CFA Societies Canada

Canadian Advocacy Council

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March 6, 2025

To:

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

VIA EMAIL

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Re: Proposed Amendments to the Principal Distributor Model (the "Consultation")

The Canadian Advocacy Council of CFA Societies Canada (the "**CAC**")[1] appreciates the opportunity to provide the following general comments on the Consultation and specific responses to the questions set out below.

As currently conceived, we believe the principal distributor model is in need of substantive reform because of embedded conflicts of interest. So much so that we question whether it is appropriate to retain the model at all. It is unclear to us how this model is compatible with the principles behind the Client Focused Reforms ("**CFRs**") –

[1] The CAC is an advocacy council for CFA Societies Canada, representing the 12 CFA Institute Member Societies across Canada and over 21,000 Canadian CFA charterholders. The council includes investment professionals across Canada who review regulatory, legislative, and standard setting developments affecting investors, investment professionals, and the capital markets in Canada. Visit www.cfacanada.org to access the advocacy work of the CAC.

As the global association of investment professionals, CFA Institute sets the standard for professional excellence and credentials. The organization is a champion of ethical behaviour in investment markets and serves as the leading source of learning and research for the investment industry. CFA Institute believes in fostering an environment where investors' interests come first, markets function at their best, and economies grow. With more than 200,000 charterholders worldwide across 160 markets, CFA Institute has ten offices and 160 local societies. Find us at www.cfainstitute.org or follow us on LinkedIn and X at @CFAInstitute.

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specifically that securities registrants' interests should be aligned with investors' interests to the greatest extent possible, and that registrants should place clients' interests first in the face of conflicts of interest.

It is noted in the Consultation that the Canadian Securities Administrators ("**CSA**") had considered banning principal distributors but instead decided that there is still room for this model where principal distributors only distribute mutual fund securities of one mutual fund family. An industry association quote from a consultation conducted in 1997 was provided as the seeming sole source of support for this view. We would have preferred a more robust, data-driven analysis as to why the CSA has accepted this view, particularly given the significant changes to the Canadian investment funds industry and its regulation over the past 28 years, most significantly in enacting significant changes to registrant obligations, culminating most recently in the CFRs. Although we acknowledge that mutual fund investors still purchase mutual funds from firms regulated as principal distributors, in our view, this fact is not adequate justification as to why this regulatory model and these channels should remain open. Support for the continued preservation of this regulatory model should instead be based on whether the absence of this model would cause any negative outcome for investors. We were disappointed with the lack of robust analysis from this perspective for consideration.

In addition, the quote mentioned above appears more relevant within our current regulatory landscape for situations where the principal distributor is affiliated with the investment fund manager. In these cases, retail investors could expect that certain firms would sell securities of a proprietary fund. However, where they are not affiliated, there could be problematic commercial realities where the principal distributor's duties to clients may be compromised by the commercial considerations present in the relationship with the investment fund manager. This could be particularly problematic where the principal distributor also functions as a participating dealer for other mutual funds. This concern may not be totally alleviated by regulating incentives for representatives. As such, we would have preferred a discussion of, and a position statement by, the CSA on whether this model should as an intermediate regulatory action be limited to circumstances where the principal distributor is affiliated with the investment fund manager of the mutual fund. In our view, immediate change to restricting this model to affiliated entities while a broader policy project is undertaken as to the appropriateness of this regulatory model altogether would be more in keeping with the broader direction of related securities policy in recent years, and would better meet the expectations of investors.

Any justification for maintaining the principal distributor model should be premised on how it is consistent with the overarching regulatory obligations of registrants placing the interests of investors first. If as part of that analysis, it is determined that the primary benefit of this model to investors (or industry participants) is historic convenience, in our view that would be grounds to sunset the model, given the various conflicts of interest it poses. Considering this, we would encourage the CSA to set out its long-term vision for this model. As noted in the Consultation, discussions regarding the modernization of National Instrument 81-105 *Mutual Fund Sales Practices* ("**NI 81-105**") have been ongoing since 2018, and this Consultation is taking place almost seven years later. Rather than revisiting the issue again some number of years in the future, if the CSA and its regulatory partners do not see a place for principal distributors in the long-term post-

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CFRs, we think it would be best to retire the model and provide sufficient time for impacted stakeholders to rearrange their operations.

Please find below are our responses to the listed questions.

1. The Proposed 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.

We believe this requires immediate regulatory action while a broader policy project is undertaken, as we've noted above. We don't believe there exist valid circumstances to continue its allowance. The participating dealer model is that which we believe is likely better suited in all circumstances when it comes to investors' interests.

3. Do the Proposed 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?

Overall, we agree that the proposals to (i) extend the prohibition on deferred sales charges to principal distributors, (ii) add the prohibition on principal distributors from providing incentives to representatives to recommend certain mutual fund securities over others it functions as a principal distributor for, and (iii) add a requirement for increased disclosure regarding the nature of the relationship and compensation, would represent improvements on the current state, and are an urgent need for policy change.

With respect to how to display the new disclosure, given that principal distributor relationships carry the risk of less competitive pricing for investors and are otherwise not investor-centric, it should be required to be made prominently in the applicable documentation. As an example, it could be required to be included in a bold typeset.

These immediate required actions do not in our view remove the need for there to be a broader policy review as to the appropriateness of the continued allowance of this regulatory model.

4. The Proposed Amendments to NI 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

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distribution arrangements for their mutual fund securities prior to the effective date? If not, please explain.

In our view, 18 months would be more than enough time for impacted firms to arrange their affairs accordingly. However, we would also support a shorter time limit, up to 12 months after the final publication date, as an appropriate transition period. We do not consider the nature of these changes to be overly burdensome, and the investor protection benefits are comparatively more pressing, and we see these changes as broadly overdue.

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.

We agree that the use of chargebacks presents a significant conflict of interest for principal distributors. In our view, chargebacks carry the negative potential that representatives may consider their own interests above that of their clients. It is foreseeable that in certain circumstances, representatives may encourage investors to continue to hold and not redeem securities, simply to ensure that the representative is not subject to a chargeback, even when such actions may not be in the investor's best interest. Such incentives should not have a place in our capital markets (particularly following the enactment of the CFRs), and as such, we would strongly encourage the CSA to prohibit chargebacks.

Concluding Remarks

We thank you for the opportunity to provide these comments and would be happy to address any questions you may have. Please feel free to contact us at cac@cfacanada.org on this or any other issue in the future.

(Signed) *The Canadian Advocacy Council of*
CFA Societies Canada

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