



INVESTMENT INDUSTRY ASSOCIATION OF CANADA
ASSOCIATION CANADIENNE DU COMMERCE DES VALEURS MOBILIÈRES

Ian C.W. Russell FCSI
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December 22, 2008

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Dear Sirs/Mesdames:

**Re: CSA Notice 81-318 Request for Comment: Framework 81-406 Point of Sale
Disclosure for Mutual Funds and Segregated Funds (the Framework)**

Thank you for providing us with the opportunity to comment on the Framework. The Investment Industry Association of Canada (IIAC or Association) is the professional association representing over 200 investment dealers in Canada. Our mandate is to promote efficient, fair and competitive capital markets for Canada and assist our member firms across the country.

Our members represent a major distribution channel for the mutual fund industry. In 2007, the securities industry generated \$2.2 billion in revenue from mutual fund sales. This represents 35% of industry commissions and 13% of total brokerage industry revenues.¹ Furthermore, of the \$900 billion in assets our members manage on behalf of

¹ IIAC, Securities Industry Performance Report Q4 2007.

retail clients, over \$200 billion is invested in mutual funds.² It is clear then, that our members have a strong interest in the Framework.

The Association generally supports the initiative of the Joint Forum of Market Regulators (Joint Forum) to create a meaningful, more simplified form of disclosure for mutual fund and segregated fund investors.

In general, the IIAC and its members are pleased that many of the concerns raised in our submission of October 5, 2007 were considered by the Joint Forum and have been reflected in the revised Framework. We hope that the Canadian Securities Administrators (CSA) will ensure that many of the Joint Forum's concepts are incorporated in specific requirements and/or amendments to existing securities laws.

Specifically, the Framework presently provides greater clarity and certainty for both investors and member firms now that the trigger point for the cooling-off right occurs at the receipt of the trade confirmation.

It is also welcome news that a Fund Facts will no longer be required to be delivered for any subsequent purchases of the same fund unless a copy of the Fund Facts is requested by the investor. In addition, investors will receive the Fund Facts for money market funds with their trade confirmations unless it is requested before or at the point of sale.

The IIAC supports the distinction for discount brokers who will only be required to send the Fund Facts with the trade confirmation.

We also appreciate that the content of the Fund Facts will be revised to provide clarity surrounding information on fees and compensation. The IIAC supports the Joint Forum's recognition of the need to balance the degree of prescription with flexibility to ensure that the content of the Fund Facts is relevant and clear.

We understand that the Joint Forum has recognized that a one-size-fits-all approach is not always workable and has incorporated flexibility for different business models. The Association is pleased that the Joint Forum has attempted to differentiate between trades executed through a discount broker and those executed through a full-service firm. However, we continue to have ongoing concerns with the Framework, which we hope the CSA will consider in the next stages of development of this important initiative.

OPERATIONAL ISSUES

Recommended by Adviser or Initiated by Investor

While the Framework would permit an investor who has initiated a purchase to waive receipt of the Fund Facts at or before the point of sale, there can be a great deal of uncertainty as to when a purchase has, in fact, been recommended by the adviser or initiated by the investor. Moreover, there are significant operational challenges

² Investor Economics.

surrounding audit trails and supervision with respect to client or adviser initiated purchases.

Specifically, for some firms, their systems require the notation, either “solicited” or “unsolicited” to be placed on every mutual fund trade confirmation. It also appears on client statements, creating a permanent record. However, as the systems are structured so that the notation is only included post-trade, it cannot be reconfigured to drive other automated processes, such as automatically sending the client a pre-trade Fund Facts document. Consequently, regardless of the origination of the trade the client would receive the same documentation.

Under the Framework, a firm would have to build systems to read these trailers and take certain actions. An example of this type of action may be to stop a solicited trade with a question or confirmation that the Fund Facts had been delivered and add a trailer to the confirmation saying the adviser had done so. In addition, as the Fund Facts must be delivered before the trade for adviser recommended trades, firms would have to feed that information to the fulfillment system to provide this on some but not all trades.

Procedurally, a firm would probably expect the adviser to keep some evidence of the delivery (fax or e-mail) or make a notation of the delivery in their client relationship management system. A firm would likely wish to add in some form of audit/oversight process to ensure compliance.

These procedural concerns would become further complicated in dealing with initial versus subsequent orders. For example, how would the proposal work in scenarios in which the client initiated the initial purchase but the adviser solicited a subsequent purchase to add to the holding? Would the Fund Facts have to be delivered before or at the point of sale for the subsequent purchase? Similarly, if a client held an equity fund, switched it into a money market fund and four months later switched it back to the equity fund, would that be considered a subsequent purchase or a new purchase?

Furthermore, we question if consideration has been given to providing any guidance or definition in the Framework surrounding “recommendations” by the adviser or investor “initiated” trades. There is little regulatory guidance in this area other than Investment Industry Regulatory Organization of Canada (IIROC) Member Regulation Notice MR-098, issued in 2001.³

Many of our members have indicated that with this uncertainty and the accompanying operational challenges, firms will continue to deliver a Fund Facts prior to or at the point of sale. For members, this will avoid any doubts and potential repercussions for non-compliance with the requirements if an investor contends, after the fact, that a purchase was not investor initiated.

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³ IIROC MR-098, What Constitutes a “Recommendation”? Is a Suitability Determination Required under Regulation 1300.1. (September 6, 2001)

The result would be that despite two options in the Framework, members firms would not recognize this distinction and continue to provide a Fund Facts to every single client regardless of the client's desire to waive receipt.

Right of Action and Verification of the Delivery Requirement

Under the Framework, purchasers will have the right of rescission or damages if they do not receive the Fund Facts document. This will require firms to have a very detailed compliance regime in order to be able to track whether the delivery of the Fund Facts has in fact occurred. If the adviser gives the document to a client during a face to face meeting, there must be some means to ensure that the delivery has occurred, likely through a client signature or acknowledgement. Similarly, if the document is sent via e-mail, there must be some audit trail of the e-mails. Consequently, although the Framework states that the only delivery requirement imposed is for the dealer to bring the Fund Facts to the attention of the investor, members must develop more stringent operation and compliance systems to ensure that they can review whether the client has in fact received the Fund Facts. This is the only method by which the firms can provide evidence if an investor claims, at some later point in time, that they never received the Fund Facts document.

This rescission right is also problematic as records are generally only kept for five years to ensure compliance with SRO rules, so if a client returns years later and claims that they did not receive the Fund Facts document, a firm may not be able to defend its position after the five years have elapsed.

This perpetual right of rescission by the investor in the event of non-delivery of the Fund Facts will create challenges in developing a suitable compliance framework, audit trail and adequate record keeping.

A suitable compliance framework to address these issues will take significant time to be developed by firms. As such, sufficient lead time will be needed if the requirements of the Framework, as currently contemplated, come into force. In addition, we suggest that greater clarity be provided in the rule or possible companion policy.

Audit Trails

We suggest some additional clarification as to the responsibility of general compliance with the Framework and what type of audit trail may be required. Will the self-regulators, such as IIROC, have the responsibility to supervise adequate compliance with the requirements? What sort of sales compliance reviews will be undertaken by IIROC in these situations? As stated above, the audit trails that will be required to limit the liability to firms will be a huge undertaking given the consequences of the failure to show that the client did indeed receive the Fund Facts.

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Learning from PPN Requirements

Our members are currently facing significant operational issues with respect to the new Principal Protected Notes (PPNs) legislation, which came into force on July 1, 2008. The new legislation has been a source of major challenges for member firms from a compliance perspective, and also added new burdens and requirements that ultimately impact clients. Our members have told us that they will face similar hurdles in implementing the requirements of the Framework. As a result, one member firm in particular has suggested that we extend an invitation to the CSA to visit this member and observe how the PPN requirements are impacting member business and the servicing of clients. The IIAC would be happy to arrange a visit with staff of the CSA if they wish to gain a better practical understanding of the challenges that members are facing.

Electronic Delivery

Lastly, and perhaps most importantly, we request some further clarification regarding the Framework's discussion of the method of electronic delivery of the Fund Facts.

As the IIAC outlined in previous submissions to the Joint Forum, our members have some concerns regarding the method of delivery, which is still extremely limited and not practical for our members or investors. The IIAC suggests that delivery options be made more flexible so that delivery does not dramatically affect how our members operate and their clients are serviced.

The Framework suggests that the methods of delivery of the Fund Facts document could be by hand, by fax, by mail or electronically. However, our members conduct a significant amount of transactions over the phone and it is likely that these investors will be frustrated by the fact that they must wait for the Fund Facts to be mailed/faxed/e-mailed to them before they can proceed with their transaction.

The Framework now allows the option of "sending an electronic copy of the document directly to the investor as an attachment or a link, or directing the investor to the relevant Fund Facts on the fund manager's or insurer's website."

A number of our members have indicated that they have internal policies that prohibit the distribution of client documents via e-mail. These policies are in place to safeguard clients from on-line fraud, particularly where individuals are asked to provide their account numbers and/or log-on using a password. To ensure that clients are not exposed to these frauds, many members tell their clients that their firms never e-mail documents unless, for example, clients have asked to receive their statements online. Even in those situations, clients would receive an e-mail stating that their account statements are waiting for them, but would then have to sign on to the member's secure website to access it. However, in this situation the information is not as time sensitive. Similarly, some members have chosen not to transmit client documents via fax because that too, presents security concerns. For example, client fax numbers may change or be given

incorrectly to the adviser causing advisers to inadvertently send documents to unintended parties.

Furthermore, an e-mail directing the client to the relevant Fund Facts on a fund manager's website will likely require the adviser to have tens of thousands of links to each particular Fund Facts readily available to send to clients. Requiring the adviser to have these links immediately accessible is simply not practical.

In order to deal with the limited options of delivery under the Framework, the IIAC believes that the principle of access equals delivery should be applied to the Fund Facts document.

Speed, efficiency and prompt customer service are attributes that many clients value when choosing to conduct a mutual fund transaction and this is exemplified in a call centre or discount brokerage environment. For example, one member firm indicated that calls to their mutual fund call centre average less than 390 seconds per client. A discussion surrounding a Fund Facts document between the adviser and client over the phone, even simply to indicate that it will be sent to the client for their review and that the client will have to call back to execute the transaction after receipt of the Fund Facts document will significantly impact the service that clients expect. In addition, one firm indicated to the IIAC that every 10 seconds added to a phone conversation with the client translates into added costs of \$500,000 per year for the dealer, representing the hiring of approximately seven additional investment representatives. This would be a disadvantage to smaller dealers, and the increased costs in all types of firms will ultimately be borne by clients.

Consequently, we believe that the provision of access equals delivery would adequately balance the regulators' concerns as to the provision of meaningful disclosure to investors and the members' concerns surrounding customer satisfaction and operational issues. In order to achieve an access equals delivery model a change could be made to the account opening document which informs the investor that a Fund Facts document exists and that they are entitled to a copy of it. The Fund Facts documents could be made available to those clients who wish to look at them through an industry centralized database, similar to SEDAR where all Fund Facts could be stored. Members could also offer to deliver a hard copy of the Fund Facts document to clients who wish to receive a copy. The SEC has recently adopted a similar protocol with respect to delivery of proxy materials.⁴ Under the mandated E-Proxy Rules, issuers and others can satisfy their delivery obligations by posting proxy material on a publicly accessible website and sending a notice of availability informing that such materials are available and how to access them. In addition to the Fund Facts document being referenced in the account opening documentation and directing clients to the centralized database, it could also be mailed to all investors with their confirmation statement following their purchase.

In our suggested model above, investors would receive adequate disclosure in a timely fashion with the ability to review the details before the transaction if they so choose or

⁴ Securities and Exchange Commission, 17 CFR Parts 240, Release No. 34-56135.

after the decision to buy a fund has been made. As such, the IIAC supports an access equals delivery approach.

NEED FOR FUND FACTS IN SPECIFIC SITUATIONS

Discretionary Accounts

As it was not addressed in the Framework, the IIAC proposes that the Fund Facts document not be required in situations where an investor has a discretionary or managed account, as under this type of account relationship, the adviser or a third party portfolio manager is making decisions on the client's behalf. Currently, such investors would not necessarily receive disclosure materials but under the Framework would be required to receive the Fund Facts, thereby changing the nature of this type of relationship.

Accredited Investor Exemption

Proposed National Instrument 31-103 *Registration Requirements* currently proposes an exemption to the suitability obligation for permitted clients who have waived the suitability obligation under subsection 5.5(3).

This is presumably due to the fact that a sophisticated investor does not need a suitability review to properly understand the nature of his or her purchase and the implications for his or her account. Based on this rationale, the IIAC proposes that an accredited investor be exempt from having to receive a Fund Facts document at or before the point of sale. We do not believe that a Fund Facts will add any value for such investors. We believe it would be sufficient for such accredited investors to receive the document at the time that a confirmation is delivered.

Use of Waiver

The IIAC proposes that a waiver should be available for clients who wish to conduct a trade from a remote location, such as a cottage without internet access. If remote clients call their advisers wishing to redeem or purchase a mutual fund, they would have to wait for receipt via mail of the Fund Facts document under the current proposal. Purchases could be negatively impacted due to price fluctuations over the days it takes to receive the Fund Facts. In this situation, clients should have the option to waive receipt of the Fund Facts document, with an audit process implemented to document such waiver. Such a waiver could be available for limited time periods such as 60 or 90 days to deal with these specific situations.

BROADER ISSUES

Involvement of SROs

The IIAC suggests that the CSA ensure that implementation discussions occur at an early stage with the relevant regulators, such as IIROC and the Mutual Fund Dealers Association of Canada. If, presumably, these self-regulatory organizations will be

implementing and enforcing these requirements, their input is required earlier in the process of point of sale disclosure requirements rather than later.

We urge the CSA to engage in discussions and rule review with the self-regulatory organizations as soon as possible.

IFIC Proposal

In considering the IIAC comments above, we would like to indicate our support for the Investment Funds Institute of Canada (IFIC) proposal submitted to the CSA on November 24, 2008.

IFIC has suggested the implementation of a draft rule in early 2009 that deals only with the content of the Fund Facts and requires, at a minimum, that such Fund Facts be made available by mutual fund companies through a website by the end of 2009. The industry would also work with regulators on an accelerated process for substituting the delivery of the Fund Facts in place of the prospectus if this is viewed as desirable by the CSA.

The industry could then work with the CSA to examine the delivery options contained in the Framework to ensure the methods of delivery of the Fund Facts are both practical for the industry to implement and meaningful for investors.

This approach has the benefit of allowing investors timely access to Fund Facts while allowing sufficient time and consultation to develop constructive solutions to the issues raised by the industry with respect to the methods of delivery.

In closing, we welcome the opportunity for an ongoing dialogue with the CSA on this important initiative and would be pleased to discuss this submission should you have any questions.

Yours sincerely,

A handwritten signature in black ink, appearing to read "J. Russell". The signature is written in a cursive style with a long horizontal flourish extending to the right.