

OSC Investor Advisory Panel
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September 6, 2012

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

Dear Mr. Stevenson,

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 Contents of Fund Facts Document and Companion Policy 81-101CP Mutual Fund Prospectus Disclosure – 2nd Request for Comments.

As members of the Ontario Securities Commission's Investor Advisory Panel ("IAP"), we enclose our submission in response to the Canadian Securities Administrators' (CSA) 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 Contents of Fund Facts Document and Companion Policy 81-101CP Mutual Fund Prospectus Disclosure – 2nd Request for Comments (the "Proposed Amendments").¹

The IAP is an independent body that was established 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.²

OVERVIEW

We would like to begin by reiterating our strong support for the point-of-sale (POS) initiative. Ontario investors need clear and meaningful disclosure about their investments

¹ We thank Chava Schwebel, J.D., for her valuable assistance in the research and preparation of this submission.

² IAP "Terms of Reference" (revised, adopted August 2, 2012), online: http://www.osc.gov.on.ca/en/Investors_iap_20120802_terms-reference.htm.

at the time they are making their purchase decision. We appreciate the efforts that are being made to improve the Fund Facts document and move forward quickly with the POS delivery regime.

We are pleased with the changes that the CSA has made to the Fund Facts document in response to feedback from the IAP and other investor advocates. For example, we find that the presentation of risk has been improved and we support the proposal to compare a fund's performance to a benchmark of a one-year GIC, which we believe will provide useful context to investors in a format that is familiar and easy to understand.

In previous submissions, we identified a number of issues with the proposed Fund Facts document and POS delivery regime.³ In relation to the content of the Fund Facts document, we recommended that the CSA:

- Use clearer, more straightforward language in critical areas such as cost and conflicts disclosure and investor remedies;
- Incorporate a standardized risk measure such as worst quarterly/annual return over a specified period (e.g., 10 years); and,
- Include performance benchmarks showing the fund's comparative rate of return relative to industry sector and/or major market indices;

We asked that the CSA defer elimination of the simplified prospectus delivery requirement until these aspects of the Fund Facts document were improved. While this document can be further refined, many of our earlier concerns regarding risk, performance measurement, and the use of vague, "marketing" language have abated. As such, we support delivery of the Fund Facts document in lieu of the simplified prospectus at this time.

In our previous submissions, we also asked the CSA to:

- Introduce regulatory enforcement mechanisms;
- Extend the POS disclosure regime to other investment products such as ETFs which are substantively similar to mutual funds and likewise marketed to retail investors; and,
- Accelerate implementation of the POS initiative, as it is our view that delivery of

³ See IAP, "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" (November 10, 2011) ("Stage 2 – 1st Request for Comments"); IAP, "Annual Report of the Investor Advisory Panel" (August 31, 2011); IAP, "Re: OSC's Notice 11-765 Statement of Priorities for Fiscal Year ending March 31, 2012" (April 27, 2011) ("SOP 2011"); and, IAP, "Re: Draft Statement of Priorities 2012-2013" (May 29, 2012).

even an imperfect Fund Facts document would improve the current disclosure regime.

These and other issues as well as our recommendations to further improve the Fund Facts document are discussed below.

DETAILED SUBMISSIONS

The Panel generally supports the changes that have been or will be made to the Fund Facts since the previous draft was published for comment last year.⁴ Some concerns that we raised in prior submissions persist, however. These include the timing of implementation of the regime, its extension to other investment products, and the lack of explicit enforcement measures to ensure industry compliance. We also have specific suggestions for ways to improve the substantive content of the Fund Facts document. Our concerns and recommendations are as follows:

a. Added Content

We recognize that in a document of this length, which is intended to highlight key product information for potential investors, not all worthy information can be included. In light of this, our suggestions regarding the inclusion of other content are minimal. Specifically, we propose that:

- In the basic ‘Quick Facts’ area on the first page of the document, information should be included to show the highest capitalization value of the fund and the date that this was achieved.
- In the section, ‘What are the risks of this fund?’ we suggest adding a line which answers the question, ‘To what extent does this fund rely on one or a small group of key portfolio managers?’
- For Ontario investors, we recommend that a link to the Investor Education Fund’s website should be added to the above section.⁵ This website contains a number of useful tools and calculators that would assist investors in learning more about risk assessment.

b. Risk Measurement

Research conducted by the Panel in 2011 indicated that risk was one of the most important pieces of information Ontario investors seek in making their investment

⁴ *Ibid*, Stage 2 – 1st Request for Comments.

⁵ See Investor Education Fund (IEF) website, online:
<http://www.getsmarteraboutmoney.ca/en/Pages/default.aspx>.

decisions.⁶ It is also well-known that retail investors generally do not read conventional mutual fund disclosure documents, such as the prospectus and annual information form, which are lengthy and tend to be opaque.⁷ The presentation of risk in the Fund Facts is crucial as this document may, practically speaking, be the single or primary resource that individuals rely on in making their investment decisions.

- *Risk Scale.* We had previously commented on the importance of a standardized risk measure in the Fund Facts document. The use of a low to high risk “scale” that is self-assessed by the fund sponsor is an ongoing concern. In our view, a measure prescribed by the CSA would be more useful to investors, as it would provide an objective and consistent baseline against which the risks of different products could be compared. It would also encourage consumers to ask questions about the risks of a particular product and whether it is in fact the best suited to their needs and investment goals. Although we appreciate changes since the previous draft such as the addition of explanatory language below the scale, the CSA should consider further ways to improve the present risk measure, perhaps as part of Stage 3 of the POS initiative.

c. Performance measurement

- *Benchmark rate of return.* We support the adoption of a one-year Guaranteed Investment Certificate (GIC) as a benchmark to illustrate graphically and in concrete dollar terms the fund’s performance over the past 10 years. GICs are a familiar investment vehicle to most retail investors. The use of this benchmark in the Fund Facts document informs investors about the fund’s volatility and rate of return, and the relationship between these concepts, in a fairly simple and straightforward manner.

d. Delivery

- *Removal of the simplified prospectus.* The Panel has in previous submissions raised concerns about the removal of the requirement to deliver the Simplified Prospectus (SP) to investors until the Fund Facts document was strengthened.⁸ We recognize that the SP is not widely read by investors and that the CSA proposes significant improvements to the Fund Facts which in part allays some of our earlier concerns. If the Commission is going to proceed with this policy choice, we request that the Fund Facts include a link to the fund’s SP and clearly state that the SP contains important information and should be consulted prior to investing in the fund.⁹

⁶ See Report of the Brondesbury Group for the Investor Advisory Panel, “Focus Groups with Retail Investors on Investor Rights and Protection,” (April 7, 2011) Appendix A to SOP 2011 *supra* note 3; and, SOP 2011, *ibid* at 27.

⁷ See Stage 2 – 1st Request for Comments, *supra* note 3; and, e.g., Task Force on Financial Literacy, “Report of Recommendations on Financial Literacy - Canadians and Their Money” (December, 2010) at 81, online: <http://www.financialliteracyincanada.com/pdf/canadians-and-their-money-1-report-eng.pdf>.

⁸ SOP 2011, *supra* note 3 at 30; and, Stage 2 – 1st Request for Comments, *ibid* at 6.

⁹ These details would likely have the greatest impact if included in the discussion of risk on the first page,

- *Separation of Fund Facts from promotional/other material.* The Panel appreciates the CSA’s recognition of our input regarding the delivery of promotional and other non-educational material to investors either bound with or accompanying the Fund Facts document.¹⁰ It is important that the CSA continue to restrict the documents that can be bound to the Fund Facts or provided to investors at point-of-sale. We have reservations regarding the proposal to permit investment dealers and advisers to bind account application documents and registered tax plan documents to the Fund Facts. Specifically, we seek clarification regarding the substantive content of these latter documents and the extent to which they may be used for marketing and promotional purposes, which we believe would greatly devalue the Fund Facts to investors.¹¹

e. Clarity of language

- *Conflicts and fees disclosure.* The Panel is pleased to see the addition of clearer and more definitive language regarding the payment of trailing commissions to dealers/advisers which takes into account our earlier feedback to the CSA.¹² While we appreciate the inclusion of language alerting investors that such commission payments may give rise to a conflict of interest on behalf of dealer representatives, we think that the CSA could go further in this respect. Other jurisdictions such as Australia and the United Kingdom have completely banned the payment of such commissions to financial services representatives on the grounds that these payments are wholly incompatible with the provision of unbiased, independent investment advice to consumers.¹³ It is misleading to suggest that trailing commissions “may” create a conflict of interest, when, in

after: “For a full list of this fund’s risk factors and details about them, see the Risk section of the fund’s simplified prospectus.” Alternately, this information could be included on the last page of the Fund Facts, under the section “For more information”: see Appendix A – Sample Fund Facts Document, (“Sample Fund Facts”) CSA, “Notice and Request for Comment: 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 Contents of Fund Facts Document and Companion Policy 81-101CP Mutual Fund Prospectus Disclosure – 2nd Request for Comments,” (June 21, 2012) (“Notice”). See also Stage 2 – 1st Request for Comments, *ibid*, where the IAP noted that, at a minimum, stronger language should be included in the Fund Facts signaling to investors the importance of this document to their investment decisions.

¹⁰ See Appendix C, Summary of Public Comments, Notice, *ibid* (“Summary of Comments”).

¹¹ I.e., by conveying the impression that it is a sales brochure rather than a legal disclosure document.

¹² Summary of Comments, *supra* note 10.

¹³ See, e.g., Article 24(5) and (6) European Commission, *Proposal for a Directive of the European Parliament and the Council on Markets in Financial Instruments* repealing Directive 2004/39/EC of the European Parliament and of the Council (COM (2011) 656/4) (recast); FSA, *Retail Distribution Review*, online: <http://www.fsa.gov.uk/rdr>; and, Ch. 2.3, *FSA Conduct of Business Sourcebook (COBS)*; Australian Government – The Treasury, *Future of Financial Advice, FAQ*, online: <http://futureofadvice.treasury.gov.au/content/Content.aspx?doc=faq.htm>; and, Parliament of the Commonwealth of Australia, *Corporations Amendment (Future of Financial Advice) Bill 2012 (Corporations Amendment)* online: http://www.aph.gov.au/Parliamentary_Business/Bills_Legislation/Bills_Search_Results/Result?bId=r4689.

fact, they do.

- *Investor rights.* The Panel continues to recommend that the CSA provide more explicit information to investors about their statutory rights to withdraw or rescind their purchase in the event they change their mind.¹⁴ We recognize (although do not support) the fact that statutory rights of withdrawal and rescission are not harmonized across Canada. The existing language to this effect in the Fund Facts is too vague and places the onus on investors to investigate whether or not these rights are actually available to them.¹⁵ The CSA should consider a requirement that fund companies specify in the Fund Facts whether these statutory rights exist on a jurisdiction-by-jurisdiction basis or mandate that this information be provided to customers at point-of-sale by their dealer representative, e.g., to be confirmed by a signed client acknowledgement.

f. Enforcement

We again urge the CSA to consider specific enforcement mechanisms such as sanctions and penalties for non-compliance with the POS regime. The CSA responded to our earlier commentary on this issue by noting that it “actively monitors compliance with the Form through prospectus and continuous disclosure reviews [...]”¹⁶ We believe this approach leaves too much to the discretion of provincial securities regulators: specific and harmonized plans for enforcement of the POS regime would go further to protect investors.

g. Implementation

The Panel appreciates the CSA’s efforts to move forward quickly with the implementation of Stage 2 of the POS initiative. Future delays should be avoided in light of the length of time it has already taken to realize this initiative. While we recognize that the industry has expressed concerns about the practicality and costs of compliance with this initiative, *actual point-of-sale delivery* of the Fund Facts to investors is a fundamental aspect of the POS regime and should be implemented sooner rather than later to better serve investors.¹⁷

h. Extension to other products.

We continue to support the CSA’s plans to consider extending the POS delivery and disclosure requirements to other investment products, such as Exchange Traded Funds,

¹⁴ See Stage 2 – 1st Request for Comments, *supra* note 3.

¹⁵ E.g., by consulting a lawyer which many lay investors may be reluctant to do given the cost of legal services and/or the additional time it may take to procure them: see Sample Fund Facts, *supra* note 9.

¹⁶ Summary of Comments, *supra* note 10 at 21.

¹⁷ *Ibid*; see also Investment Industry Association of Canada, “Submission re: Canadian Securities Administrators Notice and Request for Comments on Proposed Amendments to NI 81-101 regarding Implementation of Stage 2 of Point of Sale Disclosure for Mutual Funds” (November 10, 2011) at 3 (“our main concern is the timing of delivery which may not be practical for the way many of our members conduct their business.”)

which are substantively similar to mutual funds and may be offered to investors at the same time or instead of mutual funds to avoid or subvert the Fund Facts delivery requirement. Investors need clear, simple, and meaningful disclosure regardless of the type of product they invest in. There is no principled basis to limit the POS framework to mutual funds and we hope that the CSA abides by its commitment to extend these requirements to other investment products and does so as soon as possible.¹⁸

CONCLUSION

Overall, the IAP is pleased with the Proposed Amendments in the Notice. We would like to see further attention paid to enforcement and the timely implementation of Stage 2 of the POS initiative, as well as the extension of the Fund Facts and point-of-sale delivery requirements to other investment products, preferably as part of Stage 3 of the implementation process. We also hope that the CSA considers our above recommendations, in particular with regard to cost and conflicts disclosure and risk measurement in the Fund Facts, which we believe would further improve the value and utility of this document to Ontario investors.

Thank you for considering our comments.

Yours truly,

The Investor Advisory Panel

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

¹⁸ E.g., in Stage 3 of the POS implementation process as committed to by the CSA in the Notice, *supra* note 9, at 2 (“As part of Stage 3, we will consider the applicability of a summary disclosure document and point of sale delivery for other types of publicly offered investment funds.”). Extension of the POS regime to other types of investment products such as hedge funds, fund-of-funds, as well as corporate and government bonds should similarly be considered by the CSA at this time: see Stage 2 – 1st Request for Comments, *supra* note 3 at 3, fn 7.