



September 18, 2015

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Dear Sirs/Mesdames:

**Re: CSA Notice and Request for Comment - Mandating a Summary Disclosure Document for Exchange-Traded Mutual Funds and its Delivery - Proposed Amendments to National Instrument 41-101 *General Prospectus Requirements* and to Companion Policy 41-101CP**

We are writing on behalf of members of The Investment Funds Institute of Canada ("IFIC") to comment on Proposed Amendments to National Instrument 41-101 General Prospectus Requirements and to Companion Policy 41-101CP, Mandating a Summary Disclosure Document for Exchange-Traded Mutual Funds and its Delivery (the "Proposals").

We appreciate the opportunity to provide our comments on the Proposals. Notwithstanding IFIC's traditional role as the association representing managers and distributors of conventional retail mutual funds, IFIC's membership includes investment fund managers that currently manage in excess of \$70 billion in ETF assets or 82% of industry total assets. Our comments are of a more general nature, primarily to identify comparative differences and inconsistencies the Proposals will create in the experience of investors in ETFs and mutual funds. We understand that several of our members that manage ETFs will be submitting individual letters with more detailed comments on various aspects of the Proposals, including on the content of the ETF Facts.

We appreciate the efforts made by the Canadian Securities Administrators ("CSA") to propose creation of a point of sale disclosure regime for ETFs that is similar to that for retail mutual funds, the objective of which is to ensure greater consistency in the disclosure provided to retail investors for these functionally equivalent, substitutable products. Requiring the provision of a Fund Facts or ETF Facts ensures an investor in either product has key information about the product in a comparable, plain-language format. This initiative is especially important as ETFs are frequently sold as low-cost alternatives to mutual funds, although we recognize the

increasing momentum shown by actively-managed ETFs that are even closer equivalents to mutual funds.

We have identified some fundamental inconsistencies that the Proposals in their current form would create in the point of sale disclosure regimes for mutual funds and ETFs, contrary to the CSA's objective of enhanced consistency, as well as concerns with some aspects of the Proposals.

### **Distribution of ETF Units**

We agree with the CSA's approach to essentially ignore the distinction between ETF creation units and resale units for purposes of the disclosure requirement, ensuring that all ETF investors receive ETF Facts, and prospectuses if desired. To maintain the current statutory requirement for prospectus disclosure only to the purchaser on first re-sale of a creation unit on an exchange or other marketplace, is not appropriate since retail investors do not typically have any knowledge as to which type of units will be used to fill their orders. Similarly we are pleased that consistency with the mutual fund regime is maintained in the requirement that a prospectus continue to be prepared and filed, and a copy provided to investors at their request, at no cost.

We also agree with the CSA's proposal to codify the 2013 exemptive relief granted to specified dealers, so as to require all dealers acting for purchasers to deliver to investors a summary document within two days of the investor buying the ETF, whether or not the investor's purchase order is filled with Creation Units. It is also appropriate that this delivery obligation will apply to dealers acting as agents of the purchasers on the buy-side of the transaction, rather than to dealers acting in a distribution on the sell-side of the transaction, as is currently required under securities legislation.

### **Contents of ETF Facts**

As ETFs are functionally-equivalent investment products to mutual funds it is appropriate that the ETF Facts disclose similar information, but also, as importantly, information that is unique to the structure and operation of ETFs, so that investors can understand that there are substantive differences to conventional mutual funds.

In principle we agree it is important that information about an ETF's liquidity be included in the ETF Facts, as this is information relevant to an investor's purchase decision. Data such as "bid-ask spread" and "premium/discount to NAV" may be recognized indicators of liquidity, however we wonder whether the proposed descriptions of these concepts in the ETF Facts will be meaningful to the typical retail investor. Similarly, the proposed disclosure of average daily trading volume and the number of trading days does not appear to be particularly useful to investors. Some members have suggested this is not an ideal measure of liquidity. If the CSA wishes to retain the disclosure of the number of trading days, it might better serve investors if this information were disclosed as a percentage, rather than leaving it to investors to calculate the percentage themselves. More clarity on the importance of liquidity and the relevance of the data provided as indicators of liquidity might be helpful, as is suggested by the CSA's own document testing.

Members have noted that the proposed currency of the data to be included in the ETF Facts for bid-ask spread and the premium/discount to NAV (within 60 days of the date of the ETF Facts), raises a question about the utility of this information, especially if such information is subsequently affected by a significant market event.

Several members that manage ETFs have indicated they will be submitting additional comments on several aspects of the Proposals in their individual comment letters. However, they have noted that much of the data required in the ETF Facts will need to be sourced from third-party providers. This raises several concerns, including who will be responsible for the

accuracy of the data in this document. We understand some members will discuss this concern in detail in their individual letters.

#### *How ETFs are Priced*

The information provided under this section of the ETF Facts is generally helpful to investors. However, reordering the disclosure so that the pricing information appears before the risk discussion, closer to the column presenting Trading information and Pricing information may enhance investors' comprehension of this information.

Also, as a general comment, it may be more accurate to describe ETFs, in the opening words of this section, as 'different' or that they 'vary', rather than referring to them as 'unique,' given the proliferation of ETFs of many different attributes.

#### *Disclosure of Cost*

The CSA has done well to make consistent the fee and cost disclosure in the ETF Facts to that in the Fund Facts. Consistent cost of ownership information empowers investors to perform fair product comparisons.

Proposed Form 41-101F4, Part II – Costs, Rights and Other Information, Item 1 – Costs of Buying, Owning and Selling the ETF, section 1.4 – Other Fees, requires disclosure of information about the amount of other fees payable by an investor when they buy, hold, sell or switch units or shares of the ETF. Can the CSA provide greater specificity as to the types of fees that may be in contemplation for disclosure in this “Other” category? Given the final sentence in Instruction 2, which permits replacement of the fee table with a statement that there are no other fees associated with buying, holding, selling or switching units or shares of the ETF, is this simply meant as a “standby” section in the event there are any transaction fees that are not already otherwise disclosed?

#### *Disclosure of Risk Classification Methodology*

The Proposals note that the CSA is developing a risk classification methodology for use in the Fund Facts and ETF Facts. Since the release of the Proposals, the Canadian ETF Association has endorsed a fund volatility recommendation for use by ETFs for purposes of their Fund Facts disclosure. This methodology is largely based on IFIC's recommended methodology for mutual funds, and therefore would comprise a very consistent approach to this disclosure requirement. Please confirm whether the CETFA methodology is an acceptable methodology for use in the ETF Facts.

Furthermore, it is hoped that the CSA will coordinate the final rules to implement the Proposals with any rules to implement the CSA's risk classification methodology, to permit ETF managers to adopt the CSA's classification methodology at the outset, rather than having to switch methodologies and disclosure after the first ETF Facts have been filed and delivered. We also urge the CSA to consider the implications and timing of amendments to the applicable ETF prospectuses to reflect the addition of the CSA's risk classification methodology,

#### **Delivery**

If enacted in their current form, the Proposals would result in the CSA creating an inconsistent point-of-sale disclosure delivery requirement for ETFs and for retail mutual funds, despite introducing consistency in many other areas of the disclosure regime. This approach appears to contradict the CSA's principles underlying and objectives of a consistent point-of-sale disclosure regime and leaves open the risk of regulatory arbitrage.

The CSA's three principles supporting the conversion of mutual funds to a pre-sale delivery model for Fund Facts were: (a) to provide investors with key information about a fund; (b) to provide the information in a simple, accessible and comparable format; and (c) to provide the information before investors make their decision to buy. That the Proposals seek to address only the first two of these principles with respect to ETFs, and not at all seek to ensure ETF investors have this information before they make their decision to buy will result in an inconsistent investor experience, particularly given that ETFs are often recommended as substitutes for mutual funds.

Ideally the CSA would have holistically studied the possible delivery models for all substitutable products before moving forward with a change in the model for only one product. A broader industry-wide consideration might have identified that the various products' differing attributes and business models there would be a real prospect that different timing of delivery models would result. This suggests that a more high-level approach across all products could have been developed that would meet the CSA's principles while "delivering" a consistent approach for investors, thereby avoiding any opportunity for regulatory arbitrage.

Different delivery requirements create, for dealers and advisors that distribute both ETFs and mutual funds, the added administrative burden of managing compliance with two separate and distinct delivery systems. Mutual fund dealers are currently in the midst of the very substantial conversion of their systems to pre-sale delivery for mutual funds. The existence of two different delivery requirements may lead to regulatory arbitrage where products without a pre-sale disclosure requirement are recommended in place of products for which pre-sale delivery is required. With the development of more efficient mechanisms to permit non-IIROC dealers to access the exchanges, the number of MFDA dealers who will be distributing ETFs will increase; a trend that will increase the number of dealers impacted by the need to ensure compliance with two disclosure delivery models.

Since the CSA will permit delivery to be made in person, by mail, by fax, electronically or otherwise, consistent with the methods that can be used by mutual funds, a ready solution that could resolve the inconsistent timing of delivery of disclosure for these products is for the CSA to reconsider its aversion to "access equals delivery" for point of sale disclosure documents. Such a delivery method offers a viable, broadly applicable solution to ensure investors in all products are able to receive this key information in a consistent format, conveniently and when they need it, regardless of the distribution channel through which they are purchasing their security(ies) of choice. Despite our concerns we certainly agree with the Proposals' intention to entrench the transfer of the prospectus delivery obligation, currently imposed by securities legislation on the dealer acting as underwriter in the ETF distribution (the sell-side dealer) to the dealer that is acting as agent of the purchaser of an ETF security (the buy-side dealer).

### **Definition of ETF and Exchange-traded Mutual Fund**

Section 1.1 of the Proposal contains a definition of "ETF" (an exchange-traded mutual fund) plus a separate definition of "exchange-traded mutual fund" (a mutual fund in continuous distribution, the securities of which are (a) listed on an exchange, and (b) trading on an exchange or an alternative trading system). Would a merger of these definitions, as suggested below, be a more efficient and appropriate approach?

"exchange-traded mutual fund" or "ETF" means a mutual fund in continuous distribution, the securities of which are

- (a) listed on an exchange, and
- (b) trading on an exchange or an alternative trading system.

## **Responses to Questions Posed by the CSA**

### *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.*

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.*

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.*

**IFIC’s responses to Questions 1, 2 and 3 are noted in the Contents of ETF Facts section above, starting on page 2.**

### *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 currently have no response to this Question.**

### *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.*

**We currently have no response to this Question.**

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.

**Our members have indicated that a minimum of 12 months is necessary to prepare and file the ETF Facts; this amount of time is needed to permit changes to templates and to reflect any new data inputs.**

**Given mutual fund managers' experience with implementation of the Fund Facts, we discourage the use of a single switchover date because it could require a manager to file ETF Facts twice within a short period of time. Rather, we recommend that the filing be permitted to be made at the next prospectus renewal cycle. Given that the Summary Document is already required for ETFs, it is doubtful that investors would be prejudiced by this approach.**

**If a single-switch over date is selected, we recommend avoiding RRSP season and year-end as transition deadlines, given the strain on resources during these periods.**

*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.

**We do not think there should be a distinction based on Creation Units. This is consistent with the CSA's proposal that all investors receive the ETF Facts regardless of the type of units they receive. As investors will not know which type of units have been used to fill their orders, their right to withdraw should not differ based only on this detail.**

*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.*

**We currently have no response to this Question.**

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Again we appreciate the opportunity to express our members' concerns and to raise points of clarification on the Proposals. We would be pleased to discuss, at your convenience, any questions or comments you may have on our submission. Please feel free to contact me by email at [rhensel@ific.ca](mailto:rhensel@ific.ca) or by phone at (416) 309-2314.

Yours sincerely,

THE INVESTMENT FUNDS INSTITUTE OF CANADA



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