April 28, 2025

British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marches financiers
Financial and Consumer Services Commission, New Brunswick
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
Registrar of Securities, Northwest Territories
Registrar of Securities, Yukon Territory
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Re: CSA Notice and Request for Comment – Proposed Amendments and Changes – The Principal Distributor Model

On behalf of the Ontario Securities Commission's Investor Advisory Panel (the "Panel"), we wish to thank you for this opportunity to comment on the Canadian Securities Administrators' (the "CSA") Notice and Request for Comment regarding proposed amendments to the principal distributor ("PD") model in the distribution of mutual fund securities (the "Proposed Amendments").

The Panel is an initiative of the Ontario Securities Commission ("OSC") to ensure investor concerns and voices are represented in the OSC's policy development and rulemaking process. Our mandate is to solicit and articulate the views of investors on regulatory initiatives that have investor protection implications.

Comments

The Panel supports the Proposed Amendments and commends the CSA for its efforts to modernize the PD model, improve investor protection and maintain investor confidence in the capital markets. We believe that the Proposed Amendments will achieve their stated goals of reducing conflicts of interest, improving disclosure to investors, and eliminating the gap in the application of the DSC Ban Amendments.

We note that the Proposed Amendments are based on the general purpose of NI 81-105, namely to "ensure that the interest of investors remain uppermost in the actions of participants in the mutual fund industry by setting minimum standards of conduct to be followed by industry participants in their activities in distributing mutual fund securities."[1] 81-105CP identifies the fundamental obligations of industry participants to their investor clients, and these obligations were further addressed in the CFRs. In previous comments we have made to the OSC, we suggested that there is a need for ongoing and timely guidance and clarification on certain elements of the CFRs. In our view, the Proposed Amendments present an opportunity to clarify the meaning of a client's "best interests". For example, in the PD model, the limited product shelf can affect the extent to which an advisor can consider a reasonable range of alternatives when determining suitability. Our comments below are primarily focused on this issue and other suggestions that we believe would enhance the Proposed Amendments and foster investor protection, as addressed by question 3 of the Notice and Request for Comment. We also comment on the issue of chargebacks, addressed in question 5 of the Notice and Request for Comment.

CFRs

The Panel recognizes that the Proposed Amendments are limited to modernizing the PD model. However, given that the review of NI 81-105 was undertaken in light of the CFRs, and that one of the strategic goals of the 2022-2025 CSA Business Plan is to "improve investor protection by enhancing investors' ability to obtain redress and strengthening the advisor-client relationship", we note that the consequences of the CFRs are an ongoing area of interest to the Panel. In our view, both industry participants and investors would benefit from a comprehensive evaluation of the CFRs against the original objectives that led to their development. As discussed below, there is a gap between the PD model and the CFRs, which is one example of an issue that could be addressed by a comprehensive review that would include clarification of the obligation to act in the client's best interests.

Since the CFRs came into force in 2021, there have been two rounds of compliance sweeps. While we acknowledge that these reviews are valuable and can lead to additional guidance, they are focused on specific issues, and it can take time for the results to be published. It would be extremely beneficial to investors if the results of the most recent sweeps could be published soon. In the absence of timely guidance and clarification, industry participants may take inconsistent approaches to their obligations. We

[1] Companion Policy 81-105CP to National Instrument 81-105, *Mutual Fund Sales Practices* ("81-105CP"), s. 2.2(1).

also note that measuring the impact and results of initiatives like these is valuable not only for investor protection but for investors' trust in the capital markets.

Disclosure to Investors

The Proposed Amendments require disclosure on two fronts: first, that the PD has the exclusive right to distribute funds, and second, details about compensation provided to the PD for its services. In our view, disclosure of the PD model should be considered separately from disclosure about compensation.

Disclosure of the PD model

If investors are considering an investment offered by a PD, they should be able to understand the PD model and the implications of that model for the investor (*i.e.*, that the investor is only being offered a limited range of investment products, without consideration of a broader range of potential alternatives, including funds offered by other dealers). This is a critical piece of information that investors require to properly evaluate what they have been offered.

Given the importance of this information, clear disclosures about the limited product shelf offered under the PD model should be provided both at account opening and point of sale. Disclosure should be provided in plain language that is easy to understand. For example, referring to "proprietary products" may not be sufficient to make investors aware that they will not be able to purchase funds offered by a variety of firms. Disclosure should also include information about the limitations on the client's ability to transfer their holdings (*i.e.*, a client may have to sell their holdings rather than being able to transfer in kind). Relationship disclosure does include the limits on the products offered, but investors may not understand the effect of these limits, particularly given that investors are also told that an advisor must determine that the investments being recommended are suitable and that the advisor must put the client's interest first.

This highlights a gap between the PD model and the CFRs: if an advisor is required to consider a "reasonable range of alternatives", but the advisor is limited to consideration of products from only one fund family, we query whether the advisor can fulfill their obligation to consider a reasonable range of alternatives. However, addressing conflicts of interest in the best interests of the client requires, at a minimum, that the limited product shelf and corresponding limits on the ability to determine suitability must be disclosed to the investor, both at account opening and at the point of sale (*i.e.*, when choosing to work with a PD *and* when considering a transaction).

The Panel therefore suggests that the Proposed Amendments could be improved by requiring disclosure of the PD's exclusive right to distribute, not in a footnote but in clear and prominent language that will bring this fact to an investor's attention and help them understand the implications of the PD model.

Compensation disclosure

The Panel supports the enhanced compensation disclosure included in the Proposed Amendments. However, investors would benefit from full transparency regarding dealer compensation, including upfront

commissions, trailing commissions, and other fees or benefits provided to the PD from the affiliated fund company. Information about dealer compensation should be presented in a way that is clear and easy to understand, at the point of sale. We also suggest that changes to disclosure documents should be tested prior to implementation, to ensure that the disclosure has the intended effect in terms of investor understanding.

Providing limited compensation disclosure in the Fund Facts document could be confusing for the investor depending on their circumstances. It can be difficult for an investor with low knowledge of investing or compensation to connect the information in the Fund Facts to the impact on their own investments. For example, the impact of a payment to the PD could be minimal for an individual investor making a relatively small investment, due to the dollar amounts at play in that particular circumstance, but that would not necessarily be apparent to an investor simply by reading the Fund Facts. The disclosure contemplated by the Proposed Amendments might be more meaningful if it is explained by the advisor at the point of sale, as well as being included in the simplified prospectus, Fund Facts, and ARCC.

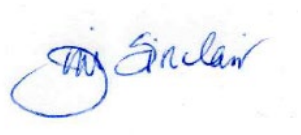
However, if the Fund Facts are revised to include additional compensation disclosure, we note that this document currently includes the MER and an illustration of nominal cost. For funds distributed using the PD model, this information could be enhanced by identifying the portion of the MER that is provided to the dealer. One approach might be to provide disclosure in a manner similar to what is expected to be provided under Total Cost Reporting, using dollar amounts to illustrate how each party (fund manager, dealer) is compensated based on a notional investment amount (*e.g.* $1000).

Chargebacks in the PD model

The Panel agrees with the CSA's view that the use of chargebacks raises a conflict of interest for PDs. This practice can lead to situations where an advisor may encourage a client to continue holding a fund that is underperforming or is otherwise no longer in the client's best interests, due to the interest the advisor may have in retaining the upfront commissions or fees they received. This is clearly contrary to the obligation to act in the client's best interests. Accordingly, we recommend that the CSA take steps to ban this compensation practice.

Again, thank you for the opportunity to comment on the Proposed Amendments. We would be pleased to clarify or elaborate on our comments should the need arise.

Sincerely,



James Sinclair
Chair, Investor Advisory Panel