Via email: comments@osc.gov.on.ca; consultation-en-cours@lautorite.qc.ca

December 13, 2018

The Secretary
Ontario Securities Commission
20 Queen Street West, 22nd Floor, Box 55
Toronto, Ontario M5H 3S8

and

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

Dear Sirs/Mesdames,

Re: Proposed Amendments to National Instrument 81-105 *Mutual Fund Sales Practices* ("NI 81-105"), Companion Policy 81-105CP to NI 81-105 ("81-105CP") and Related Consequential Amendments

This comment letter is being submitted on behalf of the following RBC entities: RBC Dominion Securities Inc., RBC Direct Investing Inc., Royal Mutual Funds Inc., RBC Global Asset Management Inc., RBC Phillips, Hager & North Investment Counsel Inc., RBC InvestEase Inc. and Phillips, Hager & North Investment Funds Ltd. (collectively, "RBC" or "we"). We are writing in response to the Canadian Securities Administrators' ("CSA") notice and request for comment on the proposed amendments to NI 81-105 and 81-105CP *Mutual Fund Sales Practices* and Related Consequential Amendments published on September 13, 2018 (the "Notice").

We thank the CSA for its thoughtful consideration of industry concerns with respect to the option of discontinuing embedded commissions as proposed in CSA Consultation Paper 81-408 and we recognize and appreciate the substantial efforts and advancements that the CSA has made in publishing this Notice.

The CSA's proposal comes in response to three key investor protection and market efficiency issues that the CSA identified with respect to the use of trailing commissions. These key issues are:

1) Addressing conflicts of interest;
2) Raising awareness and control of costs; and
3) Aligning of cost and services.

We agree with the CSA that these are important considerations and that compensation paid by fund managers to dealers should be clear and transparent to investors, represent a fair and reasonable cost for the services provided and not result in a misalignment between the investors' interests and those of the dealer or fund manager. However, we strongly believe that continuing to permit appropriately priced mutual fund trailing commissions in the Order Execution Only ("OEO") platform is consistent with all three of the above-noted concerns. Further, we believe that certain of the CSA's recent proposed reforms to

National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* ("NI 31-103"), when implemented, would address the above-noted concerns.

We appreciate the opportunity to provide input on the proposed amendments to NI 81-105 and specifically, to respond to certain of the CSA's specific questions as set out in the Notice.

Please find below our specific comments to the two primary objectives of the proposed amendments.

(1) Discontinuance of DSC Option

RBC does not object to the CSA's proposal to discontinue the DSC option on mutual funds. However, we caution against the CSA's assumption that – since fund managers will no longer incur the cost of financing the upfront sales commission to dealers on DSC mutual fund sales – that the management fees charged to those mutual funds will be correspondingly reduced. We note that not all fund managers have chosen to increase the management fee on DSC funds for the purposes of covering the upfront commission payment. Accordingly, there will not always be a direct correlation between the upfront commission paid to dealers and the management fee charged by the fund manager. .

(2) Prohibition of Trailing Commissions to OEO & Suitability-Exempt Dealers

For the reasons noted below, RBC does not believe that it is necessary to ban all trailing commissions within the OEO channel; we believe that appropriately priced trailing commissions (e.g. Series D mutual funds) are an efficient mode of dealer compensation that may be beneficial to the client. We are concerned that the CSA's proposal to prohibit all forms of trailing commissions in the OEO channel will result in several inadvertent consequences to the detriment of clients, both initially and on an ongoing basis.

Key Reasons for Preserving Series D Mutual Funds on the OEO/Suitability-Exempt Dealer Platform

i. Addressing Conflicts of Interest

We note that the CSA's recent proposed reforms to NI 31-103 are extensive, and include enhanced conflict of interest mitigation requirements for securities registrants. Given that the proposed reforms to NI 31-103, once finalized, will also apply to OEO and suitability exempt dealers, it is our view that these reforms will be sufficient to address the CSA's specific conflict of interest related concerns regarding the payment of trailing commissions to these dealers. Furthermore, since the CSA has not proposed to prohibit the payment of trailing commissions on mutual funds generally within the securities industry, we submit that to do so on the OEO platform alone would represent an inconsistent approach to the application of the CSA's rules in this regard.

ii. Alignment of Costs and Service

Trailing commissions on mutual funds do not only compensate dealers for advice, but also for service costs related to the offering and holding of mutual funds. We note that this view is also consistent with the CSA's definition of "trailing commission" within the Notice where the CSA specifically stated that this definition is "*not restricted to payments intended to compensate dealers and their representatives for advice afforded to clients, but rather captures payments for all services of any kind to the client in connection with their ownership of mutual fund securities*".

For example, mutual fund trailing commissions paid to OEO dealers are used to cover service costs such as:

- Providing investors with access to physical and online infrastructure to enable the purchase of mutual funds through multiple channels including by telephone and through the online and mobile platform;
- Account servicing and administration costs including the reporting, production and delivery of account statements, trade confirmations and other communications such as the CRM2 annual report on fees and performance;

- Personnel and system requirements to comply with rigorous regulatory requirements;
- Offering third-party research tools to assist investors in making informed decisions with respect to their mutual fund purchases; and
- Offering enhanced account features such as automatic investment plans.

Series D mutual funds allow an OEO dealer to properly align the related costs of offering mutual funds on its platform with the services that are provided to investors by providing a lower, channel-appropriate pricing structure.

iii. Increased Costs and Reduced Choice with Non-Trailer Compensation Models

The CSA's intent with prohibiting the payment of mutual fund trailing commissions to OEO dealers and dealers who do not make suitability determinations is for such dealers to implement new direct-fee charging systems to collect their fees from clients. We note that most OEO dealers currently use a trailing commission compensation system, and as such, these proposed amendments would require these dealers to develop and operationalize a new non-trailer compensation model. This will lead to a significant upfront cost and restructuring, as well as ongoing costs, for OEO dealers which may ultimately be passed on to the client through the fees that are charged. Further, increased costs of operation may lead OEO dealers to reconsider the suite of mutual fund products that are available on their platforms.

In addition to the foregoing, a direct-fee charging system, such as a fee-based compensation model, would typically involve a percentage fee applied at the account level and a minimum account fee. Minimum account fees could deter new and small balance clients from investing in mutual funds.

There may also be a concern with commission-based compensation models as they relate to automatic investment plans ("AIP"). For example, currently many OEO dealers offer AIPs to clients which permit them to invest in mutual funds for as little as $25 per purchase. The introduction of transaction-based commissions on these regular mutual fund purchases would make these types of plans significantly more expensive for clients and consequently may lead OEO dealers to re-evaluate or even discontinue AIPs from their platforms and thereby remove what is otherwise an effective savings vehicle for the typical OEO client base.

iv. Operational Challenges and Increased Complexity with Non-Trailer Compensation Models

Apart from the additional costs for both OEO dealers and, potentially, investors in migrating to a fee-based compensation model, many operational challenges will also be created and need careful consideration. For example, if clients have insufficient cash in their account to cover the monthly account fee, an overdraft situation will ensue which will require the liquidation of the client's funds in order to cover the fee. This could be operationally challenging for OEO dealers and create unwanted tax consequences in non-registered accounts for clients. For many OEO dealers, a fee-based account would also involve a product specific engine to be created to capture mutual fund compensation separately from the other products offered by the dealer which are charged differently. Requiring a client to open a separate, fee-based account for the mutual fund securities would be cumbersome for both the client and the dealer. Client reporting would also become fragmented as a result.

In addition to the operational issues described above, the use of a fee-based model for mutual fund compensation adds cost and complexity to OEO investors with respect to the reporting of their taxable gains or losses realized by redeeming units of funds to pay for account level fees. Any errors that are made when a client is accounting for such fees on their personal tax returns may result in the overpayment of taxes, penalties and/or audit costs to the client. Similarly, the cost of serving these types of fee-based accounts could increase as OEO dealers could face higher volumes of tax administration and reporting obligations. By way of contrast, with Series D trailing commissions, tax deductions are managed at the fund level and therefore avoid such complexities for investors.

v. *Fee Transparency with Series D Trailing Commissions*

We recognize the CSA's concern that clients may not be sufficiently making the connection between the trailing commissions that they are indirectly paying with the services that they are receiving. That said, we believe that this can be addressed through means other than a prohibition. For instance, RBC Direct

Investing, our OEO dealer, provides clear mutual fund fee disclosure information to clients at point of sale to ensure they are making an informed decision on their purchase. Notwithstanding the foregoing, additional measures can be implemented in the OEO channel to enhance client awareness of the indirect nature of trailing commissions. For instance, clients could be presented with an additional disclosure after accepting the Fund Facts document which highlights the trailing commission and asks the client to check an acknowledgement box. This would enhance awareness of the trailing commission prior to making the mutual fund purchase and would allow the client to make the ultimate choice of whether to proceed with the investment which is consistent with the "do-it-yourself" aspect of the OEO business model. With respect to ongoing trailing commissions, we note that clients will continue to receive annual reporting as to the actual dollar value of all trailing commissions associated with their investments.

Responses to Certain of the Specific Questions of the CSA Relating to the Proposed Amendments set out in Annex A of the Notice:

Amendment of section 3.2 of NI 81-105

Question #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.

Response:

Yes, fund managers would encounter issues in confirming whether a dealer has made a suitability determination. Although some fund managers may have some visibility in identifying such dealers, it is only on a manual basis. We note that the CSA has proposed in the 81-105CP that dealers should establish a process under which the dealer is required to confirm to the fund manager that it has made a suitability determination for a client as a prerequisite to receiving trailing commission payments. Should the proposed amendments be passed, the CSA would need to provide further guidance and clarity on how the process noted above could be consistently established across the industry. Notwithstanding establishing such a process, there is still the issue of potential risk of transfers in on an ongoing basis of securities into the OEO channel that contain a trailing commission.

Transition Period

Question #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.

Response:

For the reasons outlined above, we do not agree that it is necessary to prohibit all trailing commissions within the OEO channel in order to meet the CSA's policy objectives. However, should the CSA go forward with its current proposal, given the substantial impact and changes required by the proposed amendments, including updating technology on the OEO platform to offer fee-based or other direct pay models, updating technology on brokerage and fund manager platforms in order to accommodate switches/reimburse clients, dealing with issues surrounding potential transfers in and dealing with the additional operational complexities to current processes arising out of the foregoing, RBC would suggest a minimum two-year transition period.

Question #8: With the implementation of the Proposed Amendments, would the required changes to the disclosure in the simplified prospectus and fund facts documents within the proposed 1-year transition period necessitate amendments outside of a mutual fund's prospectus renewal period? Would these changes be considered to be material changes under NI 81-106?

Response:

If the CSA goes forward with its proposed changes in its current form, the resulting changes could be material changes under NI 81-106 that could potentially necessitate an amendment to the simplified prospectus and fund facts documents outside of a mutual fund's normal renewal period. Engaging in such

amendments outside of the normal-course renewal schedule will be expensive, with unitholders ultimately bearing that expense.

Question #9: By the effective date of the Proposed Amendments, the CSA expects 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.*

Response:
As noted above, we support retaining a reduced trailing commission series in the OEO channel. Assuming that the switch occurs from a full-freight trailer series to a discounted trailer series, we believe it would be appropriate to request exemptive relief from the fund facts delivery requirement where the only difference to the client is that the series to which the client's funds are being switched bears a more favourable fee.

b) *Are there any other types of exemptions from CSA or SRO rules that we should consider to facilitate switches to trailing commission-free classes or series of mutual funds? If so, please describe.*

Response:
While we do not agree that it is necessary to prohibit all trailing commissions within the OEO channel in order to meet the CSA's policy objectives, we do think that exemptive relief to enable OEO dealer-initiated switches from, for instance, full-freight trailer series to a discount trailer series when new funds are transferred-in to the OEO platform, or where there may be legacy holdings of full-freight trailer series, should be permitted without having to obtain client consent where the only difference to the client is that the series to which the client's funds are being switched bears a more favourable fee. We further note that such exemptive relief could be included in any final CSA rule.

If the proposed amendments go ahead as currently drafted, in addition to providing exemptive relief to effect switches, we encourage the CSA to develop an industry-wide approach regarding the process for effecting switches. Specifically, it is not clear whether the intention is for switches to be effected by bulk transfer or on a client by client basis, and whether such switches should be effected at the same time as other securities registrants. In addition, the CSA needs to address how to monitor transfers-in of trailing commission series of funds on a go forward basis and determine how that impacts the prohibition on fund managers to not pay, and dealers to not accept, trailers in the suitability exempt space.

Question #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?

Response:

We agree with the CSA in allowing redemption schedules on existing DSC holdings as of the effective date of the amendments to run their course until their scheduled expiry date with fund managers continuing to charge redemption fees as per the redemption schedule.

Regulatory Arbitrage

Question #11: *We understand that the elimination of the DSC option may give rise to the risk of regulatory arbitrage to similar non-securities 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.*

Response:

We believe the CSA needs to be mindful of the risk of potential regulatory arbitrage of non-securities products and should liaise with other regulators (such as insurance regulators) to ensure that regulatory requirements are consistent before making any substantive changes.

Modernization of NI 81-105

Questions #12 – 15: After the implementation of the Proposed Amendments, the CSA may consider future amendments to modernize NI 81-105, an instrument that has been in place since May 1998. The following questions will help inform the CSA's initiative to modernize NI 81-105.

Response:

Given the breadth of proposed regulatory reforms under the NI 31-103 Client Focused Reforms, we think that the CSA should take the time to assess the impact of those reforms, which would then allow the CSA to apply an evidence-based lens to consider any potential further regulatory changes to NI 81-105.

****

We appreciate the opportunity to provide comments and welcome the opportunity to discuss the foregoing with you in further detail. If you have any questions or require further information, please do not hesitate to contact the undersigned.

Doug Guzman
Group Head, RBC Wealth Management & Insurance

Neil McLaughlin
Group Head, RBC Personal & Commercial Banking