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September 14, 2015

British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumer Services Commission (New Brunswick)
Office of the Superintendent of Securities, Prince Edward Island
Nova Scotia Securities Commission
Office of the Superintendent of Securities, Newfoundland and Labrador
Office of the Superintendent of Securities, Northwest Territories
Office of the Yukon Superintendent of Securities
Office of the Superintendent of Securities, Nunavut

c/o

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Dear Sirs and Mesdames,

Re: Summary Disclosure Document for ETFs

The following is submitted by **Russell Investments Canada Limited** in response to the CSA Request for Comment – Mandating a Summary Disclosure Document for Exchange-Traded Mutual Funds and Its Delivery dated June 18, 2015 (**the ETF Facts Proposal**).

Russell Investments Canada Limited is the Canadian arm of Russell Investments, a global asset manager and one of only a few firms that offers actively managed multi-asset portfolios and services that include advice, investments and implementation.

Russell Investments has more than CAD$331 billion in assets under management (as of June 30, 2015) and works with over 2,500 institutional clients, independent distribution partners and individual investors globally. As a consultant to some of the largest pools of capital in the world, the firm has US$2.4 trillion in assets under advisement (as of Dec. 31, 2014). It has four decades of experience researching and selecting investment managers and meets annually with more than 2,200 managers around the world. Russell Investments traded more than US$1.7 trillion in 2014 through its implementation services business.

Headquartered in Seattle, Washington, Russell Investments is wholly owned by London Stock Exchange Group (LSEG) and operates globally, including through its offices in Seattle, New York, London, Paris, Amsterdam, Milan, Dubai, Sydney, Melbourne, Auckland, Singapore, Seoul, Tokyo, Beijing, Toronto, Montreal, Vancouver, Calgary, San Diego, Chicago, Milwaukee, Edinburgh and Frankfurt.

General Comments

We would like to thank the Canadian Securities Administrators (**CSA**) for taking the initiative on the ETF Facts. We believe that the ETF Facts Proposal is a positive start to regulating in a similar manner financial products which compete with one another. A cornerstone of financial regulation should be to seek to be product neutral as between products and services which serve the same financial need.

As recognized in the ETF Facts Proposal, exchange traded funds and mutual funds regulated by National Instrument 81-101, National Instrument 81-102 and National Instrument 81-106 (**conventional mutual funds**) are similar in that they are collective investment vehicles marketed by their sponsors to the same groups of investors, namely retail investors served by financial advisors. They are competitive products, but subject to differing regulation because of differences in the manner of their legal formation. These differences are for the most part unimportant to the end users. We believe that most retail investors care little about the underlying legal structure of an investment product.

As regulators are aware, the industry has raised similar concerns about level playing field and regulatory arbitrage with respect to variable annuity insurance products ("segregated funds"). Here is another instance in which the products are widely regarded as substitutes for one another, and yet are subject to very different regulation. We understand that securities regulators do not have jurisdiction over insurance products. However, in the case of exchange-traded funds (**ETFs**) and conventional mutual funds, there is an opportunity to get it right insofar as the jurisdictional divisions are not present.

We support the ETF Facts Proposal as an important step in remedying the current situation which in our view puts conventional mutual funds at a disadvantage compared to ETFs. We believe this unsatisfactory state of affairs takes on greater importance as ETFs gain in popularity and become a mainstream investment product. In our view, insufficient regulatory attention has been paid to ETFs and the manner in which they are sold to consumers and the ETF Facts Proposal is long overdue. We believe that the ETF Facts Proposal by itself does not result in a level playing field as between conventional mutual funds and ETFs. We encourage regulators to explore further steps that can be taken to ensure that comparable products are similarly regulated so that investors are afforded equal measures of protection.

Specific Comments

Below are our responses to some of the specific questions posed by the ETF Facts Proposal. For convenience of reference, we have reproduced your questions in bold below and as presented in Annex B of the ETF Facts Proposal.

Content of the ETF Facts

1. **The ETF Facts is substantially similar to the Fund Facts, except for additional information related to trading and pricing (e.g., average daily volume, number of days traded, market price range, net asset value range, average bid-ask spread and average premium/discount to NAV). We seek specific feedback on these proposed elements of the ETF Facts. In particular, please comment on the disclosure instructions for these elements as outlined in Form 41-101F4. For example, should the range of market prices exclude odd lot trades? In terms of the calculation of the average bid-ask spread, should trading days that do not have a minimum number of quotes be excluded from the calculation? We also seek feedback on whether there are alternative methods or alternative metrics that can be used to convey this information in a more meaningful way for investors.**

1.1. <u>Improved Disclosure re Tracking Error</u>

One of the most important and least understood features of an ETF is the existence of tracking error due the ETF's portfolio not perfectly tracking its index (sometimes referred to as "replication risk"). Many retail investors assume, incorrectly, that the performance of their ETF units will accurately track its underlying index, and that the only difference between the performance of the index and the performance of the ETF will be attributable to fees. That is not the case. As discussed below, it's virtually impossible for an ETF to perfectly track its index in real time.

For clarity, we are referring here to the differences between the performance of an index ETF and the performance of its benchmark index which are attributable to factors *other than the fees and expenses charged by the fund manager*. These differences can result from, among other things and depending on the nature of the fund and its benchmark index: (i) transaction costs in replicating the benchmark index and making adjustments thereto; (ii) taxes, including withholding taxes; (iii) other expenses such as stamp duties, registration fees and the like; (iv) the temporary unavailability in the secondary markets of securities included in the index; (v) inability or failure of the fund to collect income distributed by an underlying security or level of expenses incurred to collect such income; (vi) the timing of changes to the composition of the underlying index.

Furthermore, ETFs are not all constructed the same way, and use different strategies to replicate the performance of the benchmark index, with varying degrees of success.

Some ETFs do not hold securities which make up the index on a proportionate basis. Instead, they use a "sampling strategy", and hold a representative sample of securities which the ETF sponsor deems to have an investment profile similar to the underlying index. Or the ETF may have a portfolio which the sponsor deems to have characteristics, in the aggregate, similar to the index.

The proposed ETF Facts only prescribes disclosure that performance may deviate due to fund expenses. In our view, this disclosure is inadequate and fails to capture a critical feature in the risk profile of the product that consumers are entitled to know about. It could lead to an inference that the above tracking errors are unimportant and can be ignored.

For conventional mutual funds, there is, in addition to the Fund Facts, a simplified prospectus which must be prepared in plain language and contain prescribed disclosure on "What is a mutual fund and what are the risk of investing in a mutual fund". There is no similar document for purchasers of ETFs. There is a long-form prospectus which is legalistic and unlikely to be read and understood by average retail investors. As a result, while referring the investor in a conventional mutual fund to the simplified prospectus can act as backup to the Fund Facts, simply referring the investor to the ETF's prospectus for an explanation of tracking error is unlikely to assist that investor.

This "tracking error" problem was put into high relief during the recent market turmoil. There were reports in the press of instances of significant discrepancies between the prices of securities included in benchmark indices and their prices as reflected in the ETF. *The Wall Street Journal* reported: [1]

> When the market sold off in the first six minutes of trading [on Monday Aug. 24, 2015], many stocks were halted after triggering circuit breakers, including stocks that are included in popular exchange-traded funds.
>
> Because this happened so quickly, many ETF market makers, or the broker-dealers who buy and sell those products were unable to accurately calculate the value of the underlying holdings or properly hedge their trades. That caused them to lowball their buy offers and overprice their sell orders to ensure they didn't take on too much risk. This sent EFT market value tumbling, too, and caused disruptions in the trading of other assets.

Proposal:

We suggest that the ETF Facts prescribe disclosure, in plain language, about tracking error. For example, under "How risky is it?", the following could be added:

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[1] From: The Wall Street Journal, August 25, 2015: http://www.wsj.com/articles/stock-market-tumult-exposes-flaws-in-modern-markets-1440547138

"**Tracking Error**

The ETF will not replicate exactly the performance of the Index. Compared to the return of the Index, the total return of the ETF will be reduced by the ETF's expenses. Additionally, the ETF may have to pay costs, taxes and fees that are not included in calculating the returns of the Index. From time to time, the ETF may not hold the same securities in the same proportions as the Index and these differences will also result in the performance of the ETF differing from the Index."

1.2. Improved Disclosure re Cost of Investing

The disclosure under "How much does it cost? – Brokerage commissions" is inadequate in that it does not provide a full picture of the costs to the customer in owning an ETF. The focus of the Fund Facts document has always been on what the investor may experience in terms of fees when purchasing and holding a mutual fund investment, regardless of whether the fee is paid to the fund manager, the dealer, the dealing representative, or another party such as a registered plan trustee or similar service provider. The same principle should apply to disclosure in the ETF Facts with respect to purchases of ETFs.

ETFs are very often held out to retail investors as a low fee alternative to conventional mutual funds. While the management fees charged at the level of the fund are generally much lower than for conventional mutual funds, particularly actively managed mutual funds, it is not clear that the all-in cost to the investor is as low as advertised.[2]

This becomes significant for example for any retail investor who wishes to participate in a periodic investment program, commonly referred to in the industry as a PAC or a systematic redemption program, also known as a SWIP. Typically for conventional mutual funds, each PAC or SWIP transaction does not attract a separate brokerage commission. Amounts are withdrawn directly from or deposited directly to the investor's bank account (or account with another financial institution). The dealer does receive compensation for PAC purchases, but such commissions are paid by the manager of the conventional mutual fund and are not deducted from the amount invested. By contrast, outside a fee-based account, the investor will incur a brokerage commission with every purchase and sale transaction in an ETF. The amount of the brokerage commission varies depending on the broker or dealer, and can be a flat fee or a percentage of the price. Over time, these fees can be significant.

There is a risk with ETFs that the financial advisor will trade excessively for a client account ("churning the account"). We submit that the prescribed disclosure should better highlight this risk.

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[2] As an example, differences in the level of taxable distributions received by an ETF investor may negatively impact on the value of the ETF investment vs. a conventional mutual fund investment. We trust that the Canadian securities regulators will ensure that required tax disclosure in ETF long-form prospectuses fully and fairly discloses the differential tax impact to investors.

Proposal:

The ETF Facts should clearly require full fee disclosure of all fees payable by the investor, so that investors are provided with an apples-to-apples comparison of the all-in cost versus the Fund Fact documents. Furthermore, the proposed statement with respect to brokerage commissions in the "How much does it cost? – Brokerage commissions" section should be revised to "You may have to pay a commission each time you buy and sell [shares/units] of the ETF" and expanded to require specific information regarding the rates of brokerage commissions payable (including for any form of periodic purchase plan).

2. **The "How ETFs are priced" section of the ETF Facts is intended to provide ETF investors with some additional information on the factors that influence trading prices and to explain the difference between market price and NAV. This section has been modified in response to investor testing, which showed that investors valued this type of information but were not necessarily aware of how to use it in practice. We seek feedback on whether there is an alternative form of presentation of this information that may better assist investors.**

We submit that the proposed disclosure under "How ETFs are priced" is misguided and could be misleading. Too much emphasis is placed on the "bid-ask spread" and whether units are trading at a "discount" or "premium". The level of the bid ask spread and degree of premium or discount to NAV, while not unimportant, pales in significance compared to the real drivers of the price of a ETF unit, namely the market and economic factors that apply to the underlying securities or index. We question whether the reader of the ETF Facts is interested in, or benefits from knowing more about, the technical mechanism for pricing ETFs, any more than the reader of the Fund Facts is interested in knowing the detailed valuation rules for pricing mutual funds.

The title "How ETFs are priced" may lead an average, non-industry investor to think that this is a discussion about the factors that impact the price of their ETF holding, and not a discussion of the mechanics of pricing. The factors that impact the price of an investor's ETF will be general economic conditions, phase of the business cycle, interest rate environment, the global price for commodities and the like. So there should be a general statement that the price of their ETF can be expected to move up or down with the price of the underlying index or asset, and then a brief discussion of the principal factors that affect the prices in the underlying economic exposure.

Recent market events have highlighted that during periods of unusual volatility, the ETFs themselves, as well as the underlying securities, will be subject to temporary trading halts imposed by circuit breakers.[3] This can have adverse consequences that investors are entitled to know about. By contrast, conventional mutual funds do not trade on an exchange and while in certain circumstances the redemption privilege may be temporarily suspended, the units of conventional mutual funds are not subject to trading halts

Proposal:

This section can be considerably shortened and replaced with disclosure that directs the investor to underlying risk factors. We ask that you consider changing the title to "What affects the price of your ETF?" The prescribed disclosure should state that the price of the ETF Unit will reflect the movement of the underlying index or reference security or asset. Then there should be a summary discussion of the principal factors. To deal with the mechanics of pricing, we suggest as follows:

> "**What affects the price of your ETF?**
>
> ETFs are unique because they generally hold a basket of investments, like mutual funds, but trade on an exchange, like stocks. Although your ETF sponsor calculates a net asset value (NAV) for your ETF, you will buy and sell your ETF units at its market price, which could differ from the NAV.
>
> You can expect that the price of your ETF will reflect the prices of your ETF's underlying assets or reference index (subject to tracking error as discussed elsewhere in the EFT Facts). So the price of your ETF unit will move up and down, in greater or lesser amounts, reflecting the prices of such assets or index. The principal factors which affect the price movement of the Index are [list e.g. general economic conditions; phase of the business cycle, level of interest rates, the global price of commodities, prevailing exchange rates].
>
> Some ETFs have underlying securities and assets which are more liquid than others. Some ETFs trade in much higher volumes than others. As a result, the liquidity of the ETF will differ, and that can also impact the trading price of your ETF. During periods of market volatility, there can be a significant variance between the price of a security and the price of such security as reflected in the price of the ETF. Additionally, during times of market volatility, the existence of circuit breakers on the exchange on which your ETF is traded will affect both the price and the liquidity of the ETF units. For further details on how your ETF is priced, see the ETF's prospectus."

3. Please comment on whether there are other disclosure items/topics that should be added to reflect the differences between ETFs and conventional mutual funds.

3.1. <u>Pre-Sale Delivery</u>

Unlike conventional mutual funds, which under Stage 3 of the Point of Sale Project will require pre-trade delivery of Fund Facts (commencing May 30, 2016), delivery of ETF Facts will only be required within 2 days after the trade. No explanation was provided for this asymmetry. An unlevel playing field which materially favours ETFs will be created if ETFs can be sold using post-trade delivery while conventional mutual funds must achieve pre-trade delivery

[3] ibid 1, Pg. 4

Proposal:

The Canadian Securities Administrators have emphasized that the Fund Facts are far less useful to investors if not received before submitting their purchase order. The same policy rationale should require pre-delivery of ETF Facts. Dealers and advisors are already putting in place a process to deliver Fund Facts at or prior to the purchase transaction. That same process can be used to have ETF Facts delivered in the same way. All parties should be able to leverage their pre-delivery regime for Fund Facts in order to pre-deliver ETF Facts.

3.2. <u>De-emphasize the MER of an ETF</u>

MERs (**management expense ratios**) are poorly understood by retail investors. Put bluntly, retail investors have been conditioned, by years of coverage in the media, prescribed disclosure requirements, and industry usage to believe that the MER is equal to the total cost of investing.

The MER for a conventional mutual fund is not comparable to a MER for an ETF. The former includes distribution cost, the compensation paid to the dealer and financial advisor. Such compensation covers the cost of prescribed services which the financial advisor is required, by statute, to provide (i.e. the costs associated with the financial advisor conducting KYP, KYC, suitability, account monitoring, and the like). For an ETF, the MER reflects solely the cost of operating the ETF and excludes all of the other services typically required by a retail investor in connection with the purchase and holding of the ETF. The MER for an ETF does not include costs that the investor will incur in connection with opening and operating an account with a broker in addition to brokerage commissions: account opening and account administration fees, registered plan fees, transfer fees, NSF fees where applicable, etc. None of this is captured in the MER of an ETF, but many investors mistakenly assume that the MER is an “all-in” cost. If investors are making this assumption, emphasis on the MER is misleading as it does not provide for an “apples to apples” comparison. We encourage you to place less emphasis on the MER of an ETF or better disclose that the MER of an ETF is only one component of the cost of owning and transacting in ETFs.

Anticipated Costs of Delivery of the ETF Facts

4. We seek feedback on the anticipated costs of delivery of ETF Facts for those dealers who do not have Exemptive Relief and are not currently delivering ETF Facts; specifically, the anticipated one-time infrastructure costs and ongoing costs.

We observe that in the past, securities regulators have given relatively little sympathy to costs of this type as a reason for delaying or dispensing with important investor protection initiatives. Accordingly, we would be surprised if such cost deference were to be shown to the ETF industry.

Transition Period

5. **We seek feedback from dealers on the appropriate transition period for ETF Facts delivery under the Proposed Amendments. We are specifically interested in feedback from dealers who are not subject to the Exemptive Relief. Please comment on the feasibility of implementing the delivery requirement under the Proposed Amendments within 21 months of the date the Proposed Amendments come into force. In responding, please comment on the impact a 21 month transition period might have in terms of cost, systems implications, and potential changes to current sales practices.**

6. **We seek feedback from ETF managers on the appropriate transition period to file the initial ETF Facts. We currently contemplate that 6 months after the date the Proposed Amendments come into force, ETF managers will be required to file an initial ETF Facts concurrently with a preliminary or pro forma prospectus for their ETFs. Please comment on the feasibility of making the changes to compliance and operational systems that are necessary to produce the ETF Facts, instead of the summary disclosure document pursuant to the Exemptive Relief, within this timeline.**

7. **We seek feedback from ETF managers and dealers on whether they prefer a single switch-over date for filing the initial ETF Facts rather than following the prospectus renewal cycle as currently contemplated. The CSA implemented a single switch-over date for the Stage 2 Fund Facts, and recognize that there are challenges in doing so, especially for ETF managers, from a business planning and business cycle perspective. If a single switch-over date is preferred, are there specific months or specific periods of the year that should be avoided in terms of selecting a specific switch-over date? Please explain.**

These questions do not directly involve Russell Investments.

For the reasons stated herein, we urge regulators to have the ETF Facts regime in place as quickly as possible.

Right for Withdrawal of Purchase

8. **Currently, under securities legislation, investors have a right for withdrawal of purchase within two business days after receiving the prospectus. This right only applies in respect of a distribution for which prospectus delivery is required. In the case of ETFs, today only purchases filled with Creation Units trigger a prospectus delivery requirement and are therefore subject to a withdrawal right.**

   Consistent with the approach taken in the Exemptive Relief, the Proposed Amendments do not extend the right of withdrawal of purchase to investors for the delivery of the ETF Facts. In some jurisdictions, investors will continue to have a right of rescission with delivery of the trade confirmation.

We seek feedback on this proposed approach. Specifically, please highlight if any practical impediments exist to introducing a right of withdrawal for purchases made in the secondary market in connection with delivery of the ETF Facts, should we decide to pursue this.

Unlike mutual fund purchases where investors have a 2 day withdrawal period, there is no withdrawal period afforded to ETF purchasers. We recognize that there is a logistical reason for this: a secondary market trade cannot be reversed if the investor exercises the withdrawal right. However, this is not in the best interests of investors, particularly those investors that are potential or actual investors in both ETFs and conventional mutual funds.

Proposal:

We urge the CSA to explore a mechanism for providing investors with the functional equivalent of a withdrawal right. For example, the selling dealer could provide the investor with the right for a refund of all of the investor's money, with the dealer having the right to collect any net losses incurred from the ETF provider on some periodic basis, perhaps quarterly or semi-annually. If such a mechanism would prove difficult or would result in further delay in implementing the ETF Facts regime, for example, by requiring further legislative changes, we suggest more prominent disclosure of the absence of a withdrawal right.

Concluding Observations

We support the ETF Facts Proposal as taking an important step toward the goal of product neutral regulation. We urge regulators to consider further steps that can be taken in this regard. We also note that regulation should not, even as an unintended consequence, promote one class of product over another. This is not only a matter of fundamental fairness among industry participants. It is to ensure that consumers, particularly retail consumers, enjoy equal measures of investor protection. At the end of the day, we need regulation which encourages competition and innovation and drives product selection on the basis of perceived value to users.

We thank you for providing us with an opportunity to comment and we would be pleased to respond to any questions or comments you may have on the foregoing.

Yours truly,

"David Feather"	"Samir Khan"
David Feather Chief Executive Officer and President Russell Investments Canada Limited	Samir Khan General Counsel, Americas, CCO, Canada Russell Investments Canada Limited