December 7, 2018

BY EMAIL

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

The Secretary
Ontario Securities Commission
20 Queen Street West
22nd Floor, Box 55
Toronto, Ontario M5H 3S8
Email: comments@osc.gov.on.ca

Me Anne-Marie Beaudoin
Corporate Secretary
Autorité des marchés financiers
800, Square Victoria, 22e étage
C.P. 246, tour de la Bourse
Montréal (Québec) H4Z 1G3
Email: consultation-en-cours@lautorite.qc.ca

Dear Sirs/Mesdames:

Re: CSA – Proposed Amendments to NI 81-105 *Mutual Fund Sales Practices and related consequential amendments* (the "Proposed Amendments")

The Canadian Advocacy Council[1] for Canadian CFA Institute[2] Societies (the CAC) appreciates the opportunity to provide comments on the Proposed Amendments and respond to certain of the specific questions posed in the Request for Comment.

The CAC believes that simple and transparent fee structures help promote investor protection and may strengthen the relationship between the investor and the advisor. As a

[1] The CAC represents more than 15,000 Canadian members of CFA Institute and its 12 Member Societies across Canada. The CAC membership includes portfolio managers, analysts and other investment professionals in Canada who review regulatory, legislative, and standard setting developments affecting investors, investment professionals, and the capital markets in Canada. See the CAC's website at http://www.cfasociety.org/cac. Our Code of Ethics and Standards of Professional Conduct can be found at http://www.cfainstitute.org/ethics/codes/ethics/Pages/index.aspx.

[2] CFA Institute is the global association of investment professionals that sets the standard for professional excellence and credentials. The organization is a champion of ethical behavior in investment markets and a respected source of knowledge in the global financial community. Our aim is to create an environment where investors' interests come first, markets function at their best, and economies grow. There are more than 154,000 CFA charterholders worldwide in 165+ countries and regions. CFA Institute has eight offices worldwide and there are 151 local member societies. For more information, visit www.cfainstitute.org or follow us on Twitter at @CFAInstitute and on Facebook.com/CFA Institute.

general comment, we are disappointed to see the use of trailing commission payments to dealers will persist. The current proposal allows fund organizations to use trailing commission payments as an incentive to promote fund sales to investors so long as the dealer makes a suitability determination. The CAC believes trailing commissions create conflicts of interest for the dealer/advisor who may be incentivized to not always act in the best interest of their client. We query if there are other methods to incentivize the distribution and sale of mutual fund products that could more closely align the interests of the dealer/advisor with the client. As technology continues to advance and more and more investors become comfortable with online investing platforms, the internet might be a low cost, transparent and competitive way to distribute investment funds directly to investors without the need to pay a trailing commission to an intermediary.

We are of the view that incentives drive behavior. Compensation structures that fail to align the financial interest of the dealer/advisor with the investor may lead to suboptimal outcomes. We would respectfully request additional guidance detailing how an advisor should manage such conflicts within the potential new enhanced suitability requirements set out in the Client Focused Reforms in the proposed amendments to National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations*.

We agree with the view stated in the Request for Comment that if fund organizations will not incur the cost of financing upfront sales commissions, the management fees charged to those funds should be reduced once there are no DSC options available for purchase, and that instead dealers will likely turn to their clients for direct compensation. We understand and agree with the proposal to permit managers to facilitate such payments through the fund in lieu of an explicit direct payment from the investor to the dealer, provided however that such payments are very clearly outlined and explained to investors.

As the proposals would permit embedded commissions in certain circumstances, please see below our responses to certain of the specific questions posed with regards to the Proposed Amendments.

Amendment of section 3.2 of NI 81-105

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 commission in compliance with subsection 3.2(4) of NI 81-105? If so, please explain.*

   There may be informational barriers and difficulty with obtaining the necessary information to verify whether a suitability determination was properly conducted or updated as required. Additional documentation and recordkeeping would need to be put in place by fund organizations, and the CSA may need to specifically mandate that participating dealers provide the requisite confirmation to fund organizations. Particularly given the proposed heightened suitability requirements in the Client

Focused Reforms, it will be difficult for fund organizations to confirm the requirements have been met without some form of dealer certification and confirmation from the CSA that such certification would be sufficient.

Transition Period

7. *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.*

   The transition period should be sufficient for an orderly transition, but consideration must be given in particular to key stakeholders such as custodians, who will bear much of the brunt of increased operational and technological requirements.

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 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.

   Under the circumstances we believe it would be advisable, as a transitional measure, to implement an exemption from the fund facts document delivery requirement for such switches.

10. *At this time, the CSA is allowing redemption schedules on existing DSC holdings as of the effective date of the Proposed Amendments to run their course until their scheduled expiry, and fund organizations to continue charging redemption fees on those existing holdings that are redeemed prior to the expiry of the applicable redemption schedule. Should the CSA propose amendments to require existing DSC holdings as of the effective date of the Proposed Amendments to be converted to the front-end load option or other sales charge option? If so, are there any transitional issues for fund*

organizations and participating dealers with converting existing DSC holdings to another sales charge option? What would be an appropriate transition period?

We are of the view that existing contractual arrangements stemming from past investment decisions should be honoured and thus the CSA should allow redemption schedules on existing DSC holdings as of the effective date of the Proposed Amendments to run until their scheduled expiry.

Regulatory arbitrage

11. *We understand that the elimination of the DSC option may give rise to the risk of regulatory arbitrage to similar nonsecurities financial products, such as segregated funds, where such purchase option and its associated dealer compensation are still available. Please provide your thoughts on controls and processes that registrants may consider using, and on specific measures or initiatives that the relevant regulators should undertake, to mitigate this risk.*

    We would prefer to see harmonized rules that regulate compensation structures across the spectrum of available financial products. Please also see our response to Question #13 below.

Modernization of NI 81-105

12. *Given that NI 81-105 aims to restrict compensation arrangements that can conflict with registrants' fundamental obligations to their investor clients, and given that the proposed Client Focused Reforms introduce the requirement for registrants to address conflicts of interests, including conflicts arising from third-party compensation, in the best interests of clients or avoid them, should the modernization of NI 81-105 entail a consolidation of its requirements into the registrant conduct obligations of NI 31-103?*

    We agree that it would be helpful for registrants if all the requirements relating to conflicts and compensation were streamlined and contained in one National Instrument.

13. *NI 81-105 currently applies only to the distribution of prospectus qualified mutual funds. In our view, the conflicts arising from sales practices and compensation arrangements that are addressed by the provisions in NI 81-105 are not unique to the distribution of prospectus qualified mutual funds and also arise in the distribution of other investment products, either sold under a prospectus or a prospectus exemption. Are there other types of investment products that are not currently subject to NI 81-105, such as non-redeemable investment funds, certain labour-sponsored investment funds, structured notes and pooled funds that should also be subject to NI 81-105? If not, why should these investment products, their investment fund managers and the dealers that distribute them, remain outside the scope of NI 81-105?*

    Generally, we are of the view that payments that are substantively similar to those that are proposed to be discontinued should also be terminated in an integrated fashion, to

ensure consistent and fair competitive dynamics and investor choice. Conflicts that arise from monetary or non-monetary benefits provided to dealers and representatives from product manufacturers also arise for other investment fund products, including those that are sold on a prospectus-exempt basis. In fact, some of the conflicts may be more difficult to identify in the exempt market as there may be less disclosure provided to potential investors. We are thus of the view that it is important to consider expanding the scope of NI 81-105 to cover more investment funds.

In addition, the CSA should work with their insurance and other counterparts to view segregated funds and the universal life portion of insurance policies. Regulators may also wish to examine in more detail the compensation practices and benefits provided to scholarship plan dealers.

14. *We seek feedback on whether we should change the term "trailing commission" to a plain language term that investors would better understand and would better describe what a trailing commission is. If so, what are some suggested terms?*

If the use of trailing commissions by dealers who make a suitability determination is to persist the fee should be charged at a fixed rate and based upon the initial amount invested. Despite the requirement to ensure that the investment remains suitable at specific points in time (e.g. after a material change in an investor's circumstances), we believe that in the majority of cases clients rely on the advice given at the time of sale and not at the time of redemption. If $100 is invested in a mutual fund today and that initial investment grows to $200 in seven years, the fee for the advice provided on the initial purchase ought to be based on the initial investment of $100. If the intent of the trailer is to provide optionality to the advisor then that should be explicitly laid out in the investment agreement. To the extent trailer fees are used to pay for portfolio administration services that are part of an ongoing level of service (e.g. tax services) that should also explicitly be stated.

We think that a term such as "perpetual sales charge" or "ongoing sales charge" would help an investor understand that the size of the fee grows at a compound rate.

15. *The definition of "participating dealer" in NI 81-102 carves out a principal distributor. As a result, principal distributors are not subject to the provisions of NI 81-105 that apply to participating dealers. Should the modernization of NI 81-105 contemplate the inclusion of principal distributors in the application of all the provisions of NI 81-105? Alternatively, are there specific provisions in NI 81-105 that should also apply to principal distributors? Please explain.*

To ensure a level playing field, dealers engaging in similar forms of activities should fall under similar regulations. Integrated financial institutions involved in both the manufacturing and distribution of a mutual fund product should not be exempt from the requirements applicable to third party dealers. We would be in favour of harmonizing the scope of NI 81-105 to treat principal distributors similarly to participating dealers.

Concluding Remarks

We thank you for the opportunity to provide these comments. We would be happy to address any questions you may have and appreciate the time you are taking to consider our points of view. Please feel free to contact us at cac@cfacanada.org on this or any other issue in future.

(Signed) *The Canadian Advocacy Council for*
Canadian CFA Institute Societies

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