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November 10, 2011

John Stevenson, Secretary
Ontario Securities Commission
20 Queen Street West, Box 1903
Toronto, ON M5H 3S8

Dear Mr. Stevenson,

Re: Notice and Request for Comments re Implementation of Stage 2 of Point of Sale Disclosure for Mutual Funds – Proposed Amendments to NI 81-101 Mutual Fund Prospectus Disclosure, Form 81-101F3 and Companion Policy 81-101CP Mutual Fund Prospectus Disclosure and Consequential Amendments.

As members of the Ontario Securities Commission's Investor Advisory Panel ("IAP"), we enclose in this letter our submission regarding Notice and Request for Comments regarding the Implementation of Stage 2 of Point of Sale Disclosure for Mutual Funds – Proposed Amendments to NI 81-101 Mutual Fund Prospectus Disclosure, Form 81-101F3 and Companion Policy 81-101CP Mutual Fund Prospectus Disclosure and Consequential Amendments (the "Proposed Amendments").¹

The IAP is an independent body that was appointed by the Ontario Securities Commission in August, 2010. We are charged with representing the views of investors and providing input on the Commission's policy initiatives, including proposed rules and policies, the annual Statement of Priorities, concept papers and other issues.

OVERVIEW

As we have indicated in previous submissions, the Investor Advisory Panel supports the continued efforts of the Canadian Securities Administrators ("CSA") to introduce an effective point-of-sale ("POS") disclosure regime for the benefit of Canadian investors. Given the size and importance of the mutual fund industry in Canada, and the pronounced information imbalance between investors and dealers or advisors, the

¹ We extend our thanks to Chava Schwebel, J.D. student at the Faculty of Law, University of Toronto for her valuable assistance in the research and preparation of this letter. We also rely on previous research by Corinne Bordman and Christopher Somerville in the preparation of this letter.

fulfillment of this initiative is long overdue.²

The point-of-sale disclosure requirements are being introduced in stages. Stage 1 introduced the requirement that mutual fund companies prepare, file, and make available to investors a “Fund Facts” document by July 1st, 2011.³ Industry and investor advocates were given the opportunity to comment in October 2010, prior to the release of the Stage 1 amendments.⁴ We appreciate this opportunity to comment on the Proposed Amendments before the CSA proceeds with the implementation of Stage 2.

The Fund Facts document is the mainstay of the POS regime. It is a four-page document that outlines, in plain language, key features of the mutual fund such as its historical performance, costs, and risk profile. Such simplified disclosure may be beneficial to investors because product information is presented in a potentially more accessible and understandable format than is provided by conventional disclosure documents.

We have affirmed our support for the POS disclosure regime on several occasions.⁵ While the Panel continues to strongly endorse this initiative, we have significant concerns about the suitability of the Fund Facts form and delivery requirements at this stage. In particular, we believe that:

- ***Removal of the simplified prospectus delivery requirement is premature.*** We recommend that the CSA maintain statutory prospectus and delivery requirements at least until the Fund Facts document is strengthened. Until then, exemptions are available for dealers of funds managed by specified mutual fund managers according to the CSA’s Staff Notice *Early Use of the Fund Facts to Satisfy Prospectus Delivery Requirements*.⁶
- ***Risk measurement needs improvement.*** The presentation of low-to-high level risk in the Fund Facts is vague and potentially misleading to investors. It is not addressed by the Proposed Amendments and should be improved before the Fund Facts are delivered to investors in lieu of the simplified prospectus, which contains more fulsome (if hard to understand!) disclosure.
- ***Clear language is important.*** The Fund Facts document is vague in critical areas, such as the description of costs and investor rights, including access to the

² We understand that Canadians have more than \$620 billion invested in mutual funds yet despite this large investment, only a small number of investors understand the fundamental objectives, risks, or costs involved with their financial choice: CSA, Staff Notice, “81-319 Status Report on the Implementation of Point of Sale Disclosure for Mutual Fund” (June 16, 2010).

³ CSA, “Implementation of Stage 1 of Point of Sale Disclosure of Mutual Funds – Supplement to the OSC Bulletin” (October 8, 2010) Volume 33, Issue 40 (Supp-4) (2010), 33 OSCB (“Stage 1 Amendments”).

⁴ See CSA, “Appendix B: Summary of Comments”, *ibid*.

⁵ See, for example, our submission regarding the OSC’s Draft Annual Statement of Priorities (April 27, 2011) (“Comment re OSC Priorities”). Online: http://www.osc.gov.on.ca/documents/en/Securities-Category1-Comments/com_20110427_11-765_ananda.pdf; and the OSC Investor Advisory Panel Initiatives, online: http://www.osc.gov.on.ca/en/Investors_iap_initiatives_index.htm

⁶ CSA, Staff Notice “Early Use of the Fund Facts to Satisfy Prospectus Delivery Requirements” (February 2011). Online:

simplified prospectus. A key purpose of this project is to enhance investor understanding of the value, risks, and performance of managed investment products. Vague language in the Fund Facts undermines this objective and should be addressed.

In addition, we ask that the CSA focus on the following items as the POS project progresses:

- ***Extension of Fund Facts to other instruments.*** We appreciate the CSA's ongoing commitment to explore the extension of the point-of-sale disclosure requirements to other financial instruments.⁷ We understand that the CSA plans to consider this at Stage 3 of the implementation process and would like to emphasize our continued support for these efforts.
- ***Enforcement.*** We strongly encourage the CSA to establish an enforcement approach, such as regulatory sanctions and penalties for non-compliance, for failure to comply with the new regime. Such measures are especially important in the absence of a legislated fiduciary duty for financial services advisors.
- ***Timeline.*** We remain concerned about the delayed timeframe for the implementation of the point-of-sale measures. Although we have important reservations about the present form of the Fund Facts document, we believe that mandatory point-of-sale disclosure of fees, risk, and performance data for fund dealers should be introduced as soon as possible. We encourage the CSA to address deficiencies in the Fund Facts document so that it can be implemented without further or undue delay.

DETAILED SUBMISSIONS

We recognize the difficulty of designing a robust disclosure regime and support the steps that the CSA has already taken to advance investor's interests in this regard.⁸ As mentioned above, we have concerns with the Proposed Amendments and the general POS framework, namely:

Providing a simplified prospectus. Under the Proposed Amendments, delivery of the Fund Facts would satisfy a dealer's post-trade prospectus delivery obligation under applicable securities laws. The Fund Facts is not a replacement for the prospectus or other legal disclosure documents which provide valuable information about investment products. Until the Fund Facts document is improved, the removal of the prospectus delivery obligation is premature and could potentially lull investors into a false sense of

⁷ Including, for example, Exchange Traded Funds, government and corporate bonds, structured products such as fund-of-funds, and hedge funds. Eventually, point-of-sale disclosure requirements should be extended to other investment and quasi-investment products such as segregated funds and bank Guaranteed Investment Certificates. Until POS is extended to other investment products, we are concerned that advisors could substitute other instruments for mutual funds to avoid the new requirements.

⁸ Such as improvements to performance and cost disclosure in NI 31-103.

security regarding their understanding of an investment product.⁹ At a minimum, we would like to see stronger language in the Fund Facts document signaling to investors the availability, at no cost, of the simplified prospectus and its overall importance to their investment decisions.

Risk measurement. Risk is a key determinant of investment suitability.¹⁰ We have noted our dissatisfaction with the risk measurement contained in the Fund Facts on other occasions.¹¹ The Proposed Amendments do not address our concerns. We maintain that the presentation of risk in this document provides an overly simplistic, vague, and distorted picture of a fund's risk profile. The CSA has responded to industry and investor advocate concerns at Stage 1 by allowing fund sponsors the discretion to measure risk according to their own preferred methodology. A cross-reference in the Fund Facts directing investors to further details in the simplified prospectus does not mitigate the defects in this approach. The basic problem with the traditional prospectus regime is the opacity and inaccessibility of the information contained in legal disclosure documents. The current approach puts the onus on investors to investigate risk measures reported in the Fund Facts by resorting to another document, one which the CSA itself maintains is rarely used and difficult to understand.¹²

We are concerned that the absence of a standardized risk measure limits the comparability of a given mutual fund to other, similar products. We have suggested that the CSA employ a concrete, specific measure such as the worst quarterly/annual loss in the previous 10 years.¹³ If the fund does not have a ten-year history, the loss for the average fund in the comparable group (to be confirmed by the regulators) could serve as an alternate requirement. While we recognize the difficulties involved in prescribing a standardized method of risk reporting, particularly where such standard methodology may diverge from that employed in the fund's prospectus, we ask that the CSA revisit this aspect of the Fund Facts document.

Vague/imprecise language. The language of the Fund Facts document is unclear in key areas. For example, under "Fund Expenses", the impact of fees on investor returns is not

⁹ As noted by Ken Kivenko: "By describing the scale as "medium", "high" etc. the disclosure minimizes the perceived risk and makes consumers more comfortable than they should be." Kenmar Associates Investor Education and Protection, "Response to the CSA's Request for Comments" (August 15, 2011) at 6 ("Kenmar Response").

¹⁰ Our focus group participants responded that the key pieces of information that retail investors consider in their investment decisions relate to: fund performance, performance history, projections, and risk: see *Report of the Brondesbury Group for the Investor Advisory Panel*, "Focus Groups with Retail Investors on Investor Rights and Protection," (April 7, 2011) at 6 in Appendix A of our Comment re OSC Priorities, *supra* note 5.

¹¹ See *id.*, for example.

¹² For example, the CSA observes that "many investors do not use the information in the simplified prospectus because they have trouble finding and understanding the information they need": OSC "Notice and Request for Comments re Implementation of Stage 2 of Point of Sale Disclosure for Mutual Funds – Proposed Amendments to NI 81-101 Mutual Fund Prospectus Disclosure, Form 81-101F3 and Companion Policy 81-101CP Mutual Fund Prospectus Disclosure and Consequential Amendments" (August 12, 2011) 34 OSCB 8563 at 3, 4 ("Request for Comments"). Online: http://www.osc.gov.on.ca/en/SecuritiesLaw_rule_20110812_81-101_stage2-pos.htm.

¹³ This information is available in the "Performance" section of the Fund Facts, under year-by-year returns.

clearly stated.¹⁴ Other fees, such as switch fees, change fees, and trailing commissions are presented as potential, rather than actual costs to the investor. If they are discretionary, then this should be clearly stated. Similarly, if a salesperson or advisor receives a commission from the sale of a particular product, then he or she is in a conflict of interest situation that *actually* exists and should be disclosed.¹⁵ The disclosure of other information, such as foreign exchange hedging policies, should also be considered.¹⁶

Separation from promotional/other material. Although we appreciate the restrictions placed on documents that may be attached to, or bound with, the Fund Facts on delivery, we believe that the proposal does not go far enough in this respect. Rather, it begs the question of whether promotional and non-educational material is appropriate *at all* in the delivery of legal disclosure materials to investors. A separate folder, staple, or clip may not make a meaningful difference to how investors process information in formulating their investment decisions.

Enforcement. It is not clear how compliance will be monitored and what penalties exist for non-compliance. Even though they may be legally available, private enforcement measures such as investor rights of rescission or withdrawal are weak and will not, on their own, motivate robust compliance with new regime. This concern is augmented without a legal duty requiring advisors and dealers to act in the best interests of their client. Although the supervision of investment dealers and advisors is primarily the responsibility of Industry Regulatory Organization of Canada (IIROC) and the Mutual Fund Dealers Association (MFDA), the CSA should collaborate with these organizations and other industry groups to develop stronger and harmonized public enforcement

¹⁴ This section reads: “You don’t pay these funds directly. They affect you because they reduce the fund’s returns.” The distinction between investor and fund returns is specious and potentially misleading.

¹⁵ We agree with the submission by Kenmar Associates on this point: Kenmar Response *supra* note 9 at 3. To the list of areas where the Fund Facts document incorporates vague or unspecific language, we add: i) under “For More Information”, we believe stronger language is required regarding the no cost availability and overall importance of the simplified prospectus, for example: “The simplified prospectus contains more detailed information about past performance, risks, volatility, and costs which is critical to your understanding of this product. You are entitled to a free copy of this document. Ask your adviser for details”. The CSA has acknowledged this concern: CSA, Appendix A “Notice and Request for Comment, Implementation of Point of Sale Disclosure for Mutual Funds – Supplement to the OSC Bulletin” (June 19, 2009) Volume 32, Issue 25 (Supp-1) (2009), 32 OSCB at 35; ii) the statement of investor rights in the “For more information” section is also vague: the language “investors *may* have the right to” [emphasis added] renders the availability of withdrawal and rescission rights a question which investors need to actively investigate. We understand that national securities laws are not harmonized in this area, however this language could deter the exercise of these important rights and their disciplinary effect on fund dealers/advisors; iii) statutory misrepresentation rights are not referred to. Investors should be made aware that their legal rights regarding misrepresentations in a prospectus extend to misrepresentations in the Fund Facts.

¹⁶ Benchmarks showing comparative rates of return provide additional context which could also be useful to investors. Although we support the use of benchmark comparisons in general, they can be misleading; therefore, the CSA is correct to exclude them from the Fund Facts document at this time. We recommend that the CSA study this issue so that benchmarks may be incorporated in the Fund Facts at a later date. For additional details of our position on the use of benchmarks in disclosure documents see: IAP “Comment re 31-103 Cost Disclosure and Performance Reporting” (September 23, 2011). Online: http://www.osc.gov.on.ca/documents/en/Securities-Category3-Comments/com_20110923_31-103_iap.pdf.

mechanisms.

CONCLUSION

In our response to the OSC's Draft Statement of Priorities, we commented that the Fund Facts document would greatly assist in providing investors with information that is easy to understand and potentially facilitate intelligent decision-making for all investors. However, we noted some concerns regarding the early withdrawal of the simplified prospectus delivery requirement, the lack of meaningful risk measurement and vague language in the Fund Facts document, and the prolonged implementation period of the new regime.

We continue to support the Fund Facts as a method of providing relevant information to investors in a plain language, accessible and easily comparable format. The CSA has emphasized, on several occasions, that the aim of the POS framework is to increase investors' understanding of financial products, prompt them to seek out information, and reduce information asymmetries between consumers and industry participants.¹⁷ We believe that these objectives are not yet satisfied, although we recognize that the framework is not fully implemented and that further amendments may be made. We urge the CSA, therefore, to:

- a) improve the form and content of the Fund Facts to eliminate vague or contingent language, further enhance cost disclosure, risk measurement and performance information, and more clearly describe investor rights; and,
- b) defer the blanket elimination of the simplified prospectus delivery requirement until the Fund Facts document is improved; then,
- c) act quickly to implement mandatory point-of-sale delivery of the Fund Facts; and, finally,
- d) introduce regulatory enforcement mechanisms. Statutory rights of withdrawal or rescission require action by private investors and may not be an effective discipline on fund dealers and advisors.

In sum, while we endorse the POS initiative and look forward to the continued enhancement and development of this regime, we believe that the Fund Facts disclosure document and delivery requirements require further amendment. Absent concrete details regarding the proposed Stage 3 amendments, we have concerns, expressed above, about the final point-of-sale requirements. We encourage the CSA to address these issues to better protect the interests of investors in Canadian capital markets.

Thank you for considering our comments.

Yours very truly,

¹⁷ See, for example: "Request for Comments" *supra* note 12 at 4; and, Stage 1 Amendments *supra* note 3 at 6.

The Investor Advisory Panel

Anita Anand, Nancy Averill, Paul Bates, Stan Buell, Lincoln Caylor, Steve Garmaise and Michael Wissell