



Independent Financial Brokers of Canada

740-30 Eglinton Avenue West, Mississauga, ON L5R 3E7

June 25, 2020

The Secretary
Ontario Securities Commission
20 Queen Street West
Toronto ON M5H 3S8

Submitted by email: comments@osc.gov.on.ca

Subject: Proposed OSC Rule 81-502, Restrictions on the use of the DSC option for Mutual Funds

Independent Financial Brokers of Canada (IFB) appreciates the opportunity to comment on the proposals affecting deferred sales charges (DSC) for mutual funds.

IFB is a not-for-profit, professional association with approximately 3,500 members. IFB members are provincially licensed financial advisors and planners who provide advice and guidance to individuals, families, and businesses in communities across Canada. Many IFB members hold multiple licenses and in various jurisdictions. Most often they are mutual fund registrants and/or life insurance licensees. IFB members are self-employed, independent owner/operators of a small or medium-sized financial practice, typically in their home community.

IFB provides a unified voice for these independent advisors by providing advocacy, and representation on their behalf to government, regulators, and industry stakeholders. In addition, IFB supports the professional needs of its members, and the financial services industry more broadly, by offering high-quality in-person and online education, access to a comprehensive professional liability program, and compliance support.

Introductory comments

For some years, IFB has been involved in the various discussions and consultations held by both the Canadian Securities Administrators (CSA) and the Ontario Securities Commission (OSC) on the suitability of the DSC option for mutual funds. It has been our position in these previous consultations that continuing the DSC option in a more restricted format, to address the investor protection concerns expressed by the CSA, would be preferable to a complete ban. When the CSA endorsed a ban that will be implemented in all jurisdictions except Ontario, IFB expressed cautious support for the decision by Ontario to consider alternatives to a ban.

Having now had the opportunity to review the details of the DSC¹ restrictions, as outlined by the OSC in the proposed Rule, IFB has reservations that what is being proposed may not be a practical framework for mutual fund clients, advisors or firms.

Other industry factors

As noted in the consultation paper, sales of DSCs have declined since 2008, and continue to do so. In addition, some mutual fund manufacturers and/or dealers have already chosen to discontinue offering the DSC option.

¹ DSC includes low load funds per the OSC paper.



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This industry response will undoubtedly continue as the implementation date of the CSA ban in other jurisdictions across Canada approaches.

Of further note, the CSA (including the OSC) endorsed the Client Focused Reforms (CFRs) in October 2019, to be implemented in two stages. In phase one, registrants must comply with the enhanced conflict of interest provisions by June 2021 (one year before the DSC restrictions are proposed to become effective). Compliance will require registrants to manage any material conflict of interest in the best interest of the client, or to avoid the conflict.

The OSC has stated in Annex B of the Proposed Rule that it views it as “an inherent conflict of interest for registrants to accept upfront commissions for sales of mutual funds under the deferred sales charge option”². This statement, when considered alongside the heightened management of conflicts in the CFRs referenced above, significantly raises the risks for advisors selling a DSC, regardless of whether it was a reasonable choice for that client. Advisors who recommend such products will be subject to heightened scrutiny and potential enforcement based on “hindsight” suitability reviews. We believe the effect will be for firms and advisors to avoid DSCs as an investment choice.

With these observations in mind, IFB has prepared the following comments on the specific OSC proposals.

Comments on the OSC proposals to restrict the use of the DSC option

Maximum term of DSC redemption fee limited to 3 years

IFB supports this change, as it ensures greater flexibility for clients to access their funds. Indeed, it was one of the recommendations IFB made in its response to the CSA in June 2017 and again in December 2018, when we suggested shortening the timeframe. This, combined with tightened suitability assessments and oversight of compensation conflicts, can provide reasonable alternatives to an outright ban.

As noted in this paper, research has shown that DSC investors tend to be those with small investment accounts. A feature of DSCs is that 100% of the funds are invested upfront and are not subject to any sales charge if held for the prescribed period. Upfront commissions have helped offset the cost of advice for advisors servicing such clients. IFB has often cited concern that regulatory initiatives should not limit access to the personalized financial advice independent financial advisors provide.

Permit 10% annual redemption of value of the investment without redemption fee.

As noted, this codifies a general industry practice and offers investors an option to redeem funds throughout the locked-in period. If reduced to a 3-year term, this significantly reduces the DSC timeframe. We see this as a positive change.

Sales of DSC restricted to clients under age 60

We appreciate the objective to prohibit sales of DSC funds to older investors, who are more likely to have a limited investment time horizon. As such, IFB has no particular objection to defining this group as those over 60 years of age, although it appears to be somewhat arbitrary, and inconsistent with the definition of a senior used

² (2020), 43 OSCB 1582:



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in the OSC's Seniors Strategy. The OSC Strategy refers to a senior as an individual who has reached age 65, albeit with the following qualifiers:

That being said, our consultations with stakeholders and research on this topic have made clear to us that, for the OSC's purposes as a regulator, age should not be viewed as the only indicator for determining whether a person is a senior. Relying on age alone fails to capture the specific characteristics, lifestyles and personal and financial needs of each investor. With life expectancies lengthening, the health of individuals who reach the age of 65 improving, and the share of individuals continuing to participate in the labour force at age 65 increasing, it becomes increasingly important not to treat Canadians aged 65 and over, or seniors, for that matter, as a single, homogenous group.³

IFB suggests adopting a less age-specific restriction and using other markers, such as employment status, if the intent is to prevent clients at or nearing retirement from being sold a DSC product. Alternatively, the age restriction could simply be eliminated and instead used as an example of an investor whose investment time horizon may not be suitable.

In our view, there should be a reference to vulnerable clients - those who may have reduced financial decision-making capabilities, mental health concerns or cognitive impairment. A vulnerable client may not have reached age 60 or retirement.

Restrict DSC sales to investors with a maximum account size of \$50k

IFB would like further clarity on how account size will be determined. For example, will the \$50k be based on the value of all holdings at that firm? Does the \$50k include market appreciation as determined at the time of a subsequent purchase, or does it apply only to contributions? We note that the OSC points out that mutual fund investors with an account size of \$50k or under, have an average account size of only \$13k. It seems clear that the commission paid to an advisor selling a DSC (after the firm takes its portion, and likely reduced to reflect the 3-year term) will not be a determining factor.

Restrictions to limit the DSC option to clients whose time horizon fits with the redemption period (3 years), prohibiting the use of borrowed funds, allowing DSCs to apply to new contributions only, and no DSC fees on reinvested distributions.

IFB generally supports these restrictions although we note that repeated use of the phrase "the dealer knows or reasonably ought to have known" seems to be open to broad interpretation. For example, in the instance of borrowed funds, while the firm or advisor can make inquiries, if the investor is using funds borrowed outside of the firm, and chooses not to share this, what is the responsibility of the dealer or advisor to meet this obligation? Other questions include what constitutes borrowed funds? Would a family loan qualify? Funds from a private lender? Interest free loan?

No redemption fees on death, involuntary loss of full-time employment, permanent disability or critical illness.

IFB appreciates the OSC's intention to address concerns that in the past investors were unable to access locked-in funds early without incurring potentially hefty redemption fees. However, if the locking-in provision is

³ https://www.osc.gov.on.ca/documents/en/Securities-Category1/sn_20180320_11-779_seniors-strategy.pdf



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reduced to 3 years (as opposed to 6-7 years), we anticipate the need to exercise the early redemption feature will be greatly reduced.

If this particular proposal is to remain in its current form, IFB recommends simply using 'financial hardship' as the criteria to unlock the investment early, and using death, involuntary loss of full-time employment, permanent disability, and critical illness as examples that might qualify under the financial hardship provision. IFB suggests that the OSC look to existing examples of thresholds that must be met to unlock funds in other sectors, such as pensions, LIRAs, LIFs, etc. In Ontario, FSRA has on its website [a guide to unlocking funds](#) which sets out the circumstances and the process required. The OSC may want to align its categories with the 4 categories used by financial institutions to permit an individual to unlock funds.

Other comments

Transition issues:

IFB recommends that the OSC move to lower the redemption period to 3 years in advance of the CSA ban, and instead align it with the implementation of conflict of interest CFRs. Many of the other restrictions in this OSC proposal will also be addressed by these enhanced conflict standards.

Harmonization:

We see practical issues related to permitting the sale of DSCs in Ontario and not in other Canadian jurisdictions. This creates a 2-tiered regulatory approach and leaves advisors and firms in Ontario, or advisors and firms servicing Ontario-based clients from other jurisdictions, at risk of inadvertent errors.

In closing, IFB appreciates the work the OSC has done to find a compromise which retains DSCs as an investment choice, while addressing the investor criticisms and concerns. We do, however, think some of the proposals would benefit from further consideration if the DSC is to remain a viable investor choice in Ontario.

Thank you for the opportunity to provide comment. Should you wish to discuss, please contact the undersigned, or Susan Allemang, Director Policy & Regulatory Affairs (email: sallemang@ifbc.ca).

Yours truly,

A handwritten signature in black ink that reads 'Nancy Allan'.

Nancy Allan

Executive Director

Email: allan@ifbc.ca