May 21, 2020

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

SENT VIA EMAIL

Dear Sirs/Mesdames:

Re: Ontario Securities Commission Notice and Request for Comment
Proposed Rule 81-502 *Restrictions on the Use of the Deferred Sales Charge Option for Mutual Funds*, Proposed Companion Policy 81-502 to Ontario Securities Commission Rule 81-502 and Related Consequential Amendments

On behalf of Advocis, The Financial Advisors Association of Canada, we are pleased to provide our comments to the Ontario Securities Commission ("OSC") in regards to the OSC's notice and request for comment regarding Proposed Rule 81-502 *Restrictions on the Use of the Deferred Sales Charge Option for Mutual Funds,* proposed Companion Policy 81-502 to OSC Rule 81-502 and related consequential amendments (collectively, the "Proposal").

1. About Advocis

Advocis is the association of choice for financial advisors and planners. With more than 13,000 members across the country, Advocis is the definitive voice of the profession, advocating for professionalism and consumer protection. Our members are provincially licensed to sell life, health and accident and sickness insurance, as well as by provincial securities commissions as registrants for the sale of mutual funds or other securities. Members of Advocis are primarily owners and operators of their own small businesses, creating thousands of jobs across Canada. Advocis members provide advice in several key areas, including estate and retirement planning, wealth management, risk management, tax planning, employee benefits, critical illness and disability insurance.

Professional financial advisors and planners are critical to the ongoing success of the economy, helping consumers to make sound financial decisions that ultimately lead to greater financial stability and independence both for the consumer and the country. No one spends more time with consumers than advisors and planners, educating them about financial matters and helping them to reach their financial goals. Advocis works with decision-makers and the public, stressing the value of financial advice and striving for an environment in which all Canadians have access to the advice they need.

2. OUR COMMENTS

We support the OSC's efforts to preserve consumer choice by permitting the DSC option to continue with new restrictions that will address key investor protection concerns associated with its use. While DSC is generally becoming less prevalent in the marketplace,[1] it is a suitable sales option for some clients who would not otherwise be able to access the capital markets and benefit from the value of advice. We have several comments and suggestions that we believe would improve the Proposal, which we are pleased to detail below.

A. INVESTMENT FUND MANAGER RESTRICTIONS

Section 3(a)(ii), Redemption of Units Without Penalty

The Proposal states that "clients can redeem 10% of the value of their investment without redemption fees annually, on a cumulative basis" (emphasis added). This is different than what is contained in the actual text of Annex A, which provides that "10% of the number of securities that would otherwise be subject to a fee or charge upon redemption in the calendar year…" (emphasis added) may be redeemed without charge.

Additional clarity is needed here. Is it the OSC's intention that the frame of reference for calculating the amount (whether units or dollars) that can be redeemed without charge be based on the initial investment only (crystallizing the t=0 number of units and price per unit)? If so, and there is only one single investing action, there would be no difference between the two calculation streams.

However, the calculation can become muddled if the investor makes subsequent, new investments that are within the account threshold of s. 3(b)(ii) of the Proposal; if the investor subscribes to dividend reinvestment plans ("DRIPs") or pre-authorized contribution plans; and the simple fluctuations in unit price/net asset value over time, if not explicitly basing the calculation on the t=0 price.

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[1] According to a recent *Advisor's Edge* article, gross sales under the DSC option accounted for only about 2.5% of total mutual fund sales in the first nine months of 2019. Per https://www.advisor.ca/news/industry-news/will-dsc-funds-continue-to-be-offered-in-ontario/.

If the penalty-free redemption for any given year is based on the number of units, is that number the average number of units held by the investor through the year (dollar or time weighted); the number held at the year's start; or the units held at year end?

Clarity on how this calculation is to be performed is particularly important because the "value" of the penalty-free redemption will now be bankable and carried forward for up to three years. We ask that the OSC provide explicit guidance on how it intends that investment fund managers perform the calculation. To minimize the regulatory burden associated with implementing this requirement, we suggest the OSC work with fund managers to formalize the most widely-accepted calculation methodology.

B. DEALER RESTRICTIONS

Section 3(b)(i), Maximum Age of Client

The Proposal requires dealers to restrict the DSC option and make it unavailable for clients who are aged 60 or over. We realize that age is not a perfect proxy for the suitability of DSC, but it is an objective metric that is easy to apply with minimal regulatory burden. If forced to choose a number for a "bright line" metric of age, 60 seems like a justifiable choice.

We would like the OSC to clarify its intended application of this rule in situations where the client/account owner is not the same person as the account beneficiary, or is not the sole beneficiary. Examples of the former would include RESPs and spousal RRSPs, and an example of the latter would be joint accounts.

In the former case, we believe that the age of the beneficiary is more relevant to assessing the timeframe for the intended use of the funds (and consequently, the suitability of the DSC option in that beneficial situation). In the latter case, we suggest that, at a minimum, the OSC consider using the average of the joint beneficiaries' ages when applying the maximum age restriction.

A further complication with implementing an age restriction is that not all clients are natural persons; corporations and partnerships are often owners of mutual fund assets, and there can be many beneficial owners of such entities. In theory, these entities last forever so the age of the entity itself is not often relevant. We suggest the OSC add additional details regarding its expectations for how non-natural clients can be serviced under the Proposal.

Section 3(b)(ii), Maximum Client Account Size

The maximum size renders the Proposal uneconomical

Our greatest concern with the Proposal has to do with the maximum client account size. With a proposed maximum of $50,000, the Proposal will render the DSC option not economically viable and the effect will be nearly the same as if Ontario had banned DSCs.

With the new maximum three year redemption schedule, the upfront commission paid by the investment fund for the DSC option is likely to be 3%. This means the maximum commission will be $50,000 x 3% = $1,500. This commission is split between the dealer and the advisor, with 50-50 or 60-40 ratios being quite common. Therefore, the maximum commission the advisor might earn under this option would be about $750 for three years of service.[2]

The actual earnings will certainly be less than the maximum; per the OSC's research, only about 17% of investors owning securities have an account size equal to, or under, the $50,000 threshold, with the average size being just $13,000.[3] If these accounts utilized the DSC option, the average advisor commission would only amount to $195 for three years of service. This is plainly uneconomical.

This untenable economic situation is exacerbated by the cost of complying with the additional (and new to the securities industry) redemption provisions in Section 3(b)(v), which are further discussed below. The bottom line is that, as proposed, the severe restrictions on who can use the DSC option bring about an effective ban. We do not believe this was the OSC's intention.

Increase the maximum account size and restrict its use to professionals

A clear solution is to increase the maximum account size to $100,000, but restrict the DSC option's use to Financial Advisors or Financial Planners who qualify to use those titles under the *Financial Professionals Title Protection Act, 2019*[4] (the "FPTPA"). This would be a truly "made in Ontario" solution that achieves the OSC's policy objective of protecting Ontarians from potential abuses of the DSC option while supporting the Government's priority of enhancing the professional standards of retail-facing advisors and planners.

As the OSC is aware, the Government of Ontario passed the FPTPA in the spring of 2019. It will restrict the titles of "Financial Advisor" and "Financial Planner" to intermediaries who hold

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[2] There are also trailing commissions associated with DSC funds, but trailers under the DSC option are generally minimal – 0.1% to 0.6% annual commissions are typical, depending on whether the client is still within the DSC redemption schedule. Trailing commissions are also split amongst advisor and dealer.

[3] Proposal at (2020), 43 OSCB 1588.

[4] S.O. 2019, c. 7, Sched. 25.

recognized credentials in good standing from recognized credentialing bodies. In short, it will ensure that these titles, which many Ontarians already place faith in as a proxy for skill or expertise, will actually be backed up by meaningful standards of education and competency. Ontarians will be able to trust that the intermediaries who qualify for their use are serious about professionalism.

The Government has empowered the Financial Services Regulatory Authority of Ontario ("FSRA") to develop the rules regarding Ontario's title protection regime. Two key facts merit mentioning here: i) FSRA is actively working towards getting the regime up-and-running, with an expected 2021 launch well in advance of the Proposal's effective date of June 1, 2022; ii) once proclaimed, the FPTPA will amend the *Securities Act* to bring about parallel title restrictions for securities registrants.

The bottom line is that the coming title restriction regime is both <u>timely</u> and <u>effective</u> for use with the Proposal. It only makes sense to leverage the Government's push for professionalism for the benefit of DSC investors.

Increasing the account size maximum to $100,000 will open up the DSC option to 45% of investors,[5] with the average account size being roughly $47,000 – which is still under the originally-proposed $50,000 maximum account size.[6] This would result in average advisor commissions of about $700 over the three year redemption schedule. This is still not a large amount, but it is an improvement that may make the DSC option economically viable.

<u>Maximum amounts: by account or client</u>

The Proposal suggests a maximum client account size of $50,000. We seek clarification here, as clients often have more than one account with their dealer: it is quite common for a client to have, with one dealer, multiple unregistered accounts (individual, joint) as well as a slate of registered accounts.

A plain reading of the wording in the section suggests that the DSC option could be used for more than one account owned by a single client so long as the balance immediately after the distribution in each account, considered independently, is below the proposed threshold. For example, using the $50,000 figure proposed, a client with five accounts could deposit that

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[5] In actuality, the proportion of investors that would be eligible for the DSC option would likely be less than 45%, when this restriction is considered in concert with the age restriction that would prevent the option's use by investors over the age of 60. According to the Proposal at (2020), 43 OSCB 1588, 33-36% of investors who own mutual funds are aged 60 or over. Without further details about the account sizes held by this subset of investors, we cannot estimate the impact of the "age" and "maximum amount" restrictions acting simultaneously.

[6] Based on the OSC's reporting at (2020), 43 OSCB 1588 and the weighting of 17% of investors with account sizes <$50,000 and an average of $13,000 and 28% of investors with account sizes >$50,000 but <$100,000 and an average of $68,000.

amount in each of them and have, in aggregate, $250,000 in mutual funds purchased via the DSC option. Would this outcome be consistent with the intention behind the Proposal?

A further wrinkle is added when considering the dichotomy of client name and nominee accounts. The mechanics of client name accounts allow for clients to more easily exceed prescribed account maximums, intentionally or otherwise, whereas the centrality of nominee name accounts would make reporting and compliance more transparent.

How to assess "account size": by balance or contributions

We also have concerns with the maximum account size being connected to its balance immediately after the contribution; we believe any notion of maximum amount should be based on the total amount of DSC-series based commissionable contributions. After all, a major objective of investing is to grow the capital invested over time, so there should not be a penalty associated with capital growth.

For example, again using the $50,000 maximum as an example: if in year 1, a client having a single account invests $45,000 in a DSC fund and its value appreciates to $50,000 in year 2, then under the rule as written, the client would not be able to make an additional investment using the DSC option. In this hypothetical, we believe that the client should be able to invest another $5,000 via DSC, as long as the total commissionable contributions via DSC series funds do not exceed the specified maximum. We place an emphasis on commissionable contributions so that contributions from non-commissionable sources (such as DRIPs) are not counted towards the maximum.

Making the focus on DSC series commissionable contributions also deals with the situation of client accounts holding funds purchased via more than one purchase option, such as front end load or no load. The rule, as written, seems intended only for very homogenous accounts where there is only one initial purchase under the DSC option, immediately and up to the maximum amount, and that account is used to purchase no other type of fund.

Section 3(b)(v), No Redemption Fees

We appreciate that the OSC is attempting to introduce fair hardship provisions whereby clients will have DSC redemption fees waived in particular situations. However, there are certain unintended consequences with the proposal as written that we believe merit further consideration.

Hardship provisions and full-time employment

The provision specifying involuntary loss of full-time employment as a qualifying measure has the effect of placing investors who work in traditional, full-time employment roles in a

preferential position vis-à-vis investors who do not have the comforts of traditional full-time roles.

These effective "second class" investors include the self-employed, part-time employees, project-based and seasonal employees and those who are characterized as independent contractors in the increasingly prevalent gig economy. These are often the types of clients with modest investable assets who need DSC the most. And while these clients will pay the exact same MERs as their full-time counterparts, the latter will have an easier route to avoid fees in time of hardship. Adding insult to injury, many of these "second class" investors do not qualify for employment insurance in times of hardship.

Perhaps the OSC could consider language that is more inclusive, such as making the employment-related hardship release available to all clients upon the involuntary loss of, or inability to perform, the client's primary remunerative activities.

The challenge of assessing critical illness

The OSC's inclusion of a hardship release upon the client's suffering of a critical illness is compassionate. We caution, however, that assessing the severity of an illness, including whether it should be characterized as critical, is not an easy matter – it is something that mutual fund dealers do not have experience in doing and they are simply not equipped to make such assessments.[7]

We believe that the OSC underestimates the severity of the new compliance burden when it calls the requirement to assess critical illness as something that simply "builds upon the existing requirement in NI 31-103 for a registrant to take reasonable steps to ensure that it has sufficient information about a client's financial circumstances" and characterizes this obligation as a natural extension of the Client Focus Reforms taking effect on December 31, 2021.[8]

We recommend the OSC take a look at the insurance sector which does have a demonstrated history in this area. Insurance companies have proverbial armies to assess critical illness claims. Morbidity is not a simple "yes" or "no" decision and qualification periods exist for this reason. Critical illness policies typically list which diseases are covered as, actuarially, some illnesses are not truly life threatening despite how devastating it can seem to the patient-client. For example, males with stage one prostate cancer, or females with stage one breast cancer, are

[7] The Proposal seems to suggest, by placing this obligation in the "Dealer" section (as opposed to the "Investment Fund Manager" section) that mutual fund dealers are expected to make the determination on the validity of a client's critical illness claim. We believe that both groups are ill-equipped to make this determination for reasons explained in this section, but dealers have even fewer resources than the fund managers to attempt to cope with this very complex area of responsibility.
[8] Proposal, at (2020) 43 OSCB 1591.

generally not covered by most plans. Critical illness coverage generally activates at stage two before paying a benefit.

To deal with critical illness claims properly, life insurance companies have determined it is necessary to build out entire administration departments to handle such matters specifically, even having doctors on staff to help assess complex claims. Neither mutual fund dealers nor investment fund manufacturers have any relevant experience in this area and the OSC's ask in this regard will bring about considerable new burdens and potential liabilities.

Financial hardship to client from other connected individuals

We caution that legitimate client hardship situations that warrant the release of DSC investments without penalty are not limited to negative shocks that happen directly to the client. Events including the involuntary unemployment of a spouse, marital breakdown/divorce or illness of a child or other dependent can have equally devastating impacts on personal finances that equally warrant hardship consideration.

We recommend that the OSC take a more expansive approach here, so that the qualifying hardship criteria apply to negative shocks occurring both to the client directly, as well as to certain specified classes of client-connected individuals.

Financial hardship and non-natural clients

Advisors and dealers require additional details on how the OSC would like them to address situations of financial hardship for non-natural (corporate or partnership) clients. Do the financial hardship provisions apply to the situation of the corporate/entity-level owner, the beneficial owners, or either of them? If they apply only to the beneficial owners, are they restricted to those beneficial owners with a controlling or substantial interest? Additional clarity would be appreciated here.

3. CONCLUSIONS AND NEXT STEPS

Advocis supports the OSC's efforts to retain the DSC option for those investors who could benefit from its use, while proposing reasonable safeguards to mitigate the risks that have been associated with it.

In our view, the Proposal requires some reconsideration, particularly in regards to the investable amounts that will qualify for use under the DSC option. As drafted, the amounts are so small to render the Proposal uneconomical. We believe that pairing a larger maximum to the Ontario Government's efforts to increase the professionalism of Financial Advisors and Financial Planners is a natural and sensible way to improve this situation.

We look forward to working with the OSC as it refines the Proposal. Should you have any questions, please do not hesitate to contact the undersigned, or James Ryu, Senior Director, Legal and Regulatory Affairs at 416-342-9849 or jryu@advocis.ca.

Sincerely,

Greg Pollock, M.Ed., LL.M., C.Dir., CFP	Abe Toews, CFP, CLU, CH.F.C., CHS, ICD.D
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