

## CSA Notice of Consultation

### Draft Regulation to Amend *Regulation 31-103 respecting Registration Requirements, Exemptions and Ongoing Registrant Obligations, Regulation 81-101 respecting Mutual Fund Prospectus Disclosure, Regulation 81-102 respecting Investment Funds and Regulation 81-105 respecting Mutual Fund Sales Practices*

and

### Draft Changes to *Policy Statement to Regulation 31-103 respecting Registration Requirements, Exemptions and Ongoing Registrant Obligations, Policy Statement to Regulation 81-102 respecting Investment Funds and Policy Statement to Regulation 81-105 respecting Mutual Fund Sales Practices*

## The Principal Distributor Model

November 28, 2024

### Introduction

The Canadian Securities Administrators (the **CSA** or **we**) are proposing amendments to the principal distributor model in the distribution of mutual fund securities.

We are publishing, for a 90-day comment period, draft amendments (the **Draft Amendments**) to

- *Regulation 31-103 respecting Registration Requirements, Exemptions and Ongoing Registrant Obligations (**Regulation 31-103**),*
- *Regulation 81-101 respecting Mutual Fund Prospectus Disclosure (**Regulation 81-101**),*
- *Regulation 81-102 respecting Investment Funds (**Regulation 81-102**),*
- *Regulation 81-105 respecting Mutual Fund Sales Practices (**Regulation 81-105**)*

and draft changes (the **Draft Changes**) to

- *Policy Statement to Regulation 31-103 respecting Registration Requirements, Exemptions and Ongoing Registrant Obligations (**Policy Statement 31-103**),*

- *Policy Statement to Regulation 81-102 respecting Investment Funds (Policy Statement 81-102)*, and
- *Policy Statement to Regulation 81-105 respecting Mutual Fund Sales Practices (Policy Statement 81-105)*.

In addition to the Draft Amendments and the Draft Changes, we have also set out questions for stakeholders to consider (**Consultation Questions**) in Annex A of this notice. The public comment period expires on February 27, 2025.

The text of the Draft Amendments and the Draft Changes is published with this notice and will also be available on the websites of the following CSA jurisdictions:

www.besc.bc.ca  
 www.asc.ca  
 www.fcaa.gov.sk.ca  
 www.mbsecurities.ca  
 www.osc.ca  
 www.lautorite.qc.ca  
 www.fcnb.ca  
 nssc.novascotia.ca

## **Substance and Purpose**

The Draft Amendments address the principal distributor model for mutual funds and seek to improve investor protection and maintain investor confidence in our capital markets. The Draft Amendments clarify that a principal distributor may only act for mutual funds in the same mutual fund family, require disclosure of principal distributor arrangements and compensation and ensure that the DSC option (as defined below) is not available to investors purchasing mutual fund securities distributed by principal distributors.

### **(a) Principal Distributor Model**

The general purpose of Regulation 81-105, as set out in Policy Statement 81-105, is to “ensure that the interest of investors remain uppermost in the actions of participants in the mutual fund industry by setting minimum standards of conduct to be followed by industry participants in their activities in distributing mutual fund securities.”

Mutual fund securities are distributed by participating dealers and principal distributors. Principal distributors are carved out of the definition of “participating dealer” in Regulation 81-102 because they have an exclusive right to distribute mutual fund securities in a particular area or a feature that gives, or is intended to give, the principal distributor a material competitive advantage over others in the distribution of mutual fund securities.

Principal distributors offer the exclusive distribution of, or benefit from a feature that gives the principal distributor a material competitive advantage over others in the distribution of, mutual fund securities of an investment fund manager (**manager**) that is an affiliate, or in

some cases, an unaffiliated manager. They might have ongoing participation in the design, selection, as well as ongoing training and monitoring in respect of the mutual fund products that it distributes. Such an arrangement would allow a principal distributor to customize the range of mutual fund products that are offered to clients. This participation in the product development process is recognized by the fact that principal distributors are required to review and certify the prospectus. As a result, they share liability with managers for the disclosure provided in mutual fund offering documents with managers.

Principal distributors are not subject to all the provisions of Regulation 81-105 that apply to participating dealers. The reason for the principal distributor carve-outs from Regulation 81-105 is provided in the CSA's notice of draft Regulation 81-105<sup>1</sup> published on July 25, 1997 (the **1997 Consultation**). The 1997 Consultation states that the representatives of principal distributors are "employed to sell only mutual funds within the principal distributor's mutual fund family."<sup>2</sup> In reference to principal distributors, the 1997 Consultation indicated that "IFIC noted that an ordinary investor purchasing a product in an environment in which the only product offered is an in-house brand knows, just as the ordinary car purchaser knows, that their choice in that environment is limited."<sup>3</sup>

Regulation 81-105 established minimum standards of conduct in the distribution of mutual fund securities to minimize conflicts of interests between industry participants and investors. Principal distributors are carved out of the Regulation 81-105 provisions that apply to participating dealers because the conflicts of interest raised by participating dealers distributing mutual fund securities of multiple managers are less acute for principal distributors distributing only mutual fund securities of the same mutual fund family. Regulation 81-105 also imposes additional obligations on a "principal distributor" as a "member of the organization", which is consistent with the broader framework of Regulation 81-105. The premise that principal distributors only distribute mutual fund securities of the same mutual fund family is the basis for the principal distributor carve-outs from some Regulation 81-105 obligations, however, this premise is currently not captured in the provisions of Regulation 81-105. The Draft Amendments clarify that principal distributors may only distribute mutual fund securities of the same mutual fund family.

## **(b) Disclosure of Principal Distributor Compensation**

One of the fundamental obligations of industry participants to their investor clients is to provide full, true and plain disclosure of all material facts concerning a mutual fund, including the compensation paid to participating dealers and their representatives and other sales practices followed in connection with the distribution of mutual fund securities, which is essential to ensure that investors understand the nature of the investments they are

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<sup>1</sup> Notice of Proposed Changes to Proposed Rule 81-503 and Companion Policy 81-503CP *Sales Practices Applicable to the Sale of Mutual Fund Securities* and Notice of Proposed National Instrument 81-105 and Companion Policy 81-105CP *Mutual Fund Sales Practices* published on July 25, 1997 at (1997), 20 OSCB 3979.

<sup>2</sup> See footnote 1 above, 3907.

<sup>3</sup> See footnote 2 above.

making and the impact of fees and charges on them.<sup>4</sup> This fundamental obligation also extends to the disclosure of the compensation paid to principal distributors and their representatives. The Draft Amendments require disclosure of principal distributor arrangements and compensation.

**(c) Deferred Sales Charge Option**

Previously, under the deferred sales charge option (**DSC option**), the investor did not pay an initial sales charge for purchased fund securities but paid a redemption fee to the manager (i.e., a deferred sales charge) if the securities were redeemed before a predetermined period from the date of purchase. Redemption fees decline according to a redemption fee schedule that is based on the length of time the investor holds the securities. While the investor did not pay a sales charge to the dealer, the manager paid the dealer an upfront commission.

As of June 1, 2022, the CSA adopted amendments (**DSC Ban Amendments**)<sup>5</sup> to prohibit managers from paying upfront sales commissions to participating dealers in respect of mutual fund securities, which were intended to result in the discontinuation of all forms of the DSC option. The DSC Ban Amendments addressed the conflict of interest that arose from the payment of the upfront sales commission by managers to participating dealers for mutual fund sales made under the DSC option that could incentivize participating dealers and their representatives to make self-interested investment recommendations to the detriment of investor interests. This same conflict of interest arises from the payment of the upfront sales commission by managers to principal distributors. However, as principal distributors are carved out of the Regulation 81-105 provisions that apply to participating dealers, the DSC Ban Amendments do not technically apply to principal distributors. While we do not see the DSC option currently being made available by principal distributors, to ensure that the DSC option is not available to investors purchasing mutual fund securities from participating dealers or principal distributors, managers should be prohibited from charging a fee to investors upon the redemption of mutual fund securities in all circumstances.

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<sup>4</sup> Section 2.2(2)(f) of Policy Statement 81-105.

<sup>5</sup> CSA Multilateral Notice of Publication, *Amendments relating to Prohibition of Deferred Sales Charges for Investment Funds*, Regulation to amend Regulation 81-105 respecting Mutual Fund Sales Practices, *Amendments to Companion Policy 81-105: Mutual Fund Sales Practices*, *Amendments to Policy Statement to Regulation 81-101 respecting Mutual Fund Prospectus Disclosure* published on February 20, 2020 and OSC Notice of Local Amendments to National Instrument 81-105 *Mutual Fund Sales Practices*, Local Changes to Companion Policy 81-105 *Mutual Fund Sales Practices* and Related Consequential Local Amendments and Changes – Prohibition of Deferred Sales Charges for Mutual Funds published on June 3, 2021.

## Background

### *CSA 2018 Consultation*

The CSA published draft amendments (the **2018 Consultation**) on September 13, 2018 to

- (a) prohibit fund organizations from paying upfront commissions to dealers, resulting in the discontinuation of all forms of the DSC option, including low-load options (**DSC Ban**), and
- (b) prohibit the payment of trailing commissions to dealers who were not subject to a suitability requirement, such as dealers who were not required to provide investment recommendations in connection with the distribution of prospectus qualified mutual fund securities (**OEO Trailer Ban**).

Subsequent to the 2018 Consultation, the CSA published final amendments<sup>6,7</sup> to adopt both the DSC Ban and the OEO Trailer Ban, which took effect on June 1, 2022.

In the 2018 Consultation, the CSA indicated that we may consider future amendments to modernize Regulation 81-105. The 2018 Consultation included questions to stakeholders which were intended to inform the CSA's initiative to modernize Regulation 81-105.

### *2022 – 2025 CSA Business Plan*

One of the strategic goals of the 2022-2025 CSA Business Plan<sup>8</sup> is to improve investor protection by enhancing investors' ability to obtain redress and strengthening the advisor-client relationship. In furtherance of this goal, the CSA has stated its commitment to the modernization of mutual fund sales practices as follows:

- “Review and modernize NI 81-105 *Mutual Fund Sales Practices* and contemplate whether amendments are necessary in light of the Client Focused Reforms - including reviewing principal distributors' practices, considering whether amendments are needed to clarify the circumstances in which a principal distributor model should be available and whether such a model remains appropriate in light of the Reforms”.<sup>9</sup>

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<sup>6</sup> See footnote 4 above.

<sup>7</sup> CSA Notice of Publication, Regulation to amend Regulation 81-105 respecting Mutual Fund Sales Practices, *Related Consequential Amendments, Prohibition of Mutual Fund Trailing Commissions Where No Suitability Determination Was Required* published on September 17, 2020.

<sup>8</sup> See page 7: 2022-2025 CSA Business Plan, [https://www.securities-administrators.ca/wp-content/uploads/2022/10/2022\\_2025CSA\\_BusinessPlan.pdf](https://www.securities-administrators.ca/wp-content/uploads/2022/10/2022_2025CSA_BusinessPlan.pdf).

<sup>9</sup> See footnote 8 above.

## **Summary of the Draft Amendments and the Draft Changes**

The following is a summary of the Draft Amendments and the Draft Changes:

### **(a) Principal Distributor Model**

The Draft Amendments clarify that a dealer cannot have multiple principal distributor relationships except where it acts as a principal distributor for mutual funds in the same mutual fund family. A mutual fund family is defined in Regulation 81-105 as “two or more mutual funds that have (a) the same manager, or (b) managers that are affiliates of each other.”

The Draft Amendments do not affect the ability of a principal distributor to also distribute mutual fund securities as a participating dealer to multiple managers. Additionally, although a dealer can act as principal distributor for a mutual fund family, managers that are affiliates of each other are not required to have the same principal distributor. A manager may also have more than one principal distributor for the distribution of its mutual fund securities.

### **(b) Principal Distributor Practices**

The Draft Amendments replicate the prohibition on providing incentives to representatives to recommend mutual funds of one family over another that currently applies to participating dealers to also apply to principal distributors. More specifically, the Draft Amendments aim to prohibit a principal distributor from providing incentives to representatives to recommend one mutual fund over another mutual fund.

### **(c) Disclosure of Principal Distributor Compensation**

The Draft Amendments will require the simplified prospectus (**SP**), fund facts document (**Fund Facts**) and annual report on charges and other compensation (**ARCC**) to disclose that the principal distributor has the exclusive right to distribute funds and if the principal distributor receives a payment, other than trailing commissions, in connection with services provided to the fund manager and the funds as a principal distributor, the maximum percentage of the management fee that is paid by the manager to the principal distributor for its services.

### **(d) Prohibition on Fees for Redemptions**

As discussed under the sub-heading “Deferred Sales Charge Option” in “Substance and Purpose” above, to ensure that the DSC option is not available to investors purchasing mutual fund securities from principal distributors, the Draft Amendments prohibit managers from charging a fee to investors upon the redemption of mutual fund securities. The Draft Amendments include an exception for mutual fund securities purchased prior to June 1, 2022 for so long as such securities are subject to a redemption fee schedule.

The Draft Amendments do not impact fees charged by a mutual fund (as opposed to a manager) to investors in connection with the redemption of mutual fund securities that are not based on the sales charge option, such as fees for short-term trading and large redemption orders, provided that such fees are retained by the mutual fund for the benefit of remaining securityholders.

As a housekeeping amendment, the Draft Amendments will also repeal the provision related to commission rebates. The provision applies to commission rebates from dealer representatives who paid all or part of the redemption fee when an investor redeemed mutual fund securities purchased under the DSC option from one mutual fund family and purchased mutual fund securities under the DSC option from a different mutual fund family. It is our understanding that this provision is only used in the context described above, i.e., a transaction that includes a purchase of new mutual fund securities under the DSC option. However, since the purchase of new mutual fund securities under the DSC option is no longer permitted under the DSC Ban, this provision is no longer required. The housekeeping amendment is expected to come into force approximately 90 days after final publication.

## **Transition**

We are proposing that the Draft Amendments and the Draft Changes will come into force 3 months after the final publication date with the exception of:

- the Draft Amendments to Regulation 31-103 and the Draft Changes to Policy Statement 31-103, and
- the Draft Amendments to Regulation 81-105.

The CSA recognizes that existing business models or new business models might be developed that do not fit within the parameters of the Draft Amendments. The CSA encourages commenters whose existing business model in particular might be uniquely impacted by the Draft Amendments to provide feedback as to whether there are alternative transition measures that could ease any burden for a particular business model in changing their business model to align with the Draft Amendments.

### **(a) Draft Amendments to Regulation 31-103 and Draft Changes to Policy Statement 31-103**

The Draft Amendments to Regulation 31-103 and the Draft Changes to Policy Statement 31-103 will come into force on January 1, 2026. The effective date will coincide with the January 1, 2026 effective date of the final amendments and changes

published on April 20, 2023 by the CSA and the Canadian Council of Insurance Regulators relating to Total Cost Reporting for Investment Funds and Segregated Funds.<sup>10</sup>

**(b) Draft Amendments to Regulation 81-105**

The Draft Amendments to Regulation 81-105 will come into force 18 months after the final publication date. We anticipate that the period between the final publication date and the effective date will provide sufficient time for principal distributors who act as a principal distributor for more than one unaffiliated manager to transition their practice, operational model and compensation arrangements. Any impacted managers will need to make alternate distribution arrangements for their mutual fund securities prior to the effective date.

We are seeking comments on the appropriate transition period for the Draft Amendments to Regulation 81-105. Please see the Consultation Questions in Annex A.

**Local Matters**

An annex is being published in any local jurisdiction that is making changes to local securities laws, including local notices or other policy instruments in that jurisdiction. It also includes any additional information that is relevant to that jurisdiction only.

**Request for Comments**

Please submit your comments on the Draft Amendments, the Draft Changes and the Consultation Questions in this notice. We cannot keep submissions confidential because securities legislation requires publication of a summary of written comments received during the comment period. All comments received will be posted on the website of each of the Alberta Securities Commission at [www.asc.ca](http://www.asc.ca), the Ontario Securities Commission at [www.osc.ca](http://www.osc.ca) and the Autorité des marchés financiers at [www.lautorite.qc.ca](http://www.lautorite.qc.ca). Therefore, you should not include personal information directly in comments to be published. It is important you state on whose behalf you are making the submissions.

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<sup>10</sup> CSA and CCIR Notice of Publication – *CCIR Individual Variable Insurance Contract Ongoing Disclosure Guidance*, Regulation to amend Regulation 31-103 respecting Registration Requirements, Exemptions and Ongoing Registrant Obligations, *Amendments to Policy Statement to Regulation 31-103 respecting Registration Requirements, Exemptions and Ongoing Registrant Obligations – Total Cost Reporting (TCR) for Investment Funds and Segregated Funds* published on April 20, 2023.



## **Deadline for Comments**

Please submit your comments in writing on or before February 27, 2025. If you are not sending your comments by email, please send a USB flash drive containing the submissions (in Microsoft Word format).

## **Where to Send Your Comments**

Address your submission to all of the CSA as follows:

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

Deliver your comments only to the addresses below. Your comments will be distributed to the other participating CSA jurisdictions.

Me Philippe Lebel  
Corporate Secretary and Executive Director, Legal Affairs  
Autorité des marchés financiers  
Place de la Cité, tour Cominar  
2640, boulevard Laurier, bureau 400  
Québec (Québec) G1V 5C1  
Fax: 514 864-8381  
Email: [consultation-en-cours@lautorite.qc.ca](mailto:consultation-en-cours@lautorite.qc.ca)

The Secretary  
Ontario Securities Commission  
20 Queen Street West  
22nd Floor  
Toronto, Ontario M5H 3S8  
Fax: 416 593-2318  
Email: [comments@osc.gov.on.ca](mailto:comments@osc.gov.on.ca)

## Content of Annexes

This notice contains the following annex:

Annex A: Consultation Questions

### Questions

Please refer your questions to any of the following:

#### *Autorité des marchés financiers*

Ata Kassaian  
Senior Policy Analyst,  
Investment Products Oversight  
Autorité des marchés financiers  
Tel: 514 395-0337, ext. 4457  
Email: [ata.kassaian@lautorite.qc.ca](mailto:ata.kassaian@lautorite.qc.ca)

Philippe Lessard  
Analyst, Investment Products Oversight  
Autorité des marchés financiers  
Tel: 514 395-0337, ext. 4364  
Email: [philippe.lessard@lautorite.qc.ca](mailto:philippe.lessard@lautorite.qc.ca)

Gabriel Vachon  
Analyst, Investment Products Oversight  
Autorité des marchés financiers  
Tel: 514 395-0337, ext. 2689  
Email: [gabriel.vachon@lautorite.qc.ca](mailto:gabriel.vachon@lautorite.qc.ca)

#### *British Columbia Securities Commission*

Kathryn Anthistle  
Senior Legal Counsel, Legal Services  
Capital Markets Regulation Division  
British Columbia Securities Commission  
Tel: 604 899-6536  
Email: [kanthistle@bcsc.bc.ca](mailto:kanthistle@bcsc.bc.ca)

Noreen Bent  
Chief, Corporate Finance Legal Services  
British Columbia Securities Commission  
Tel: 604 899-6741  
Email: [nbent@bcsc.bc.ca](mailto:nbent@bcsc.bc.ca)

#### *Alberta Securities Commission*

Chad Conrad  
Senior Legal Counsel, Investment Funds  
Alberta Securities Commission  
Tel: 403 297-4295  
Email: [chad.conrad@asc.ca](mailto:chad.conrad@asc.ca)

*Financial and Consumer Affairs Authority of Saskatchewan*

Heather Kuchuran  
Director, Corporate Finance  
Financial and Consumer Affairs Authority of Saskatchewan  
Tel: 306 787-1009  
Email: [heather.kuchuran@gov.sk.ca](mailto:heather.kuchuran@gov.sk.ca)

*Manitoba Securities Commission*

Patrick Weeks  
Deputy Director, Corporate Finance  
Manitoba Financial Services Agency  
Manitoba Securities Commission  
Tel: 204 945-3326  
Email: [patrick.weeks@gov.mb.ca](mailto:patrick.weeks@gov.mb.ca)

*Ontario Securities Commission*

Irene Lee  
Senior Legal Counsel,  
Investment Management Division  
Ontario Securities Commission  
Tel: 416 593-3668  
Email: [ilee@osc.gov.on.ca](mailto:ilee@osc.gov.on.ca)

Stephen Paglia  
Manager,  
Investment Management Division  
Ontario Securities Commission  
Tel: 416 593-2393  
Email: [spaglia@osc.gov.on.ca](mailto:spaglia@osc.gov.on.ca)

## ANNEX A

### SPECIFIC CONSULTATION QUESTIONS

In addition to your comments on all aspects of the Draft Amendments and the Draft Changes, we are seeking specific feedback on the following questions:

1. The Draft Amendments clarify that a principal distributor cannot have multiple principal distributor relationships except where it acts as principal distributor for mutual funds in the same mutual fund family. Are there any circumstances under which a dealer should be permitted to act as a principal distributor for more than one mutual fund family? In responding, please explain the advantages and disadvantages of such a model as compared to a participating dealer model for both investors and market participants. In particular, please outline the specific benefits for investors as they pertain to competition, cost and investor choice. Please provide quantitative data, where relevant, to support your answer.
2. If your answer to question #1 was yes, please also comment on the following:
  - (i) What are the specific circumstances under which a principal distributor should be allowed to act for more than one mutual fund family?
  - (ii) If a principal distributor could act for more than one mutual fund family, should the compensation arrangements between the principal distributor be required to be the same or substantially similar in respect of each mutual fund family? If not, how could we ensure that any compensation arrangement differences would not influence a principal distributor to favour the mutual fund family with the most favourable compensation structure?
  - (iii) What factors and considerations would be relevant to determining the appropriate number of mutual fund families for which a dealer should act as principal distributor? Explain how the distinction between principal distributors and participating dealers does not become blurred as the number of mutual fund families distributed by the same principal distributor increase.
  - (iv) Should there be minimum duties and obligations owed by the principal distributor in respect of each principal distributor relationship? Should those obligations be the same across all mutual fund families for which the dealer acts as principal distributor?
  - (v) Should mutual funds that have a principal distributor be exclusively distributed by the principal distributor and not be distributed by other principal distributors or participating dealers? Should mutual funds that have a principal distributor be exclusively distributed by the principal distributor and not be distributed by other principal distributors or participating dealers?

3. Do the Draft Amendments fully address potential investor protection concerns for existing principal distributor business models and any foreseeable new mutual fund distribution business models? Are there any other considerations, limits or factors about a principal distributor arrangement that we should consider?
4. The Draft Amendments to Regulation 81-105 will come into force 18 months after the final publication date. Does this provide sufficient time for dealers that act as a principal distributor for more than one unaffiliated manager to transition their practice, operational model and compensation arrangements? Does this provide sufficient time for impacted investment fund managers to make alternate distribution arrangements for their mutual fund securities prior to the effective date? If not, please explain.
5. Some principal distributors may currently use chargebacks. Chargebacks involve a compensation practice where a representative is paid upfront commissions and/or fees from the dealer when their client purchases securities. Chargebacks occur when investors redeem their securities before a fixed schedule as determined by the dealer, and the dealing representative is required to pay back all or part of the upfront commission/fees to the dealer. In June 2023, the CSA announced that it would be reviewing the use of chargebacks in the mutual fund industry due to concerns about potential conflicts of interest associated with this practice. The CSA is of the view that the use of chargebacks raises a significant conflict of interest for principal distributors in the distribution of mutual fund securities and we are considering the appropriate regulatory steps. We are requesting additional feedback on this practice.