1.1.2 CSA Notice of Amendments to National Instrument 81-105 Mutual Fund Sales Practices and Related Consequential Amendments Prohibition of Mutual Fund Trailing Commissions Where No Suitability Determination Was Required

CSA Notice of Amendments to
National Instrument 81-105 *Mutual Fund Sales Practices*

and

Related Consequential Amendments

Prohibition of Mutual Fund Trailing Commissions
Where No Suitability Determination Was Required

September 17, 2020

Introduction

The Canadian Securities Administrators (the **CSA** or **we**) are adopting amendments to National Instrument 81-105 *Mutual Fund Sales Practices* (**NI 81-105**), changes to Companion Policy 81-105CP *Mutual Fund Sales Practices* (**81-105CP**) and related consequential amendments to National Instrument 41-101 *General Prospectus Requirements* (**NI 41-101**) and National Instrument 81-101 *Mutual Fund Prospectus Disclosure* (**NI 81-101**) (collectively, the **Amendments**).

The Amendments

- prohibit the payment of trailing commissions by members of the organization of publicly-offered mutual funds (**fund organizations**) to participating dealers who were not required to make a suitability determination in connection with a client's purchase and ongoing ownership of prospectus qualified mutual fund securities, and

- prohibit the solicitation or acceptance of trailing commissions by participating dealers from fund organizations, in connection with securities of the mutual fund held in an account of a client of the participating dealer if the participating dealer was not required to make a suitability determination in respect of the client in connection with those securities.

The Amendments will effectively prohibit the payment of mutual fund trailing commissions to dealers who are not subject to the obligation to make a suitability determination under section 13.3 of National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* (**NI 31-103**) or under the corresponding rules and policies of the Investment Industry Regulatory Organization of Canada (**IIROC**) and the Mutual Fund Dealers Association of Canada (**MFDA**) (together, the **SROs**). Such dealers would include, among others, order-execution only (**OEO**) dealers and dealers acting on behalf of a "permitted client"[1] that has waived the suitability requirements.

In some jurisdictions, ministerial approvals are required for the implementation of the Amendments. Provided all ministerial approvals are obtained, the Amendments to NI 81-101 and NI 41-101, which provide certain exemptions from the delivery requirements for fund facts documents (**Fund Facts**) and ETF facts documents (**ETF Facts**), respectively, for all switches from a trailing commission paying series or class of a mutual fund to a no trailing commission series or class of the same mutual fund, will come into force on December 31, 2020, and the Amendments to NI 81-105 will come into force on June 1, 2022.[2]

The text of the Amendments is contained in Annexes B through E of this notice and will also be available on websites of the following jurisdictions:

www.bcsc.bc.ca
www.asc.ca
www.fcaa.gov.sk.ca
www.mbsecurities.ca
www.osc.gov.on.ca

[1] "Permitted client" as defined in section 1.1 of NI 31-103.
[2] The Amendments to NI 81-105 will take effect on June 1, 2022 with the exception of the "suitability determination" definition, which will take effect on December 31, 2020. Please see the explanation provided under "Effective Date".

www.lautorite.qc.ca
www.fcnb.ca
nssc.novascotia.ca

Substance and Purpose

The Amendments, together with the enhanced conflict of interest mitigation framework for dealers and representatives under detailed reforms to NI 31-103 (the **Client Focused Reforms**) published on October 3, 2019, comprise the CSA's policy response to the investor protection and market efficiency issues we have identified with the payment and acceptance of trailing commissions where no suitability determination was required. The Amendments restrict the compensation that fund organizations may pay to participating dealers who were not required to make a suitability determination in connection with a client's purchase and ongoing ownership of prospectus qualified mutual fund securities.

Background

The Amendments were developed over the course of an extensive consultation process.

CSA Consultation Paper 81-408

On January 10, 2017, the CSA published for comment CSA Consultation Paper 81-408 *Consultation on the Option of Discontinuing Embedded Commissions* (the **Consultation Paper**), which identified and discussed key investor protection and market efficiency issues arising from mutual fund embedded commissions.[3] The Consultation Paper sought specific feedback, including evidence-based and data-driven analysis and perspectives, on the option of discontinuing embedded commissions as a regulatory response to the identified issues and on the potential impacts to both market participants and investors of such a change, to enable the CSA to make an informed policy decision on whether to pursue this option or consider alternative policy changes.

CSA Staff Notice 81-330

On June 21, 2018, the CSA published CSA Staff Notice 81-330 *Status Report on Consultation on Embedded Commissions and Next Steps* (**CSN 81-330**) which proposed the following policy changes:

(a) implement enhanced conflict of interest mitigation rules and guidance for dealers and representatives requiring that all existing and reasonably foreseeable conflicts of interest, including conflicts arising from the payment of embedded commissions, be addressed in the best interests of clients or avoided,

(b) prohibit all forms of the DSC option (as defined below) and their associated upfront commissions in respect of the purchase of securities of a prospectus qualified mutual fund, and

(c) prohibit the payment of trailing commissions to, and the solicitation and acceptance of trailing commissions by, dealers who were not required to make a suitability determination in connection with the distribution of securities of a prospectus qualified mutual fund.

In addition to announcing the CSA's policy decision and providing a summary of the consultation process and the feedback received, CSN 81-330 provided an overview of the regulatory concerns that the proposed policy changes aimed to address, and also discussed why CSA members were not proposing to ban all forms of embedded commissions.

The Proposed Amendments

On September 13, 2018, the CSA published proposed amendments (the **Proposed Amendments**) to

(a) prohibit fund organizations from paying upfront commissions to dealers, which will result in the discontinuation of all forms of the deferred sales charge option[4] including low-load options[5] (collectively, the **DSC option**), and

[3] The Consultation Paper followed the CSA's initial consultation on mutual fund fees under CSA Discussion Paper and Request for Comment 81-407 *Mutual Fund Fees* published on December 13, 2012, which was followed by in-person consultations in several CSA jurisdictions in 2013. The CSA published an overview of the key themes that emerged from this consultation process in CSA Staff Notice 81-323 *Status Report on Consultation under CSA Discussion Paper and Request for Comment 81-407 Mutual Fund fees*.

[4] Under the traditional deferred sales charge option, the investor does not pay an initial sales charge for fund securities purchased but may have to pay a redemption fee to the investment fund manager (i.e., a deferred sales charge) if the securities are sold before a predetermined period of typically 5 to 7 years from the date of purchase. Redemption fees decline according to a redemption fee schedule that is based on the length of time the investor holds the securities. While the investor does not pay a sales charge to the dealer, the investment fund manager pays the dealer an upfront commission (typically equivalent to 5% of the purchase amount). The investment fund manager may finance the payment of the upfront commission and accordingly incur financing costs that are included in the ongoing management fees charged to the fund.

[5] The low-load purchase option is a type of deferred sales charge option but has a shorter redemption fee schedule (usually 2 to 4 years). The upfront commission paid by the investment fund manager and redemption fees paid by investors are correspondingly lower than the traditional deferred sales charge option.

(b) prohibit the payment of trailing commissions to dealers who were not subject to a suitability requirement, such as dealers who were not required to provide investment recommendations in connection with the distribution of prospectus qualified mutual fund securities.

The 90-day comment period ended on December 13, 2018.

CSA Staff Notice 81-332

On December 19, 2019, the CSA published CSA Staff Notice 81-332 *Next Steps on Proposals to Prohibit Certain Investment Fund Embedded Commissions* (**CSN 81-332**) to announce that the CSA, with the exception of the Ontario Securities Commission,[6] would publish for adoption final amendments in early 2020 to prohibit the DSC option (the **DSC Ban**).[7]

CSN 81-332 also announced that all members of the CSA would publish for adoption final amendments later in 2020 to prohibit payments of trailing commissions to, and the solicitation and acceptance of trailing commissions by, dealers who are not required to make a suitability determination.

Summary of Written Comments Received by the CSA

The CSA received 55 comment letters on the Proposed Amendments. We thank everyone who provided comments. A summary of the comments together with our responses are set out in Annex A. The names of the commenters are also set out in Annex A.

Copies of the comment letters are posted on the websites of the Alberta Securities Commission at www.asc.ca, the Ontario Securities Commission at www.osc.gov.on.ca, and the Autorité des marchés financiers at www.lautorite.qc.ca.

Summary of Changes to the Proposed Amendments

After considering the comments received, we have made some non-material changes to the Proposed Amendments. These changes are reflected in the Amendments that we are publishing as Annexes to this notice. As these changes are not material, we are not republishing the Amendments for a further comment period.

The following is a summary of the key changes made to the Proposed Amendments:

(a) Definition of "suitability determination" in section 1.1 of NI 81-105

We added a definition of "suitability determination" in section 1.1 of NI 81-105 to specify where a suitability determination is required under securities legislation and SRO rules and policies. The definition of suitability determination references section 13.3 of NI 31-103 and the corresponding rules and policies of IIROC and MFDA named in Appendix G and Appendix H, respectively, of NI 31-103, as applicable.

(b) Clarification of the prohibition on participating dealers in subsection 2.2(3) of NI 81-105

We added subsection 2.2(3) to NI 81-105 to provide clarification that a participating dealer may not solicit or accept a payment of a trailing commission from a member of a fund organization in connection with mutual fund securities held in a client account if the participating dealer was not required to make a suitability determination under securities legislation or SRO rules and policies.

(c) Knowledge qualifier in subsection 3.2(4) of NI 81-105

We received comments from fund organizations indicating that they may not know whether a suitability determination was required to be made in connection with a mutual fund purchase. For example, some participating dealers use separate dealer codes for their full-service dealer and their OEO dealer, and in those circumstances, fund organizations should be able to determine whether mutual fund purchase orders are from the OEO dealer, who was not required to make a suitability determination. However, other participating dealers use a single dealer code for multiple affiliated dealers, including their full-service dealer and their OEO dealer and, as a result, the mutual fund purchase orders for their full-service dealer and their OEO dealer are aggregated with the same dealer code. In those circumstances, fund organizations may not be able to distinguish whether the mutual fund purchase orders are from the full-service dealer, who was required to make a suitability determination, or from the OEO dealer, who was not required to make a suitability determination.

[6] 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 was published on February 20, 2020 by the Ontario Securities Commission.

[7] 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 was published on February 20, 2020 by the CSA, except the Ontario Securities Commission.

For circumstances where fund organizations do not know, or would not reasonably be expected to know, whether a suitability determination was required to be made in connection with a mutual fund purchase, we added a knowledge qualifier to clarify that subsection 3.2(4) applies only if the fund organization knows, or ought reasonably to know, that the participating dealer was not required to make a suitability determination.

We added corresponding guidance in section 5.4 of 81-105CP, as discussed in (e) below.

(d) Exemptions from the Fund Facts and ETF Facts Delivery Requirements in section 3.2.04.1 of NI 81-101 and section 3C.2.1 of NI 41-101, respectively

We added section 3.2.04.1 to NI 81-101 and section 3C.2.1 to NI 41-101 to provide exemptions from the Fund Facts delivery requirement[8] and the ETF Facts delivery requirement,[9] respectively, for all switches from a trailing commission paying series or class of a mutual fund to a no-trailing commission series or class of the same mutual fund in client accounts administered by dealers who are not required to make a suitability determination. The exemptions can be relied upon for switches of existing mutual fund holdings, transfers and pre-authorized purchase plans.

(e) Changes to section 5.4 of 81-105CP

We revised section 5.4 of 81-105CP to reference section 2.2(3) of NI 81-105 which sets out the restriction on the payment and acceptance of trailing commissions where no suitability determination was required to be made.

Section 5.4 was also revised to remind members of the organization of a mutual fund and participating dealers of their duty under section 11.1 of NI 31-103 to establish, maintain and apply policies and procedures that establish a system of controls and supervision sufficient to provide reasonable assurance that the firm and each individual acting on its behalf complies with securities legislation, including the prohibitions in subsections 2.2(3) and 3.2(4) of NI 81-105.

We also revised section 5.4 to indicate that we expect members of the organization of a mutual fund and participating dealers to be diligent in complying with subsections 2.2(3) and 3.2(4) of NI 81-105. Participating dealers should be operating in a manner that enables members of the organization of a mutual fund to ascertain whether a suitability determination was required to be made in connection with the securities of the mutual fund held in an account of the dealers' clients and members of the organization of a mutual fund should be aware of the information that a participating dealer makes available to them regarding whether a suitability determination was required to be made.

Effective Date

With the exception of the "suitability determination" definition, the Amendments to NI 81-105 will take effect on June 1, 2022 (the **Effective Date**). Compliance with the Amendments to NI 81-105 will therefore be required approximately 20 months after the publication of this notice.

The "suitability determination" definition is cross-referenced in the Fund Facts and ETF Facts delivery exemptions set out in the NI 81-101 and NI 41-101 Amendments and will therefore come into effect on December 31, 2020 in order to match up with the effective dates of those amendments.

The CSA anticipate that the extended period between the publication of this notice and the Effective Date will provide sufficient time for participating dealer firms and representatives who currently are not required to make a suitability determination in connection with mutual fund purchases and holdings to transition their practices, operational systems and processes to comply with the Amendments to NI 81-105. For some dealer firms, this may also require a reassessment of their internal compensation arrangements and implementation of new direct-fee charging systems and processes to enable them to collect fees for their services directly from mutual fund investors as of the Effective Date.

Fund organizations who wish to offer their mutual fund securities to investors with OEO accounts after the Effective Date should make available a no-trailing commission series or class of their mutual funds to participating dealers. The extended period should also provide fund organizations with sufficient time to amend their prospectuses, Fund Facts and ETF Facts, if necessary.

Transition

As of the Effective Date, mutual funds securities that are subject to a trailing commission will no longer be permitted to be held in the account of a client for whom a dealer was not required to make a suitability determination. This will have the following transitional impacts:

[8] Section 3.2.01 of NI 81-101.
[9] Section 3C.2 of NI 41-101.

(a) Existing holdings of trailing commission paying mutual funds securities, except those purchased under the DSC option

As of the Effective Date, mutual fund securities not purchased under the DSC option and subject to a trailing commission must be switched to a no-trailing commission series or class of the same mutual fund if the dealer who administers the client account was not required to make a suitability determination. However, if a no-trailing commission series or class of the same mutual fund does not exist, those holdings may be subject to other alternatives, such as being transferred to a dealer who is required to make a suitability determination.

(b) Mutual fund securities purchased under the DSC option

As of the Effective Date, dealers who are not required to make a suitability determination will no longer be allowed to accept trailing commissions in respect of mutual fund securities purchased under the DSC option (**DSC holdings**).[10]

For current DSC holdings in accounts administered by dealers who were not required to make a suitability determination, we expect fund organizations and dealers to comply with the Amendments using a range of options available that will ensure the best outcome for investors with DSC holdings. Specifically, our expectation is that fund organizations and dealers will take any necessary measures to ensure that investors with DSC holdings will not be required to pay redemption fees as a result of the implementation of the Amendments by a fund organization or a dealer.

One option would be to allow investors to continue holding their DSC holdings after the Effective Date. In respect of these DSC holdings, fund organizations would suspend the payment of trailing commissions to dealers and dealers would not solicit or accept the payment of trailing commissions in respect of such holdings in compliance with the Amendments.

Another option would be for fund organizations to waive the redemption fees payable by investors for switches or redemptions of their DSC holdings, if applicable, in situations where such fee is triggered as a result of an action taken to comply with the Amendments.

We expect fund organizations and dealers to clearly communicate their implementation plans and expected outcomes to investors with DSC holdings in accounts administered by dealers who are not required to make a suitability determination. We also expect fund organizations and dealers to collaborate and facilitate client communications, as necessary.

For investors who would prefer to transfer their DSC holdings to a dealer who is required to make a suitability determination, we expect that dealers will help facilitate such transfers.

We also remind dealers of their obligation to deal fairly, honestly, and in good faith with their clients, in accordance with applicable securities legislation.

(c) Pre-authorized purchase plans

Prior to the Effective Date, fund organizations and dealers should give consideration of how to deal with pre-authorized purchase plans that provide for the periodic purchase of mutual fund securities that are subject to a trailing commission. In order to comply with the Amendments, these plans will need to be amended to switch over to the purchase of a no-trailing commission series or class of the same mutual fund if the dealer was not required to make a suitability determination. Alternatively, if a no-trailing commission series or class of the same mutual fund does not exist, the pre-authorized purchase plan would need to be terminated or potentially amended in consultation with the client to allow for periodic purchases of another mutual fund that is available on a no-trailing commission basis.

(d) Transfers from full-service accounts to OEO accounts

Similar to existing holdings of trailer commission paying mutual fund securities, as of the Effective Date, when investors transfer their accounts from a full-service dealer to an OEO dealer, any mutual funds that are subject to a trailing commission must be switched to a no-trailing commission series or class of the same mutual fund at or before the time of transfer.

We expect that OEO dealers will inform investors at, or before, the time of a proposed transfer of accounts that they are unable to accept transfers of trailing commission paying mutual fund securities, including DSC holdings, into OEO accounts.

[10] See footnote 7. Following the effective date of the DSC Ban on June 1, 2022, dealers will not be allowed to sell mutual funds with the DSC option. However, the redemption fee schedules on existing DSC holdings will be allowed to run their course.

Given that DSC holdings pay trailing commissions and trigger a redemption fee upon early redemption, DSC holdings should not be transferred to OEO dealers after the Effective Date.

(e) Exemptions from the Fund Facts Delivery Requirement and ETF Facts Delivery Requirement

The Amendments to NI 81-101 and NI 41-101 provide exemptions from the Fund Facts delivery requirement and the ETF Facts delivery requirement, respectively, for all switches from a trailing commission series or class of a mutual fund to a no-trailing commission series or class of the same mutual fund for existing holdings, transfers and pre-authorized purchase plans.

The exemptions from the Fund Facts and ETF Facts delivery requirements have an effective date of December 31, 2020, which is 17 months prior to the Effective Date. This 17-month period provides considerable time for fund organizations and dealers to facilitate switches of trailing commission paying mutual fund securities to no-trailing commission series or class of the same mutual fund held in client accounts administered by dealers who are not required to make a suitability determination, on or before the Effective Date.

Contents of Annexes

The text of the Amendments is contained in the following annexes to this notice and is available on the websites of members of the CSA:

Annex A: Summary of Comments on the Proposed Amendments and Responses

Annex B: Amendments to National Instrument 81-105 *Mutual Fund Sales Practices*

Annex C: Changes to Companion Policy 81-105CP *Mutual Fund Sales Practices*

Annex D: Amendments to National Instrument 41-101 *General Prospectus Requirements*

Annex E: Amendments to National Instrument 81-101 *Mutual Fund Prospectus Disclosure*

Questions

Please refer your questions to any of the following:

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ANNEX A
SUMMARY OF COMMENTS ON THE PROPOSED AMENDMENTS AND RESPONSES

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Part 2	**General Comments**
Part 3	**Comments on Amendments of Section 3.2 of NI 81-105**
Part 4	**Comments on Transition Period**
Part 5	**List of Commenters**

Part 1 – Background

Summary of Comments

On September 13, 2018, the Canadian Securities Administrators (the **CSA**) published for comment (the **2018 Consultation**) proposed amendments to National Instrument 81-105 *Mutual Fund Sales Practices* (**NI 81-105**) and Companion Policy 81-105CP to National Instrument 81-105 *Mutual Fund Sales Practices* (**81-105CP**) and proposed consequential amendments to National Instrument 81-*101 Mutual Fund Prospectus Disclosure* (**NI 81-101**), including Form 81-101F1 *Contents of Simplified Prospectus* (**Form 81-101F1**) and Form 81-101F3 *Contents of Fund Facts Document* (**Form 81-101F3**), and National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* (**NI 31-103**), (collectively, the **Proposed Amendments**). The purpose of the Proposed Amendments is to implement the CSA's policy response to the investor protection and market efficiency issues arising from the prevailing practice of investment fund managers remunerating dealers and their representatives for mutual fund sales through commissions, including sales and trailing commissions (embedded commissions). The Proposed Amendments:

- prohibit investment fund managers from paying upfront commissions to dealers, which results in the discontinuation of the DSC option (the **DSC ban**), and
- prohibit the payment of trailing commissions to dealers who are not subject to a suitability requirement, such as dealers who do not provide investment recommendations, in connection with the distribution of prospectus qualified mutual fund securities (the **OEO trailing commission ban**).

On December 19, 2019, the CSA published CSA Staff Notice 81-332 *Next Steps on Proposals to Prohibit Certain Investment Fund Embedded Commissions* (**CSN 81-332**) to provide an update on next steps on the 2018 Consultation. In that publication, the Ontario Securities Commission (**OSC**) stated that, while it will participate in the OEO trailing commission ban, it will not be implementing the DSC ban. Also, on December 19, 2019, the OSC published OSC Staff Notice 81-730 *Consideration of Alternative Approaches to Address Concerns Related to Deferred Sales Charges* indicating that the OSC is considering restrictions on the use of the DSC option to mitigate negative investor outcomes (**DSC restrictions**).

We received 55 comment letters and the commenters are listed in Part 5. We thank everyone who took the time to prepare and submit comment letters. This document contains a summary of the comments we received relating to the Proposed Amendments for an OEO trailing commission ban and our responses to those comments. We have considered the comments received and in response to the comments, we have made some amendments (the **Amendments**) to the Proposed Amendments.

With respect to the Proposed Amendments for a DSC ban, a summary of the comments we received and the responses to those comments were provided in the February 20, 2020 publication, *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 81-101Mutual Fund Prospectus Disclosure relating to Prohibition of Deferred Sales Charges for Investment Funds.*

Part 2 – General Comments		
Issue	**Comments**	**Responses**
OEO trailing commission ban	**Investors and Investor Advocates** The majority of investors and investor advocates support the immediate implementation of the OEO trailing commission ban. Key comments provided are: • ***Mutual fund investors on OEO platforms are being overcharged:*** Investors/investor advocates submit that DIY mutual fund investors are being overcharged for the limited services provided in the OEO channel and that these costs, compounded over time, erode client returns, and accordingly impair investor outcomes. They submit that trailing commissions to OEO dealers should be eliminated immediately with full redress to clients; • ***Only "F" mutual fund series should be offered in the OEO channel:*** Investors/investor advocates submit that all OEO dealers offering a particular mutual fund should be required to offer the "F" series (no trailing commission) version of the fund on their platform and adopt a transaction-based fee model on mutual fund trades. They question the reasonableness of any embedded commissions, even if reduced (such as Series D) and request that the CSA critically assess whether the investor actually receives any services to justify the ongoing trailing commission; • ***No rule changes may be required – CSA should use existing tools:*** Some investors and investor advocates submit that the collection of trailing commissions by OEO dealers for advice they do not provide should be considered a breach of a dealer's requirement to deal fairly, honestly and in good faith with clients. There is clear overcharging, misrepresentation and conflict of interest. The CSA should act to protect investors without time-consuming consultation and simply take enforcement action to stop the overcharging of fees by OEO dealers. **Industry Stakeholders** While many industry stakeholders agree that full trailing commission-paying mutual fund series, such as Series A, should be limited to	We appreciate the support from the commenters. The Amendments prohibit the payment by fund organizations (as defined below) from paying trailing commissions where the participating dealer is not required to make a suitability determination in connection with a client's purchase and ongoing ownership of prospectus qualified mutual fund securities. The Amendments also prohibit the solicitation or acceptance of trailing commissions by participating dealers from a member of the organization of the mutual fund, in connection with securities of the mutual fund held in an account of a client of the participating dealer if the participating dealer is not required to make a suitability determination in respect of the client in connection with those securities. This will effectively prohibit the payment of mutual fund trailing commissions to dealers who are not subject to the obligation to make a suitability determination under section 13.3 of National Instrument 31-103 Registration Requirements, Exemptions and Ongoing Registrant Obligations or under the corresponding by-laws, rules, regulations or policies of the self-regulatory organizations (**SROs**). Such dealers would include, among others, order-execution only (**OEO**) dealers and dealers acting on behalf of a "permitted client" that has waived the suitability requirements. We continue to be of the view that dealers must provide investors with advice arising from the suitability

Part 2 – General Comments		
Issue	**Comments**	**Responses**
	channels that permit advice, they oppose the complete ban of trailing commissions in the OEO channel for the following reasons: • ***Discounted embedded commissions are appropriate in the OEO channel:*** Several industry stakeholders submit that appropriately priced trailing commissions tailored to the direct investing channel are an efficient mode of dealer compensation that may be beneficial to mutual fund clients of OEO dealers. Lower-cost mutual fund series, such as Series D, allow an OEO dealer to properly align the related costs of offering mutual funds on its platform with the services that are provided to investors by providing a lower, channel-appropriate pricing structure. They submit that Series D should be preserved, and its availability increased to help mitigate the unintended consequences to investors, as discussed further below; • ***Other proposed regulatory changes may address conflicts in the OEO channel:*** Some industry stakeholders submit that the enhanced conflict of interest mitigation requirements proposed under the Client Focused Reforms will, if implemented, apply to OEO and other suitability exempt dealers, and that this should be sufficient to address the CSA's conflict of interest concerns regarding the payment of trailing commissions to these dealers; • ***OEO trailing commission ban would give rise to inconsistent policy approach to the regulation of embedded commissions:*** Some industry stakeholders submit that since the CSA has not proposed to prohibit the payment of trailing commissions on mutual funds generally within the securities industry, to do so on the OEO platform alone would represent an inconsistent approach to the application of the CSA's rules in this regard. They also submit that OEO dealers, notwithstanding the fact they don't make a suitability determination, are providing their clients a range of ongoing services (e.g. call centers, technological platforms, disclosure documents);	requirements in order to qualify for the receipt of trailing commission payments. Dealers who are not required to make suitability determinations should charge investors directly for the services they provide.

Part 2 – General Comments		
Issue	**Comments**	**Responses**
	• ***OEO trailing commission ban would give rise to unintended consequences:*** o ***Increased costs for smaller investors:*** Several integrated firms (i.e. banks) submit that OEO dealers will incur significant upfront and ongoing costs to develop and operationalize direct fee compensation models for mutual fund trades, which may be passed on to the client through fees that are charged. Furthermore, these direct fee arrangements may be cost-prohibitive for small accounts because, to the extent a transaction-based compensation model is implemented, these transaction fees would have to be higher than the standard trading fee applied to other types of securities (i.e. equities, ETFs) to account for the lower trading volume and smaller trades in mutual fund securities relative to other types of securities. These transaction costs would reduce the purchasing power of mutual fund investors in the OEO channel and disproportionately affect investors with smaller portfolios; o ***Reduced investor choice/product range:*** Several integrated firms submit that the increased costs of operation associated with direct-fee arrangements may lead OEO dealers to reconsider the suite of mutual fund products that are available on their platform (e.g. limit shelf to proprietary mutual funds) or even remove mutual funds altogether from their product shelf. This may result in a more limited range of products offered by OEO dealers; o ***Complexity in paying for services through direct fees:*** Several integrated firms submit that collecting fees at the time a transaction is processed is problematic for smaller accounts and/or accounts that do not hold cash. They advise that many clients who hold mutual funds on the OEO platform do not carry a cash balance sufficient to cover an	

Part 2 – General Comments		
Issue	**Comments**	**Responses**
	annual fee or transaction fees. The result may be that redemptions will be required in order to cover fees, which would result in a negative client experience and likely attract tax consequences in the case of registered accounts. Or clients may need to leave a certain amount of cash in their account, which would create a cash drag. This would eliminate the more frictionless experience that mutual fund investors on the OEO channel are accustomed to under the current embedded commission model; • ***Investment fund managers should not be required to police OEO dealers' compliance with the OEO trailing commission ban:*** Several investment fund managers and other industry stakeholders submit that the proposed prohibition on investment fund managers paying trailing commissions to dealers who do not provide suitability assessments is incapable of being reasonably implemented because investment fund managers are unable to determine whether advice is attached to an order. Accordingly, if the ban is implemented, investment fund managers should not be required to police which series dealers are making available to clients. Instead, responsibility for compliance with the OEO trailing commission ban should be squarely on the OEO dealer.	

Part 3 – Comments on Amendments of Section 3.2 of NI 81-105		
Issue	**Comments**	**Responses**
5. We expect that fund organizations will make available a trailing commission-free class or series of securities of a mutual fund to participating dealers who do not make suitability determinations. Would fund organizations have any issues with making available a class or series of securities of a mutual fund without trailing commissions to such dealers?	***Trailing Commission-Free Class or Series of Mutual Fund Securities*** A few commenters expressed that many (if not all) investment fund managers offer Series F, which contains no embedded compensation. It is not clear why the creation of additional funds is required. Discount brokerage firms have the sole discretion to offer Series F to their clients. Another industry commenter wrote that offering "D" Series with trailing commissions is a practical solution for distributing mutual funds through	It is up to fund organizations to make available a trailing commission-free class or series of securities of a mutual fund to participating dealers who do not make suitability determinations. Fund organizations are not required to do so under the Amendments.

Part 3 – Comments on Amendments of Section 3.2 of NI 81-105		
Issue	**Comments**	**Responses**
	discount brokers and should be maintained. In many cases, "D" Series would be more economical for the client than "F" Series with separate brokerage commissions. One commenter who was in support of the amendment suggested that all firms offering a particular mutual fund should be required to offer the "F" class version of the fund at discount brokerages rather than urged to offer trailing commission free versions. If a "F" class exists, it should be required to be offered through the OEO firm for those investors who want to invest without advice. One commenter expressed that it would not be difficult to make a trailing commission free class or series available, however, in some instances revisions to prospectus disclosure would be necessary and could, subject to the specific facts, be completed at the next prospectus renewal. ***Rebating*** Another commenter suggested that where no trailing commission-free version is available, OEO dealers should be permitted to sell the fund class that includes trailing commissions, subject to the following conditions: (a) The dealer must rebate to their client all trailing commissions paid to the dealer in respect of the client's fund units (less a small, reasonable fee to cover the cost of administering the rebate program); and (b) When a trailing commission-free version of the fund becomes available, the dealer must arrange for conversion of their client's unit holdings to the trailing commission-free version at no cost to the client.	The Amendments do not permit OEO dealers to rebate trailing commissions to their clients.
6. Would fund organizations encounter any issues, including any operational challenges, in confirming whether a participating dealer has made a suitability determination, and is thus eligible to be paid a trailing	Several industry commenters pointed out that investment fund managers currently have no way of tracking whether trades are being placed by dealers that do not make a suitability determination. Since suitability determination is a dealer obligation,	For circumstances where a fund organization does not know, or would not reasonably be expected to know, whether a suitability determination has been made in connection with a mutual fund purchase, the Amendments include a knowledge

Part 3 – Comments on Amendments of Section 3.2 of NI 81-105		
Issue	**Comments**	**Responses**
commission in compliance with subsection 3.2(4) of NI 81-105? If so, please explain.	investment fund managers should not be obligated to police which series dealers are making available to their clients. The CSA should make it clear in the Proposed Amendments that investment fund managers do not have an obligation to confirm whether a participating dealer or principal distributor has made a suitability determination and thus, is or is not eligible to be paid a trailing commission. One industry commenter indicated that investment fund managers cannot determine if the prohibition applies when they receive a purchase order as some participating dealers use a separate code for an OEO dealer whereas others use a single dealer code for multiple affiliated dealers. This results in aggregating mutual fund orders for full service dealers with orders for OEO dealers. Another industry commenter wrote that the assignment of dealer codes for discount brokerage accounts is inconsistent, and therefore system edits would only be effective in certain cases and would be difficult to maintain. Two industry commenters noted that there is no way for the fund company on its own to know, absent disclosure from the dealer or the client, that the client is a permitted client and that suitability has been waived. Clients who have waived suitability may be further complicated where the client relationship is with a registrant such as a portfolio manager, who executes transactions through a participating dealer. Placing a prohibition on investment fund managers would introduce an unnecessary regulatory burden on investment fund managers. Another commenter noted that as OEO firms are not permitted to provide suitability recommendations, there should be no need to confirm to the members of the organization of the mutual fund as to whether it has made a suitability recommendation.	qualifier to clarify that subsection 3.2(4) applies only if the fund organization knows or ought reasonably to know that the participating dealer is not required to make a suitability determination.

Part 4 – Comments on Transition Period			
Issue	**Sub-Issue**	**Comments**	**Responses**
7. A transition period of 1 year from the date of publication of the final amendments is sufficient time for registrants to operationalize the Proposed Amendments. **Are there any transitional issues for fund organizations and participating dealers with implementing the Proposed Amendments within the proposed 1-year transition period?** **If so, please provide details of the relevant operational, technological, systems, compensation arrangements or other significant business changes required, and the minimum amount of time reasonably required to operationalize those changes and comply with the Proposed Amendments.**		Several industry stakeholders submit that the design and implementation of the systems necessary to charge direct fees to mutual fund clients on OEO platforms and implement associated compliance procedures will be a multi-year process that would extend beyond the proposed 1-year transition period. Some stakeholders suggest a 2-year transition period if lower-cost series (i.e. Series D) are preserved in the OEO channel, but a longer 3-year transition period if OEO firms are expected to build a direct-fee system.	The effective date of the Amendments is June 1, 2022. This date coincides with the effective date of the DSC ban[1] in all CSA jurisdictions, except for Ontario, and the proposed effective date of the DSC restrictions in Ontario.[2]
9. By the effective date of the Proposed Amendments, the CSA expect that those dealers who do not make suitability determinations in respect of a client will have switched any existing mutual fund holdings of such client to a trailing commission-free class or series of the relevant mutual fund.	**(a) Switching a client from a class or series of securities of a mutual fund that pays a trailing commission to one that does not pay a trailing commission would trigger the delivery requirement for the fund facts document. As a transitional measure, should there be an exemption from the fund facts document delivery requirement for such switches? Such an**	Many stakeholders submit that if the proposal is implemented, the regulators should provide blanket exemptive relief to OEO dealers to facilitate switches of mutual fund client holdings from a trailing commission-paying series to a no-trailing commission series without having to comply with fund facts document (the Fund Facts) delivery requirements and trade confirmation requirements. Such exemptive relief should cover switches from series that	The Amendments provide an exemption from the Fund Facts and ETF Facts delivery requirements for switches of a trailing commission series or class of mutual fund securities, or ETF securities, respectively, to a no-trailing commission paying series or class of mutual fund securities. These exemptions have an effective date of December 31, 2020, which is 17 months prior to the effective date of the Amendments. This 17-month period provides considerable

[1] 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 was published on February 20, 2020 by the CSA, except the Ontario Securities Commission.

[2] 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 was published on February 20, 2020 by the Ontario Securities Commission.

Part 4 – Comments on Transition Period			
Issue	**Sub-Issue**	**Comments**	**Responses**
	exemption would mean that the investor would not have the right of withdrawal from the purchase, however, the investor would continue to have a right of action for rescission or for damages if there is a misrepresentation in the prospectus of the mutual fund, including any documents incorporated by reference into the prospectus, such as the fund facts document. In some jurisdictions, investors have a right of rescission with delivery of the trade confirmation for the purchase of mutual fund securities and this right would remain unchanged with such an exemption.	include trailing commissions to series that do not include trailing commissions before the effective date of the Proposed Amendments, as well as switches of series thereafter for clients that transfer their assets from a full-service dealer to an OEO dealer.	time for fund organizations and dealers to facilitate switches of trailing commission paying mutual fund securities to no-trailing commission series or class of the same mutual fund held in client accounts administered by dealers who are not required to make suitability determinations, on or before the effective date of the Amendments. OEO dealers must comply with the trade confirmation delivery requirements or exemptions in accordance with the Investment Industry Regulation Organization of Canada (**IIROC**) rules.
	(b) Are there any other types of exemptions from CSA or SRO rules that we should consider to facilitate switches to trailing commission-free classes or series of mutual funds? If so, please describe.	Some commenters suggested that there should be an exemption to authorize OEO dealers to be able to effect this switch, given that they do not have discretionary authority over their clients' accounts. However, the ability to effect a switch between series is not a "one time" issue since clients may choose to transfer from the "advice" channel to an OEO dealer at any time.	OEO dealers should refer to IIROC rules with respect to client consent matters relating to switches from a trailing commission series or class of mutual fund securities to a no-trailing commission series or class of mutual fund securities.

Part 5 – List of Commenters

Commenters

- Advocis, The Financial Advisors Association of Canada
- AGF Investments Inc.
- Alternative Management Association
- Blanes, Alan
- Boom, Mary
- Borden Ladner Gervais LLP
- CARP
- Clark, Keir
- Durnin, James S.
- Dusmet, Tom
- Elford, Larry
- Elliot, Ruth
- FAIR Canada
- Federation of Mutual Fund Dealers
- Fidelity Investment Canada
- Fieldstone, David
- Financial Planning Standards Council
- Finandicap Inc.
- Franklin Templeton Investments Corp.
- Glick, Isaac
- Gosselin, Eric F.
- Group Cloutier Investissements
- HighView Asset Management Ltd.
- Independent Financial Brokers of Canada
- Invesco Canada Ltd.
- Investment Industry Association of Canada
- Jagdeo, Millie
- Kenmar Associates
- Kivenko, Ken
- L'Association Professionnelle des Conseillers en Services Financiers
- Le Group financier PEAK
- Loeppky, Bruce
- MacDonald, James Richard
- Mackenzie Financial Corporation
- McFadden, D.
- Merici Services Financiers Inc.
- MICA Capital Inc.
- Mouvement Desjardins
- Naglie, Harvey
- National Bank of Canada
- OSC Investor Advisory Panel
- Portelance, Eric
- Portfolio Strategies Corporation
- Pozgaj, Steve
- Primerica Financial Services (Canada) Ltd.
- RBC Entities
- Rosen, Yegal
- Ross, Art
- Stenzler, Gary
- TD Wealth
- The Canadian Advocacy Council for Canadian CFA Institute Societies
- The Investment Fund Institute of Canada
- The Portfolio Management Association of Canada
- The Small Investor Protection Association
- Whitehouse, Peter

ANNEX B

AMENDMENTS TO
NATIONAL INSTRUMENT 81-105 *MUTUAL FUND SALES PRACTICES*

1. National Instrument 81-105 Mutual Fund Sales Practices is amended by this Instrument.

2. Section 1.1 is amended by adding the following definition:

"**suitability determination**" means a determination or other assessment required to be made under any of the following:

(a) section 13.3 of National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations*;

(b) the rules of the Investment Industry Regulatory Organization of Canada named in Appendix G of National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* that are in effect, as amended from time to time, and that correspond to section 13.3 of National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations*;

(c) a rule or policy of the Mutual Fund Dealers Association of Canada named in Appendix H of National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* that are in effect, as amended from time to time, and that correspond to section 13.3 of National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations*.**.**

3. Section 2.2 is amended by adding the following subsection:

(3) Despite subsection (2), a participating dealer may not solicit or accept a payment of a trailing commission from a member of the organization of the mutual fund, in connection with securities of the mutual fund held in an account of a client of the participating dealer, if the participating dealer was not required to make a suitability determination in respect of the client in connection with those securities.**.**

4. Section 3.2 is amended

(a) in subsection (1) by deleting "in money that is based upon the aggregate value of securities of the mutual fund held in accounts of clients of the participating dealer as at a particular time or during a particular period,***",***

(b) in paragraph 3.2(1)(a) by replacing "the trade***" with "***a trade in securities of the mutual fund by a client of the participating dealer***",***

(c) by adding the following paragraph to subsection (1):

(a.1) the amount of the trailing commission is based on the value of securities of the mutual fund held in an account of the client as at a particular time or during a particular period;***, and***

(d) by adding the following subsection:

(4) Despite subsection (1), no member of the organization of a mutual fund may pay a trailing commission to a participating dealer in connection with securities of the mutual fund held in an account of a client of the participating dealer if the member knows or ought reasonably to know that the participating dealer was not required to make a suitability determination in respect of the client in connection with those securities.**.**

Effective dates

5. (1) The provisions of this Instrument listed in column 1 of the following table come into force on the date set out in column 2 of the table:

Column 1 Provision of this Instrument	Column 2 Date
1, 2	December 31, 2020
3, 4	June 1, 2022

(2) In Saskatchewan, despite subsection (1), if these regulations are filed with the Registrar of Regulations after the effective dates indicated in column 2, these regulations come into force on the day on which they are filed with the Registrar of Regulations.

ANNEX C

CHANGES TO
COMPANION POLICY 81-105CP *MUTUAL FUND SALES PRACTICES*

1. Companion Policy 81-105CP Mutual Fund Sales Practices is changed by this Document.

2. Part 5 of the Companion Policy is changed by adding the following section:

5.4 Restriction on payment and acceptance of trailing commissions where no suitability determination made – Subsection 3.2(4) of the Instrument prohibits members of the organization of a mutual fund from paying trailing commissions to participating dealers who were not required to make a suitability determination for a client in connection with securities of the mutual fund held in an account of the client. Correspondingly, subsection 2.2(3) of the Instrument prohibits participating dealers from soliciting or accepting payment of trailing commissions from a member of the organization of the mutual fund when they were not required to make a suitability determination for a client in connection with securities of a mutual fund held in an account of the client. Consequently, participating dealers who are not subject to the obligation to make a suitability determination under National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* or corresponding SRO rules may not solicit or accept such payments. In addition, members of the organization of a mutual fund should make available to participating dealers who are not required to make a suitability determination in respect of a client, a class or series of securities of a mutual fund that does not pay trailing commissions, which the dealer should offer to the client.

We remind members of the organization of a mutual fund and participating dealers of their duty under section 11.1 of National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* to establish, maintain and apply policies and procedures that establish a system of controls and supervision sufficient to provide reasonable assurance that the firm and each individual acting on its behalf complies with securities legislation, including the prohibitions in subsections 2.2(3) and 3.2(4).

We expect members of the organization of a mutual fund and participating dealers to be diligent in complying with subsections 2.2(3) and 3.2(4). Participating dealers should be operating in a manner that enables members of the organization of a mutual fund to ascertain whether a suitability determination was required to be made in connection with the securities of the mutual fund held in an account of the dealers' clients and members of the organization of a mutual fund should be aware of the information that a participating dealer makes available to them regarding whether a suitability determination was required to be made..

3. These changes come into effect on June 1, 2022.

ANNEX D

AMENDMENTS TO
NATIONAL INSTRUMENT 41-101 *GENERAL PROSPECTUS REQUIREMENTS*

1. National Instrument 41-101 General Prospectus Requirements is amended by this Instrument.

2. Part 3C is amended by adding the following section:

3C.2.1 Delivery of ETF facts documents for no-trailing-commission ETF switches

(1) In this section,

"no-trailing-commission ETF switch" means, in respect of a client of a participating dealer, a purchase of securities of a class or series of an ETF in respect of which an investment fund manager does not pay the participating dealer a trailing commission immediately following a redemption of securities of another class or series of the ETF in respect of which the investment fund manager pays the participating dealer a trailing commission, if all of the following apply:

(a) the aggregate value of the securities purchased is the same as the aggregate value of the securities redeemed;

(b) there are no material differences between the class or series of securities purchased and the class or series of securities redeemed other than the rate of management fees charged in respect of the two classes or series;

(c) the participating dealer, who executed the purchase and redemption of the securities, was not required by securities legislation or the rules of an SRO applicable to the dealer to make a suitability determination in respect of the client in connection with those securities;

"suitability determination" has the same meaning as in section 1.1 of National Instrument 81-105 *Mutual Fund Sales Practices*.

(2) Despite subsection 3C.2(2), a dealer is not required to deliver or send to the purchaser of a security of an ETF the most recently filed ETF facts document for the applicable class or series of securities of the ETF in connection with a no-trailing-commission ETF switch..

Effective date

3. (1) This Instrument comes into force on December 31, 2020.

(2) In Saskatchewan, despite subsection (1), if these regulations are filed with the Registrar of Regulations after December 31, 2020, these regulations come into force on the day on which they are filed with the Registrar of Regulations.

ANNEX E

AMENDMENTS TO
NATIONAL INSTRUMENT 81-101 *MUTUAL FUND PROSPECTUS DISCLOSURE*

1. National Instrument 81-101 Mutual Fund Prospectus Disclosure is amended by this Instrument.

2. Section 3.2.01 is amended

(a) by deleting "or***" in subparagraph (4)(a)(ii),***

(b) by replacing "." with ", or***" in paragraph (4)(b), and***

(c) by adding the following after paragraph (4)(b):

(c) section 3.2.04.1 applies.*.*

3. The following section is added:

3.2.04.1 Delivery of Fund Facts Documents for No-Trailing-Commission Switches

(1) In this section,

"no-trailing-commission switch" means, in respect of a client of a participating dealer, a purchase of securities of a class or series of a mutual fund in respect of which an investment fund manager does not pay the participating dealer a trailing commission immediately following a redemption of securities of another class or series of the mutual fund in respect of which the investment fund manager pays the participating dealer a trailing commission, if all of the following apply:

(a) the aggregate value of the securities purchased is the same as the aggregate value of the securities redeemed;

(b) there are no material differences between the class or series of securities purchased and the class or series of securities redeemed other than the rate of management fees charged in respect of the two classes or series;

(c) the participating dealer, who executed the purchase and redemption of the securities, was not required by securities legislation or the rules of an SRO applicable to the dealer to make a suitability determination in respect of the client in connection with those securities;

"suitability determination" has the same meaning as in section 1.1 of National Instrument 81-105 *Mutual Fund Sales Practices*.

(2) Despite subsection 3.2.01(1), a dealer is not required to deliver to the purchaser of a security of a mutual fund the most recently filed fund facts document for the applicable class or series of securities of the mutual fund in connection with a no-trailing-commission switch.*.*

Effective date

4. (1) This Instrument comes into force on December 31, 2020.

(2) In Saskatchewan, despite subsection (1), if these regulations are filed with the Registrar of Regulations after December 31, 2020, these regulations come into force on the day on which they are filed with the Registrar of Regulations.

Chapter 1

Notices

1.1 Notice

1.1.1 Notice of Correction – CSA Notice of Amendments to National Instrument 81-105 Mutual Fund Sales Practices and Related Consequential Amendments Prohibition of Mutual Fund Trailing Commissions Where No Suitability Determination Was Required – Annex F

The following Annex F was omitted from the original publication of *CSA Notice of Amendments to National Instrument 81-105 Mutual Fund Sales Practices and Related Consequential Amendments Prohibition of Mutual Fund Trailing Commissions Where No Suitability Determination Was Required*, published at (2020) 43 OSCB 7299, September 17, 2020.

ANNEX F

LOCAL MATTERS

In Ontario, the Amendments, as well as other required materials, will be delivered to the Minister of Finance on or about October 8, 2020. The Minister may approve or reject these Amendments or return them for further consideration. If the Minister approves the Amendments or does not take any further action, the Amendments to 81-101 *Mutual Fund Prospectus Disclosure* and National Instrument 41-101 *General Prospectus Requirements* will come into force on December 31, 2020, and the Amendments to National Instrument 81-105 *Mutual Fund Sales Practices* will come into force on June 1, 2022, with the exception of the "suitability determination" definition in section 1.1 of National Instrument 81-105 *Mutual Fund Sales Practices*, which will come into force on December 31, 2020.