback

PMAC conducted a survey of our 185 IFM-registered member firms to solicit feedback on the Consultation. We received responses from 30 firms, a response rate of 16%, representing a total AUM of $184 billion. We specifically asked firms about their long-term plans for DSC usage in Ontario. We received 18 responses to this question; fourteen (14) firms (78%) responded that they do not offer a DSC option. Of the respondents that do, one (6%) indicated that it would discontinue the use of DSCs in Ontario due to the additional cost and compliance burden that would be caused by the Proposed Rule, and three (17%) responded that they will phase out the use of DSCs across Canada, regardless of the Ontario rule. None of the respondents said that they would continue to offer DSC funds in Ontario; however, one firm separately indicated that it has not yet decided whether to keep the DSC option in Ontario after June 2022.

On the issue of harmonization, some of the comments we received on the Consultation include: "The proposed rules [are] complicated and unnecessary, if DSCs are eliminated altogether"; "We should be 100% consistent nationally. We are too small an industry to justify the burden of costs and the confusion presented to industry, clients and regulators"; and, "simply prohibit DSC fees".

Some respondents also commented on the potential harm to investors caused by DSCs, saying that they consider DSCs to be non-client friendly in the ordinary course, and should be eliminated altogether, and that firms do not believe that DSCs are an appropriate fee vehicle. Additional feedback on this point included "We do not use DSC but come into contact with prospective clients who are locked into these charges and are unaware of them. It really restricts investors from making other choices"; "Get rid of them, [they] harm investors" and "they are yesterday's product."

Given the above feedback, PMAC does not support the direction Ontario has decided to take with respect to the use of DSCs and, instead, we encourage Ontario to harmonize the elimination of DSCs across Canada.

Comments on the Proposed Rule

In the event that Ontario proceeds with the Proposed Rule, we provide the following comments on specific aspects of the Consultation.

Clarification required regarding certain responsibilities

Because IFMs do not have access to the following information from investors, the OSC should clarify that the responsibility for adhering to the time horizon, age requirement, account size and other KYC and suitability considerations rests with the dealer and not the IFM. Ambiguity on these obligations would create confusion and could undermine the intended investor protections.

Client mobility

The lack of harmonization across Canada raises an issue with respect to client mobility. The Proposed Rule is silent on what is expected when a client moves from Ontario to another CSA jurisdiction where DSCs will not be permitted; it would be unfair to the investor if they were forced to redeem early and were penalized as a result.

Cost consequences

Members pointed out the cost implications of various aspects of the rule, which would make them burdensome to implement. For example, with respect to the maximum account size, limiting the DSC option to a smaller group of investors with smaller account values will decrease the asset base and increase the costs of operating these funds. We also note that it would be possible to circumvent the maximum account size by opening multiple accounts, including with multiple dealers.

Responses to questions in Annex D

1) Do you agree that mandating a separate DSC series will help in curtailing the cross-subsidization of the costs attributable to DSC investors? Why or why not?

Response:

It is not clear that cross-subsidization is, in fact, occurring in the relevant funds, nor is it clear that separating the DSC to a different series will meaningfully curtail any cross-subsidization. For example, cross-subsidization can occur between registered and non-registered accounts and for reasons other than as a result of DSCs.

The costs of launching and operating a new fund or separate series are significant, and these costs are likely to be passed on to investors in the form of higher management fees, regardless of which series or compensation model is selected. It is not clear that separating the series would result in lower fees to front-end load purchasers.

There are numerous consequences that flow from mandating a separate series, including increased costs and lower efficiency. Additional resources at the fund level would be required for implementation and ongoing monitoring and compliance; for example, the regulatory prospectus filing fees are based on the series and not on the fund, which would increase the fees payable. There would be additional costs for fund administration and auditing (auditors charge for auditing an extra series in a smaller group of funds – this is more costly for the fund manager if the fund pays a fixed expense fee, and more costly for investors if a variable expense fee is charged), and the need to update and file additional disclosure for the series, such as Fund Facts, would require additional compliance resources.

In addition, as noted in the Consultation, additional training, enhanced KYC and suitability review at account opening and on-going monitoring of the client account would be required at the dealer level. Therefore, the overall costs of running and distributing the funds is likely to increase. These costs will be disproportionately borne by the smaller investors that are typically put into DSC products.

2) The effective date of the Proposed Rule coincides with the effective date of the final amendments to implement a DSC ban in the other CSA jurisdictions. Are there additional transition issues that we should consider?

<u>Response:</u>

We are supportive of the Proposed Rule amendments being made to coincide with the DSC ban in other jurisdictions. Implementing changes on a particular subject matter all at once is more efficient from an operational perspective and with respect to disclosure.

3) Annex E sets out the anticipated costs and benefits of the Proposed Rule. Are there any other significant costs or benefits that have not been identified in this analysis? Please explain with concrete examples and provide data to support your views.

<u>Response:</u>

We have outlined some of the costs of the Proposed Rule above, which will not make the use of DSC funds economically attractive to IFMs. This may result in fewer funds being offered, and therefore fewer choices available to investors. There is a risk that these costs will also be passed on to investors in the form of higher management fees.

We are concerned that such unintended consequences will be harmful to investors, in particular, those with smaller accounts and less money to invest, and therefore urge Ontario to consider these costs in determining whether to harmonize its policy with other CSA jurisdictions.

Conclusion

PMAC supports nationally harmonized legislation across CSA jurisdictions to promote efficiency and reduce regulatory burden. We also believe that harmonization is important so that investors are owed the same obligations and afforded the same opportunities, regardless of their province of residence. We understand that Ontario has chosen to deviate from other CSA jurisdictions on this particular issue and urge you to consider the unintended cost consequences and the potential resulting harm to investors highlighted in this submission, and ultimately to align Ontario securities regulation with the CSA Multilateral Notice.

We would be pleased to discuss any of our comments with you at your convenience. Please do not hesitate to contact Katie Walmsley at (416) 504-7018 or Victoria Paris at (416) 504-7491.

Yours truly,

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