

ANNEX A
SUMMARY OF COMMENTS ON THE PROPOSED AMENDMENTS AND RESPONSES

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Part 1 – Background

Summary of Comments

On September 13, 2018, the Canadian Securities Administrators (the **CSA**) published for comment (the **2018 Consultation**) proposed amendments to National Instrument 81-105 *Mutual Fund Sales Practices* (**NI 81-105**) and Companion Policy 81-105CP to National Instrument 81-105 *Mutual Fund Sales Practices* (**81-105CP**) and proposed consequential amendments to National Instrument 81-101 *Mutual Fund Prospectus Disclosure* (**NI 81-101**), including Form 81-101F1 *Contents of Simplified Prospectus* (**Form 81-101F1**) and Form 81-101F3 *Contents of Fund Facts Document* (**Form 81-101F3**), and National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* (**NI 31-103**), (collectively, the **Proposed Amendments**). The purpose of the Proposed Amendments is to implement the CSA's policy response to the investor protection and market efficiency issues arising from the prevailing practice of investment fund managers remunerating dealers and their representatives for mutual fund sales through commissions, including sales and trailing commissions (embedded commissions). The Proposed Amendments:

- prohibit investment fund managers from paying upfront commissions to dealers, which results in the discontinuation of the DSC option (the **DSC ban**), and
- prohibit the payment of trailing commissions to dealers who are not subject to a suitability requirement, such as dealers who do not provide investment recommendations, in connection with the distribution of prospectus qualified mutual fund securities (the **OEO trailing commission ban**).

On December 19, 2019, the CSA published CSA Staff Notice 81-332 *Next Steps on Proposals to Prohibit Certain Investment Fund Embedded Commissions (CSN 81-332)* to provide an update on next steps on the 2018 Consultation. In that publication, the Ontario Securities Commission (**OSC**) stated that, while it will participate in the OEO trailing commission ban, it will not be implementing the DSC ban. Also, on December 19, 2019, the OSC published OSC Staff Notice 81-730 *Consideration of Alternative Approaches to Address Concerns Related to Deferred Sales Charges* indicating that the OSC is considering restrictions on the use of the DSC option to mitigate negative investor outcomes (**DSC restrictions**).

We received 55 comment letters and the commenters are listed in Part 5. We thank everyone who took the time to prepare and submit comment letters. This document contains a summary of the comments we received relating to the Proposed Amendments for an OEO trailing commission ban and our responses to those comments. We have considered the comments received and in response to the comments, we have made some amendments (the **Amendments**) to the Proposed Amendments.

With respect to the Proposed Amendments for a DSC ban, a summary of the comments we received and the responses to those comments were provided in the February 20, 2020 publication, *Multilateral CSA Notice of Amendments to National Instrument 81-105 Mutual Fund Sales Practices, Changes to Companion Policy 81-105CP to National Instrument 81-105 Mutual Fund Sales Practices and Changes to Companion Policy 81-101CP to National Instrument 81-101 Mutual Fund Prospectus Disclosure relating to Prohibition of Deferred Sales Charges for Investment Funds*.

Part 2 – General Comments		
<u>Issue</u>	<u>Comments</u>	<u>Responses</u>
OEO trailing commission ban	<p>Investors and Investor Advocates</p> <p>The majority of investors and investor advocates support the immediate implementation of the OEO trailing commission ban. Key comments provided are:</p> <ul style="list-style-type: none"> • <i>Mutual fund investors on OEO platforms are being overcharged:</i> Investors/investor advocates submit that DIY mutual fund investors are being overcharged for the limited services provided in the OEO channel and that these costs, compounded over time, erode client returns, and accordingly impair investor outcomes. They submit that trailing commissions to OEO dealers should be eliminated immediately with full redress to clients; • <i>Only “F” mutual fund series should be offered in the OEO channel:</i> Investors/investor advocates submit that all OEO dealers offering a particular mutual fund should be required to offer the “F” series (no 	<p>We appreciate the support from the commenters. The Amendments prohibit the payment by fund organizations (as defined below) from paying trailing commissions where the participating dealer is not required to make a suitability determination in connection with a client’s purchase and ongoing ownership of prospectus qualified mutual fund securities. The Amendments also prohibit the solicitation or acceptance of trailing commissions by participating dealers from a member of the organization of the mutual fund, in connection with securities of the mutual fund held in an account of a client of the participating dealer if the participating dealer is not required to make a suitability determination in respect of the client in connection with those securities. This will effectively prohibit the payment of mutual fund trailing commissions to dealers who are not subject to the obligation to make a suitability determination under section 13.3 of</p>

Part 2 – General Comments

<u>Issue</u>	<u>Comments</u>	<u>Responses</u>
	<p>trailing commission) version of the fund on their platform and adopt a transaction-based fee model on mutual fund trades. They question the reasonableness of any embedded commissions, even if reduced (such as Series D) and request that the CSA critically assess whether the investor actually receives any services to justify the ongoing trailing commission;</p> <ul style="list-style-type: none"> • <i>No rule changes may be required – CSA should use existing tools:</i> Some investors and investor advocates submit that the collection of trailing commissions by OEO dealers for advice they do not provide should be considered a breach of a dealer’s requirement to deal fairly, honestly and in good faith with clients. There is clear overcharging, misrepresentation and conflict of interest. The CSA should act to protect investors without time-consuming consultation and simply take enforcement action to stop the overcharging of fees by OEO dealers. 	<p>National Instrument 31-103 Registration Requirements, Exemptions and Ongoing Registrant Obligations or under the corresponding by-laws, rules, regulations or policies of the self-regulatory organizations (SROs). Such dealers would include, among others, order-execution only (OEO) dealers and dealers acting on behalf of a “permitted client” that has waived the suitability requirements.</p>

Part 2 – General Comments

<u>Issue</u>	<u>Comments</u>	<u>Responses</u>
	<p>Industry Stakeholders</p> <p>While many industry stakeholders agree that full trailing commission-paying mutual fund series, such as Series A, should be limited to channels that permit advice, they oppose the complete ban of trailing commissions in the OEO channel for the following reasons:</p> <ul style="list-style-type: none"> • <i>Discounted embedded commissions are appropriate in the OEO channel:</i> Several industry stakeholders submit that appropriately priced trailing commissions tailored to the direct investing channel are an efficient mode of dealer compensation that may be beneficial to mutual fund clients of OEO dealers. Lower-cost mutual fund series, such as Series D, 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. They submit that Series D should be preserved, and its availability increased to help mitigate the 	<p>We continue to be of the view that dealers must provide investors with advice arising from the suitability requirements in order to qualify for the receipt of trailing commission payments. Dealers who are not required to make suitability determinations should charge investors directly for the services they provide.</p>

Part 2 – General Comments

<u>Issue</u>	<u>Comments</u>	<u>Responses</u>
	<p>unintended consequences to investors, as discussed further below;</p> <ul style="list-style-type: none"> • <i>Other proposed regulatory changes may address conflicts in the OEO channel:</i> Some industry stakeholders submit that the enhanced conflict of interest mitigation requirements proposed under the Client Focused Reforms will, if implemented, apply to OEO and other suitability exempt dealers, and that this should be sufficient to address the CSA’s conflict of interest concerns regarding the payment of trailing commissions to these dealers; • <i>OEO trailing commission ban would give rise to inconsistent policy approach to the regulation of embedded commissions:</i> Some industry stakeholders submit that since the CSA has not proposed to prohibit the payment of trailing commissions on mutual funds generally within the securities industry, to do so on the OEO platform alone would represent an inconsistent approach to the 	

Part 2 – General Comments

<u>Issue</u>	<u>Comments</u>	<u>Responses</u>
	<p>application of the CSA’s rules in this regard. They also submit that OEO dealers, notwithstanding the fact they don’t make a suitability determination, are providing their clients a range of ongoing services (e.g. call centers, technological platforms, disclosure documents);</p> <ul style="list-style-type: none"> • <i>OEO trailing commission ban would give rise to unintended consequences:</i> <ul style="list-style-type: none"> ○ <i>Increased costs for smaller investors:</i> Several integrated firms (i.e. banks) submit that OEO dealers will incur significant upfront and ongoing costs to develop and operationalize direct fee compensation models for mutual fund trades, which may be passed on to the client through fees that are charged. Furthermore, these direct fee arrangements may be cost-prohibitive for small accounts because, to the extent a transaction-based compensation model is implemented, these transaction fees would have to be higher than the 	

Part 2 – General Comments

<u>Issue</u>	<u>Comments</u>	<u>Responses</u>
	<p>standard trading fee applied to other types of securities (i.e. equities, ETFs) to account for the lower trading volume and smaller trades in mutual fund securities relative to other types of securities. These transaction costs would reduce the purchasing power of mutual fund investors in the OEO channel and disproportionately affect investors with smaller portfolios;</p> <ul style="list-style-type: none"> ○ <i>Reduced investor choice/product range:</i> Several integrated firms submit that the increased costs of operation associated with direct-fee arrangements may lead OEO dealers to reconsider the suite of mutual fund products that are available on their platform (e.g. limit shelf to proprietary mutual funds) or even remove mutual funds altogether from their product shelf. This may result in a more limited range of products offered by OEO dealers; ○ <i>Complexity in paying for services through direct fees:</i> Several 	

Part 2 – General Comments

<u>Issue</u>	<u>Comments</u>	<u>Responses</u>
	<p>integrated firms submit that collecting fees at the time a transaction is processed is problematic for smaller accounts and/or accounts that do not hold cash. They advise that many clients who hold mutual funds on the OEO platform do not carry a cash balance sufficient to cover an annual fee or transaction fees. The result may be that redemptions will be required in order to cover fees, which would result in a negative client experience and likely attract tax consequences in the case of registered accounts. Or clients may need to leave a certain amount of cash in their account, which would create a cash drag. This would eliminate the more frictionless experience that mutual fund investors on the OEO channel are accustomed to under the current embedded commission model;</p> <ul style="list-style-type: none"><li data-bbox="766 1287 1318 1352">• <i>Investment fund managers should not be required to police OEO dealers'</i>	

Part 2 – General Comments

<u>Issue</u>	<u>Comments</u>	<u>Responses</u>
	<p><i>compliance with the OEO trailing commission ban:</i> Several investment fund managers and other industry stakeholders submit that the proposed prohibition on investment fund managers paying trailing commissions to dealers who do not provide suitability assessments is incapable of being reasonably implemented because investment fund managers are unable to determine whether advice is attached to an order. Accordingly, if the ban is implemented, investment fund managers should not be required to police which series dealers are making available to clients. Instead, responsibility for compliance with the OEO trailing commission ban should be squarely on the OEO dealer.</p>	

Part 3 – Comments on Amendment of Section 3.2 of NI 81-105

<u>Issue</u>	<u>Comments</u>	<u>Responses</u>
<p>5. We expect that fund organizations will make available a trailing commission-free class or series of securities of a mutual fund to participating dealers who do not make suitability determinations. Would fund organizations have any issues with making available a class or series of securities of a mutual fund without trailing commissions to such dealers?</p>	<p><i>Trailing Commission-Free Class or Series of Mutual Fund Securities</i></p> <p>A few commenters expressed that many (if not all) investment fund managers offer Series F, which contains no embedded compensation. It is not clear why the creation of additional funds is required. Discount brokerage firms have the sole discretion to offer Series F to their clients.</p> <p>Another industry commenter wrote that offering “D” Series with trailing commissions is a practical solution for distributing mutual funds through discount brokers and should be maintained. In many cases, “D” Series would be more economical for the client than “F” Series with separate brokerage commissions.</p> <p>One commenter who was in support of the amendment suggested that all firms offering a particular mutual fund should be required to offer the “F” class version of the fund at discount brokerages rather than urged to offer trailing commission free versions. If a “F” class exists, it should be required to be</p>	<p>It is up to fund organizations to make available a trailing commission-free class or series of securities of a mutual fund to participating dealers who do not make suitability determinations. Fund organizations are not required to do so under the Amendments.</p>

Part 3 – Comments on Amendment of Section 3.2 of NI 81-105

<u>Issue</u>	<u>Comments</u>	<u>Responses</u>
	<p>offered through the OEO firm for those investors who want to invest without advice.</p> <p>One commenter expressed that it would not be difficult to make a trailing commission free class or series available, however, in some instances revisions to prospectus disclosure would be necessary and could, subject to the specific facts, be completed at the next prospectus renewal.</p> <p><i>Rebating</i></p> <p>Another commenter suggested that where no trailing commission-free version is available, OEO dealers should be permitted to sell the fund class that includes trailing commissions, subject to the following conditions:</p> <p>(a) The dealer must rebate to their client all trailing commissions paid to the dealer in respect of the client’s fund units (less a small, reasonable fee to cover the cost of administering the rebate program); and</p>	<p>The Amendments do not permit OEO dealers to rebate trailing commissions to their clients.</p>

Part 3 – Comments on Amendment of Section 3.2 of NI 81-105

<u>Issue</u>	<u>Comments</u>	<u>Responses</u>
	(b) When a trailing commission-free version of the fund becomes available, the dealer must arrange for conversion of their client’s unit holdings to the trailing commission-free version at no cost to the client.	
<p>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.</p>	<p>Several industry commenters pointed out that investment fund managers currently have no way of tracking whether trades are being placed by dealers that do not make a suitability determination. Since suitability determination is a dealer obligation, investment fund managers should not be obligated to police which series dealers are making available to their clients. The CSA should make it clear in the Proposed Amendments that investment fund managers do not have an obligation to confirm whether a participating dealer or principal distributor has made a suitability determination and thus, is or is not eligible to be paid a trailing commission.</p> <p>One industry commenter indicated that investment fund managers cannot determine if the prohibition applies when they receive</p>	<p>For circumstances where a fund organization do not know, or would not reasonably be expected to know, whether a suitability determination has been made in connection with a mutual fund purchase, the Amendments include a knowledge qualifier to clarify that subsection 3.2(4) applies only if the fund organization knows or ought reasonably to know that the participating dealer is not required to make a suitability determination.</p>

Part 3 – Comments on Amendment of Section 3.2 of NI 81-105

<u>Issue</u>	<u>Comments</u>	<u>Responses</u>
	<p>a purchase order as some participating dealers use a separate code for an OEO dealer whereas others use a single dealer code for multiple affiliated dealers. This results in aggregating mutual fund orders for full service dealers with orders for OEO dealers.</p> <p>Another industry commenter wrote that the assignment of dealer codes for discount brokerage accounts is inconsistent, and therefore system edits would only be effective in certain cases and would be difficult to maintain.</p> <p>Two industry commenters noted that there is no way for the fund company on its own to know, absent disclosure from the dealer or the client, that the client is a permitted client and that suitability has been waived. Clients who have waived suitability may be further complicated where the client relationship is with a registrant such as a portfolio manager, who executes transactions through a participating dealer. Placing a prohibition on investment fund managers would introduce an unnecessary regulatory burden</p>	

Part 3 – Comments on Amendment of Section 3.2 of NI 81-105		
<u>Issue</u>	<u>Comments</u>	<u>Responses</u>
	<p>on investment fund managers.</p> <p>Another commenter noted that as OEO firms are not permitted to provide suitability recommendations, there should be no need to confirm to the members of the organization of the mutual fund as to whether it has made a suitability recommendation.</p>	

Part 4 – Comments on Transition Period			
<u>Issue</u>	<u>Sub-Issue</u>	<u>Comments</u>	<u>Responses</u>
7. A transition period of 1 year from the date of publication of the final amendments is sufficient time		<i>OEO Trailing Commission Ban</i> – Several industry stakeholders submit that the design and implementation of the systems necessary to charge direct fees to mutual fund clients on OEO platforms and implement associated compliance procedures will be a multi-year process that would extend beyond the proposed 1-year	The effective date of the Amendments is June 1, 2022. This date coincides with the effective date of the DSC ban ¹ in all CSA jurisdictions, except for Ontario, and the

¹ Multilateral CSA Notice of Amendments to National Instrument 81-105 *Mutual Fund Sales Practices*, Changes to Companion Policy 81-105CP to National Instrument 81-105 *Mutual Fund Sales Practices* and Changes to Companion Policy 81-101CP to National Instrument 81-101 *Mutual Fund Prospectus Disclosure* relating to Prohibition of Deferred Sales Charges for Investment Funds was published on February 20, 2020 by the CSA, except the Ontario Securities Commission.

Part 4 – Comments on Transition Period

<u>Issue</u>	<u>Sub-Issue</u>	<u>Comments</u>	<u>Responses</u>
<p>for registrants to operationalize the Proposed Amendments.</p> <p>Are there any transitional issues for fund organizations and participating dealers with implementing the Proposed Amendments within the proposed 1-year transition period?</p>		<p>transition period. Some stakeholders suggest a 2-year transition period if lower-cost series (i.e. Series D) are preserved in the OEO channel, but a longer 3-year transition period if OEO firms are expected to build a direct-fee system.</p>	<p>proposed effective date of the DSC restrictions in Ontario.²</p>

² Ontario Securities Commission Notice and Request for Comment – Proposed Ontario Securities Commission Rule 81-502 *Restrictions on the Use of the Deferred Sales Charge Option for Mutual Funds* and Proposed Companion Policy 81-502 to Ontario Securities Commission Rule 81-502 *Restrictions on the Use of the Deferred Sales Charge Option for Mutual Funds and Related Consequential Amendments* was published on February 20, 2020 by the Ontario Securities Commission.

Part 4 – Comments on Transition Period

<u>Issue</u>	<u>Sub-Issue</u>	<u>Comments</u>	<u>Responses</u>
<p>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.</p>			
<p>9. By the effective date of the Proposed</p>	<p>(a) Switching a client from a class or series</p>	<p>Many stakeholders submit that if the proposal is implemented, the regulators should provide blanket exemptive relief to</p>	<p>The Amendments provide an exemption from the Fund Facts and ETF Facts delivery requirements for switches of a trailing</p>

Part 4 – Comments on Transition Period

<u>Issue</u>	<u>Sub-Issue</u>	<u>Comments</u>	<u>Responses</u>
<p>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.</p>	<p>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</p>	<p>OEO dealers to facilitate switches of mutual fund client holdings from a trailing commission-paying series to a no-trailing commission series without having to comply with fund facts document (the Fund Facts) delivery requirements and trade confirmation requirements. Such exemptive relief should cover switches from series that include trailing commissions to series that do not include trailing commissions before the effective date of the Proposed Amendments, as well as switches of series thereafter for clients that transfer their assets from a full-service dealer to an OEO dealer.</p>	<p>commission series or class of mutual fund securities, or ETF securities, respectively, to a no-trailing commission paying series or class of mutual fund securities. These exemptions have an effective date of December 31, 2020, which is 17 months prior to the effective date of the Amendments. This 17-month period provides considerable time for fund organizations and dealers to facilitate switches of trailing commission paying mutual fund securities to no-trailing commission series or class of the same mutual fund held in client accounts administered by dealers who are not required to make suitability determinations, on or before the effective date of the Amendments.</p> <p>OEO dealers must comply with the trade confirmation delivery requirements or exemptions in accordance with the Investment Industry Regulation Organization of Canada (IIROC) rules.</p>

Part 4 – Comments on Transition Period

<u>Issue</u>	<u>Sub-Issue</u>	<u>Comments</u>	<u>Responses</u>
	<p>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</p>		

Part 4 – Comments on Transition Period

<u>Issue</u>	<u>Sub-Issue</u>	<u>Comments</u>	<u>Responses</u>
	<p>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.</p>		
	<p>(b) Are there any other types of</p>	<p>Some commenters suggested that there should be an exemption to authorize OEO</p>	<p>OEO dealers should refer to IIROC rules with respect to client consent matters relating to</p>

Part 4 – Comments on Transition Period

<u>Issue</u>	<u>Sub-Issue</u>	<u>Comments</u>	<u>Responses</u>
	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.	dealers to be able to effect this switch, given that they do not have discretionary authority over their clients' accounts. However, the ability to effect a switch between series is not a "one time" issue since clients may choose to transfer from the "advice" channel to an OEO dealer at any time.	switches from a trailing commission series or class of mutual fund securities to a no-trailing commission series or class of mutual fund securities.

Part 5 – List of Commenters

Commenters

- Advocis, The Financial Advisors Association of Canada
- AGF Investments Inc.
- Alternative Management Association
- Blanes, Alan

- Boom, Mary
- Borden Ladner Gervais LLP
- CARP
- Clark, Keir
- Durnin, James S.
- Dusmet, Tom
- Elford, Larry
- Elliot, Ruth
- FAIR Canada
- Federation of Mutual Fund Dealers
- Fidelity Investment Canada
- Fieldstone, David
- Financial Planning Standards Council
- Finandicap Inc.
- Franklin Templeton Investments Corp.
- Glick, Isaac
- Gosselin, Eric F.
- Group Cloutier Investissements
- HighView Asset Management Ltd.
- Independent Financial Brokers of Canada
- Invesco Canada Ltd.
- Investment Industry Association of Canada
- Jagdeo, Millie
- Kenmar Associates
- Kivenko, Ken
- L'Association Professionnelle des Conseillers en Services Financiers
- Le Group financier PEAK
- Loepky, Bruce
- MacDonald, James Richard

- Mackenzie Financial Corporation
- McFadden, D.
- Merici Services Financiers Inc.
- MICA Capital Inc.
- Mouvement Desjardins
- Naglie, Harvey
- National Bank of Canada
- OSC Investor Advisory Panel
- Portelance, Eric
- Portfolio Strategies Corporation
- Pozgaj, Steve
- Primerica Financial Services (Canada) Ltd.
- RBC Entities
- Rosen, Yegal
- Ross, Art
- Stenzler, Gary
- TD Wealth
- The Canadian Advocacy Council for Canadian CFA Institute Societies
- The Investment Fund Institute of Canada
- The Portfolio Management Association of Canada
- The Small Investor Protection Association
- Whitehouse, Peter