NATIONAL BANK

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VIA ELECTRONIC MAIL

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Financial and Consumer Affairs Authority of Saskatchewan
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Ontario Securities Commission
Autorité des marchés financiers (the "AMF")
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

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

We are writing in response to the request for comments on Canadian Securities Administrators ("CSA") Notice and Request for Comment – Proposed Amendments to NI 81-105 Mutual Fund Sales Practices and Related Consequential Amendments, published on September 13, 2018 (the "Proposed Amendments"). This letter is being submitted on behalf of National Bank Investments Inc. ("NBI"), National Bank Financial Inc. and its four divisions which include National Bank Independent Network, National Bank Direct Brokerage, Private Banking 1859 and National Bank Financial - Wealth Management.

We appreciate the opportunity to provide our comments on the Proposed Amendments, and commend 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).

While direct sales charge ("DSC") options and trailing commissions are used for legitimate reasons and in accordance with the current regulations, we agree with the changes outlined in the Proposed Amendments related to DSC options. However, we do not support the ban of trailing commissions for discount brokers. We submit a few comments in this respect, as outlined below.

In our opinion, offering "D" Series with trailing commissions is a practical solution for distributing mutual funds through discount brokers, and should be maintained. We believe that in many cases, "D" Series would be more economical for the client than "F" Series with separate brokerage commissions. Charging fixed fees (e.g., fee-based account) to all clients without considering their portfolio could have a negative impact on small investors, which will limit their access to savings mechanisms. Conversely, charging commissions for each trade would be incompatible with the regular trades involved in systematic investment and withdrawal plans commonly used by mutual fund investors (e.g., paying a $10 commission to buy $50 of mutual funds). In either scenario, we would have to proceed to substantial system upgrades, whether to build a fee based system, or to modify our current systems that calculate mutual fund book values. A considerable number of operational issues without practical solutions would be raised as a result of banning trailing commissions for discount brokers, potentially limiting, or rendering further unattractive, access to mutual funds for modest investors. This does not appear in line with regulators' mandates to protect investors and foster efficient markets.

As a solution, we suggest that more transparent disclosure be required for "D" Series. For example, at the time of purchase, the discount broker could set up a reminder to the client (e.g., a popup with a checkbox) regarding the mutual fund the client is purchasing and the fees related to the series, including the indirect fees the discount broker will receive from the fund manufacturer. The client could confirm having been made aware of the information before completing the transaction. With this disclosure, discount brokers could keep "D" Series and enhance investor protection without causing client confusion through switches between different series. In addition, we believe that the Proposed Amendments to NI31-103 are sufficient to address the concerns pertaining to embedded commissions.

If trailing commissions are banned for discount brokers, we are of the view that investment fund managers should be free to use commission-free "D" Series, "F" Series or any other trailing commission-free series they choose to offer. This would be transparent to the investor as there would be a global understanding that no mutual fund has trailing commissions when sold through a discount broker. We also comment here on some other important issues to consider.

Identifying Discount Brokers

NBI, in its capacity as investment fund manager, encounters significant operational challenges in confirming which dealers are discount brokers; this confirmation would be required to identify those who would not be eligible to receive trailing commissions in compliance with an amended NI 81-105. Indeed, in many cases, the only reliable data accessible to NBI is one Fundserv code which is used by both a full-service broker and its affiliated discount broker. For such brokers, investment fund managers will need to have access to reliable data (such as a separate Fundserv code) to distinguish discount brokers from full service brokers in order to comply with any ban or requirement applicable only to discount brokers. The various investment fund managers, discount brokers and full-service

brokers all have systems that are built differently, with no practical-implemented adjustments to allow such platforms to exchange information reliably and seamlessly. This will have to be taken into consideration and addressed before any rule changes are implemented.

Switches

We are of the view that switches must be implemented by investment fund managers, not by brokers. If a discount broker were to rebate a trailer fee to a unitholder of a fund, adverse tax consequences could result for the entire fund as a result of the application of subsection 12(2.1) of the *Income Tax Act* (Canada). This provision, generally, includes in the income of a trust an amount received by a beneficiary of the trust as a reimbursement in respect of an expense of the trust. The rebate of the trailer fee to a unitholder would likely be a reimbursement of part of the management fee paid by the fund. Furthermore, it is possible that the amount would also be taxed in the hands of the unitholder as ordinary income under paragraph 12(1)(x) of the *Income Tax Act* (Canada), with no chance of it being taxed as a capital gain or return of capital. Moreover, the fund would bear harmonized sales tax on the full amount of the management fee including the portion ultimately rebated to the unitholder.

We believe that to implement switches, close collaboration between the broker and the investment fund manager is crucial. In fact, if switches are addressed on a case-by-case basis, there will be many impacts on all parties: investment fund managers, funds, brokers and clients. To maintain uniformity across the industry and to ensure consistency in clients' portfolios, investment fund managers should be required to implement any switches required as a result of trailing commission bans.

Moreover, discount brokers will continue to receive transfer requests containing DSCs or "A" Series perpetually. For this purpose, we would need more clarification on conversion delays to other series (e.g. should a grace period of 90 days, for example, be permitted following a transfer-in to allow for continuous switch processes to be implemented by investment fund managers on a quarterly basis?), investment fund manager requirements (e.g. what happens when no equivalent trailer-free series exists? Should the investor be forced to either redeem his/her position or to maintain a full-service brokerage account despite the desire of the client to transfer to a discount platform?), and several other issues.

Since the trades required to change series would not be borne of a client's investment decision, we also believe that the amended rule should provide an exemption from the requirement to deliver trade confirmations and fund facts documents (POS-3) for these switches. This exemption is necessary to facilitate switches to trailing commission-free classes or series of investment funds and to minimize client impacts. Also, we submit that filing fees payable to the AMF in respect of any material change reports and prospectus amendments tied to implementation of the changes arising as a result of the new rules should be waived.

Regulatory Arbitrage and Modernization of NI 81-105

We consider that the elimination of the DSC option may give rise to the risk of regulatory arbitrage with similar non-securities financial products, which would not be beneficial for investor protection. We encourage a collaborative approach among regulators to avoid the risk of regulatory arbitrage.

Therefore, we are of the opinion that investment products that are not mutual funds offered by way of prospectus should not be included in NI 81-105 at this time.

Similarly to Fixed-Rate Guaranteed Investment Certificates, structured deposits are conceived in such a way that the issuer's revenues are generated upon issuance as a percentage of the notional value (as opposed to a management fee on the daily net asset value for mutual funds). Given this fact, it is therefore logical that the distributor's fees are also paid upon issuance as a percentage of notional value. Furthermore, each structured deposit is built to achieve a specific defined outcome at maturity and is therefore positioned as a buy-and-hold investment. The full extent of returns is then not realized until maturity. Consequently, we can assess that there is no visible trend of investors selling a given structured product note following the end of the Deferred Sales Charge (DSC) period. It is also worth mentioning that the DSC period on structured product notes is usually no longer than 360 days, which is considerably shorter than the typical 5- to 7-years period of mutual fund DSCs.

We believe that it is unnecessary to have investments such as structured products included in NI 81-105 because they raise no investor protection issues. The current coverage is sufficient; if more requirements are placed upon these products, the cost of offering them will increase. In addition, it would be a significant challenge to identify, on a case-by-case basis, future investments for which the rules would apply.

We suggest that there be no change to the term "trailing commission". The term has been in use by the industry for a long time; it is a term with which interested clients have become familiar. Changing the term could cause more confusion, since they might think it is a new fee. Moreover, the term is currently used in a lot of documents, such as compliance manuals, policies and procedures, prospectuses, CRM2 reports, etc. Many unwarranted operational impacts are anticipated if the term is changed.

Transition Period

It is our view that the transition period of one year from the date of the publication of the final amendments is sufficient time to operationalize the Proposed Amendments.

Thank you for the opportunity to provide our views and recommendations regarding the Proposed Amendments. Should you require any further information or have any concerns regarding the foregoing, please do not hesitate to contact us.

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