IIAC ACCVM
INVESTMENT INDUSTRY ASSOCIATION OF CANADA
ASSOCIATION CANADIENNE DU COMMERCE DES VALEURS MOBILIÈRES

TD West Tower | 100 Wellington Street West
Suite 1910, PO Box 173 | Toronto, ON M5K 1H6

416.364.2754 | www.iiac.ca

www.iiac.ca

Michelle Alexander
Vice President
malexander@iiac.ca

Annie Sinigagliese
Managing Director
asinigagliese@iiac.ca

December 13, 2018

Submitted via 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

Attention:

The Secretary
Ontario Securities Commission
20 Queen Street West
22nd Floor, Box 55
Toronto, Ontario M5H 3S8
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
consultation-en-cours@lautorite.qc.ca

Dear Sirs and Mesdames:

Re: Proposed Amendments to National Instrument 81-105 *Mutual Fund Sales Practices* and Related Consequential Amendments

The Investment Industry Association of Canada (the "IIAC" or "we") appreciate the opportunity to provide comments to the Canadian Securities Administrators (the "CSA") with respect to the Proposed Amendments to National Instrument 81-105 ("NI 81-105" or the "Proposed Amendments"). The IIAC is the national association representing the investment industry's position on securities regulation, public policy and industry issues on behalf of our 121 IIROC-regulated investment dealer members in the Canadian securities industry[1]. These dealer firms are the key intermediaries in the Canadian capital markets, accounting for the vast majority of financial advisory services, securities trading and underwriting in the public and private markets for government and corporations.

Section One of our letter, along with Appendix A, addresses issues raised by the prohibition in the Proposed Amendments on trailing commission payments by fund organizations to dealers who do not make a suitability determination, such as order-execution-only ("OEO") dealers.

Section Two of our letter addresses concerns raised by the prohibition in the Proposed Amendments on the payment of upfront sales commissions by fund organizations to dealers, which is intended to discontinue sales charge options that involve such payments, such as all forms of the deferred sales charge option (collectively, the "DSC Option").

[1] For more information visit, **http://www.iiac.ca**

<u>SECTION ONE:</u> IIAC comments regarding the Proposal to prohibit trailing commission payments by fund organizations to OEO firms

<u>Overview</u>

IIAC members do not support a complete ban of embedded commissions on the OEO platform (the "Proposal"). We believe that the Proposal would be detrimental to investors who choose to take advantage of the benefits offered by an OEO platform, such as ease of use and lower cost. This comment letter highlights possible unintended consequences of the Proposal that could negatively impact Do-It-Yourself (DIY) investors and as a result, fail to achieve the CSA's policy objectives. As described in more detail below, these unintended consequences could include:

1) Increased investor costs – the Proposal likely will result in increased upfront costs to investors thereby reducing purchasing power and disproportionately having a negative impact on investors with smaller portfolios;

2) Reduced investor choice – the Proposal may result in more limited product shelves offered by OEO platforms if lower cost series mutual funds, such as series D, which were originally designed for the OEO platform, are no longer permitted, or if fund manufacturers choose to stop offering products on the OEO platform instead of providing products that meet the requirements set out in the Proposal; and

3) Investor confusion – the Proposal may result in confusion for investors (the particulars of which are set out in the attached Appendix A).

We ask that the CSA reconsider the Proposal in light of the above and consider alternatives that will address the CSA's concerns. One such option would be to maintain (and increase) the availability of lower cost series mutual funds, where an embedded commission may still be paid, on OEO platforms. This would help to mitigate the unintended consequences to investors, while still recognizing and preserving the benefits of the OEO model (i.e., investor choice with investment tools and ease of use provided to DIY investors at a lower cost).

If the option of maintaining and increasing the number of lower cost series available in the OEO model is implemented, we expect that the transition period would be less significant than the period resulting from the implementation of the Proposal. A shorter transition period would ultimately benefit investors. Please see the discussion under "Transition: Timeframe" below for more details.

<u>Unintended consequences of the Proposal</u>

OEO firms play a critical role in the capital markets. The OEO "no advice" model provides investors with low cost, easy access investing. The Proposal may have the following unintended consequences, which will impact the benefits of the OEO model.

1. <u>Increased costs – administrative costs, operational costs, development costs</u>

There may be increased costs for the DIY investor if the Proposal is implemented. To comply with the Proposal, OEO firms will need to perform additional tasks and build new systems, which may increase the cost to investors:

- Increased cost for monitoring the client holdings;
- Increased cost for obtaining client instructions;
- Increased costs for executing transfers; and
- Increased costs for developing a new direct fee model.

While certain of these costs relate to back office and operational systems of OEO firms, and therefore do not represent direct costs to investors, investors will likely end up paying for such systems upgrades indirectly. IIAC members estimate that the development cost for a direct fee model is quite high. Operationalizing such a model would require a product-based fee engine, a completely new capability, requiring a significant investment in technology and operations. A precise estimate would require additional time as additional stakeholders would need to be involved in the cost assessment. These costs will very likely ultimately be borne by investors, with little added value.

Because conventional mutual funds trade less frequently and in smaller amounts than other securities such as Common Shares and Exchange Traded Funds ("ETFs") and distributions tend to be automatically reinvested rather than held in cash that is subsequently traded, fixed OEO dealer trading costs associated with mutual fund trading platforms will be spread across significantly less trading volumes which will necessarily lead to higher mutual fund transaction costs for investors. As a result, mutual fund clients would be at a disadvantage with a flat transactional fee compared to an asset-weighted fee (embedded commission).

2. <u>Increased complexity in paying for services through direct fees</u>

The principal challenge with a direct fee model is the collection of fees. In particular, collecting fees at the time a transaction is processed is problematic for smaller accounts and/or in accounts that do not hold cash. Many clients who hold mutual funds 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, a significant client irritant. Further, the majority of mutual funds are held in registered accounts, making redemptions to cover fees even more challenging.

Transaction fees for mutual fund holdings are also problematic for smaller accounts and accounts that do not hold cash for the following reasons:

- Investors may receive payment requests from the OEO firm if the cash balance in an account is small or non-existent;
- If dividends are automatically reinvested, it may be difficult to fund the account with cash. Clients would have to make a new cash contribution to their account when the OEO firm makes a fee payment request;
- The account's cash balance may, if fees are paid from the client's account, become a debit balance. OEO firms may once again ask the client to contribute to the account;
- If a registered account has a debit balance, it will trigger a negative impact for the investor. OEO firms will ask the client to contribute to the account; and
- If clients pay the fees from cash not held in their account, tax agencies (such as the Canada Revenue Agency) may object in the case of registered accounts.

In order to cover account fees, clients may need to leave a certain amount of cash in their account, which is not the case under the embedded fee model. This creates a cash drag, as the assets of the investor cannot be fully invested according to their investment parameters, which erodes one of the value propositions of mutual funds (i.e., being able to reinvest all cash immediately).

Further, OEO firms have accommodated investors who desire to set up systematic plans (such as Pre-Authorized Contribution plans) with respect to their mutual fund investments. For example, some firms may charge $25 per quarter on accounts under $15,000 and waive this fee for clients who set up automatic contributions of at least $100 a month. Systematic plans help to ensure that client dollars get fully invested immediately and are particularly beneficial for smaller investors. The benefits of this structure may be diluted with a transactional fee model.

3. <u>Limited product range</u>

Operationalizing a new direct fee model will be complex and will require a lengthy implementation period. In the interim, it would not be viable for OEO firms to support series F without any compensation. This will negatively impact investors, who likely will have reduced investment options during a transition period.

Even if the model could be operationalized, it may not be feasible for fund manufacturers to create series for the OEO model for some legacy products. To avoid these complications, fund manufacturers may choose to stop offering products under the OEO model.

DIY investors should not have their ability to access mutual funds on OEO platforms reduced (either in the interim or permanently). Mutual funds enable diversification, particularly for smaller investors. Mutual funds are also advantageous for smaller investors for their other features, such as the ability for investors to set up systematic plans. Not all of these features are available for other investment products, such as ETFs.

We understand that the CSA has spent many years reviewing the embedded commission model and that the current Proposal reflects the work performed by the CSA since 2012. The mutual fund industry has changed significantly since then. For example, in 2012, when the CSA began its assessment of embedded commissions, manufacturers were offering a very limited number of lower cost series mutual funds to investors. Today, OEO investors have access to a growing number of lower cost series mutual funds. If the CSA does move ahead with the Proposal, DIY investors may have access to a limited product range.

4. Limited investment tools (to keep costs down for the investor)

Trailing commissions are intended to pay for a multitude of products and services. The following is an excerpt from the 2013 IIAC Discussion Paper and Request for Comment 81-407 – *Mutual Fund Fees*:

> *"A possible change suggested in the Discussion Paper calls for "a minimum level of ongoing services that advisors must provide to investors in exchange for the payment of these commissions...". We are concerned that the CSA may not fully recognize the role trailers play in the business of our member firms and the scope of services dealers provide with the assistance of the trailer revenues. Investment advice is not the sole service dealers provide their mutual fund clients. There are many other services provided by investment dealers that facilitate the management of the mutual fund investment such as product information and research, tax documentation, corporate action processing and efficient clearing and settlement of securities. The following is a list of some services supported by trailing commissions that are provided by investment dealers on an ongoing basis (many apply equally to execution only and full-service dealers):*
>
> - *Printing and mailing of disclosure documents (prospectuses, Fund Facts, other shareholder communications including proxy material);*
> - *Processing registered in nominee name, the dealer takes on responsibility for updating client account records for things such as mutual fund reorganizations and client payments of interest, dividends, etc.;*
> - *Preparation and distribution of tax reporting information such as annual trading summaries, and, in some cases, T3 and T5013 tax slips;*
> - *Provide the widest selection of mutual funds from multiple fund families (This requires efforts by the dealer/advisor to conduct extensive product due diligence and legal documentation before making these funds available to clients.);*
> - *Custody services;*
> - *Portfolio monitoring of margin requirements;*
> - *Clearing and settlement for purchase and sales through FundSERV and/or CDS.*
>
> *The services above should be taken into consideration with respect to the importance of trailers to advisors and their firms."*

Firms currently invest significant resources in developing tools that benefit their clients, including mutual fund clients, such as screeners, goal-planning tools, projected income calculators, and more. The DIY investor uses such investment tools to perform analysis (fundamental or technical), to review research reports and to analyze documents often provided on the OEO platform. Maintaining these high-quality investment tools has a cost. In order to keep costs down for investors, firms may limit the tools or development of new tools offered to investors. In the alternative, increased costs for these tools may be charged directly to the investor, resulting in investor confusion and increased payment complexity (as described above). Neither of these outcomes is beneficial to the investor. Permitting the continued payment of embedded commissions on lower cost series in the OEO model will allow OEO firms to continue to offer these tools and services to investors with as little disruption as possible to the investor.

5. <u>Limited transfer possibilities</u>

There is currently no mechanism to collect a fee in connection with holdings that are transferred into an OEO account in a transaction-based model. In order to adapt to a transaction-based model, such a mechanism would have to be developed.

There is also a restricted ability to transfer in non-eligible funds, particularly if there is no equivalent eligible fund. Further, there is complexity with converting to different series at the time of transfer, and limitations as an OEO firm cannot execute discretionary trades for the DIY investor or provide advice.

6. <u>The Proposal represents a fundamental change to the OEO model</u>

In order for an OEO dealer to comply with the Proposal, it would need to:

- Enhance operational and compliance systems to permit the firm to review products transferred by investors to ensure the products are appropriate for the OEO platform;
- Change its core “no advice” model to perform a series conversion or to “propose” alternative products (if no other series exists) if an inappropriate product is held by a DIY investor;
- Change and limit its range of products, which may lead to operational issues when an account is transferred between a full-service firm and an OEO firm (when products are not offered by the OEO firm); and
- Develop new systems to support a transition from the current fee model to a direct fee model – which may result in an increased cost to the investor and the OEO firm.

Underlying the above is the increased complexity entailed if portfolio holdings must be custodied/maintained in different accounts because of the remuneration associated with a product. Clients may need to maintain an account with a full-service dealer for certain products that are currently custodied/held in their OEO account, increasing the cost for investing.

Executing an initial product transfer or ongoing transfer in a client account may be seen, by the client, as an OEO firm executing a discretionary trade. We note that IIROC has stated that it does not consider it to be a "recommendation" when an OEO firm informs a client of the availability of a lower cost series of a fund. If an OEO firm's actions go beyond this, we believe an investor may see such an action as a recommendation/advice and may wrongly expect the OEO firm to be involved in monitoring other products held by the client. This would blur the line between full-service and OEO firms and could cause confusion for investors.

Because of the foregoing concerns, the OEO model may become a less viable option for many investors, thereby reducing investor choice and limiting low cost access to the capital markets.

Options to address the CSA concerns

Given our concerns with the Proposal, we ask that the CSA reconsider it and consider alternatives that will address its policy objectives.

One such alternative would be to maintain the availability of lower cost series mutual funds, where an embedded commission may still be paid, in the OEO model. This option would avoid the increased costs, complexity and confusion faced by investors under a direct fee model, while also enhancing investor choice (if fund manufacturers continue to make lower cost series mutual funds available for the OEO model). This option could also be combined with other solutions, such as educational materials or additional disclosures, to assist in achieving the CSA's policy goals.

In considering any solution, including the Proposal, the CSA must keep in mind the unique features of the OEO model – DIY investors have specifically chosen to invest using this method as they want choice, control and easy access investing. An outright ban on a form of compensation in the OEO model may reduce choice and control for investors. The Proposal goes beyond what is necessary to achieve the CSA's regulatory objectives, when other policy measures could help achieve the same goals with fewer negative consequences to investors.

Transition: Timeframe

If the CSA proceeds with the IIAC recommendation, we would suggest a two-year transition period. We expect that the option of increasing the number of lower cost series available in the OEO model will be less complex and onerous to implement and therefore will entail a less significant transition period compared to the Proposal. However, it is difficult for OEO firms to estimate a precise transition timeline for this option, as it is contingent on the timeline of fund manufacturers to create additional lower cost series for the OEO model. It would be important for OEO firms to have grandfathering clauses until the manufacturers are ready to provide the appropriate products.

The transition period would possibly be increased to a three-year period (maybe more) if the CSA Proposal is implemented and OEO firms are expected to build a product-specific (fee-based) engine.

Transition: Manufacturer-led transition and OEO firm process

As explained above, the Proposal is a fundamental change for the OEO business model. The transition period should ensure clients have a positive experience before, during and after the transition.

If the Proposal is implemented, we expect that the industry would request relief for mass conversion and ongoing right to conversion, as well as exemptions from, among other things, the following:

1. Asking for consent before the series transfer;
2. Sending the fund fact sheet to the investor - transaction triggered because of a series transfer;
3. Sending a trade confirmation for the series transfer; and
4. Providing tax impact information to the investor.

We expect that OEO firms would also request grandfathering for some holdings (where clients could hold but no longer buy), the right to perform bulk transfers, as well as clarity regarding the process for transition.

To simplify the process for the industry and the investor, we believe the transition should be manufacturer-driven and not dealer-driven. A dealer-led transition would create further operational issues such as discrepancies in position reconciliations. We believe a manufacturer-driven transition would be simpler to perform since manufacturers have the expertise and competence as well as a current view on client holdings. Their fund family mapping (underlying source database) is also highly reliable. Manufacturers' databases of funds are complete while OEO firms do not have that complete view.

We would also hope for a consistent and synchronized approach for all manufacturers (product, automatic transfer, conversion timing).

Even if the transition is manufacturer-driven, there will be significant, if not insurmountable hurdles to manufacturers. For example, a manufacturer may not be able to distinguish between a full-service firm and its related OEO firm. OEO firms would need to determine how to limit its product shelf from a particular manufacturer if they share an identifier with its related full-service dealer. OEO firms should not be expected to perform "broker code splitting" (creating separate codes for the OEO firm and its full-service firm) for the manufacturer as it would create further operational issues.

Manufacturers may also have issues in converting historical funds as they may require voting from unit holders to change these funds.

Even if our industry members believe that the transition (one-time and ongoing conversions) should be manufacturer-led, OEO firms should still have the ability to implement conversions. Such an ability would be required, for example, when a full-service client who holds series mutual funds that are not low cost, transfers to an OEO firm.

Furthermore, a manufacturer-led conversion is preferred as the fund companies have the technical capacity to conduct mass conversions/switches. There appears to be economies of scale in manufacturers obtaining a blanket regulatory relief as opposed to each firm seeking such relief and conducting transactions for clients. Lastly, this would remove the “discretionary trading” issue - as an OEO dealer cannot trade in a client’s account without client instructions.

Ongoing consultation between the CSA, IIROC and industry members

The IIAC and industry members remain available for further consultation on the current Proposal and to discuss any of the operational issues that are listed in this letter. We wish to collaborate with the CSA and IIROC in order to reach a solution that will be beneficial to Canadian investors.

SECTION TWO: IIAC comments regarding the ban of the DSC Option

The IIAC wishes to point out that in our comments outlined below, we have not necessarily answered all questions posed by the CSA but only those of particular relevance to our members.

Repeal of section 3.1 of NI 81-105

CSA Question 2: Would the proposed repeal of section 3.1 of NI 81-105 have the expected effect of eliminating all forms of the deferred sales charge ("DSC") option? If not, what other measures should be taken to ensure that all forms of the DSC Option are eliminated?

CSA Question 3: Would there be any sales practices and/or compensation arrangements with a redemption fee schedule and redemption fee that could exist despite the repeal of section 3.1 of NI 81-105? If so, are rule changes required to specifically prohibit redemption fees that are charged for purposes other than to deter excessive or short-term trading in funds?

IIAC Response: We expect the proposed repeal of section 3.1 of NI 81-105 will achieve the intended effect of eliminating all forms of the DSC Option and we are not aware of any mutual fund sales practices and/or compensation arrangements with a redemption fee schedule and redemption fee that would continue to exist.

CSA Question 4: We do not expect that the repeal of section 3.1 of NI 81-105 will have any impact on the availability and use of other sales charge options, including the front-end load option as it currently exists today.

(a) Are there any unintended consequences on the front-end load option with the repeal of section 3.1 that we should consider?

(b) Are there any other types of sales charge options that will be impacted by repealing section 3.1?

IIAC Response: As the IIAC has previously indicated in our response to CSA Consultation Paper 81-408, the majority of our members either no longer offer DSCs or have been moving away from the DSC Option. As a result, the Proposed Amendments, as it relates to the payment of upfront sales commissions by fund organizations to dealers, will not have a material impact on the operations of our members.

However, the IIAC recognizes that the removal of the DSC Option may impact smaller investors who purchase mutual funds with a DSC because they may be particularly price sensitive. These clients could be discouraged from investing generally or from investing smaller amounts when faced with a front-end load. Furthermore, there will be a material impact on those advisors who rely primarily on DSCs for compensation and they will have to shift their business models and ensure they can justify their value proposition to clients. Under the Proposed Amendments, advisors will need to engage in direct discussions of compensation costs with clients. As part of these discussions, advisors will need to educate their clients on the Proposed Amendments, the changes in available payment options and what clients will receive in exchange for the sales commission they will pay, as negotiated exclusively between the two parties.

Transition Period

CSA 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.

IIAC Response: As noted above in our response to Question 4, there will be some significant changes for investors and advisors that currently utilize the DSC Option. The transition period needs to provide sufficient time for important client conversations regarding payment options, as well as time for those firms and advisors to update their business models.

In addition, for those members that currently offer the DSC Option, a one-year transition period is an aggressive time-line to address the necessary operational issues. For example, the management of pre-authorized contribution plans (“PACs”) that would be discontinued could prove challenging in terms of simply ensuring: (i) clients sign the necessary paperwork that would be involved in switches; (ii) that the advisor receives new instructions from clients as to their preferred sales charge option; and (iii) allocating the time necessary for negotiating the amount of such a sales commission. Given the foregoing, the IIAC would suggest a two-year transition period.

CSA 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?

IIAC Response: The IIAC supports the CSA’s proposed approach in allowing redemption schedules on existing DSC holdings as of the effective date to run their course until their scheduled expiry, and fund organizations to continue charging redemption fees on those existing holdings. This approach will be helpful in avoiding transitional issues. In addition, for clients that are invested in a mutual fund with a DSC, additional time may be required for investors to complete the redemption schedule without paying the DSC charge if they were forced to switch to another purchase option due to the Proposed Amendments.

We assume that this approach of allowing redemption schedules on existing DSC holdings would also apply to transfers-in of holdings from another dealer. A reference to such transfers in the Proposed Amendments would ensure clarity in this area.

Regulatory arbitrage

CSA 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.

IIAC Response: The IIAC supports the development of regulatory proposals that create a level playing field with non-securities financial products. We encourage the relevant regulators to work collaboratively to address this issue and avoid any risk of regulatory arbitrage.

Modernization of NI 81-105

CSA Question 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?

IIAC Response: We believe that NI 81-105 is appropriately designated specifically for retail-oriented mutual funds and provides simplicity by having the requirements contained in one national instrument focused on this specific product. We are also unclear on the benefits of re-opening NI 31-103 to material changes if NI 81-105 is included, considering that the industry has just completed a complete review of NI 31-103 and those changes have yet to be finalized. Given the detail and length of NI 31-103 and 31-103CP, we believe including NI 81-105 would create undue complexity and confusion for industry participants.

CSA Question 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?

IIAC Response: The IIAC is of the view that it is unnecessary to have products such as structured notes and pooled funds included in NI 81-105. For IIROC firms, most of these products are portfolio managed, discretionary solutions predominantly aimed at higher net worth clients. As such, these portfolio managed services and products are not usually purchased by middle income Canadians, the key investors that both the Client Focused Reforms and the Proposed Amendments are designed to protect. Furthermore, costs of offering these products will likely increase if more regulatory requirements are placed upon them.

CSA Question 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?

IIAC Response: The IIAC suggests that there be no change to the term “trailing commission”. The term has been in use by the industry for quite some time and we believe consistency and continuity of the term helps to provide clarity. A new term may not necessarily alleviate any client confusion that exists, and the term is currently employed throughout the industry – in compliance manuals, in prospectuses, CRM2 reports, etc. Introducing a new term may only increase client confusion as it may raise questions as to whether it is some sort of new fee.

CSA Question 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.

IIAC Response: The IIAC does not believe that principal distributors should be included in any modernization of NI 81-105. There are justified reasons why the definition of participating dealer in NI 81-102 excludes principal distributors given their relationship with participating dealers and the distribution model utilized.

Furthermore, the CSA has not articulated any evidence that would necessitate this change and the rationale for removing this carve-out. The IIAC would be interested to understand what regulatory objective the CSA contemplates could be achieved by this Proposal.

<u>IIAC proposed exemption to the ban on DSC Option</u>

The IIAC suggest that CSA consider an exemption to the proposed ban of the DSC Option in the following scenario:

> When a client has DSC funds at an institution that cannot be transferred in-kind, and the DSC penalty is material, the client is forced to remain at the same institution unless they pay the penalty. Dealers would like the ability to give investors more freedom to move their accounts. This could occur if firms had the ability to purchase only enough transferable (non-proprietary) DSC or LL funds to generate commission not exceeding the amount of the DSC penalty, and rebate the commission into the client's account with the new firm. The client starts a new DSC or LL schedule for a portion of their funds, but they can now move the account to the new firm or to other firms, in the future.

By permitting this option, clients receive a rebate for the redemption penalty they have incurred while providing them with the flexibility to change firms if they so wish. We hope the CSA would consider including this as a permitted exemption under NI 81-105.

We would welcome an opportunity to discuss our submission and address any further questions the CSA might have.

Sincerely,

Michelle Alexander

Annie Sinigagliese

APPENDIX A

CSA PROPOSAL: CONFUSION FOR INVESTORS AND OEO FIRMS

IIAC members believe that the CSA Proposal, if implemented, would create confusion for DIY investors. It would also create significant issues and confusion for the OEO firms in implementing the Proposal. The issues and questions listed below justify a transition period of three years (maybe more).

Banning embedded commissions: Transfer issues

If embedded commissions are banned in the OEO model, many transfer issues arise. These issues can include but are not limited to the following:

1. A new direct fee model could result in higher upfront costs for the investors as transferring a client's product to another and setting up a mutual fund has a cost;
2. Transferring a client's product to another may trigger unwanted tax consequences for the investor if no equivalent series is available (and the OEO firm must liquidate the inappropriate product);
3. "Series F" mutual funds were created for fee-based accounts, they were not intended to be used on OEO platforms;
4. Keeping "series F" in a full-service model (for a DIY investor having an account on an OEO platform) may prove to be impossible as the value of the series F holdings may be lower than the full-service firm's minimum value threshold. The costs to maintain that part of the portfolio in a full-service model may be excessive;
5. Transferring OEO holdings to "series F" to comply with the current Proposal may mean OEO firms would need to go to a fee-based model, changing the firm's remuneration model through significant and costly system development;
6. Transferring OEO holdings to "series F" automatically creates inaccurate book values in some dealer systems. These issues must be fixed manually through individual entries;
7. Transferring OEO holdings to "series F" may create an automatic "disposition" for the investor, creating tax implications for the client and an impact on the portfolio's performance;
8. Some OEO firms do not carry "series F" mutual funds as they were specifically for fee-based accounts (and not for commission-based accounts);
9. Some OEO firms may choose to reject a transfer if the incoming portfolio contains "series F" mutual funds which would limit the investing options for investors;
10. Some dealer agreements prohibited OEO firms from buying and holding "series F" mutual funds;
11. OEO firms may not have the distribution rights to all possible mutual fund series;
12. Decreased investment control (clients may feel that they no longer control their investment decisions if transactions are made by the OEO dealer, transactions that may include liquidation of positions without client consent);
13. OEO firms having control over the DIY investor's account may be extremely confusing for the client; and
14. The time period required to complete account transfers between firms may lengthen due to operational challenges.

Banning embedded commissions: Operational issues

IIAC members have flagged operational issues and have new questions regarding the operational process needed to implement the Proposal.

1. What should a firm do if the client's product does not have a different series?
2. What will firms do if no "equivalent" series are available?
3. Going to a fee-based model would require OEO firms to manually enter a direct fee or direct commission for a transaction. This manual entry would create an inaccurate book value for OEO firms using certain platforms;
4. Inaccurate book values would need to be fixed by manual entries in the dealer's platform;
5. There are risks involved if dealers are requested to fix book value costs. These risks include inaccurate performance reporting and inaccurate tax reporting;
6. The manual entries to fix book values would take time and increase costs (and may lead to errors just like any manual entry);
7. Transfers-in are not currently rejected if an inappropriate product is present in the client's portfolio. Would firms need to implement a new transfer process in order to deal with the inappropriate product?
8. How are firms expected to deal with inconsistencies in timing between different manufacturers? For example, Manufacturer A may convert clients out of an inappropriate product before Manufacturer B takes similar action. What should OEO firms tell the client that owns both Manufacturer A and Manufacturer B products?
9. If trailing commissions from an inappropriate product are received by the OEO dealers during the transfer process, are firms expected to develop a tool to flag and return the commission to the manufacturer? If so, there will be further cost increase for the investor;
10. If OEO firms must communicate the tax implications of transfers to their clients, how can they ensure that they are communicating the proper information (as OEO firms are not taxation specialized organizations)?
11. How are firms expected to deal with Pre-Authorized Contribution Plans? Because of the dollar cost averaging, clients may want to continue contributing.