New Compensation Restrictions for a New Decade – CSA Bans with Twists in Ontario

December 20, 2019

Just in time for the holidays, the Canadian Securities Administrators yesterday released CSA Staff Notice 81-332 *Next Steps on Proposals to Prohibit Certain Investment Fund Embedded Commissions*. The CSA in all provinces and territories, other than the OSC, have decided to move forward with final rule changes to ban payments by fund managers to dealers of upfront sales commissions (that is, those payments associated with deferred sales charge purchase options). The CSA in all provinces and territories, inclusive of the OSC, have also decided to move forward with final rule changes to ban trailing commission payments to discount brokers. We can expect to see these policy decisions reflected in final rule amendments to National Instrument 81-105 *Mutual Fund Sales Practices* published during the first quarter 2020.

This publication comes a little over a year after the end of the comment period on the proposed amendments to NI 81-105 that were published in September 2018. BLG's Investment Management Bulletin on this publication is available here and our comment letter is available here .

The CSA indicate that there will be a transition period of at least two years for the DSC ban and after the effective date, no new sales using the DSC purchase options will be permitted in Canada, other than in Ontario (but see below). The redemption schedules applicable to investors who acquired securities before the DSC ban will be permitted to run their course. Similarly, a two-year transition period will apply for the ban on trailing commissions.

The CSA signal that they also plan to explain how they view the application of the upcoming enhanced conflict of interest rules that are part of the Client Focused Reforms (amendments to National Instrument 31-103 that will be effective December 31, 2020) to any continued use of the DSC purchase option. It will be important to consider the CSA's views and respond, as necessary, particularly if the CSA are attempting to do indirectly, what they have not done directly.

While the OSC is not implementing a total ban on DSC, they are, however, considering restrictions on the use of DSC to (in their words) "mitigate negative investor outcomes". OSC Staff Notice 81-730 *Consideration of Alternative Approaches to Address Concerns*

Related to Deferred Sales Charges" was released by the OSC simultaneously with the CSA Staff Notice.

Options being considered by OSC staff include:

- Ban on DSC sales to older investors
- Regulatory limits on the terms for redemption fees
- Ban on the use of borrowed funds to finance DSC purchases
- Regulatory limits on account sizes
- Requiring firms to give investors "hardship exceptions from redemption penalties".

The OSC provided no timing of any future publication to implement these restrictions (which will need to be in draft open for comments).

The regulatory conversation about embedded compensation in the fund industry has been a long one (since 2012) and no matter what position one takes, it will be refreshing to have it come to a close (pending any OSC developments), particularly heading into a new decade. We will continue to watch for future publications and keep you informed.

Please contact your BLG lawyer or the authors of this Bulletin if you have any questions about the CSA's pronouncements on sales compensation, including those of the OSC on regulatory options regarding DSC, or on the Client Focused Reforms.

By

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