

**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**

February 20, 2020

Introduction

The Canadian Securities Administrators (**CSA**) except the Ontario Securities Commission (the **Participating Jurisdictions** or we), are adopting amendments to National Instrument 81-105 *Mutual Fund Sales Practices* (**NI 81-105**) and changes to Companion Policy 81-105CP to NI 81-105 (**81-105CP**) and Companion Policy 81-101CP to National Instrument 81-101 *Mutual Fund Prospectus Disclosure* (**81-101CP**) (collectively, the **Amendments**).

The Amendments prohibit the payment by fund organizations (as defined below) of upfront sales commissions to dealers, which will result in the discontinuation of all forms of the deferred sales charge option¹ including low-load options² (collectively, the **DSC option**).

The Ontario Securities Commission is not adopting the Amendments but will publish for

¹ Under the traditional deferred sales charge option, the investor does not pay an initial sales charge for fund securities purchased, but may have to pay a redemption fee to the investment fund manager (i.e. a deferred sales charge) if the securities are sold before a predetermined period of typically 5 to 7 years from the date of purchase. Redemption fees decline according to a redemption fee schedule that is based on the length of time the investor holds the securities. While the investor does not pay a sales charge to the dealer, the investment fund manager pays the dealer an upfront commission (typically equivalent to 5% of the purchase amount). The investment fund manager may finance the payment of the upfront commission and accordingly incur financing costs that are included in the ongoing management fees charged to the fund.

² The low-load purchase option is a type of deferred sales charge option, but has a shorter redemption fee schedule (usually 2 to 4 years). The upfront commission paid by the investment fund manager and redemption fees paid by investors are correspondingly lower than the traditional deferred sales charge option.

comment an alternative proposal to address the investor protection and market efficiency issues arising from the payment of upfront sales commissions by fund organizations to dealers.

In some jurisdictions, ministerial approvals are required for the implementation of the Amendments. Provided all ministerial approvals are obtained, the Amendments will come into force on June 1, 2022.

The text of the Amendments is contained in Annexes B through D of this notice and will also be available on websites of the following jurisdictions, including:

www.bcsc.bc.ca

www.mbsecurities.ca

www.lautorite.qc.ca

www.fcnb.ca

<https://nssc.novascotia.ca>

Substance and Purpose

The Amendments, together with the enhanced conflict of interest mitigation framework for dealers and representatives under detailed reforms to NI 31-103 (the **Client Focused Reforms**) published on October 3, 2019, comprise the Participating Jurisdictions' policy response to the investor protection and market efficiency issues we have identified with the use of the DSC option. The Amendments restrict the compensation that members of the organization of publicly-offered mutual funds (**fund organizations**) may pay to participating dealers, and that participating dealers may solicit and accept in connection with the distribution of mutual fund securities.

Background

The Amendments were developed over the course of an extensive consultation process.

CSA Consultation Paper 81-408

On January 10, 2017, the CSA published for comment CSA Consultation Paper 81-408 *Consultation on the Option of Discontinuing Embedded Commissions* (the **Consultation Paper**), which identified and discussed key investor protection and market efficiency issues arising from mutual fund embedded commissions.³ The Consultation Paper sought specific feedback, including evidence-based and data-driven analysis and perspectives, on the option of discontinuing embedded commissions as a regulatory response to the identified issues and on the potential impacts to both market participants and investors of such a change, to enable the CSA

³ The Consultation Paper followed the CSA's initial consultation on mutual fund fees under CSA Discussion Paper and Request for Comment 81-407 *Mutual Fund Fees* published on December 13, 2012, which was followed by in-person consultations in several CSA jurisdictions in 2013. The CSA published an overview of the key themes that emerged from this consultation process in CSA Staff Notice 81-323 *Status Report on Consultation under CSA Discussion Paper and Request for Comment 81-407 Mutual Fund fees*.

to make an informed policy decision on whether to pursue this option or consider alternative policy changes.

CSA Staff Notice 81-330

On June 21, 2018, the CSA published CSA Staff Notice 81-330 *Status report on Consultation on Embedded Commissions and Next Steps (CSN 81-330)* which proposed the following policy changes:

1. to implement enhanced conflict of interest mitigation rules and guidance for dealers and representatives requiring that all existing and reasonably foreseeable conflicts of interest, including conflicts arising from the payment of embedded commissions, be addressed in the best interests of clients or avoided;
2. to prohibit all forms of the DSC option and their associated upfront commissions in respect of the purchase of securities of a prospectus qualified mutual fund; and
3. to prohibit the payment of trailing commissions to, and the solicitation and acceptance of trailing commissions by, dealers who do not make a suitability determination in connection with the distribution of securities of a prospectus qualified mutual fund.

In addition to announcing the CSA's policy decision and providing a summary of the consultation process and the feedback received, CSN 81-330 provided an overview of the regulatory concerns that the proposed policy changes aimed to address, and also discussed why CSA members were not proposing to ban all forms of embedded commissions.

The Proposed Amendments

On September 13, 2018, the CSA published proposed amendments (the **Proposed Amendments**) to

- prohibit investment fund managers from paying upfront commissions to dealers, which would result in the discontinuation of the DSC option, 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 90-day comment period ended on December 13, 2018.

CSA Staff Notice 81-332

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 announce that the Participating Jurisdictions will publish for adoption final amendments in early 2020 to prohibit the DSC option.

CSN 81-332 also announced that all members of the CSA will publish for adoption final amendments later in 2020 to prohibit payments of trailing commissions to dealers who do not make a suitability determination.

Summary of Written Comments Received by the CSA

The CSA received 56 comment letters on the Proposed Amendments. We thank everyone who provided comments. A summary of the comments together with our responses are set out in Annex A. The names of the commenters are also set out in Annex A.

Copies of the comment letters are posted on the website of the Autorité des marchés financiers at www.lautorite.qc.ca.

Summary of Changes to the Proposed Amendments

After considering the comments received, we have made some non-material changes to the Proposed Amendments. These changes are reflected in the Amendments that the Participating Jurisdictions are publishing as Annexes to this Notice. As these changes are not material, we are not republishing the Amendments for a further comment period.

The following is a summary of the key changes made to the Proposed Amendments:

- **Definition of “trailing commission”**

After consideration of the comments received, we have not added a definition of “trailing commission” as proposed in the Proposed Amendments, as it is not needed.

- **Section 3.1 of NI 81-105**

As section 3.1 of NI 81-105 will continue to apply in Ontario, section 3.1 will no longer be repealed. However, we have added subsection (2) to section 3.1 to carve out the Participating Jurisdictions so that the provision does not apply to a distribution of a mutual fund security to a client resident in a Participating Jurisdiction. As a result, the DSC option will not be permitted for clients who are resident in Participating Jurisdictions as of the Effective Date (as defined below).

- **Section 4.1.1 of 81-105CP**

We did not add section 4.1.1 of 81-105CP as proposed in the Proposed Amendments because it is a statement regarding the operation of NI 81-105, rather than guidance, and is not necessary. We did add section 4.1.2 of 81-105CP as proposed in the Proposed Amendments as it provides clarification that the front-end load option is not impacted by the Amendments to NI 81-105. We have re-numbered section 4.1.2 of 81-105CP as section 4.1.1 and changed the sub-heading from “Means of payment” to “Front-end load option” for clarity.

- **Section 4.1.2 of 81-105CP**

As the deferred sales charge option will be prohibited in the Participating Jurisdictions, we added section 4.1.2 of 81-105CP to provide guidance relating to the disclosure of the DSC option in the simplified prospectus and the fund facts document where the DSC option is available in Ontario. Where the DSC option is one of multiple purchase options available under a single series or class of mutual fund securities in Ontario, the simplified prospectus should provide disclosure to clearly indicate that the DSC option is not available in the Participating Jurisdictions and is only available in Ontario. Investment fund managers may opt to provide a separate series or class of mutual fund securities for the sale of the deferred sales charge option in Ontario.

- **Sections 4.1.6 and 5.6 of 81-101CP**

Similar to section 4.1.2 of 81-105CP, we added sections 4.1.6 and 5.6 of 81-101CP to provide guidance relating to the disclosure of the DSC option in the simplified prospectus and the fund facts document, respectively, where the DSC option is available in Ontario.

- **No 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)**

We have not made consequential amendments to NI 81-101, including Form 81-101F1 and 81-101F3 as proposed in the Proposed Amendments as these provisions will continue to apply to Ontario. Once the Amendments come into effect, the provisions requiring disclosure of the DSC option will no longer be applicable to the Participating Jurisdictions as the DSC option will no longer be offered in the Participating Jurisdictions.

- **No Consequential Amendments to National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* (NI 31-103)**

We have not made consequential amendments to NI 31-103 as proposed in the Proposed Amendments as these provisions will continue to apply to Ontario. Once the Amendments come into effect, the provisions requiring disclosure of the DSC option will no longer be applicable to the Participating Jurisdictions as the DSC option will no longer be offered in the Participating Jurisdictions.

Effective Date

The Amendments will take effect on June 1, 2022 (the **Effective Date**), which is approximately 27 months after the publication of this notice. As of the Effective Date, compliance with the new rules will immediately be expected.

Discontinuation of DSC option:

The Participating Jurisdictions anticipate that the extended period between the publication of this notice and the Effective Date will provide sufficient time for dealer firms and representatives who currently make use of the DSC option to transition their practices and operational systems and processes. For some dealer firms this may also require a reassessment of their internal compensation arrangements. We believe this should also give investment fund managers enough time to revise their mutual funds' simplified prospectuses and fund facts documents to reflect the discontinuation of the DSC option in the Participating Jurisdictions.

Mutual fund investments purchased under the DSC option prior to the Effective Date will not have to be converted to the front-end load option or other sales charge option. Instead, the redemption schedules on those existing DSC holdings as of the Effective Date will be allowed to run their course until their scheduled expiry. Fund organizations will therefore be allowed to charge redemption fees on those existing holdings that are redeemed prior to the expiry of the applicable redemption schedule. Any new mutual fund purchases made as of the Effective Date, however, will need to be made in compliance with the new rules.

Although some investment fund managers currently offer the DSC option as a stand-alone series, other investment fund managers offer the DSC option as one of multiple purchase options available under a single series. As the DSC option will no longer be permitted in the Participating Jurisdictions as of the Effective Date, investment fund managers that continue to offer the DSC option as one of multiple purchase options available under one series should provide disclosure in the simplified prospectus and fund facts documents to indicate that as of the Effective Date, the DSC option is no longer permitted in the Participating Jurisdictions and is only available in Ontario. Alternatively, such investment fund managers may opt to provide a separate series of mutual fund securities for the continued sale of the DSC option in Ontario as of the Effective Date.

For client name accounts, the Participating Jurisdictions expect that fund managers will be able to identify where the client resides so that they will not process the trade if the client resides outside of Ontario.

In the case of a prospectus that is receipted prior to the Effective Date and lapses after the Effective Date, staff in the Participating Jurisdictions take the view that the discontinuance of the DSC option, effective on the Effective Date, would constitute a material change as defined in National Instrument 81-106 *Investment Fund Continuous Disclosure*. Accordingly, amendments would be required to both the simplified prospectus and fund facts documents to remove the applicability of any references to the DSC option and any commissions associated with the DSC option in the Participating Jurisdictions. In lieu of such amendments, for prospectuses that are receipted prior to the Effective Date, the simplified prospectus and the fund facts documents may provide disclosure to state that the DSC option will not be available as of the Effective Date in the Participating Jurisdictions. Such disclosure can be provided under the heading, "Fees and Expenses" in the simplified prospectus, and in a textbox before the heading "Quick Facts" in the fund facts document.

Client Focused Reforms:

The elimination of the DSC option will take effect on June 1, 2022. During the period between the publication of this notice and the Effective Date, in order to allow for an orderly transition, the Participating Jurisdictions will grant relief to dealers, with respect to the DSC option, from the enhanced conflicts of interest requirements under the Client Focused Reforms. During that period, dealers will instead be required to comply with the conflicts of interest requirements that are currently in effect under NI 31-103, in relation to the use of the DSC option.

Local Matters

Annex E is being published in any local jurisdiction that is making related changes to local securities laws, including local notices or other policy instruments in that jurisdiction. It also includes any additional information that is relevant to that jurisdiction only.

Contents of Annexes

The text of the Amendments is contained in the following annexes to this Notice and is available on the websites of members of the CSA:

- Annex A:** Summary of Comments and CSA Responses
- Annex B:** Amendments to National Instrument 81-105 *Mutual Fund Sales Practices*
- Annex C:** Changes to Companion Policy 81-105CP to National Instrument 81-105 *Mutual Fund Sales Practices*
- Annex D:** Changes to Companion Policy 81-101CP to National Instrument 81-101 *Mutual Fund Prospectus Disclosure*
- Annex E:** Local Matters

Questions

Please refer your questions to any of the following:

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