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The Secretary Ontario Securities Commission
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British Columbia Securities Commission
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Financial and Consumer Affairs Authority of Saskatchewan
The Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumer Services Commission of New Brunswick
Superintendent of Securities, Prince Edward Island
Nova Scotia Securities Commission
Superintendent of Securities, Newfoundland and Labrador
Superintendent of Securities, Yukon Territory
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Nunavut

Re: CSA Notice and Request for Comment Proposed Amendments to National Instrument 81-105 Mutual Fund Sales Practices and Related Consequential Amendments

Initially I had not intended to submit a comment letter in respect the Proposed Amendments to National Instrument 81-105 (the "Proposed Amendments"). However, that was before the Ontario government's precipitous and preemptive announcement that it did not agree with the Proposed Amendments. The premature timing of this announcement combined with the absence of any meaningful justification for it, should not go unchallenged. While this comment letter has been prompted by the premature and presumptive intervention in this consultation by the Ontario government, its message is directed at all stakeholders who are inclined to dismiss or disparage the Proposed Amendments.

The Ontario government's unprecedented action should be assessed in the context of the existing framework for securities rulemaking in this province and particularly the way that framework was applied in the development of the Proposed Amendments. Over twenty years ago, the Ontario Securities Commission (OSC) was given rule-making authority by the Ontario government. In delegating this authority, the government effectively empowered the OSC to use its expertise to develop and propose the detailed rules necessary to prevent misconduct and maintain the integrity of Ontario's capital markets. The OSC has always appreciated the wide-ranging implications and consequent responsibility implicit in its rule-making authority. As a result, to the extent possible, the OSC has ensured that its rule and policy development has operated as a transparent public process featuring active engagement and consultation with all interested groups including investors and industry representatives. Furthermore, all rules proposed by the OSC must be published for comment and all comments received are also published (unless the commenter requests otherwise). The OSC is required to consider all comments received before finalizing the proposed rule and submitting it to the government for final approval. For over two decades now this process has served Ontario well thanks in large part to its two fundamental characteristics – delegation and public process. Delegation has allowed securities rulemaking to take place in an expert/technical sphere at a healthy arm's length from the political sphere; while, as a transparent public process, rule and policy development have benefitted from informed and intelligent dialogue among all interested stakeholders in the public arena.

The Proposed Amendments are the product of just this type of apolitical transparent process involving extensive consultations, rigorous research and hard-fought compromises. The formal process began in December 2012 with the publication by the CSA of *Discussion Paper and Request for Comment 81-407 Mutual Fund Fees* (2012 Discussion Paper). The discussion paper was designed to determine whether the mutual fund fee structure posed any investor protection or fairness issues that required regulatory action. In 2013, the CSA coordinated 3 roundtable discussions and 4 discussion forums to examine the investor protection and market efficiency issues identified in the 2012 Discussion Paper. In December of that year the CSA released *CSA Staff Notice 81-323 Status Report on Consultation under CSA Discussion Paper and Request for Comment 81-407 Mutual Fund Fees*. This Staff Notice identified the key themes generated by the 2012 Discussion Paper including the need for evidence of investor harm to justify changes; concern that a ban on embedded compensation would reduce access to advice for small retail investors; and, the contention that embedded compensation creates conflicts of interests which adversely impact investor outcomes. In the face of these very important but conflicting findings, the CSA spent the next two years performing additional analysis and collecting more evidence-based research to be able to develop a more informed and more intelligent policy.

In June 2015, the CSA published research on mutual fund fees prepared by the Brondesbury Group and in October 2015 (updated in February 2016) it released the findings of a work by Douglas Cumming et al. analyzing mutual fund fees, flows, and performance. These commissioned studies provided documented evidence of the detrimental impact of embedded commissions on investor outcomes. Notwithstanding

these compelling findings, the CSA did not immediately propose the outright elimination of embedded commissions. Instead, true to its public process commitment, the CSA opted for additional consultation and in January 2017 published *Consultation Paper 81-408 Consultation on the Option of Discontinuing Embedded Commissions* (the 2017 Consultation). The intent of this consultation was to solicit specific feedback on the potential impacts of a ban on embedded commissions on both market participants and investors.

In June 2018, only after thoroughly evaluating all the feedback received in response to the 2017 Consultation, did the CSA announce its policy decisions in *Staff Notice 81-330 Status Report on Consultation on Embedded Commissions and Next Steps (CSN 81-330).* In addition to setting out the policy choices that all CSA members had unanimously decided to propose, CSN 81-330 also included a detailed explanation for the policy decisions that they had made. CSA members affirmed that after considering all comments and weighing all considerations they unanimously agreed that regulatory action was necessary to mitigate the inherent conflicts of interest associated with embedded compensation. The CSA members confirmed that they had seriously considered, but ultimately rejected, the option of discontinuing all forms of embedded commissions. Instead, they opted to pursue a more targeted approach designed to address the most egregious practices while at the same time limiting potential adverse consequences to market participants and investors. This targeted approach, telegraphed in CSN 81-33, and set out in *Proposed Amendments to National Instrument 81-105 Mutual Fund Sales Practices* (Proposed Amendments 81-105) eschewed an outright ban on embedded commissions and limited prohibitions to all forms of the Deferred Sales Commission (DSC) and the payment of trailing commissions to dealers who do not make a suitability determination.

In the context of this process, a unilateral or unsubstantiated dismissal of the Proposed Amendments by any stakeholder, including the government, cannot go unchallenged. In a circumstance where it was always going to be impossible to bring forward a set of proposals that would simultaneously please all stakeholders and all CSA members, it would be unfair to dictate the fate of the Proposed Amendments based primarily, let alone solely, on any one stakeholder's own preference. Many stakeholders, including me, are not happy with every aspect of the Proposed Amendments. However, rule-making is not and should not be about making any one group happy just because that group shouts louder or has better access to decision makers. Instead, rulemaking needs to be about integrity and fairness. These qualities are more appropriate bases to measure the wisdom of the Proposed Amendments. By this measure, the thoughtful, thorough and transparent process pursued by the CSA in the development and formulation of the Proposed Amendments speaks to their integrity; while the balancing of conflicting stakeholder interests and the coalescing of competing regulatory views reflected in the Proposed Amendments speaks to their fairness.

I encourage all stakeholders, and especially those who have concerns that the Proposed Amendments go too far and those who believe that they do not go far enough, to put aside their individual biases and

consider both the challenges and the nature of the CSA process that culminated in the Proposed Amendments. While this consideration may not cause many opponents of the Proposed Amendments to change their position, I do hope that the manifest integrity and fairness of the CSA process will prompt them to frame their concerns in a transparent and evidence-based manner. The significance of these Proposed Amendments together with the thorough and thoughtful process that preceded their formulation make it imperative that no single stakeholder group be permitted, absent evidence and consultation, to arbitrarily impose its view. I regret the unilateral action taken by the Ontario government, but I hope that it, together with all other stakeholders, will participate openly and collaboratively in this consultation process. The fairness and integrity of Ontario's securities rule-making framework that underlies the development and formulation of the Proposed Amendments deserves no less.

Sincerely,

Harvey Naglie
Toronto, Ontario