Federation of Independent Dealers
Fédération des Courtiers Indépendants

VIA EMAIL ONLY

British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumer Services Commission of 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
Superintendent of Securities, Nunavut

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Re: Proposed Amendments to National Instrument 81-105 Mutual Fund Sales Practices and related Companion Policy

The Federation of Independent Dealers - Fédération des Courtiers Indépendants (FID, Federation) has been, since 1996, a dedicated voice for dealers. We currently represent firms with hundreds of billions in assets under administration and tens of thousands of licensed advisors that provide service to millions of Canadians. As such we have a keen interest in all that impacts the dealer community and its advisors.

We would like to acknowledge the importance of the CSA reviewing distribution structures used within the industry. While the goal of reducing conflicts and upholding investor protection are laudable, we have concerns with the Proposed Amendments' limitation of a dealer to only one principal distributor relationship, except where it acts as principal distributor for mutual funds in the same mutual fund family.

This limitation will reduce investor choice and in the industry. There are significant benefits to investors for a dealer acting as a PD for more than one mutual fund family, including broader choice of investments, opportunities for diversification, competition between fund managers, product customization including localization and niche market optimization. These create greater opportunities for representatives to consider alternative products in their clients' best interest.

Furthermore, the limitation on PD relationships may hinder the economics for dealers servicing markets with high costs and low revenue per account, including compliance, supervision, technology, and regulatory burdens. This limitation may reduce the likelihood that clients with small account balances receive personalized advice and increase the likelihood of account abandonment due to minimum account sizes.

We suggest that disclosure should be at the principal distributor arrangement level, similar to the current wording in the Prospectus, Fund Facts, Relationship Disclosure Document, and Conflicts of Interest Disclosures.

Questions:

Question 1: The Proposed Amendments clarify that a principal distributor cannot have multiple principal distributor relationships except where it acts as principal distributor for mutual funds in the same mutual fund family. Are there any circumstances under which a dealer should be permitted to act as a principal distributor for more than one mutual fund family? In responding, please explain the advantages and disadvantages of such a model as compared to a participating dealer model for both investors and market participants. In particular, please outline the specific benefits for investors as they pertain to competition, cost and investor choice. Please provide quantitative data, where relevant, to support your answer.

We have seen the results among the current large scale distributors of proprietary products and the outcome has been consolidation of investor assets within that single internal Principal Distributor relationship. Expanding PD to multiple third-party relationships counteracts this influence and creates a competitive consequence for utilizing a single PD relationship to distribute only in-house product. The benefits of competition between IFMs are optimized performance and potentially lower fees.

Upholding the existing robust conflict of interest management and disclosure regime will meet policy goals. We do not want to have the viable multi-principal-distributor model eliminated, disrupting the advice channel. We see no significant investor protection issue if adequate safeguards are in place (as regulation currently requires) against conflicts and the KYP product analyses are completed on a per-investor basis as is also currently required.

2. If your answer to question #1 was yes, please also comment on the following:

(i) What are the specific circumstances under which a principal distributor should be allowed to act for more than one mutual fund family?

See above.

(ii) If a principal distributor could act for more than one mutual fund family, should the compensation arrangements between the principal distributor be required to be the same or substantially similar in respect of each mutual fund family? If not, how could we ensure that any compensation arrangement differences would not influence a principal distributor to favour the mutual fund family with the most favourable compensation structure?

No, the compensation arrangements between the principal distributor and each mutual fund family should not be required to be the same or substantially similar. This is because different fund managers may have different business models, investment strategies, and fee structures, which may warrant different compensation arrangements. However, any compensation arrangement differences should not influence a principal distributor to favour one mutual fund family over another. Controls should be implemented to ensure that compensation arrangements are fair, reasonable, substantially similar between advisors for each fund family, and via the know your product process, transparent to investors.[1]

(iii) What factors and considerations would be relevant to determining the appropriate number of mutual fund families for which a dealer should act as principal distributor? Explain how the distinction between principal distributors and participating dealers does not become blurred as the number of mutual fund families distributed by the same principal distributor increase.

The nature of the PD relationships and the current marketplace realities indicate that it is very difficult to establish multiple PD relationships, and a limitation here isn't necessary. There are significant cost, oversight, and ongoing maintenance obligations attached to each relationship, and IFMs are not incented by competitive realities to establish multiples of these relationships across the marketplace. Indeed, the current maximum of these relationships held by a single dealership that we are aware of is two. Limiting the relationships to a single one establishes a protective barrier around the single PD relationship model, eliminating the ability for other firms to out-compete the model by offering investors additional choice.

(iv) Should there be minimum duties and obligations owed by the principal distributor in respect of each principal distributor relationship? Should those obligations be the same across all mutual fund families for which the dealer acts as principal distributor?

The dealer regulatory responsibilities to act fairly and in good faith towards investors do not vary with each PD relationship, and additional regulatory requirements are not needed to ensure fairness. Required

[1] Proposed Amendments to National Instrument 31-103 Registration Requirements, Exemptions and Ongoing Registrant Obligations, National Instrument 81-101 Mutual Fund Prospectus Disclosure, National Instrument 81-102 Investment Funds and National Instrument 81-105 Mutual Fund Sales Practices and Proposed Changes to Companion Policy 31-103 Registration Requirements, Exemptions and Ongoing Registrant Obligations, Companion Policy 81-102 Investment Funds and Companion Policy 81-105 Mutual Fund Sales Practices. **Page 3(b)** (https://www.asc.ca/-/media/ASC-Documents-part-1/Regulatory-Instruments/2024/11/6192081-CSA-Notice-Proposed-Amendments-NI-81-105-and-others.pdf)

oversight including disclosures, avoiding material conflicts of interest, and putting the client interest first must be maintained.

(v) Should mutual funds that have a principal distributor be exclusively distributed by the principal distributor and not be distributed by other principal distributors or participating dealers?

They might have ongoing participation in the design, selection, as well as ongoing training and monitoring in respect of the mutual fund products that it distributes. Such an arrangement would allow a principal distributor to customize the range of mutual fund products that are offered to clients. This participation in the product development process is recognized by the fact that principal distributors are required to review and certify the prospectus. As a result, they share liability with managers for the disclosure provided in mutual fund offering documents with managers.[2]

PD relationships should not be limited to a single distributor, as this inherently limits the availability to clients of that particular dealership, excluding investors working with another dealership from potentially accessing products from that manufacturer under the same structure. Even worse, this tilts the investment market further towards the largest distributors, 'Balkanizing' the marketplace. A manufacturer will not choose to work with a smaller firm if they are then prevented from working with a second, or larger firm.

Notably, the restriction on a fund family having multiple distributors will necessarily tilt investment flows into the largest, and largely non-Canadian IFMs. At this time we should be aiming to support made in Canada IFMs.

Question 3: Do the Proposed Amendments fully address potential investor protection concerns for existing principal distributor business models and any foreseeable new mutual fund distribution business models? Are there any other considerations, limits or factors about a principal distributor arrangement that we should consider?

We feel the proposed amendments fully cover the aspects of compensation that have been eliminated outside of the PD model.

Question 4: The Proposed Amendments to NI 81-105 will come into force 18 months after the final publication date. Does this provide sufficient time for dealers that act as a principal distributor for more than one unaffiliated manager to transition their practice, operational model and compensation arrangements? Does this provide sufficient time for impacted investment fund managers to make alternate distribution arrangements for their mutual fund securities prior to the effective date? If not, please explain.

[2] CSA Request for Comment Page 3(a) "This participation in the product development process is recognized by the fact that principal distributors are required to review and certify the prospectus. As a result, they share liability with managers for the disclosure provided in mutual fund offering documents with managers."

The CSA can consider grandfather provisions or exemptive relief for existing or proposed new PD arrangements. This could include implementing guidelines to ensure that compensation arrangements are not excessive.

Question 5: Some principal distributors may currently use chargebacks. Chargebacks involve a compensation practice where a representative is paid upfront commissions and/or fees from the dealer when their client purchases securities. Chargebacks occur when investors redeem their securities before a fixed schedule as determined by the dealer, and the dealing representative is required to pay back all or part of the upfront commission/fees to the dealer. In June 2023, the CSA announced that it would be reviewing the use of chargebacks in the mutual fund industry due to concerns about potential conflicts of interest associated with this practice. The CSA is of the view that the use of chargebacks raises a significant conflict of interest for principal distributors in the distribution of mutual fund securities and we are considering the appropriate regulatory steps. We are requesting additional feedback on this practice.

Chargebacks are not necessarily specific to PD relationships. There is no current ban on dealers fronting money to dealer representatives. Some insurance companies also use chargeback structures.

Question 6: Should there be minimum duties and obligations owed by the principal distributor in respect of each principal distributor relationship? Should those obligations be the same across all mutual fund families for which the dealer acts as principal distributor?

Yes, there should be (and are) minimum duties and obligations owed by the principal distributor in respect of each principal distributor relationship. These duties and obligations should include, but not be limited to, ensuring that the distribution of mutual fund securities is conducted in accordance with applicable securities laws and regulations, implementing appropriate policies and procedures to manage conflicts of interest, putting the clients interests first, and providing clear and transparent disclosure to investors. The obligations should be the same across all mutual fund families for which the dealer acts as principal distributor.[3]

Question 7: Should mutual funds that have a principal distributor be exclusively distributed by the principal distributor and not be distributed by other principal distributors or participating dealers?

No, mutual funds should not be regulated to be exclusively distributed by a single principal distributor and not distributed by other principal distributors or participating dealers. This is because it may limit competition and decrease choice for investors. Instead, measures should be implemented to ensure that all distribution channels are subject to equivalent oversight and that investors receive clear and transparent disclosure regarding any conflicts and the fees involved.

[3] CSA Request for Comment page 3(b) “One of the fundamental obligations of industry participants to their investor clients is to provide full, true and plain disclosure of all material facts concerning a mutual fund, including the compensation paid to participating dealers and their representatives and other sales practices followed in connection with the distribution of mutual fund securities.” (

Question 8: Do the Proposed Amendments fully address potential investor protection concerns for existing principal distributor business models and any foreseeable new mutual fund models? If not, what additional measures do you propose?

The amendments appear to be comprehensive. We are concerned that the proposed limitations on the number of principal distributor relationships may result in reduced competition and decreased choice for investors. We recommend that the CSA consider alternative measures to address investor protection concerns, such as measures to ensure that compensation arrangements are fair, reasonable, and transparent.

In conclusion, we encourage the CSA to seriously reconsider limiting the independent distribution channel to only use the bank model of a single distributor. These relationships could be a boon to made-in-Canada mutual fund manufacturers and investors alike, providing customized products to suit either particular niches or broad swathes of investors. We urge the CSA to continue engaging with all stakeholders to ensure that the outcome of this consultation balances the need for high standards for managing conflicts with the realities of improving the competitive aspects of the investing marketplace for Canadians. We are hopeful that the CSA will take our comments into account as it contemplates the best path for our industry.

Sincerely,

Matthew T. Latimer

Executive Director,
Federation of Independent Dealers
Fédération des Courtiers Indépendants