Chapter 1

Notices

1.1 Notices

1.1.1 Ontario Securities Commission Staff Notice 81-731 – Next Steps on Deferred Sales Charges

ONTARIO SECURITIES COMMISSION STAFF NOTICE 81-731

NEXT STEPS ON DEFERRED SALES CHARGES

May 7, 2021

Introduction

On February 20, 2020, the Ontario Securities Commission published 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**) to introduce restrictions on the use of the deferred sales charge (**DSC**) option[1] that are designed to mitigate potential negative investor outcomes. In particular, the restrictions are intended to address the "lock-in"[2] effect associated with the DSC option and reduce the potential for mis-selling, while allowing dealers to offer the DSC option to clients with smaller accounts. The Proposed Rule was a subsequent consultation to the Proposed Amendments to Prohibit Certain Embedded Commissions (as defined below) published by the Canadian Securities Administrators (**CSA**) in 2018.

The purpose of this notice is to provide an update on next steps.

OSC staff (**we** or **staff**) have considered the comments received on the Proposed Rule, which overwhelmingly expressed support for a harmonized DSC ban. We also note that industry innovation over the past few years has opened significant new avenues for investors with smaller accounts at an affordable cost.

Next Steps

Staff will bring forward final amendments to National Instrument 81-105 *Mutual Fund Sales Practices* (**NI 81-105**) for publication in spring 2021. This will allow the OSC to join the Multilateral DSC Ban (as defined below). More specifically, the final amendments will prohibit the payment of upfront sales commissions by fund organizations to dealers, and in so doing, discontinue sales charge options that involve such payments, such as all forms of the DSC option (**DSC ban**).

Transition

We anticipate a ban on the DSC option in Ontario will have an effective date of June 1, 2022, which coincides with the effective date of the Multilateral DSC Ban. Consistent with the Multilateral DSC Ban, on the effective date, no new sales would be permitted using the DSC option in Ontario, and DSC redemption schedules for sales made prior to the effective date of the DSC ban would be allowed to run their course in Ontario.

Comments on the Proposed Rule

We received 34 comment letters on the Proposed Rule.

Approximately 70% of the commenters advocated for a complete ban of DSCs and urged the OSC to harmonize with the CSA. Commenters expressed concern that the Proposed Rule would create a two-tiered regulatory approach, which would create compliance issues, be costly and burdensome to implement and monitor, and cause market inefficiency. Commenters also expressed concern that even with restrictions under the Proposed Rule, there would still be negative investor outcomes with the DSC option.

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1 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.

2 The "lock-in" feature refers to the redemption fee schedule associated with the DSC option which has the potential to deter investors from redeeming an investment or changing their asset allocation, even in the face of consistently poor fund performance, unforeseen liquidity events, or changes in their financial circumstances.

Approximately 25% of the commenters expressed support for the Proposed Rule and provided suggestions on the proposed restrictions.

The Decline of the DSC Option and Industry Innovation

Mutual funds with the DSC option have been in net redemptions since 2016 and had a total net outflow of $3.34 billion in Canada during 2020. During the same time, there was a total net inflow of $23 billion into mutual funds with no-load options.[3]

With advances in industry innovation, Ontario investors have access to affordable investment options, including no-load funds and exchange-traded funds that are available to investors of all account sizes. Ontario investors also have access to investment products and investment advice with more affordable and more transparent compensation models.

Background

Proposed Amendments to Prohibit Certain Embedded Commissions

On September 13, 2018, the CSA published for comment proposed amendments to NI 81-105 that would prohibit:

- the payment of upfront sales commissions by fund organizations to dealers, and in so doing, discontinue sales charge options that involve such payments, such as all forms of the DSC option, and

- trailing commission payments by fund organizations to dealers who do not make a suitability determination, such as order-execution-only (**OEO**) dealers (**OEO trailer fee ban**).

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* to announce that final amendments to implement a DSC ban would be published in early 2020. The OSC stated that, while it would participate in the OEO trailer fee ban, it would not be implementing a DSC ban.

OSC Staff Notice 81-730

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* to announce that the OSC would explore alternative approaches for addressing the investor protection concerns arising from the use of the DSC option.

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

On February 20, 2020, the CSA, with the exception of Ontario, published *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* (the **2020 Multilateral CSA Notice**).[4] The amendments published in the 2020 Multilateral CSA Notice prohibit the payment by fund organizations of upfront sales commissions to dealers, which results in the discontinuation of all forms of the DSC option, including low-load options (the **Multilateral DSC Ban**). The Multilateral DSC Ban comes into force on June 1, 2022.

Questions

Please refer your questions to any of the following:

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[3] See page 65 of the Investor Economics Insight Report January 2021.
[4] https://www.bcsc.bc.ca/-/media/PWS/Resources/Securities_Law/Policies/Policy8/81105-CSA-Notice-February-20-2020pdf.