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Nova Scotia Securities Commission
Superintendent of Securities, Newfoundland and Labrador
Superintendent of Securities, Yukon Territory
Superintendent of Securities, Northwest Territories
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CSA Notice and Request for Comment
Proposed Amendments to National Instrument 81-105 Mutual Fund Sales Practices and Related Consequential Amendments
http://www.osc.gov.on.ca/documents/en/Securities-Category8/csa_20180913_81-105_mutual-fund-sales.pdf

I am a retired senior who has experienced first-hand the abuses that DSC sold funds have caused to my wife and I related to our RRIF investments portfolio. I welcome the opportunity to tell the CSA how I feel about the consultation and how they have neglected the retail investor for over a decade.

The Deferred Sales Charge option

The CSA openly state that the DSC sales option is toxic to the retail investor: "In our view, the conflicts of interest inherent in the DSC option give rise to a number of specific problematic practices and investor harms that warrant regulatory action. We consider, and several industry and investor stakeholders agree, that the conflicts of interest inherent in the DSC option are generally difficult to resolve in the best interests of investors and that this purchase option should therefore be eliminated. "- http://osc.gov.on.ca/documents/en/Securities-Category8/csa_20180621_81-330-status-report.pdf

"While the DSC option may, on its face, appear to be beneficial to investors because it does not require them to pay an initial commission, it can still have a significant impact on the investor because of its impact on investor behavior. This is due to the "lock-in" feature of the DSC option created by the redemption fee that is payable on investments that are redeemed within a certain number of years of purchase (typically up to 7 years from the date of purchase for the traditional Deferred Sales Charge option). <u>This penalty can significantly deter investors from redeeming an investment or changing their asset allocation, even in the face of consistently poor fund performance, unforeseen liquidity events, or change in their financial circumstance.</u> Empirical mutual fund fee research commissioned by the CSA demonstrates the effect the redemption penalty may have on an investor, as it indicates that investments made under the DSC option show the lowest sensitivity to past performance out of all available purchase options analyzed".- http://osc.gov.on.ca/documents/en/Securities-Category8/csa_20180621_81-330-status-report.pdf

<u>There is nothing new about the forgoing revelation that the CSA have not been made aware of multiple times over the past s-years.</u> The CSA also note that the use of the DSC option can lead to higher fund costs due to the fact that an investment fund manager's cost to finance the payment of the upfront commission on purchases made on a DSC option basis is funded from the fund's annual management fees. Unless DSC option investors are segregated into a separate fund series all investors in a fund bear those financing costs irrespective of the purchase option under which they made their investment. This means that FEL option investors unknowingly subsidize the financing costs of the 5% upfront commission on DSC option transactions and accordingly pay higher management fees than they otherwise would.

A 2015 targeted sweep of MFDA Members DSC option trading activity demonstrated mis-selling, <u>particularly with respect to senior investors.</u> Among other practices, the MFDA showed that clients were sold funds with DSC option redemption schedules that were longer than their investment time horizon, and showed that clients over the age of 70 were improperly sold funds under DSC option <u>for their RRIF portfolios requiring immediate de-accumulation payouts</u>. Did IIROC and the MFDA jump in and hold these dealers accountable? Were any losses suffered by these hapless investors recovered? Were they made whole?

The CSA are now well aware of the harm the DSC sold option is doing every day. So why does it not act? On the CSA website front page we see this image:

How does allowing a toxic product to be sold maintain confidence in Canada's markets? Can you imagine the regulator for Health ever consulting on a toxic food knowing that people were ingesting it with harmful effects? They would take immediate steps to stop the harm. That is what should be done NOW by the CSA- stop consulting – do your job and protect Canadians.

I certainly agree with the proposal to ban DSC sold mutual funds. Along with CSA research and findings, the blog http://www.canadianfundwatch.com/2015/09/the-dsc-sold-mutual-fund-under.html *The DSC sold Fund Under the Microscope* clearly demonstrates the toxic nature of this sales method. The Stromberg report flagged the mis-selling issue back in 1998. [It is interesting to note that Ms Stromberg is now an employee of IPC and they have recently voluntarily discontinued the DSC sales option. It has taken a very long time and millions of dollars in lost investor retirement savings but now it looks like the CSA is finally prepared to act. But consulting is not acting. This consultation is merely dragging out the pain and anguish of unsophisticated retail investors. **[See Footnote (1) re Ontario Govt decision to block the CSA removal of the DSC sales option and other investor protection initiatives]**

It should be noted that the mutual-fund industry has voluntarily shied away from DSCs. In Sept. 2016 Investors Group announced it would be discontinuing the DSC purchase option as of Jan. 1, 2017. As at the end of December 2016, a total of 18% of mutual fund assets were held in the DSC option (with the low-load option comprising just 5% of this figure). Assuming $1.5 Trillion in fund assets, this amounts to about $270 billion trapped in DSC funds. Additionally, the CSA also note that the Canadian fund market is quite unique in its relative reliance on the DSC option. For example, while making up almost 20% of mutual fund assets in Canada, this option makes up less than 1% of mutual fund assets in the United States and Europe. But I suspect the reason is the determined SEC action and enforcement.

Banning the DSC purchase option outright now will drive a fair number of scoundrels out of the industry which will improve investor protection. The faster this is done the better. Bottom line-I do not agree at all to the CSA's planned glacial speed approach to protecting Canadians

I note that the OSC Investor Advisory Panel are suggesting a retroactive trigger on the DSC Rule should be incorporated in the Consultation- it was totally ignored.

http://www.osc.gov.on.ca/documents/en/Securities-Category8/com_20180820_81-330_iap.pdf Why? I also note that the Kenmar OPEN Letter asking that there be no consultation because the CSA already knows what needs to be done was also set aside. Ref *Open Letter to the CSA on embedded commissions and DSC* http://www.canadianfundwatch.com/2018/08/open-letter-to-csa-on-embedded.html It seems almost nothing retail investors offer as suggestions is acceptable to the CSA.

The proposals, which are out for a short 90-day comment period contemplate a one-year transition period from the time final rules are adopted. The CSA indicates that it doesn't expect firms to convert existing mutual funds sold with DSCs into a different sales charge option. Those redemption schedules would be allowed to run until expiry and dealers would also be able to sell toxic DSC funds during the transition. With new sales and reinvested distributions, this would therefore keep the DSC sold Funds breathing until 2026 and possibly forever! How can this possibly be acceptable to regulators? It certainly isn't acceptable to me. The CSA is giving the fund industry one last crack at the investor trough. A very strange form of investor protection.

In May 2017 the Investment Funds Institute of Canada (IFIC) called on regulators to establish rules to ensure that mutual funds carrying an embedded advisor fee are sold only in channels where advice is permitted. **"Investors who buy funds directly, for example through a discount broker, should be confident that they are not inadvertently overpaying by selecting a series that includes fees for services that are not available through that platform**," –
Paul C. Bourque, Q.C., IFIC's president and CEO. It is now 16 months later and we are just now getting a proposed rule. This suggests a complete lack of urgency within the CSA in protecting Main Street.

I recommend that the CSA immediately issue a Cease Trade order to contain the carnage. In addition, the CSA should mount a high profile Canada-wide investor education campaign informing investors of the known harms DSC sold funds impose on Canadians. It is unconscionable that this was not done years ago.

Dealers selling products with embedded services and advice

For well over a decade, investor advocates have requested that IIROC stop the exploitation of clients by allowing discount brokers receiving A series mutual fund trailer commissions for advice they cannot give. The CSA should compel IIROC to direct its discount broker Members to stop selling Series A funds to their clients. There is no need for this consultation whatsoever if regulators would do their investor protection job.

I don't know how much money was paid out to the online trading companies, the RBCs, the TD Waterhouses and all, over the years but I've got to think there was hundreds of millions of dollars paid annually by the fund companies to these dealers for doing basically nothing. Why the CSA did not enforce a fiduciary stand on the fund manufacturers for all these years is beyond my understanding. It is fundamental Investor protection. I recommend that the CSA take prompt enforcement action against all fund companies that continue to utilize fund assets to pay trailer commissions to dealers for advice and services they know will not be provided. To the average Canadian this sounds like robbery. The main beneficiaries of this practice are the fund companies who accumulate more fee-based assets and the discount brokers who receive cash for doing ZIP. The loser, as usual, Main Street investors.

To address potential conflicts in the discount brokerage channel and other instances where dealers do not make investment recommendations, as well as to better align the fees investors pay with the services they receive, the Consultation Paper proposes to prohibit mutual fund managers from paying, and dealers from soliciting and accepting, trailing commissions (whether for advice or any other service), where the dealer does not make a suitability determination in connection with the distribution of prospectus qualified mutual fund securities.
http://www.osc.gov.on.ca/en/SecuritiesLaw_csa_20180621_81-330-status-report.htm Why does a constraint on abusing fund assets need a consultation? Why such a roundabout way of addressing a simple problem?

I urge the CSA to change this to any product, not just mutual funds and to explicitly state that any product with an embedded fee or commission for a service / advice that cannot be provided by the discount or other dealer should not be available on the platform. Full stop. If this wording is not changed, the imaginative investment industry will be able to design products that circumvent the regulatory intent. For example, ETF's could again offer a series with embedded commissions.

Why was it necessary for class action lawyers to do the CSA's job? The proposal from the Canadian Securities Administrators (CSA) is being made just a few months after a $200 million class action law suit was filed against TD Asset Management Inc. (TDAM) and another $200 million suit against (Scotiabank's) 1832 Asset Management L.P. in regard to trailing commissions paid to discount brokers on
A series mutual funds. The court process will be long and stressful for victims.

Finally, I add this observation. It is a well-known fact that while NI81-105 came into force in 1998, the first enforcement action did not occur until 2017! That's nearly 20 years of inaction. For more than a decade investor advocates pleaded with IIROC to stop discount brokers from selling mutual fund series A to their clients. Nothing was ever done and there is NIL action even today. Why should Canadians believe that the new rules, even if approved, will be enforced by IIROC and the CSA? Provide just one reason.

I hope this forthright feedback is useful to you.

Footnote [1] – My CSA 81-105 Submission had been under development for the past week or so. And now we learned last week that the Ontario Finance Minister alone has decided to block the CSA removal of the DSC sales option as well as other investor protection initiatives.

The Minister does not seem to understand that selling mutual funds with the associated detrimental Deferred Sales Conditions (DSC) illusions is morally indefensible. It is also disingenuous and indefensible for the Ontario Government to now expropriate and override 6+ years of the Canadian Securities Administrators and other Provincial Securities Regulators efforts to bring the Financial Advisor sales remuneration more relative to the advice services that are delivered.

The Minister and those in the Ontario Government who are saying that their reason for blocking these CSA investor protection initiatives was because it was developed under the sponsorship of the previous Liberal administration should take the time to read my CSA 81-105 and all the other previous submissions by affected parties on this subject matter. What you see is not a politically connected problem.

Now that the Ontario Government has torpedoed the CSA initiatives, the problem appears to be that there has been an influence from certain parties in the financial services organizations who wish to maintain the present egregious 5% to 6% Advisor mutual fund sales commissions. This is even when the advice given can leave the unknowing investor with the undeclared liabilities of DSC penalties. This IS morally indefensible by any measure !

There needs to be communications - There would be a much more constructive approach to a resolution of the DSC subject matter if the Ontario Finance Minister would come forward with a list of the reasons for his actions to subvert the outcome of the CSA initiatives. The Minister must then convene a meeting with all the CSA, OSC and other Provincial Securities stakeholders and IIROC as well as investor advocate representatives to clean up the DSC and other related issues.

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Permission is granted for public posting. The faster it is posted the better some Canadians can see what is being done (or not) to protect their hard earned money.

Peter Whitehouse
Senior Retail Investor

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