FRANKLIN TEMPLETON INVESTMENTS

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VIA EMAIL

December 13, 2018

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
Toronto, ON M5H 3S8

Me Anne-Marie Beaudoin
Corporate Secretary
Autorité des marchés financiers
800, rue du 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* and Related Consequential Amendments

Franklin Templeton Investments Corp. ("**FTI**") is writing in respect of the Canadian Securities Administrators ("**CSA**") Notice and Request for Comments on the Proposed Amendments to National Instrument 81-105 *Mutual Fund Sales Practices* ("**NI 81-105**") and Related Consequential Amendments (collectively, the "**Proposed Amendments**"). Thank you for the opportunity to provide comments.

FTI is currently registered in most provinces and territories in Canada as a portfolio manager, investment fund manager, mutual fund dealer and/or exempt market dealer. FTI is a wholly owned subsidiary of Franklin Resources, Inc., a global investment organization operating as Franklin Templeton Investments. Through its subsidiaries, Franklin Templeton Investments provides global and domestic investment advisory services to the Franklin Templeton mutual funds, Franklin Liberty exchange-traded funds and institutional accounts. In Canada, FTI has almost 500 employees providing services to nearly 370,000 unitholder accounts and over 150 pension funds, foundations and other institutional investors.

FTI is a member of the Investment Funds Institute of Canada ("**IFIC**"). We have reviewed and generally support the comments made by IFIC (although not necessarily each of its specific comments) in its letter dated December 12, 2018. In addition, FTI wishes to provide its own comments on the Proposed Amendments.

General Comments

FTI commends the CSA for proposing a policy response that does not include a ban on embedded compensation. As noted in our response to CSA Consultation Paper 81-408 *Consultation on the Option of Discontinuing Embedded Commissions* (the "**Consultation Paper**"), FTI had concerns with the Consultation Paper, believed there would be various unintended consequences (e.g., reduction in access to investment advice, limiting investor choice and higher cost of advice, among others) and offered various alternatives to a complete ban. We are pleased that the CSA evaluated all feedback received and determined that a ban on embedded compensation was not the appropriate policy response.

OEO Proposal

We have no objection to the CSA's proposal to amend NI 81-105 to prohibit the payment of trailing commissions where a participating dealer is not required to make a suitability determination.

However, we believe the Proposed Amendments should be amended to make it clear that the obligation is on the dealer not to trade in mutual fund securities that pay a trailing commission if the dealer is not required by securities legislation to make a suitability determination. The obligation should not be on the investment fund manager since it has no way of controlling the mutual fund securities in which a dealer trades. Many (if not all) investment fund managers offer Series F, which contains no embedded compensation. Discount brokerage firms have the sole discretion to offer Series F to their clients.

Furthermore, the prohibition in the Proposed Amendments should not be limited to participating dealers; it should also apply to principal distributors. Currently, the trailing commission requirements in NI 81-105 do not apply to principal distributors. We believe the prohibition on payment of trailing commissions where no suitability determination is made should be extended to principal distributors; otherwise, those dealers that are principal distributors would have an unfair advantage over participating dealers.

DSC Proposal

FTI believes the deferred sales charge ("**DSC**") purchase option should continue to be offered and therefore does not agree with the CSA's proposal to prohibit the payment of upfront sales commissions by fund organizations to dealers. We believe DSC offers yet another option for investors in accessing advice and preserves investor choice. If the CSA feels that DSC is not being used properly by dealers and their dealing representatives and is being used to the detriment of investor interests, we suggest that the CSA and/or the self-regulatory organizations use the current regulatory tools available to them and approach this from a compliance/enforcement perspective rather than impose an outright ban on DSC.

A ban on DSC could have various consequences, including:

- *Reduction in Access to Advice* – As noted by the CSA in Annex F – Regulatory Impact Analysis of the Proposed Amendments ("**Annex F**"), many MFDA and IIROC channel registrants that make significant use of the DSC option could be negatively impacted by a prohibition on DSC. The impact to these firms would be more significant than to integrated financial service providers. The elimination of DSC could lead to a reduction in the number of small to medium-sized dealers and could result in investors having less access to independent advice (i.e., to dealing representatives whose dealer is not affiliated with an investment fund manager). This magnifies a significant conflict of interest (i.e., the sale of proprietary products) that already exists in the Canadian marketplace. Alternatively, dealers may choose not to service small investors if the revenue generated from those accounts is less than the dealer's cost to provide advice and services to those clients.

- *Increase in Investor Costs* – In Annex F, the CSA articulates its expectation that overall mutual fund costs are likely to fall modestly with the discontinuation of the DSC option. We question the CSA's assertion, since DSC charges are paid for, and financed by, the investment fund manager. Like many Canadian mutual funds, Franklin Templeton mutual funds do not have a separate fund series exclusively for the DSC option and, therefore, we do not anticipate that our mutual funds' management expense ratios would decrease if the DSC option is prohibited. In fact, overall mutual fund costs have been decreasing in recent years due to competitive pressures, which is a much more significant factor in an investment fund manager's decision to reduce management fees than the elimination of the DSC option.

  Many dealing representatives use DSC to compensate them for the upfront advice and service they provide to small investors with little to invest. If dealing representatives no longer have the DSC option available, they may be forced to charge clients other forms of compensation to offset the loss of this source of revenue. For example, dealing representatives may charge their clients a financial planning fee. Such compensation may be in addition to the trailing commissions dealing representatives receive, leading to an increase in the overall cost of advice for investors. Without DSC, small investors could be impacted more significantly if dealing representatives charge additional fees for the services they provide.

- *Reduction in Investor Choice* – Investors should be given plenty of choices in the investment options they have, including how they access and pay for their investments and/or the advice they receive from their dealing representative. DSC is one of the options investors have when purchasing mutual funds and this option has been available to them for many years. Eliminating this option will result in a reduction in investor choice and could leave investors (particularly small investors) with fewer options in the way they pay for investment advice.

- *Increased Use of Front-End Sales Charges* – If dealers are not able to access the DSC option, they may be forced to increase their use of front-end sales charges in order to be adequately compensated for the advice and services they provide to their clients. Front-end sales charges reduce the amount of initial investment into a mutual fund, which could have long-term consequences for investors in the form of less savings. DSC was originally created so that investors would not have to pay an upfront sales charge and was the main reason that front-end sales charges declined in popularity. Prohibiting DSC would represent a step backwards.

- *Regulatory Arbitrage* – As acknowledged by the CSA in Annex F, the elimination of the DSC option for mutual funds without a corresponding change for similar non-securities financial products creates ripe grounds for regulatory arbitrage. Dealing representatives who also sell other financial products may still have the opportunity to sell those products with DSC options or similar traits. For example, dealing representatives who are dually licensed as insurance agents will still be able to sell segregated funds and dealing representatives will still be able to sell other financial products such as guaranteed investment certificates for which their clients can be locked in for a considerable period of time. Furthermore, the sale of such products will not be governed by other applicable securities laws, including those proposed by the CSA in the Notice and Request for Comments on the Proposed Amendments to National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* and to Companion Policy 31-103CP *Registration Requirements, Exemptions and Ongoing Registrant Obligations* (the "**Client Focused Reforms**"), so dealing representatives will not be subject to the final form of the conflict of interest mitigation framework the CSA is proposing as part of those reforms. We question whether this is in the best interests of investors.

<u>Annex A – Specific Questions of the CSA Relating to the Proposed Amendments</u>

FTI also wishes to respond to certain questions posed by the CSA in Annex A:

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?

As noted above, Series F, which is a series with no embedded compensation, is currently offered by Franklin Templeton and can be sold by dealers who do not make a suitability determination.

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.

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. We believe 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 thereby is or is not eligible to be paid a trailing commission.

9. By the effective date of the Proposed Amendments, the CSA expect that those dealers who do not make suitability determinations in respect of a client will have switched any existing mutual fund holdings of such client to a trailing commission-free class or series of the relevant mutual fund.

(a) **Switching a client from a class or series of a mutual fund that pays a trailing commission to one that does not pay a trailing commission would trigger the delivery requirements 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 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.**

FTI believes that the CSA should grant a blanket exemption from the fund facts delivery requirement for dealers to switch clients from a series of a mutual fund that pays a trailing commission to another series that does not pay a trailing commission. We also note that the exemption will need to authorize order execution only ("OEO") dealers to be able to effect this switch, given that they do not have discretionary authority over their clients' accounts. We further note that both the fund facts delivery issue and 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.

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?

FTI does not agree with the CSA's proposal to prohibit the payment of upfront sales commissions by fund organizations to dealers. However, if the CSA proceeds with this proposal, any proposed amendments should not require existing DSC holdings to be converted to the front-end load option or sales charge option. Instead, the DSC schedules of existing holdings should be allowed to run to maturity. Investment fund managers typically finance the payment of DSC to dealers; such arrangements are predicated on the redemption schedule as set out in the mutual fund's disclosure documents. Furthermore, mutual funds sold with the DSC option typically pay a lower trailing commission to dealers. By proposing amendments to convert DSC holdings earlier than their normal redemption schedule, the CSA would be interfering with the commercial arrangement that was established between investment fund managers, dealers and investors at the time the mutual fund units were purchased by the investor.

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.

FTI questions whether effective controls and processes could be put in place by registrants to avoid the risk of regulatory arbitrage given that the distribution of non-securities financial products is generally not under the control of a registrant. As noted above, we believe this is a likely consequence of a ban on the DSC option and, since the sale of these non-securities financial products are not regulated by the CSA, we believe the CSA should not pursue a ban until there is alignment with other financial services regulators on this issue.

13. NI 81-105 currently applies only to the distribution of prospectus qualified mutual funds. In our review, the conflicts 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?

FTI believes that pooled funds should not be subject to NI 81-105. These types of products are sold pursuant to prospectus exemption and are not subject to other mutual fund rules such as National Instrument 81-101 – *Mutual Fund Prospectus Disclosure*, National Instrument 81-102 – *Investment Funds* or National Instrument 81-107 – *Independent Review Committee for Investment Funds*. We therefore question why such products would be subject to NI 81-105. We note that the Client Focused Reforms seem to enhance the existing conflict of interest obligations in a manner which would capture any concerns associated with the sale of other types of investment products.

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 provisions of NI 81-105? Alternatively, are there specific provisions in NI 81-105 that should also apply to principal distributors? Please explain.

As noted above, FTI believes that the prohibition on the payment of trailing commissions where no suitability determination is made should apply to principal distributors as well as participating dealers; otherwise, dealers that are principal distributors would have an unfair advantage over participating dealers. If there is no similar prohibition on principal distributors, OEO dealers could become principal distributors of mutual funds offered by an affiliated investment fund manager in order to receive trailing commissions.

Thank you for your consideration of this submission. Please feel free to contact me at 416.957.6010 should you have any questions or wish to discuss our submission.

Yours truly,

FRANKLIN TEMPLETON INVESTMENTS CORP.

"Brad Beuttenmiller"

Brad Beuttenmiller
Senior Associate General Counsel