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CSA Notice and Request for Comment Draft Amendments to Regulation 31-103 respecting Registration Requirements, Exemptions and Ongoing Registrant Obligations Prohibition on the Use of Chargebacks in the Distribution of Investment Fund Securities

Kenmar appreciate the opportunity to comment on the proposed prohibition of chargebacks. Quite frankly, we do not see justification for this consultation since chargebacks are a patently obvious material conflict-of-interest that can cause significant investor/consumer harm.

Kenmar Associates is an Ontario-based privately-funded organization focused on investor education via articles hosted at www.canadianfundwatch.com. Kenmar also publishes the Fund OBSERVER on a monthly basis discussing consumer protection issues primarily for retail investors. Kenmar is actively engaged with regulatory affairs. An affiliate, Kenmar Portfolio Analytics, assists, on a no-charge basis, abused consumers and/or their counsel in filing investor complaints and restitution claims.

Firms that employ Chargebacks provide powerful evidence that they are in the business of sales, not personalized, trustworthy advice. This behaviour is contrary to the CFR best interest standard. In June 2023, the CSA announced it was concerned with chargeback conflicts-of-interest and was conducting a review. This consultation should finally bring an end to the use of chargebacks in the financial services industry.

Similar to the toxic DSC structure which was banned as of June 1, 2022, the chargeback model is predicated on clients maintaining their holdings for a set period of time. In this case it is the Dealing Rep that pays the early redemption

penalty if the fund is redeemed before the fixed schedule expires. A recommendation to redeem a fund can be just as important as a recommendation to purchase a fund. Any constraint that act as a barrier to a recommendation for sale represents a major flaw in the professional advice process.

The inherent conflict embedded in the structure is that Dealer representatives would be incentivized to keep their clients in their holdings until the chargeback period has expired. This interferes with a Dealer's obligations to recommend and evaluate investment recommendations influenced only by the best interests of the client (a CFR obligation). In effect, a chargeback compensation model greatly reduces the chance that an unsuitable and/or underperforming fund will be recommended for redemption/sale. Having to repay part of the commission is a material conflict- of- interest.

The behavioural dynamics of chargebacks also exacerbate the problem. The outsized upfront commission payment and the threat of having to repay it later heighten loss aversion and incentivize inertia, delaying necessary changes to clients' portfolios. In many respects, this arrangement is even more detrimental to investors than the DSC regime.

A management that introduces the chargeback compensation system for its representatives is a management that is not focused on customers or customer outcomes. It is an open defiance of the regulatory intent behind the Client Focused Reforms (CFR). On that basis alone, we would demand that the chargeback system be prohibited. As with the DSC, we fully expect seniors and retirees to be most harmed by chargebacks.

In addition, we believe it is fundamentally unfair for the Dealer to require return of commissions received by the Dealing representative if there are subsequent redemptions because the root cause of the redemptions may not have anything to do with the salesperson.

As outlined in Appendix I, there are numerous legitimate reasons why a redemption may occur, none of which should trigger a financial penalty for the representative or perpetuate unsuitable investments for the client.

It should be a no- brainer for regulators - prohibit chargebacks. Regulators focusing on advisor proficiency, ethics and client best interests should not permit these initiatives to be undermined by antiquated Dealer Rep compensation schemes.

If chargebacks are permitted in Ontario, we would not want to see the OSC, FSRA or CIRO permit registrants to use the "Financial Advisor "title. The CSA should confirm that chargebacks are compliant with provincial and Federal labour laws, standards and Codes.

We hope the information provided proves useful to CSA decision making. Please feel free to contact us if there are any questions regarding this commentary.

Ken Kivenko, President
Kenmar Associates

cc Other CSA jurisdictions, FSRA

APPENDIX I: When would a representative be required to recommend redeeming /selling an investment fund?

A fund salesperson acting in the best interests of clients should not be penalized if she/he recommends redemption for the following reasons:

- The MER is increased
- The risk rating of the fund is increased
- The fund underperforms benchmark and competition
- Better, cheaper alternatives become available
- The fund changes its strategy
- The portfolio manager is changed
- Client is unhappy with customer service/reporting
- The fund or Fund manager is under investigation by regulators
- The clients' objectives change
- Need to rebalance portfolio asset allocation
- Client KYC profile changes
- Client redeems due to unexpected personal budget expenses

These real-life scenarios are outside the salespersons control so she/he should not be penalized. The chargeback is unfair to fund salespersons as well as investors. Indeed, if the salesperson does not recommend redemption, the investment could be deemed unsuitable and the representative subjected to a complaint and disciplinary action. Firms should be held accountable for the actions of those individuals they choose to represent them.