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Subject: Comments on Proposed Amendments to the Principal Distributor Model

Dear Members of the Canadian Securities Administrators (CSA),

I welcome the opportunity to provide feedback on the proposed amendments to the principal distributor (PD) model as outlined in the CSA Notice of November 28, 2024. The proposals represent a step forward in addressing inherent conflicts of interest, enhancing transparency, and modernizing mutual fund sales practices to better align with investor protection goals. However, several areas require further development to ensure these amendments have a meaningful impact on investor protection and market fairness.

Responses to Consultation Questions

1. Permitting Multiple Mutual Fund Families

I support restricting dealers to a single mutual fund family, as this reduces conflicts of interest and promotes accountability. Allowing multiple relationships would blur the distinction between principal and participating dealers, increasing investor confusion and risk.

2. Conditions for Multiple Relationships (If allowed)

If multiple relationships are permitted:

- Compensation arrangements must be uniform to reduce incentives for biased fund recommendations.
- Disclosure must explicitly state the nature and source of conflicts, with investor testing to ensure clarity.

- Exclusivity for principal-distributed funds should remain a requirement for simplicity and accountability.

3. Adequacy of Investor Protection

While the amendments address core concerns, more is needed:

- Titles used by representatives must accurately reflect the limited scope of advice provided. The term “Financial Advisor” is neither accurate nor appropriate for representatives limited to proprietary fund sales.
- Clear, explicit conflict-of-interest disclosures should be required, stating the nature of the conflict and its potential impact on clients.
- A pre-sale disclosure highlighting the potential difficulty of transferring accounts with proprietary funds should be mandated.

4. Transition Period

The proposed 18-month transition period is generally sufficient, provided smaller firms receive support for operational changes. Periodic reviews during the transition would allow for timely identification and resolution of challenges.

5. Prohibition on Chargebacks

Chargebacks create significant conflicts of interest and undermine client-focused reforms. A complete ban should be implemented immediately to eliminate this pernicious sales disincentive tactic.

Key Recommendations

1. Addressing Conflicts of Interest

- Marketing materials must explicitly state the limited nature of proprietary fund offerings and the consequent potential for conflicts of interest.
- Principal distributors should be required to offer index funds covering core investment categories (Canadian, U.S., and international equity, and fixed income). Offering index ETFs alongside index funds should also be encouraged.

2. Enhanced Disclosures

- Use plain language to describe conflicts of interest explicitly, detailing how compensation structures may influence fund recommendations.
- Disclosure statements should undergo investor testing and behavioral science evaluation to validate their comprehension and effectiveness.
- Transparency regarding unique PD payments should be integrated into Fund Facts and Total Cost Reporting (TCR).

3. Awareness Initiatives

- The CSA should prioritize retail investor awareness on the long-term impact of fees using decomposing as a concept, as well as the benefits of diversified product choices in portfolio construction.
- The OSC's fund fee impact calculator should be promoted more broadly as a key evaluation tool.

4. Monitoring and Enforcement

- Annual audits of principal distributor practices should focus on compensation structures, conflicts of interest, and sales practices.
- The effectiveness of disclosures and adherence to new rules must be evaluated periodically, with public reporting on findings to maintain transparency and trust.

5. Addressing Fund Underperformance

- Representatives tied to restricted shelves lack alternative fund options if a fund underperforms chronically. This inherent flaw needs to be clearly disclosed, if not highlighted, at point of sale.

Additional Comments

- The clarification of the DSC ban to include all redemption fees is a welcome step. This ensures consistency across the industry and protects investors from exploitative fee structures.
- Chargebacks should be immediately prohibited. They incentivize representatives to prioritize their monetary interests over those of their clients, a blatant conflict that compromises trust and undermines fairness.

Conclusion

The proposed amendments are a step forward in modernizing the regulatory framework and addressing systemic issues in mutual fund distribution. By incorporating the recommendations outlined above, the CSA can improve investor confidence and foster a fairer and more transparent market.

Thank you for considering these comments. I remain available to discuss these recommendations further and support their implementation.

Sincerely,

Harvey S. Naglie

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