



Advancing Standards™

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

[comments@osc.gov.on.ca](mailto:comments@osc.gov.on.ca) and [consultation-en-cours@lautorite.qc.ca](mailto:consultation-en-cours@lautorite.qc.ca)

**Re: Canadian Securities Administrators Notice and Request for Comment: Proposed Amendments to National Instrument 81-105 – Mutual Fund Sales Practices and Related Consequential Amendments**

---

**OVERVIEW AND BACKGROUND**

The Portfolio Management Association of Canada (**PMAC**), through its Industry, Regulation & Tax Committee, is pleased to have the opportunity to provide comments on the Canadian Securities Administrators' (**CSA**) notice and request for comment on proposed amendments to National Instrument 81-105 – *Mutual Fund Sales Practices* (**NI 81-105**) and related consequential amendments, collectively, the **Consultation**. Capitalized terms used in this letter but not defined here have the same meaning given to them in the Consultation.

PMAC members encompass both large and small portfolio management firms managing total assets in excess of \$1.8 trillion for institutional and private client portfolios.

We would like to thank the CSA for the work done by its members to draft the Consultation and for the opportunity to participate in various discussions on the very important proposals in this Consultation.

**FOCUS OF PMAC'S SUBMISSION**

PMAC advocates for the highest standard of unbiased portfolio management in the interest of the investors served by our members. In fact, that is PMAC's mission statement: advancing standards. For this reason, we are consistently supportive of measures that elevate standards in the industry, enhance transparency, improve investor protection and benefit the Canadian capital markets as a whole.

Through consultation with our over [250 investment management firms](#) registered with the CSA as portfolio managers, we understand that only a very small percentage of these firms use sales and

trailing commissions to compensate dealers and their representatives for mutual fund sales. While our membership is compensated for the provision of different services through a wide variety of fee models, the most prevalent compensation model is fees charged based on a percentage of an investor's assets under management. As a result, we believe that other industry associations are better positioned to provide specific feedback on the prohibition of the DSC Option as well as on trailing commissions by order-execution-only dealers.

Consequently, PMAC's response is primarily focused on aspects of the Consultation regarding the modernization of NI 81-105 and what implications the proposals may have for portfolio managers and their investors, especially with respect to the potential impact on pooled investment funds (**pooled funds**).

## **PMAC'S KEY RECOMMENDATION**

PMAC believes that the imposition of NI 81-105 is not warranted for pooled funds. The use of pooled funds differs fundamentally from retail mutual funds and they should not be treated similarly.

We note that the CSA has not articulated – nor are we aware of – any specific regulatory, market or investor protection concerns arising from the provision of pooled funds to investors that would necessitate the application of NI 81-105 to such funds. To the extent that there are any such concerns, we believe the CSA should explicitly state their nature to enable stakeholders to more effectively respond with suggestions as to their appropriate resolution.

PMAC is concerned that increased costs and regulatory burden on pooled funds could have unintended consequences on the continued ability to offer investors the unique benefits of pooled funds in a cost effective manner. Investor access to pooled funds should not be compromised as a result of an increased regulatory burden in the absence of specific policy concerns.

## **BACKGROUND TO OUR RECOMMENDATION**

### **Sophisticated clients, not retail clients**

Unlike funds subject to National Instrument 81-102 – *Investment Funds (NI 81-102)* that are currently subject to NI 81-105 sales practices and that are primarily sold to retail clients, pooled funds are generally only available to sophisticated investors (e.g. accredited investors that purchase under a prospectus exemption in National Instrument 45-106 – *Prospectus Exemptions*, or permitted clients under National Instrument 31-103 – *Registration Requirements, Exemptions and Ongoing Registrant Obligations (NI 31-103)*), or through discretionary accounts managed by portfolio managers.

Clients of portfolio managers benefit from a variety of protections, including investment management arrangements or agreements (**IMAs**) and a registrant that manages a discretionary portfolio on the client's behalf in accordance with the requirements of NI 31-103 and the terms of an investment policy statement (**IPS**). These protections are overlaid by the duty of care owed by portfolio managers to their clients. Accredited investors and permitted clients are sophisticated investors and pooled funds can only be distributed through (i) exempt market dealers (**EMDs**), (ii) IIROC registered dealers or (iii) portfolio managers whose clients have entered into an investment management agreement for a discretionary account.

This is in contrast with NI 81-102 funds which can be sold by MFDA and IIROC members to retail investors.

## Regulatory framework

[PMAC's submission](#) to the CSA on the proposed amendments to National Instrument 31-103 – *Registration Requirements, Exemptions and Ongoing Obligations* (**NI 31-103**, the **Client Focused Reforms**), outlines our concerns with respect to certain of the enhanced conflicts of interest and know your product (**KYP**) provisions as they apply to pooled funds as proprietary products. PMAC has requested that the CSA exempt pooled funds from the application of certain of those conflicts and KYP requirements, as more fully set out in that submission.

Despite our concerns, PMAC believes that the more general proposed amendments to the conflicts of interest framework with an increased focus on the analysis, mitigation/avoidance and disclosure obligations would still adequately address any regulatory concerns regarding conflicts of interest for pooled funds, without necessitating the regulatory burden of compliance with sales practices in NI 81-105.

Likewise, even if the proposed KYP requirements in the Client Focused Reforms were to be applied to pooled funds, portfolio managers adequately know their products. This is especially true in the context of pooled funds where the portfolio managers who offer these funds to clients are the creators of their own “products”, and typically also act as the investment fund manager (**IFM**). We also note that a statutory standard of care applies to IFMs in some provinces such as Ontario.

As set out in Section 2.2 of the Companion Policy to NI 81-105, the purpose of the instrument is to, among other things:

Provide a minimum standard of conduct to ensure that investor interests remain uppermost in the actions of mutual fund industry participants when they are distributing mutual fund securities and that conflicts of interest arising from sales practices and compensation arrangements are minimized<sup>1</sup>.

The standards of conduct under NI 31-103, in addition to any enhancements introduced with respect to conflicts and KYP, provides sufficient protection and requires the management, avoidance of disclosure of any material conflicts to pooled funds investors.

### **HOW PORTFOLIO MANAGERS USE POOLED FUNDS TO HELP INVESTORS SAVE**

Many portfolio managers use pooled funds that are designed to implement a certain investment strategy or to satisfy a specific mandate for a client. Pooled funds are beneficial as they allow investors access to investments they may not otherwise have, as well as help reduce overall expenses, such as custody, fund administration, and trading costs, since these costs are shared by all investors in the pooled fund. Pooled funds also carry with them the benefit of fairness in trade allocation<sup>2</sup>.

PMAC has concerns about additional regulatory burden being imposed on pooled funds generally, as well as on pooled funds managed by PMs for their discretionary clients, given their unique features and benefits. Pooled funds offer investors the benefit of access to a wider range and diversification of securities than they may have otherwise had access to in smaller, segregated accounts. Pooled funds tend to be manufactured for a sophisticated client with higher net worth than a retail client, but whose assets under management are not sufficiently large to support the

---

<sup>1</sup> Also cited in the Settlement Agreement between Staff of the Ontario Securities Commission and Sentry Investments Inc. and Sean Driscoll at para 2.

<sup>2</sup> When a portfolio manager purchases securities for the account of the pooled fund, all clients as unitholders are treated in the same manner without subjectivity bias. All investors participate equally in purchases and sales in accordance with their pro rata interest/unit ownership in the pooled fund, being a model for fairness in trade allocation. Source: [Pooled Funds: Benefits and Pitfalls](#).

creation and management of a separate account. Pooled funds play a specific and beneficial role for Canadian investors.

Some members have voiced doubts as to whether they will be able to justify the costs of having to comply with enhanced KYP requirements for pooled funds – as set out in the Client Focused Reforms – and, now, with sales practices under NI 81-105, should they be extended to pooled funds. This is especially concerning where the clients in question are sophisticated and where no regulatory concerns have been identified.

The imposition of new and unnecessary regulatory burden on pooled funds may threaten the very important benefits of such funds, namely: the access, diversification, trade allocation fairness and lower costs they offer to investors.

## **MODERNIZATION OF NI 81-105 AND THE CLIENT FOCUSED REFORMS**

PMAC values the extensive work done by the CSA to propose nationally harmonized reforms to enhance the client-registrant relationship through the Client Focused Reforms.

Subject to PMAC's specific recommendations and requests to the CSA regarding the application of the Client Focused Reforms to portfolio managers, we are generally supportive of enhanced conflicts of interest obligations. PMAC's submission in respect of the Client Focused Reforms can be reviewed [here](#). We believe the interplay between the Client Focused Reforms and the modernization of other securities law instruments such as NI 81-105 is of utmost importance and that the impact of certain Client Focused Reforms on registrant conduct and disclosure should be considered when proposing other legislative amendments, such as those to NI 81-105.

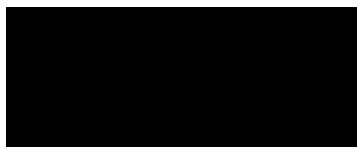
## **CONCLUDING COMMENTS**

The consultative process and the opportunity to share member feedback on this critical aspect of regulatory policy making are important to PMAC. Please do not hesitate to reach out to us should there be any clarification or follow-up prompted by our submissions herein. We would be delighted to elaborate on any point or, to the extent possible, to provide you with more tailored member feedback on specific issues.

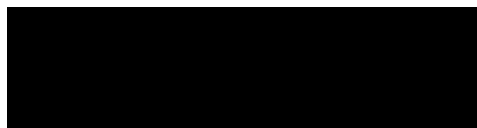
Consistent with our other advocacy, we ask the CSA to carefully consider the many ways in which portfolio managers as individuals and firms differ from other registrants and to keep this fundamental distinction in mind when revisiting the appropriate scope and application of proposed amendments to NI 81-105.

Sincerely,

PORTFOLIO MANAGEMENT ASSOCIATION OF CANADA



Katie Walmsley  
President  
Portfolio Management Association  
of Canada



Margaret Gunawan  
Managing Director – Head of Canada Legal  
& Compliance  
BlackRock Asset Management Canada  
Limited