



INVESTMENT DEALERS ASSOCIATION OF CANADA
ASSOCIATION CANADIENNE DES COURTIERS EN VALEURS MOBILIERES

1 May 2003

Mr. Stephen Paglia
Senior Policy Analyst
Joint Forum Project Office
5160 Yonge Street, Box 85, 17th Floor
Toronto ON
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Dear Mr. Paglia:

Rethinking Point of Sale Disclosure for Segregated Funds and Mutual Funds – Response to Consultation Paper 81-403 (the Paper)

We are pleased to provide you our comments on the Paper. You have raised some timely issues.

A list of the member of the IDA's Working Group that developed the response is attached. Please note that the response was also reviewed by the IDA's Insurance Sub-Committee, Retail Sales Committee and FAS Mutual Fund Dealers Sub-Committee.

We have responded by answering the 13 groups of questions that the Paper raised in the "Issues for Comment" text boxes. We trust this is appropriate and of assistance to you.

We would be pleased to discuss our response with you and wish to participate in any further consultations on point of sale disclosure requirements. Please do not hesitate to contact me by email at mmacgougan@ida.ca or at (416) 943 6991.

Sincerely,

Morag MacGougan
Ontario Regional Director

Rethinking Point of Sale Disclosure for Segregated Funds and Mutual Funds
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DRAFT RESPONSE TO CONSULTATION PAPER 81-403 (THE PAPER)

RETHINKING POINT OF SALE DISCLOSURE FOR SEGREGATED FUNDS AND MUTUAL FUNDS

1. Do you agree with our description of the disconnect between theory and practice in this part of the consultation paper? Are there any differences between segregated funds and mutual funds that we should keep in mind as we work to improve their respective disclosure regimes?

We very much agree with the Paper's description of the disconnect, particularly with respect to mutual funds. In fact, our interpretation of it is quite simply that mutual funds are a security and that there should be parity of disclosure requirements with other securities. As such, even the proposed disclosure suggested in the Paper is unnecessary. We do not support the view that purchasers of mutual funds are necessarily less sophisticated and need greater protection and greater disclosure. In fact, the opposite is true. As mutual funds are so popular, there is a great deal of information available about them and there does not need to be special disclosure with respect to the funds. In fact, the disclosure proposed in the Paper may prove to be more confusing to investors.

The Paper discusses this issue, at page 19:

The fact that securities legislation was not drafted with mutual funds in mind gives rise to anomalous results. The law requires newly issued securities to be sold with a prospectus. Previously issued securities that are sold on the secondary market need not be sold with a prospectus because it is assumed that, by that time, there is already sufficient information in the public domain. Mutual funds are always caught by the prospectus requirements because mutual fund units are always issued from treasury. Mutual funds that have existed for many years will always be sold with a prospectus, even though there may be ample information about them in the public domain....

Instead of the disclosure regime proposed in the Paper, we suggest the following, with respect to mutual funds:

- Clients may access general investor education on all securities products (including mutual funds) in the sources currently available – the Commissions' websites, the press, the Investor Learning Centre website, the TSX's Canadian Foundation for Investor Education, and IFIC's and CSI's education programs, specifically those aimed at investors.
- We support a general Guide to Securities, similar to the Guide included as Appendix 1 with the Paper. However, consistent with our argument that a mutual fund is a security, the Guide should be expanded to cover all securities and should

not be limited to mutual funds and segregated funds. The Guide should be developed, updated and made available by the Regulators' investor education arms.

- Information on the various mutual funds is currently available through SEDAR. Investors should be directed to that site both by the Regulators and by registrants, to secure information regarding mutual funds.
- Mutual fund manufacturers will, no doubt, continue to provide information to registrants and investors on mutual funds through their websites or in hard copy.

We agree that there are fundamental differences between segregated funds and mutual funds. Segregated funds are an insurance contract (and, certainly not a security). As such, the sale of a segregated fund requires a client signature. While we would be very supportive of removing the requirement for signatures in connection with segregated funds and the closer marriage of the 2 regulatory requirements, we understand that this may not be within the mandate of this project. As such, we will not further explore the issue, but ask the Regulators to consider it as a background issue.

Given that segregated funds will continue to be an insurance product and regulated as such, there are some issues pertinent to segregated funds that the Regulators may want to keep in mind while working to improve the disclosure regime. Many clients do not understand that there is a distinction between the segregated funds and mutual funds and may believe they are purchasing a mutual fund when they are actually purchasing a segregated fund. As such, it may be appropriate that clients better understand segregated funds' distinctive features, such as different management ratios, applicability of guarantees, beneficiary designation, creditor-proofing, exclusion from the estate for the purposes of calculating probate fees, etc. Clarification of the differences between the 2 products could perhaps be provided in the consumer education materials that the Regulators may develop. Please see our response to point 10, below.

Finally, the Regulators may want to consider why, with respect to segregated funds, certain information is provided twice to the client; once in the IVIC and again in the Information Folder.

- 2. If you are a mutual fund industry participant (either a fund manager or a sales representative), please comment on your experience with the rights of rescission and withdrawal. Have you or your clients ever exercised them? Do they work in practice to give consumers real (as opposed to theoretical) rights? If you are a consumer, please tell us whether you knew you had these rights and whether you have ever used them.**

The Working Group represents mutual fund industry participants. It has been our experience that clients do not exercise their rights of rescission and withdrawal. Over the last 10 years, collectively, the industry has had extremely few incidents in which the clients wished to withdraw from a mutual fund purchase.

Further, the Working Group believes that the right should be removed as the right has more often been attempted to be used by those “playing the market”. More sophisticated individuals will buy a fund and, if the NAV decreases, will exercise their right of rescission. This is an inappropriate result from what was intended to be a client protection provision.

The right of rescission is infrequently exercised and, when exercised, is seldom exercised for legitimate reasons.

3. Our proposals will require operators to post the foundation document and the continuous disclosure documents for each fund they manage on their web-sites. The IVIC used by an insurance company for its segregated funds will also be available electronically and in paper (on demand). Please comment on the pros and cons of this approach.

We support the posting of the foundation and continuous disclosure documents on the operators’ websites. However, most useful to consumers would be a document that combines the foundation and continuous disclosure documents. If posted electronically, the 2 documents could be continuously updated, in accordance with the current requirements to file with the Commissions. New information could then be reflected on SEDAR. For your convenience, SEDAR’s website address is: www.sedar.com

Additionally, as we had mentioned in 1, above, IDA Members would then provide the website address for the operator on SEDAR to ensure the client could access the most up to date data. We understand that for those who cannot access the web, documents must be available in hard copy, but could be printed with a “Valid as of [insert date]” notation.

The Working Group is not certain why, under the Joint Forum’s proposals, that IVICs for segregated funds are to be available electronically and in paper on demand, but the mutual fund foundation document and continuous disclosure documents would be available only electronically. Additionally, given the different regulatory structures for mutual funds and segregated funds, the Working Group anticipates it may not be appropriate for information regarding segregated funds to be posted on SEDAR. The Joint Forum’s direction on this issue, however, would be appreciated.

4. We recommend that consumers have access (either electronically or if they wish, in paper) to an individual foundation document for the fund of their choice. Would it be possible or advisable to allow a foundation to describe more than one fund – for example, all of the funds in a fund family? Why or why not? How would such a document work?

If the combination foundation document/continuous disclosure document were available on SEDAR and also on the Operators' websites, that document could effectively describe more than one fund.

The Working Group suggests that the Joint Forum review the form of disclosure information provided by Fidelity Investments and Mackenzie Financial on their websites.

- 5. We propose that mutual fund managers make the various documents available on their own websites, notwithstanding their availability on SEDAR. Are SEDAR postings, alone, sufficient? Is the SEDAR system structured appropriately to fulfill this function? Please comment on the usefulness of SEDAR for accessing individual disclosure documents about a mutual fund.**

The Working Group suggests that it would be more efficient if there were one source of information. However, there is some hesitation with respect to limiting that source to SEDAR as the site is difficult to navigate. Perhaps SEDAR should offer a link to the Operators' websites.

- 6. Please give us feedback on the practical issues we outline in the text box above. Please explain how marketing brochures or other sales communications are distributed and kept-up-to-date today, both at the operator and sales representative levels.**

Should mutual fund information be made available, as discussed in Point 1, above, and, should mutual funds disclosure requirements be made more uniform with other securities, the practical issues on page 28 are largely irrelevant. This is true regardless of how materials are currently distributed and kept up to date.

- 7. Please tell us about your business practices now using the existing disclosure documents. Do you use them in the sales process? Do you give them to consumers before a sale is completed? If we require you to give a printed fund summary to consumers before the sale, what impact will this have on your existing business practices? What about telling consumers what the fund summary says rather than always giving them a printed copy? Can we achieve our objectives of empowering consumers to make informed investment decisions without mandating a fund summary?**

Again, it is the Working Group's submission that mutual funds are a security and no disclosure documents should be required to be provided prior to a sale of mutual funds. It is impractical and unnecessary to require that certain documents be provided to

investors prior to the sale. Mandating that any document (no matter how condensed) or a verbal summary of a document be provided to investors before the sale will result in the same impracticalities that the Joint Forum is looking to rectify through the Consultation Paper.

Empowered investors are making informed investment decisions on any number of other securities without the requirement that certain documents or a verbal summary of those documents are provided prior to sale.

Again, the Working Group understands that given the different regulatory structures for mutual funds and segregated funds, such a proposal may not be appropriate for segregated funds.

8. Please give us your views on the proposed content of the fund summary document.

The Working Group is satisfied with the proposed content of the fund summary.

9. What are the pros and cons of a fund summary document that includes information on more than one fund? Why is a consolidated document desirable, having regard to the potential for consolidated documents becoming unwieldy?

If published on SEDAR and/or the Operators' websites, a fund summary containing information on more than one fund is desirable and would be less unwieldy. The Working Group has not yet settled on how (even electronically) details regarding fees, switches, etc., could best be conveyed to investors.

10. Please provide us with feedback on the practical questions we note in the text above.

The Guide should be developed and updated by the Regulators' investor education arms. The Regulators currently develop such material (the OSC's Investor e-ducation Fund website) that does not require industry endorsement. Likewise, the industry need not endorse the Guide, but may be consulted to review it, should the Regulators feel this would be appropriate.

The Guide is just that – a guide. There should be no requirement to offer it to investors and there should be no consequences should the member firm not do so.

11. Please comment on the content of the draft consumers' guide in Appendix 1.

The Working Group submits that the draft Consumers Guide may provide too much detail for some investors and not enough for others. Additionally, perhaps one Guide, discussing investing generally or two separate Guides, one that discusses securities, including mutual funds and another that discusses insurance products, including segregated funds, would be better digested. As had been mentioned in Point 1, above, the fundamental differences between mutual funds and segregated funds should be clarified in the Guides.

The Guide should either be product specific or discuss investing, generally.

12. Please comment on cooling-off periods in the context of mutual fund and segregated fund sales. If you believe one should be retained (or introduced in the case of segregated fund sales) please explain why. How should a cooling-off period work given the changes in the market value of funds? How can we prevent market players from using a cooling-off period to play the markets? What would be a correct period for consumers to re-consider their investment?

Further to our comments in 1, above, that mutual funds are simply a security, there should be no cooling-off period in connection with the purchase of mutual funds. Sufficient other safeguards are in place should a product be determined to be unsuitable for an investor. Additionally, if the fund information is available on SEDAR, clients have the opportunity to fully research the product, in advance of speaking to their Member firm.

A cooling off period should not be introduced for segregated funds.

13. Although we will be preparing a formal cost-benefit analysis, we are interested in your views on the costs versus the benefits of our proposals. Please comment and explain your analysis.

A very informal survey shows that, on average, Member firms spend approximately \$300,000 to \$700,000 a year depending on the size of the firm associated with the distribution of the mutual funds/seg funds for new fund purchases.