

1.1.2 CSA Notice 81-311 Report on Consultation Paper 81-403 Rethinking Point of Sale Disclosure for Mutual Funds and Segregated Funds

CSA NOTICE 81-311

**REPORT ON CONSULTATION PAPER 81-403
RETHINKING POINT OF SALE DISCLOSURE FOR MUTUAL FUNDS AND SEGREGATED FUNDS**

Introduction

The Canadian Securities Administrators (the CSA or we) are publishing a summary of the comments we received on Consultation Paper 81-403 *Rethinking Point of Sale Disclosure for Mutual Funds and Segregated Funds (the consultation paper)* together with our responses. We published the consultation paper for comment on February 14, 2003. It described a new approach to mutual fund and segregated fund disclosure that would:

- introduce a new fund summary document that we would require be delivered to investors prior to investing in a mutual fund
- make available a consumers' guide geared at novice investors that would explain mutual funds and segregated funds, and the difference between them
- enhance continuous disclosure
- develop a new foundation document that would contain the detailed information about the mutual fund.

While the comments generally supported our proposals, commenters also raised a number of issues that we are still considering.

When in force, our proposed rule NI 81-106 *Investment Fund Continuous Disclosure*, will implement an enhanced continuous disclosure regime for investment funds that meets this objective in the concept proposal. Accordingly, we will not be doing any additional work in this area as part of this initiative.

Through the Joint Forum of Financial Markets Regulators, we will continue to work with the Canadian Council of Insurance Regulators to coordinate the development and implementation of the consultation paper in a similar fashion for both segregated funds and investment funds.

Implementation

Within the next few months, the CSA will begin drafting the rules that would implement the consultation paper. The work will be done in two phases.

Phase I — Spring 2004 to Spring 2005:

We will:

- refine the consumers' guide,
- develop a new right of withdrawal to replace existing rights of withdrawal and rescission and consider what Act amendments and rules we might need to give effect to this new right
- develop and test a fund summary document with consumers, and
- develop new delivery mechanisms to replace existing prospectus delivery requirements.

We will publish for comment the proposed fund summary document, the consumers' guide and the rule amendments that will give effect to the new right of withdrawal, the adoption of the fund summary document and the changes to the prospectus delivery requirements in spring 2005.

Phase II — Beginning Spring 2005:

We will examine the need to develop a new foundation document that would replace the existing simplified prospectus and annual information form.

As we complete each phase, we will publish our proposals for public comment.

Questions

Please refer your questions to any of the following people:

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April 30, 2004.

Summary of Comments and Responses to *Joint Forum Consultation Paper 81-403: Rethinking Point of Sale Disclosure for Segregated Funds and Mutual Funds* follows

**Joint Forum Consultation Paper 81 – 403:
Rethinking Point of Sale Disclosure for Segregated Funds and Mutual Funds**

**Summary of Comments
and Responses**

**Prepared by the Canadian Securities Administrators and
the Canadian Council of Insurance Regulators**

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Background

On February 13, 2003, the Joint Forum of Financial Market Regulators (the Joint Forum) released Consultation Paper 81-403 *Rethinking Point of Sale Disclosure for Segregated Funds and Mutual Funds* (the Consultation Paper) and a background paper for public comment. The Consultation Paper outlined our proposals to improve the way information about segregated funds and mutual funds is conveyed to consumers¹ at the point of sale.

The comment period for the Consultation Paper ended on April 30, 2003. We received 30 comment letters in total, including letters from:²

- 6 trade associations
- 7 life insurance companies
- 8 mutual fund management companies
- 1 hedge fund manager
- 4 portfolio advisers
- 2 mutual fund dealers
- 3 investor advocates, including investor/consumer organizations
- 4 individual consumers
- 1 investment club
- 1 academic
- 1 provider of investment communications services

A list of respondents is set out in **Appendix 1**. All comment letters have been posted on the websites of the Ontario Securities Commission (the OSC) (www.osc.gov.on.ca) and the Canadian Council of Insurance Regulators (CCIR) (www.ccir-ccra.org). The Joint Forum thanks those who took the time to submit comment letters or otherwise participate in our consultation process.

How to read this paper

In this document, we summarize the public comments received on the Consultation Paper and offer our preliminary responses. We will be turning to additional research and consultation prior to making any final determinations.

We assume you are familiar with the original proposals and we do not repeat them here in any detail. Answers to the specific questions we posed in the Consultation Paper appear in the text boxes throughout this paper.

Please note that we have not responded to each and every comment we received. If you are interested, you can view the original comment letters on either the OSC or the CCIR websites referenced above.

Overview of the comments

The need for regulatory reform

Respondents to our proposals unanimously agreed the point of sale disclosure regimes for mutual funds and segregated funds need to be reformed. Our description of the problems with both mutual fund prospectuses and segregated fund information folders resonated with everyone who wrote to us. The letters reinforced our understanding that consumers do not read these documents, notwithstanding the time and money that goes into producing and delivering them.

¹ We refer generically to mutual fund investors and IVIC policyholders as “consumers” in this paper, as we did in the Consultation Paper. One respondent took issue with the use of this word because he believes it obscures the fact that mutual fund investors are the beneficial owners of securities while IVIC policyholders have contractual rights. The word “consumer” is used here to streamline the text and should be read to mean mutual fund investor and IVIC policyholder.

² We note that the number of respondents listed here totals more than 30 because certain comment letters represent the views of more than one respondent. Also, some respondents were counted more than once—for example, an organization offering both mutual funds and segregated funds would be listed twice.

Layered disclosure and the four document system

The layered approach to disclosure proposed in the Consultation Paper was generally well received. Respondents liked the notion of separating the dauntingly large disclosure documents we see today into more functional pieces. Most of the respondents accepted the logic behind the proposed four-document system. However, some letters raised the concern that consumers would become confused by all the different documents and that information would be needlessly repeated.

The respondents were generally enthusiastic about the idea of a one- or two-page fund summary document delivered before the purchase decision is made. We were told this is a more realistic, consumer-friendly approach to communicating key facts at the point of sale.

Our proposal to provide more detailed information in the evergreen foundation document (which would describe the static features of a fund) and the continuous disclosure record (which would contain all of the changing information about a fund) was not controversial. In addition, the separation of static and changing information into different documents was seen as reasonable.

The proposed consumers' guide was popular with industry participants and consumer-respondents alike. A generic educational document explaining the ins and outs of mutual funds and segregated funds was seen as a good thing. The only real controversy arose around the issue of who would be responsible for delivering the guide, whether delivery would be mandatory and whether any consequences would attach to non-delivery. Industry participants would like to have a say about the content of the guide, but they would prefer to leave its ownership in the hands of regulators. They would like to use the guide on a purely voluntary basis and would prefer not to see any consequences flow from a failure to deliver. Consumer-respondents, on the other hand, would like to see mandatory delivery of a document designed with a greater degree of consumer input.

Issue: consolidated fund family documents vs. one document per fund

Industry participants felt it is important that they be given the flexibility to decide what to include in the various documents. In particular, they would like the freedom to create consolidated fund summary and foundation documents that describe all the funds in a fund family. We were reminded that this approach would minimize repetition, be more cost effective and allow consumers to compare among different funds. We were also told a consolidated document would be more convenient for sales representatives to use. Insurance companies were particularly outspoken about the need for consolidated documents that describe the contract and all of the funds the consumer is entitled to choose from under the contract.

In contrast, consumer-respondents tended to favour documents prepared on a per fund basis. They warned us that fund family documents would quickly grow to be unwieldy and told us that fund family documents are really just marketing tools as far as they are concerned.

Issue: disclosure via the use of electronic media

The fund industry appears ready to embrace the use of electronic media to provide fund disclosure. The industry respondents came out strongly in favour of our proposal to permit electronic access to the foundation document and continuous disclosure record in lieu of physical delivery, provided paper copies are delivered upon request. Industry letters spoke enthusiastically about the potential cost savings and reduction in waste. The letters went on to point out that electronic data can be kept more up-to-date than information in commercially printed volumes. They also assured us that such an approach is very workable.

Consumer-respondents, on the other hand, are not as comfortable with the thought of relying on their computers for fund disclosure. They were strongly opposed to our taking what they saw as a negative option approach to disclosure. They told us this is premature because many consumers have neither the ability nor the desire to receive information electronically. They also told us that most people tend not to actively seek out information. Rather than unduly shifting the burden to consumers, we were asked to give them the option to opt-in to electronic access/delivery or decline receipt altogether. Physical delivery should always be the default, they said.

Issue: the rights of withdrawal and rescission

We suggested that the rights of withdrawal and rescission attached to the purchase of mutual fund units could be eliminated if disclosure were provided prior to the point of sale, rather than afterwards. The industry strenuously agreed. The industry letters underscored the fact that the rights are almost never used and when they are, they are used by sophisticated players to time the market. Most industry participants would not introduce any sort of cooling-off period so long as the relevant information about a fund is available before the point of sale.

The view of the consumers who wrote to us is diametrically opposed to that of the industry. We were reminded that consumers hold very few cards and are sometimes subjected to high-pressure sales tactics. Consumer-respondents would like to see regulators provide a meaningful cooling-off period that would be applicable to all purchases.

The comments and our responses

General

Public comments

Support for the general approach

The general approach we took in our proposals received strong support from the majority of respondents. Supporters liked that our proposed regime would:

- be cost efficient.
- be flexible.
- give consumers more accessible and meaningful information.
- encourage sales representatives to use the mandated disclosure documents.
- be environmentally friendly.

The letters commended us on our willingness to return to first principles and encouraged us to take bold steps towards our goal of improving point of sale disclosure for mutual funds and segregated funds.

Concerns with the general approach

But not everyone was convinced our proposals will improve decision-making by investors at the point of sale. Consumer-respondents and consumer advocates, in particular, were uneasy about the thrust of some of our proposals. Some wondered why we were entertaining notions of deregulation at a time when the financial markets are slumping and investor confidence is low.

A few respondents were of the view that parts of our proposals favour the industry's interests over those of consumers, when they should do the opposite. They point out that consumers were not involved in developing the proposals. As a result, they believe our proposals may ask too much of consumers.

Some respondents were concerned that our proposals might make things more complicated for consumers because the information in the current point of sale disclosure documents would be fragmented and consumers would have more documents to review. Another respondent warned the amount of paper could grow under our approach.

One respondent told us that our proposals are a step in the right direction but they are too little, too late. One industry participant questioned whether investors will ever become interested in point of sale disclosure documents, no matter how good they are. Given the reality of consumer apathy, we were asked to be very careful about putting the industry to the trouble and expense of reforming its documents so soon after National Instrument 81-101, the mutual fund prospectus disclosure rule, came into force.

Joint Forum response

Our overarching goal is to improve disclosure for consumers while ensuring that we are not putting them, or the industry, to any unnecessary expense. Our proposals are designed to bring more, not less, information to consumers in a user-friendly format. We do not intend to take any information away from consumers, nor do we intend to make the information less accessible in any way. To ensure we meet this end, we are seeking consumer feedback in the form of consumer surveys and focus testing. The results of this research will inform our thinking as we move forward.

While we acknowledge that consumers of segregated funds and mutual funds are not generally willing to spend a lot of time tending to their investments, we believe they will benefit from improved documents. The reality is that the existing documents are not being read. We must take steps to ameliorate this situation.

Harmonizing the regulation of segregated funds and mutual funds

Public comments

Support for harmonization

The investment funds industry largely supports our goal of harmonizing the point of sale disclosure regimes for segregated funds and mutual funds. Industry participants told us the disclosure requirements should treat the different investment products consistently.³ One letter explained that segregated funds and mutual funds are fundamentally the same product in the minds of investors and warned that differential treatment would open up the possibility of regulatory arbitrage.

Reservations about harmonization

On the other hand, the insurance industry tells us that one-size may not fit all because there are fundamental differences between mutual funds and segregated funds (see text box directly below).

Joint Forum response

While we recognize the important differences between segregated funds and mutual funds, we continue to believe the different point of sale disclosure regimes should be fundamentally harmonized. Our goal is to design one regime that works for both segregated funds and mutual funds. It must be flexible enough to accommodate the differences between the insurance product and the securities product while giving consumers on both sides the same level of disclosure.

Differences between segregated funds and mutual funds

Question: 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?

No, there are no significant differences

Segregated funds are just mutual funds with a thin veneer of term-life insurance. The maturity guarantee is not unique to segregated funds—there are mutual funds with such guarantees.

Harmonization should be achieved by tightening up segregated fund regulation rather than loosening up mutual fund regulation.

The disclosure documents for mutual funds and segregated funds should look much the same.

Yes, there are important differences

There are important differences between the products. In the case of mutual funds, the customer is purchasing units of the fund. These units are sold through a distributor and the manufacturer of the fund is not responsible for distribution. Information about the fund is delivered after the sale in the prospectus.

In the case of segregated funds, an insurance company is offering a contract of insurance to a customer which, among other things, allows the customer to participate in a number of investment options. The investment options are not limited to segregated funds, but may include GICs and pooled funds. Segregated funds usually guarantee a percentage of the principal. While segregated funds and mutual funds may be sold through the same distribution channel, the insurance company remains liable for all aspects of the contract, including its distribution. Information about the contract is delivered to a segregated fund customer in advance of the sale in the information folder. The sale of a segregated fund requires a client signature.

³ As an aside, one respondent asked us to consider removing the requirement for a signature in connection with segregated fund sales to make them more consistent with mutual fund sales. (IDA)

Problems with the existing systems

Is there really a “disconnect”?

Question: Do you agree with our description of the “disconnect” between the theory underlying our point of sale disclosure regimes and practice?

Yes, there is a “disconnect”

There is a serious disconnect between the way the existing disclosure regimes were intended to work and the way they actually work. Prospectuses and information folders serve neither consumers nor the industry particularly well.

The disconnect may be limited to the retail market

Description of the disconnect is accurate for the retail market but it may not accurately describe the exempt market.

The nature of the disconnect

Public comment

The disconnect re consumers

We were told that consumers—particularly the less sophisticated ones—ignore the current documents because:

- they do not have the time to read the documents.
- they are not able to understand the documents. An accounting background is needed for an investor to understand the documents put out by operators⁴ because the documents are just too complex and are full of legal jargon.

According to a number of operators, they receive regular complaints from consumers about the volume of materials sent to them. Some consumers specifically ask not to receive this information.

At the same time, we heard from a respondent who believes more and more consumers are starting to read the prospectus and annual report thanks to the bear market. Some respondents are convinced consumers will utilize documents that provide useful information to them.

The disconnect re dealers

We were informed that dealers do not like the existing requirements because:

- Dealer inventories of point of sale documents end up being large and cumbersome.
- The traditional warehouse pick-and-pack fulfilment process is labour intensive, error prone, and has high compliance costs due to stock-outs and delays in tracking and incorporating new documents.

The disconnect re sales representatives

We heard that sales representatives do not use the existing point of sale disclosure documents in the sales process. Many see these documents as a necessary evil and deliver them to their clients reluctantly. Others do not distribute the documents at all on the expectation that head office will do the job for them.

The disconnect re operators

Operators dislike the existing system because the mandated documents are costly to produce⁵ and result in a lot of wasted paper.

⁴ We use the generic term “operators” in this paper to describe mutual fund managers and insurance companies.

⁵ On the other hand, one respondent suggested that customers do not generally complain about the cost of the existing documents.

Joint Forum response

The existing documents are not working for consumers, sales representatives, dealers or operators. All could benefit from a layered approach to disclosure coupled with clearly spelled out delivery requirements.

The objectives of disclosure

The comments largely supported our conclusions on the objectives for point of sale disclosure. The respondents agree with us that certain objectives should be emphasized while others can be downplayed or eliminated altogether.

Communicating key information at the point of sale

Public comments

Everyone agrees the most important objective of point of sale disclosure is to communicate key information at the point of sale to consumers so they are empowered to make informed choices. We were reminded that the interests of consumers must govern the design of any disclosure system since the ultimate goal is to help them with their decisions.

Joint Forum response

We agree that consumer input is crucial. As noted above, consumer research will significantly influence the direction of this initiative.

Facilitating comparisons among funds

Public comments

Some industry participants believe facilitating comparisons among funds should also be one of the primary goals of point of sale disclosure. Their remarks indicate that consumers need to be able to compare funds if they are to make an informed purchasing decision. Some believe that a document with a standardized format is important because it allows for easy comparison among funds.

Joint Forum response

We agree that facilitating comparisons among funds should be one of the goals of point of sale disclosure. We are considering the merits of documents with a standardized format.

Educating consumers

Public comments

There is a clear consensus that consumer education is a worthwhile goal. However, some respondents believe point of sale disclosure documents are ill-suited for this purpose. Industry participants reiterate that it is not the responsibility of the operator to educate consumers about general investment concepts as part of the sales process.

Joint Forum response

We continue to believe that educational information is important but should not be included in the point of sale disclosure document. We will further develop the consumers' guide as this initiative moves forward.

The root of the problem

There were mixed views on our description of the issues that give rise to the problem. A number of respondents went on in their letters to draw our attention to other issues that contribute to the problem.

Our laws assume fund consumers need more information than other consumers

Public comments

Industry participants told us that fund consumers are just as sophisticated as consumers of other investment products. In fact, 78% of one bank's mutual fund investors claim to have investment knowledge ranging from fair to excellent.

On the other hand, consumer-respondents and consumer advocates tend to believe that fund investors actually need more information than consumers of other investment products because:

- most mutual fund investors are less investment savvy than other investors.
- fund consumers have no investor protection fund and no fund governance.
- mutual funds are more complex than GICs, savings bonds or common stocks.

Joint Forum responses

We intend to look to consumer research to help us resolve this issue. Our starting assumption is that fund consumers are not fundamentally different from other investors. At the same time, we think all consumers deserve more, rather than less, information about their investments.

The information gets to consumers at the wrong time and in the wrong form

Public comments

Respondents are concerned that documents today, particularly the simplified prospectus, are delivered at the wrong time—they arrive late or not at all. They could be delivered in a more timely manner, we were told. Respondents also pointed to the fact that the documents are daunting to read due to their size. Any information relevant to a particular fund can be difficult to identify and absorb and, to make matters worse, the documents contain a lot of small print which older investors find difficult to read. Furthermore, some respondents expressed dismay at the specialized and complex language used by the industry to communicate sophisticated information.

The prevailing view that the existing documents are of poor quality and design was reinforced by investor research commissioned by one respondent, which indicates the problem is with the packaging and presentation of the material.

Joint Forum response

We think certain pieces of information need to be provided to consumers before the point of sale. Other pieces of information are not crucial to decision-making and can wait until after the sale. The delivery requirements themselves will be clearly spelled out so there will be no chance of the mandated documents not being delivered. We will also be asking consumers to help us improve the quality and design of the proposed documents. In keeping with this consumer-focused approach, we will require all disclosure documents to be written in plain language.

Securities regulation is not well suited to mutual funds

Public comments

One respondent agreed with our conclusion that the general disclosure requirements set out in our securities regulation were not designed with mutual funds in mind. This respondent went on to argue that units of existing mutual funds should be sold without point of sale disclosure documents just like shares sold on the secondary market. We were reminded that there is a wealth of information on all existing mutual funds in the public domain.

Joint Forum response

While we understand that there is more and more information about mutual funds in the public domain, we are not yet ready to accept the argument that they should be sold without any point of sale disclosure documents.

The documents don't contain the right information

Public comments

Forward-looking information

We were told consumers do not use the documents because they do not contain any forward-looking information about the fund's prospects in general, for individual securities held in the fund, or for business sectors represented in the fund.

Portfolio holdings

We were also told that the documents do not contain detailed information about the securities held in the fund. For example, the simplified prospectus and information folder do not identify the securities in the fund, their business sector, or their percentage weight in the fund's assets.

True MER

One segregated fund consumer complained that the information folder does not show the true MER nor the true historical return the consumer would have experienced. He concluded that complicated presentations mislead consumers and stated that if any firm cannot inform a consumer of the costs of a product being purchased, they should not be allowed to sell that product.

Joint Forum response

Forward-looking information about the fund and the corporate issuers it invests in belongs in the continuous disclosure record, as does detailed information on the holdings of the fund. On the securities-side, this is being addressed in Proposed National Instrument 81-106 Investment Fund Continuous Disclosure. We agree that consumers should be given their true MER.

The content of certain documents is not standardized

Public comments

Two consumers pointed to the fact that the content of information folders and certain other disclosure documents is not standardized. We were told this makes it hard to decipher the documents and makes fund comparisons difficult.

Joint Forum response

We agree that the presentation of information has a bearing on its readability. We are considering the merits of standardized formats.

The information is out of date

Public comments

Respondents told us the information contained in the simplified prospectus and information folder is often stale-dated. It can be up to a year old. This makes it irrelevant for decision-making.

Joint Forum response

Moving the changing information about a fund out of the prospectus or information folder and into the continuous disclosure record should go a long way towards remedying this problem.

The nature of the document is not made clear

Public comments

We were told that investors are often not given an explanation of why various documents are being sent to them or the significance of the information contained therein. As a result, many assume it is marketing material.

Joint Forum response

We will take this point into consideration as we design the new documents. We see the value of including a "how to read this document" section explaining the significance of the information contained in each document.

The information is obscured by flashy advertising

Public comments

Misleading advertising and inappropriate sales practices obscure the real information, according to some. Advertising in disclosure documents takes up space and causes consumers to lose interest in the important information.

Joint Forum response

On the securities side, misleading advertising is currently prohibited by National Instrument 81-102 Mutual Funds. Furthermore, inappropriate sales practices are prohibited by National Instrument 81-105 Mutual Fund Sales Practices. The OSC's Fair Dealing Model is also expected to address this issue.

On the insurance side, misleading advertising and deceptive sales practices are currently prohibited by Part VIII of the Canadian Life and Health Insurance Association Guidelines on Individual Variable Insurance Contracts Relating to Segregated Funds. Furthermore, in Quebec, inappropriate sales practices are prohibited by regulations of the *act respecting the distribution of financial products and services*.

Third party documents outshine mandated documents

Public comments

Industry participants worry that third party summaries of fund information are better regarded than the mandated disclosure documents because they are more succinct and contain more timely information. At the same time, the insurance industry notes these third party documents often do an inadequate job of highlighting the unique features of segregated funds.

Joint Forum response

We do not propose to regulate third party information. We do intend to make sure point of sale materials are substantially improved so that people will find the mandated documents more appealing. In this respect, plain language and focus group testing will be important aspects of our review.

There is inadequate regulation and enforcement

Public comments

One consumer association pointed to the fact that there is inadequate regulation and enforcement of the rules governing the mutual fund industry. Another consumer said the same for segregated funds.

Joint Forum response

We agree that our rules must be supported by a strong system of compliance.

The basis for a solution

Unbundle the documents: the four-document system

Public comments

Support for the four-document system

The majority of respondents agreed with our approach, which would involve taking the information in the all-encompassing documents we see today and putting it into four separate documents that are delivered in different ways and at different times. Some respondents were especially receptive to the idea of separating the static fund information from ongoing performance information.

Cautions and caveats

Some respondents were concerned that the proposed system would result in duplicate information and would therefore add cost and length to the entire system. Others have no problem with the approach, provided the point of sale document is jointly signed, everything is clearly cross-referenced, and fund governance is implemented.

An alternative approach

One respondent put forward a proposal for an alternative four-document system, different from ours. The documents that would form the basis of that system are as follows:

- Educational material
- Specific fund information (Fund Summary Document and Foundation Documents)

- Investor specific information including transactions, value, unit holdings, rate of return, etc.
- Advertising and promotion

Joint Forum response

We believe the four-document system holds great promise. We will work to minimize the duplication of information between the different documents. We do not intend to regulate advertising.

Fund family documents vs. per fund documents

Public comments

To ameliorate the problems that arise when a disclosure document describes all of the funds in a fund family, we proposed that documents be prepared on a per fund basis. At the same time, we recognized there must be a good business reason for fund family documents or else the 300-page disclosure documents we see today would not have evolved. We posed the following questions in the hopes of gaining more insight into this issue.

Can a fund family approach work?

Question: Would it be possible or advisable to allow a foundation document 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?

Question: 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?

Support for fund family documents

Most insurance companies and mutual fund managers feel strongly that fund family documents are preferable to per fund documents. They offered the following reasons:

- Consolidated documents are more cost effective.
- Consumers may wish to consider families of funds, as opposed to individual funds and may purchase more than one fund at a time. A convenient fund family document with all the information in one place allows consumers to compare among funds.
- With segregated funds, the consumer enters into a contract for insurance that gives him or her exposure to any number of funds. If the disclosure documents are to accurately represent the fundamental nature of this product, they should be devised around the concept of a variable annuity contract.
- A fund-specific approach would be unwieldy. Taken as a whole, the regime would have more repetition and more paper.
- Sales representatives will not want to keep numerous one-page documents in their briefcases for each fund they sell. They will need to decide in advance which funds to recommend or they may have to pay more than one visit with the consumer if they do not have all of the relevant fund summaries on hand.
- Creating and maintaining individual documents for each fund will create needless repetition, work and cost for an operator. Some fund families have many funds. Any amendments would require the same change to each fund's documents, and, therefore, separate re-filing and approvals. The likelihood of error increases with the need for multiple filings.
- Insurance industry representatives believe that insurance companies may be subject to additional liability if the fund summary document is fund-specific and the advisor does not disclose all the funds available.

Proponents of the fund family approach conclude that, ideally, we would give operators the flexibility to create documents for families of funds.

Suggestions for fund family documents

Respondents offered the following suggestions for making fund family documents more useful:

- Multi-fund documents should consolidate information with respect to the same type of fund (e.g. all money market funds) or consolidate information with respect to funds that share the same risk profile.
- Longer fund family documents on a website should be accessible via hyperlinks. This would make navigation relatively easy for the consumer.

Support for per fund documents

A smaller group of respondents argued that documents—particularly the fund summary document—should be prepared on a per fund basis. They argue that this will:

- Reduce the size of the document because fund family documents are lengthier.
- Increase its readability.
- Simplify the sales process for sales representatives.
- Facilitate the document's maintenance cycle.

Suggestions for per fund documents

The following suggestions were offered:

- Funds that invest in other funds should have links to the underlying funds and may need to repeat some information.
- If seen as necessary, fund family documents can be created and linked to individual documents in a tree structure.
- If fund family documents are not permitted, operators should be allowed to bind or consolidate the summaries into one document.
- A "guide to available funds" can be created as a reference tool for sales representatives even if fund summaries are prepared on a per fund basis.

Joint Forum response

The issue of whether the fund summary and the foundation document should be prepared on a fund family or on a per fund basis is one of the most important issues we need to deal with. Industry is clearly in favour of the fund family approach whereas consumers prefer the per fund approach. We understand and appreciate both of these viewpoints. We will need to consult more extensively with representatives from the different sales channels and with consumers before we come to a final conclusion on this point.

Think about timing: When should investors receive the fund summary?

Public comments

Most respondents agree that investors should receive disclosure before the point of sale. Mutual fund managers, in particular, were enthusiastic about this part of our proposals because it opens the door to cleaning up the rights of withdrawal and rescission attached to mutual fund purchases. While many respondents saw delivery prior to the point of sale as ideal, we were informed this would be extremely difficult from a practical perspective.

Joint Forum response

We are of the view that dealers should deliver the information necessary for decision-making before the point of sale. Other information, such as tax disclosure or instructions on how to redeem can be provided later, although we see the merits of making the more detailed information widely available before the point of sale for those who are interested.

Think about the mode of delivery: Electronic access/delivery

Public comments

Moving away from physical delivery

Our proposals would have the industry move away from physical delivery for certain pieces of information. Industry participants felt physical delivery should not be the only method of delivery because they believe it imposes unnecessary costs on consumers. If our intention is to mandate physical delivery, we were asked to allow consumers to waive their right to receive documents.

A number of consumer-respondents and consumer advocates feel we should not move away from physical delivery of point of sale disclosure documents. One consumer told us he wants to get everything, notwithstanding the fact he does not always read it. He explained that the simplified prospectus allows him to see how closely a fund is following its objectives and allows him to flip back and forth between pages and make notes in the margins. Research conducted by one bank shows that many of its clients prefer paper delivered through the mail.

Support for access-equals-delivery

Industry participants overwhelmingly support the access-equals-delivery approach outlined in the Consultation Paper. The proponents of this approach believe that most self-directed retail investors are computer literate and can access information from the Internet. A March 2003 study commissioned by Equilogue Technologies Inc.⁶ determined that 70% of Canadian Internet users are interested in receiving documents electronically rather than in paper. Over 50% said they would be interested or very interested in electronic delivery of mutual fund documents. Preservation of the environment was cited as the main motivator.

The arguments in favour of replacing mandatory delivery with an access-equals delivery approach, coupled with paper on demand were:

- It will be cost effective. The costs charged against a fund will drop dramatically if the issuer is required to provide a paper copy of the disclosure document only to those consumers who actually want to receive it.
- It will allow information to be updated in a more timely manner. An access-equals-delivery approach will lead to more up-to-date information for consumers.
- It will reduce paper consumption. It is clearly a more ecologically sound alternative.
- It will not leave consumers wanting for information because the reality is that today's financial consumer has many sources of information. Much of this information is more timely and specific to the consumers needs than the information disclosed in the current point of sale materials, we were told.

One consumer advocate who does not support this approach for the simplified prospectus and information folder admits that the access-equals-delivery approach may be acceptable for some investors for non-decision documents,⁷ so long as it is a positive opt-in approach and the decision can be reversed on demand without penalty. A number of mutual fund managers believe the access-equals-delivery approach should apply to all disclosure documents, including the fund summary document and consumers' guide.

Concerns with electronic media in general and access-equals-delivery in particular

Consumer-respondents, consumer advocates and a current provider of investment communications services spoke out against equating electronic access with delivery. Critics of the approach asked us to remember that many consumers do not have computers or internet access. They emphasized that the elderly, in particular, are not comfortable with computer technology. Respondents asked us not to assume that consumers are willing and able to download files from the internet. They believe many consumers have trouble with the technology—specifically, they have trouble navigating and downloading and they have slow printers. They also reminded us that the cost of accessing a computer and Internet service is a barrier.

⁶ Press release available on Canada NewsWire website at http://www.canadanewswire.com/cgi-bin/org_query.cgi?text=equilogue

⁷ This concept was raised in the report of the Five Year Review Committee. Although the Committee did not expressly include mutual fund prospectuses in the category of decision documents, this respondent clearly understands them as such.

Respondents expressed the following concerns with information that is only available electronically:

- Most people find it harder to read through large documents in electronic form on a computer monitor than on paper.
- There is a risk that documents obtained electronically may not reproduce the information filed. Electronic documents may not print in the same format as paper versions and there may be difficulty printing charts and graphs.
- Reliance on electronic delivery effectively shifts the cost of printing to investors when nobody wants to print off documents.

Even those who believe consumers should have access to electronic information tell us there will always be a need for a printed document.

In additions to the reasons listed above, respondents argued we should not pursue this approach because:

- Most consumers would not want this. Electronic delivery of investment information currently has a very low level of investor acceptance.
- It will not provide consumers with sufficient information to make informed decisions Consumers are unlikely to actively seek out important information for a variety of reasons.
- It is not an appropriate mode of disclosure for a sophisticated product sold to unsophisticated investors at a time when investor confidence is low.
- It represents a “negative option” approach and puts the onus on the wrong party.
- It was considered and rejected by the Securities Exchange Commission.
- The Five-Year Review Committee⁸ expressed concerns about extending this approach to decision documents. It is premature.

One respondent summarized the issue as follows: “If disclosure is to be meaningful, it must be made in a manner that accounts for the range of individual circumstances and that does not put an undue burden on the intended recipient.”

One respondent was concerned about the legal implications of an investor not requesting disclosure documents and asked, “would this disadvantage them in a future claim?”

Respondents from the insurance-side drew our attention to the fact that it may not be possible to use an access-equals-delivery approach with the IVIC in light of provisions of the *Insurance Act* because there may be an issue concerning what counts as delivery of a contract.

One mutual fund manager who supported the access-equals-delivery approach in general, warned us not to let sales representatives fulfil their delivery obligation by printing and delivering web-based documents. This respondent was concerned this practice could lead to the dissemination of obsolete information and worried that the fund manager would lose control of the process. There was also the concern that this approach would be impractical for sales people on the road.

⁸ The *Securities Act* (Ontario) provides that, every five years, the Minister of Finance will appoint an advisory committee to review the legislation, regulations and rules relating to matters dealt with by the Ontario Securities Commission ("OSC" or the "Commission") and the legislative needs of the Commission. To this end the establishment of the Five Year Review Committee was announced on April 28, 2000. The Committee's final report was released on May 29, 2003.

Website postings

Question: Please comment on the pros and cons of requiring operators to post on their websites the foundation document, continuous disclosure documents and, for segregated funds, the IVIC.

Support for website use

We are comfortable with the idea of posting the disclosure documents for our funds on our websites. We already make extensive use of our websites and are in favour of increased use of the Internet to make disclosure documents available. The operator's website is a more intuitive place to look for information.

Concerns with website use

It will be expensive and time-consuming to put disclosure documents on the web. A reasonable transition time is necessary if we decide to pursue this approach.

Website postings are not ideal because websites constantly change, documents are moved around and broken links are very common. Also, there is no way to control all websites to ensure uniformity.

SEDAR—the system for electronic delivery and retrieval

Question: We propose that mutual fund managers make documents available on their own websites, notwithstanding their availability on SEDAR. Are SEDAR postings, alone, sufficient? Is the SEDAR system structured appropriately to fulfil this function?

SEDAR postings are sufficient

SEDAR postings, alone, are sufficient. Consumers looking for secure information on mutual funds should be directed to the site by regulators and registrants.

SEDAR should not be relied upon exclusively

SEDAR should not be relied on exclusively. SEDAR should not be used to satisfy delivery requirements because it could alter information or its site architecture without notice. A system outage would deny access to important information.

Make as many information distribution channels available as possible, provided the fund manager remains the primary source of information. SEDAR should offer a link to operators' websites. Linking to SEDAR as the original source is unacceptable because of potential delays with linking.

Segregated funds and SEDAR

Segregated fund information should not be put on SEDAR. Perhaps it would be appropriate for segregated fund information to be put on the CSA system.

SEDAR is not user-friendly

SEDAR is difficult to use. It is not user-friendly because it is structured with the filer in mind, not the consumer. The regulator should improve the usability of the site.

Guidelines for use of electronic media

We received a number of specific suggestions for minimum requirements that should be met if electronic media is to be relied upon as a means of delivery.

Let the investor opt-in to electronic access or decline receipt

A few letters proposed alternates to the proposed access-equals-delivery approach. We were told by consumer-respondents and consumer advocates that receipt of paper should be the default option unless consumers decline receipt or request electronic delivery. As one person put it, "if I truly do not want the documents, let me take some action to stop it. Otherwise I shouldn't have to do anything." One letter reiterated that consumers should be encouraged to opt-in to electronic disclosures, but their willingness to do so should not be taken for granted.

One insurance company took the opposite view in their letter when they stated, “we do not support an approach that would require the issuer to deliver the detailed materials to consumers *unless* they indicate that they do not want it. This reverse approach would require full print runs at the outset, because the issuer would have no idea how many consumers would refuse delivery.”

Let the operator decide

One respondent would only go so far as mandating SEDAR postings and would leave it to the operator to decide whether to provide information via their websites or in paper.

Print on demand

Four letters drew our attention to so-called print on demand services. We learned that “intelligent” printers can customize a print job based on a consumer’s preferences and consents. “Intelligent” web-based reports sent by e-mail can let the investor obtain the desired amount of detail.

One respondent who offers a print on demand service gave us the following information:

- The service produces a personalized welcome letter, trade confirmation and prospectus, together with necessary amendments, in one single bound document for an investor. The first page is the welcome letter that provides a detailed explanation, from the dealer, of the package contents. The document confirms all transactions for a particular account and includes all required documents based on the type of purchase—first time, subsequent, switch.
- They obtain prospectus and amendment documents from SEDAR in their electronic form, and print on demand when triggered by a trade. Because they obtain the documents directly from SEDAR, the disclosure is always up to date and waiting times for commercially produced documents are eliminated.
- Costs for fund companies and dealers decline, since there is no need for commercially printed documents or warehouse facilities for storage.
- The document is “smarter” because it includes only the segments of the overall prospectus and amendments that are relevant to the funds purchased.
- Mailing costs for dealers are lower because the package is smaller.
- Delivery of such a prospectus is timely because it is triggered by an event in the system, in this case, notice of a purchase.
- A detailed audit report is available to dealers that provide proof of compliance.
- Research suggests investors would prefer a print on demand prospectus to the current package of information they receive.
- Print on demand is an environmentally friendly choice.

Joint Forum response

We agree that it may be premature to completely replace physical delivery with electronic access to information. We believe a better approach would be for sales representatives to ask consumers to choose at the point of sale whether and how they would like to receive the fund summary, foundation document and continuous disclosure documents. They would have the option to formally waive their right to receive these documents or they could opt for physical or electronic delivery (via access to online postings or e-mail). Since the consumer would be required to make a choice, we do not believe we have to specify a default option. The dealer or sales representative should carefully document the consumer’s choice.

Any consumers who waive their right to receive the foundation document or continuous disclosure documents will receive an annual reminder of their ability to ask for these documents. There would be no need for a separate reminder card—a prominent notice in the account statement, or another annual document sent out by the fund manufacturer, would suffice.

We will also be considering further the suggestions we received on possible minimum guidelines for electronic delivery. On the securities side, National Policy 11-201 Delivery of Documents by Electronic Means already sets out some guidelines in this area but we will consider developing additional guidance for the appropriate use of electronic media.

Ensure it happens on a national basis

Public comments

It is crucial that the proposals be adopted on a national basis, according to respondents. However, one letter expressed some scepticism about our ability to bring a regime into force across Canada when Quebec has been fiercely independent on such issues in the past.

Joint Forum response

We intend to have our proposals adopted nationally.

Our proposals

The fund summary document

General

Public comments

Support for the fund summary document

The large majority of respondents support the use of a summary document at point of sale for the following reasons:

- One bank's research shows that consumers like one-page fund profiles.
- This document could inspire consumers to read the foundation document and continuous disclosure record.

Concerns with the fund summary document

One or two respondents did not support the use of such a document for the following reasons:

- The fund summary is duplicative. The information will be found in the foundation document.
- The development of yet another document will be costly and burdensome for the industry.
- The fund summary will not contain all of the information necessary for informed decision-making.

Joint Forum responses

We believe a short point of sale document is the best way to communicate important information to consumers because it stands the best chance of being read by consumers.

Form

Public comments

Length

The concept of a one- or two-page point of sale document was very well received. One respondent told us we should do our best to get the fund summary document down to a single page while others told us that our goal of creating a two-page document is too optimistic. Some think it will be hard to get information onto less than three pages.

Plain language

Everyone agrees the proposed document should be simple, concise and use plain language.

Flexibility

Operators generally argued that we should give them the flexibility to design the fund summary document as they see fit. This includes deciding how many funds the fund summary document can describe at once. See the comments regarding fund family documents above. We also got the opposite view—namely, that the form of the document be standardized so as to facilitate comparisons among funds.

Joint Forum response

Although we see the benefits of giving operators the flexibility to design the fund summary document as they see fit, we will explore the benefits of standardized formats with consumers before drawing any conclusions.

Content

Proposed content

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

Support for the proposed content

We agree with the proposals.

Let the operator decide

Give us the flexibility to decide what goes into this document.

Prescribe minimum content

Prescribe minimum content with sufficient specificity that operators can be reasonably certain of what is required. This could be done in the IVIC Guidelines.

Guidance as to what goes into the fund summary

For mutual funds only, the document should make reference to key information consumers need to consider prior to making an investment decision and where that information can be found. For segregated funds, it should also include general contractual information.

The interests of investors should determine content

Investment objectives

Everyone generally agreed that a fund's investment objectives should be outlined in the fund summary. A group of letters recommended that the summary document also identify the Investment Funds Standards Committee Fund Category⁹ and describe in plain language the investment style and the type of securities in which the fund is invested.

Risk

Everyone generally agreed the fund summary should include a description of the risks of investing in each fund. However, we saw divergent views on the amount of detail that should be included:

- There should be a plain language description of the magnitude of risk, i.e., high, medium or low.
- There should simply be a list of the risks.
- There should be a detailed explanation of risk and operators should disclose quantitative metrics like Beta, Standard Deviation and the Sharpe Ratio.
- There should be a standard statement about where the investment fits in risk-return space.

Fees and expenses

We were asked to include a description of all fees and expenses paid directly by the consumer. One letter stressed the importance of MER and went on to say that it should be explained in a way that investors can truly understand. Another letter stressed that the MER for segregated funds must be the MER to the individual, or at least a narrow range that relates to the individual (e.g. "123-131 basis points for the past 3 years and is expected to remain in the same range").

⁹ The Investment Funds Standards Committee (IFSC) was formed in January 1998 by Canada's major mutual fund database and research firms with a self-imposed mandate to standardize the classifications of Canadian-domiciled mutual funds. The primary purpose of the committee is to provide investors with a consistent set of mutual fund categories. Further information is available at: <http://www.cifsc.com/>.

Performance data

Some respondents would include performance data in the fund summary. Others, however, believe it would not be appropriate to require this kind of information in the fund summary for the following reasons:

- Events of the past several years have reinforced the public policy concerns over basing purchase decisions on past performance. Requiring this disclosure does nothing to reinforce this caution and, if anything, does just the opposite by appearing to endorse the usefulness of this information.
- Up-to-date and comparable data for all funds are readily available to the public from a number of sources, including the continuous disclosure record.
- Requiring such time-sensitive data on the summary document would entail frequent reprinting and increased costs.

Instead, it was recommended that fund operators clearly reference time sensitive information, like performance data, in the fund summary document, while the current information is presented on websites and SEDAR.

Operations

Some respondents said fund operators should include information about the manager and portfolio advisor of a fund should be included in the fund summary. Any other operational information should be included in the foundation document.

Rights of withdrawal and rescission

A respondent who was in favour of retaining the rights of withdrawal and rescission for mutual fund purchases stressed that a statement referring to these rights belongs in the fund summary.

Educational information

A consumer advocate spoke out against the industry's view that the point of sale document should not contain educational information. According to him, this document should be educational in nature.

Joint Forum response

We will consult with consumers in order to determine what information they feel they would need to know prior to making an investment decision. Certainly, fund operators should include the investment objectives, risk, fees and expenses and a notice that all consumers are entitled to a cooling-off period. We have not decided whether performance data should be included.

Regulatory filing requirements

Public comments

Review and receipt

Question: These documents will be filed with regulators. Should they be reviewed and receipted?

Views on review

- The regulator should review all fund summary documents once they are filed.
- Only a periodic review by regulator is warranted.
- Do not review the fund summary at all upon filing but review it to ensure compliance on a random basis.

If there is a review, the IVIC Guidelines should specify criteria for changes that are permitted without subsequent filing or review to avoid unnecessary delays in revising the document.

Views on receipts

- Receipts should not be necessary. It is impractical to receipt the fund summary document for each fund.
- Documents should be receipted to protect consumers.

Joint Forum response

We intend to review and receipt fund summary documents. If we opt for individual fund summary documents, these could be filed individually or bound together and filed as a single document.

Document updates

Public comments

Only when changes occur

Some industry participants envisage an evergreen fund summary document. They say if they can exclude time-sensitive information from the document, operators would only have to update those documents when changes occur.

Periodic updates

Other respondents suggested the documents be updated:

- every three months.
- twice a year.
- no less than once per year.

There was a general feeling that the commercially printed fund summary document should not be updated too frequently. Web versions, however, could be updated more often.

The logistics of updating the document

Question: How will operators update these documents? How will they ensure the updated versions of the documents get to sales representatives?

We received some good feedback on the practical considerations of the various alternatives. In particular, industry representatives outlined specific process concerns that would come into play if a per fund disclosure document approach is adopted.

Joint Forum response

We will be speaking to both insurance companies and fund companies about the practicalities of updating documents for any model that is adopted.

Delivery to consumers

Public comments

Support for mandated delivery

According to some of the letters, actual delivery should be required for all face-to-face sales. One consumer recommended that we require delivery of the fund summary even to those who have opted out of receiving documentation.

Concerns with mandating delivery

One bank explained that the logistics of actual delivery for many dealers would be staggering because they sell thousands of different funds. If document fulfilment is centralized, the sale could be delayed until the documents arrive in the mail. Lag times could be unduly long and lead to frustration on the part of consumers.

Leave it to the discretion of the sales representative

A small group of mutual fund managers would leave it to sales representatives to choose when and if to deliver the document.

Leave it to consumers to decide

A group of industry participants believe the consumer should be required to either:

- acknowledge that they have reviewed the relevant documents to their satisfaction and have satisfactorily addressed questions prior to purchase, or
- formally waive their right to review this information. This acknowledgement could be provided in writing in face-to-face sales or by clicking a reviewed/declined option in the case of telephone or internet sales. This will have the dual advantage of reinforcing to investors their responsibility to do their due diligence and will provide the necessary protections for both parties in the absence of a cooling-off period. Administration of this due diligence formality would be the responsibility of the dealer.

Joint Forum response

We tend to agree that we should require physical delivery of the fund summary document in all face-to-face sales. However, the consumer should be able to formally waive their right to receive this information.

Delivery today

Question: 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?

No consistency

- Most sales representatives give the existing documents to consumers before a sale is completed.
- The prospectus is not typically used during sales process.
- The documents are mailed out after the fact.
- A package of material (consolidated SP, educational material, educational material) is sent out when there is a request for information.
- Sales representatives prefer to use marketing materials such as electronic wealth allocation models, C3 calculators, and provide selective information from the disclosure documents.

Public comments

Delivery of the fund summary under periodic purchase plans

Question: What about consumers investing on a periodic basis (monthly, quarterly, annual debits for example)—what are their information needs?

Delivery upon establishing the plan

It is not necessary to provide new fund summary before each periodic purchase. In other words, documents should only be delivered upon the establishment of the plan.

Reliance on continuous disclosure thereafter

The continuous disclosure requirements will ensure consumers have current information.

Notification of changes

Access to continuous disclosure should not be equated with delivery. Consumers should be notified about relevant changes.

Joint Forum response

We agree that a fund summary need not be provided before each periodic purchase. This document is designed to inform the initial purchasing decision and should only be delivered once.

Public comments

Use of the fund summary in telephone and Internet sales

Question: How will the proposed document work when sales are carried out by telephone or through another means that does not involve face-to-face meetings?

Prevalence of telephone and Internet sales

The phone and Internet are the most common means of order taking for existing clients. (Lutheran) Do not assume that those who make purchases over the phone are more educated than other consumers.

Waive the delivery requirement for phone sales

Waive delivery requirement for phone sales. If the customer has already made a decision and understands the information in the fund summary, the sales person should not have to repeat it.

Give consumers the ability to waive their right to receive the document

Give consumers the opportunity to waive their right to receive the summary document prior to or at the completion of a sale. Salespersons should advise that the summary document is available and how to get it. If the client wants further information, he or she can obtain it. If not, then the trade proceeds.

Communicate the information over the phone

Tell investors what the fund summary says in circumstances where delivery prior to or at the time of purchase is impractical. Of course, a line-by-line recitation is not practical.

Practical experience suggests that without enforcement, verbal communication, if left up to the sales representative, will not take place and there will be no paper trail to provide evidence that the communication took place.

Follow-up with actual delivery

The fund summary should be delivered even where the information is discussed on the phone.

Internet sales

The client can click on a review/decline option for the summary before proceeding with the transaction.

The implications of delivering a printed fund summary before the sale

Question: 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?

Positive implications

For the insurance industry, using a fund family summary document will not significantly change the current process, but will result in the client receiving a more useful, less expensive summary of relevant information prior to signing the application.

Negative implications

Requiring consumers to read a printed fund summary before the sale will have a detrimental effect on the sale. Consumers will be unhappy if the sale is held up by delivery requirements.

Joint Forum response

If a consumer is purchasing over the phone, we believe the sales representative should deliver the fund summary either physically (in-person, mail, or fax), electronically (e-mail or viewed by consumer online), or verbally, before the sale is completed, unless the consumer waives their right to receive the fund summary. If the consumer is purchasing online, he or she should be presented with a fund summary screen before the transaction proceeds.

Public comments

Do we need to mandate a fund summary document?

Question: Can we achieve our objectives of empowering consumers to make informed investment decisions without mandating a fund summary document?

No

We don't need to mandate a fund summary. Why? Because novice consumers will rely on their advisers and more experienced ones will do their own research.

Joint Forum response

Although we feel strongly that the delivery of a commercially printed fund summary document should be the default in face-to-face sales, we agree that consumer should be able to decline the document if they do not wish to have it.

The foundation document

Form

Public comments

Flexibility

Operators asked us to regulate principles rather than mandate strict forms of disclosure. They would like the flexibility to determine what information is most valuable to consumers and how to deliver it.

Insurance companies would prefer that we make the foundation document flexible enough to accommodate all possible approaches. Some insurers would like to consolidate the IVIC and the foundation document to avoid duplication¹⁰ while others may want to incorporate it into the application. Still others may develop different, but equally useful, and imaginative approaches depending upon their distribution structures.

Standardized format

The standardized format of the existing simplified prospectus allows for comparisons between funds. We should maintain this going forward.

Length

Opinions on the ideal length of this document varied from 15 to 20 pages—for a fund family document—to 4 to 7 pages—for documents prepared per fund.

Joint Forum response

We are more interested in regulating principles than strict forms of disclosure. At the same time, we think that every foundation document should contain more or less the same information so as to facilitate comparisons among different funds. Although we would prefer that the document not grow to enormous proportions, we may be prepared to be more lenient with the content of this document because we understand it to be more of a background or reference document.

¹⁰ Desjardins has recently obtained regulatory approval to consolidate the information folder and IVIC. It is the first insurance company to do so.

Content

Public comments

Fees and expenses

Respondents offered the following suggestions regarding fee disclosure in the foundation document:

- MER should be itemized in dollars and cents
- The regulator should prescribe the language used to describe trailer fee commissions
- We need complete, total, and honest disclosure of the cost of the investment in one place, up-front. This is a basic principle.

These comments should be read together with the fee related comments for the fund summary document that were outlined earlier in this paper.

Ethics, voting, governance and conflicts

Consumer-respondents and consumer advocates focused on the importance of disclosing ethics, voting and governance policies. They also saw disclosure of conflicts as being important.

What should not be disclosed

Some respondents said that the following pieces of information should not be disclosed in the foundation document:

- Information contained in the fund summary.
- Information in the AIF that is not relevant to consumers such as the names of service providers, who is responsible for mutual fund operations, fund governance and conflicts.

Joint Forum response

Although our consultation paper outlined some of the items we thought should be included in the foundation document, this was only a preliminary view. We will first focus our efforts on identifying the items that should go into the fund summary and the foundation document. It is clear, however, that the foundation document should not simply be a repetition of the information contained in the fund summary. In addition, information that is of no use to consumers will be excluded from both documents.

Once specific content requirements have been determined, we expect to publish our proposals for comment. On the securities side this would come in the form of a draft rule. On the insurance side it would be in the form of a consultation paper.

Document updates

Public comments

Respondents agree with our conclusion that if the foundation document is evergreen, annual filing will not be necessary. We should only require filing if there has been a material change. It was noted that this will save time and money. One industry participant told us though, that although this sounds ideal, the reality is that changes will occur fairly frequently.

Joint Forum response

We are committed to making the foundation document evergreen.

Delivery to consumers

Public comments

The vast majority of industry participants supported an access-equals-delivery approach to the foundation (see comments under the heading, "Think about the mode of delivery: Electronic access/delivery" above). Only one comment letter explicitly set out the view that there is value in delivering the information in paper. This view, however, was implied in the letters from consumers and consumer advocates.

Joint Forum response

We are reconsidering our proposal to take an access-equals-delivery approach to this document. The consumer will be asked to decide whether or not they want to receive it and in which form (e.g., paper or electronic).

The continuous disclosure record

Content

Public comments

The notion of improved continuous disclosure for mutual funds received support from respondents. Funds should provide the same level of disclosure as issuers of equities, we were told. In particular, they should be required to provide MD&A, like public issuers of securities.

Joint Forum response

Proposed National Instrument 81-106 Mutual Fund Continuous Disclosure (NI 81-106) will address these issues on the mutual fund side. It is also expected that insurance regulators will be looking at NI 81-106 in the context of insurance regulation. Harmonization of the rules for both IVICs and mutual funds will continue to be a focus of regulators.

The consumers' guide

General

Public comments

Our proposal to introduce a consumers' guide received strong support. Industry participants liked that we recognize that educational information should not be included in the point of sale disclosure documents. Notwithstanding the general support, some industry participants warned that the idea of presenting a guide "at an early stage in the sales process" is somewhat problematic because the entire process, from initial contact to sale, can occur during the course of a single meeting.

Joint Forum response

We are committed to introducing a consumers' guide. This will allow us to remove educational material from the other point of sale documents.

Public comments

Who will “own” the guide?

Question: We need to agree on an approval mechanism whereby the regulators will approve and the industry will endorse the contents of the consumers’ guide.

The regulator’s document

- We recommend that the regulators own the document.
- The investor education branches would develop the document.
- The document should be identified as a Joint Forum publication.

Industry’s input

- The industry, through CLHIA and IFIC, could endorse it.
- Industry participants should have the ability to propose changes.
- A joint industry-regulatory task force could be charged with updating the document.
- The industry need not give its endorsement.
- Don’t get industry to endorse because it will water down the content.
- Fund managers should be able to brand the document without being responsible for its content.

Consumer input

- An investor panel should review the document.

Joint Forum response

We agree that the regulators should own the document. The industry (via the industry trade associations) and consumers (via a consumer panel) should have input into its content.

Public comments

Document updates

Question: How will the consumers’ guide be periodically updated?

No need to update periodically

Since the guide is intended to provide general information for unsophisticated consumers, the content will likely remain current over a reasonably long period.

Periodic review is appropriate

- A regular review by the industry and regulators could be scheduled for every five years with all parties having the right to request revisions in the interim.
- Changes should be made once a year or more frequently if the changes are time-sensitive.

Currency date and advance notice of updates

- It should be posted with a currency date.
- Industry participants should be informed in advance of any updates so as to avoid unnecessary destruction of obsolete documents.

Joint Forum response

We do not expect the document will need to be updated very frequently. Changes should be made as they become necessary.

Public comments

Avenues of distribution

Question: How will the consumers' guide be made available for use by industry participants and consumers?

SEDAR

It should be available on SEDAR.

Websites

It could be posted on the websites of operators, industry associations, regulators, and SROs.

Brochures

A brochure could be available from industry associations or dealers

Available upon request

It should be made available upon request and electronically to all consumers.

Referenced in fund summary

The availability and location should be disclosed in the Fund Summary.

Sales representatives or dealers will download and print the documents from the web.

Joint Forum response

We agree with all of the suggestions put forward by respondents.

Public comments

Who decides?

Question: Who will make the decision about which consumers should be offered the document?

The regulator

It should be offered to everyone upon account opening or first purchase. It is too hard to figure out who is a novice in what product.

All novice investors should be provided with a copy.

Mandate that it is delivered annually.

Not the regulator

There should be no requirement to offer/deliver it to consumers.

The sales representative

The guide should always be offered to consumers unless the sales representative is sure the consumer already has it and is aware of its contents.

The sales representative should be able to educate the client without actually using the guide so long as the important information is provided.

The sales representative will decide. The decision should be tied to the Know Your Client process.

The sales representative should ensure the client understands the product being purchased. If they do not, then the document should be offered.

The consumer

The consumer should decide.

Make access-equals-delivery and deliver within 5 days of request.

Consumers should be able to waive their rights.

Joint Forum responses

We believe the sales representative should always offer the document to consumers at the point of sale unless the consumer has already received a copy. Consumers can always decline.

Public comments

The consequences of not delivering

Question: What consequences will flow when a novice consumer is not offered the document?

No consequences

Failure to deliver the guide should not be viewed as proof of a failure to disclose necessary information or a breach of the duty of care.

Consumers would continue to have the remedies available for unsuitable investments—namely, cooling-off periods.

SRO's can audit compliance periodically.

Joint Forum response

A failure to deliver the consumers' guide will amount to a breach of securities and insurance regulation. Successful implementation, however, should mean that the consumers' guide will be generally available from many sources, including regulators, and not just from sales representatives.

Content

Public comments

General support for the proposed content

We were told the content and language of the proposed document are accessible without being overly simplistic.

General concerns with the proposed content

Respondents commented that the document:

- Is too lengthy. Research shows people will not read anything too long.
- Is too detailed.
- Provides too much information for some consumers and not enough for others.

General suggestions for improving the document

We received the following suggestions:

- Create different guides for consumers of differing levels of sophistication.
- Create two separate guides: one about securities (including mutual funds) and one on insurance (including segregated funds).
- Guide should be expanded to cover all securities and not be limited to segregated funds and mutual funds.
- The document should separate the mutual fund and segregated fund information to avoid confusion. Don't forget that not all firms offer both products.
- Clarify the differences between segregated funds and mutual funds.
- Standardize the information on segregated funds and mutual funds to avoid confusion.
- Consult with advisers on content.
- IFIC's "Investing in Your Future" booklet can be used as a starting point.

Consumers' rights

Rights in the case of a misrepresentation

Public comments

We were asked to provide consumers with a means of being reimbursed for misrepresentations in any of the new disclosure documents.

Joint Forum response

We agree that consumers should be able to rescind their purchases if there is a misrepresentation in any of the proposed documents.

The rights of withdrawal and rescission

Public comments

Concerns with the existing rights

The comments letters echoed our concerns that the rights are not harmonized across the country and are inconsistent with each other.

Are the rights ever used?

Question: If you are a mutual fund industry participant (either a fund manager or a sales representative), please comment on your experiences 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.

■ **No**

Consumers do not exercise these rights. We have seen very few instances in the past 10 years.

■ **If so, they are misused**

On the infrequent occasions the rights have been exercised, the investors have almost always been sophisticated. They have used the rights in order to time the market (i.e. as a put option), with the consequence that all other investors in the fund have been harmed.

The right of withdrawal leaves open the potential for abuse on the part of sophisticated consumers who recognize the value of the embedded put option.

■ **They are not misused**

We doubt that investors have used these rights as a put option and would like to see proof of this.

Why the rights are not exercised

We were told that consumers do not use them because:

- They are not clearly informed of their rights.
- The time-frames are too short.
- You need to consult with a lawyer in order to take advantage of the rights—this is expensive and generally unrealistic.

Do consumers need a cooling-off period?

Question: 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.

There should be no cooling-off period

There should be no cooling-off period. Provided:

- the documents are made available before the point of sale, like they are on the insurance side.
- the information is delivered 48 hours before the sale occurs.
- there is a disclaimer in the contract saying the consumer recognizes that all information has been offered and is sufficient. The investor should be more responsible.

Such a period is not needed because:

- mutual funds should be treated like other securities which can be purchased on the secondary market. There is ample information about mutual funds in the public domain.
- there is no way to prevent people from playing the markets.
- remedies already available are sufficient to protect customers who, through no fault of their own, purchase insurance contracts that are not suited to their needs.
- a cooling-off period is not needed for segregated fund sales. It would create new liability for segregated funds.

A cooling-off period is needed

Mandate a cooling-off period just like the one attached to the new issue of securities. Segregated fund purchasers should be given the same rights as mutual fund investors.

A cooling-off period is needed because:

- high pressure sales tactics are used in the industry.
- investors hold too few of the cards. The balance of power lies with operator.
- investments are more complex than other purchases.
- providing the investor with the limited information in the fund summary immediately prior to purchase grants only a limited opportunity for the investor to be fully informed before becoming bound.
- fund consumers are less investment savvy than other investors. Consumers often don't thoroughly understand risks, costs or reasonable expected returns.

- it provides assurance to the consumers who are aware of it.
- not having one could be negatively perceived by consumers in a post-corporate malfeasance environment where consumer protection is so strongly emphasized.
- individual investors will be prejudiced by the removal of these rights, even if they have not taken advantage of such rights in large numbers in the past.

How to prevent market-timing

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?

Suggestions

- Measures should be implemented to prevent investors from using the cooling-off period to play the markets.
- This right should be limited to recovery of the initial investment.
- The consumer should be liable for any adverse market changes in the underlying investment, but be reimbursed for all sales charges paid and not be subject to surrender or redemption fees.
- Impose a 72-hour delay between the time the units are purchased and the time at which the units are considered credited to the account. The NAV would be calculated upon the closing of the transaction. Consumers who change their minds would be able to reverse the decision at no cost to the fund company or existing unitholders. Each consumer would be given the ability to override this 72-hour delay, perhaps by clicking a button on a website. First time buyers would be encouraged not to override this delay.

How long?

Question: How long should we give consumers to re-consider their investment?

Suggestions

- 4 business days of receiving information, or 7 days of the transaction – whichever is later.
- 48 hours. Anything longer could be taken advantage of.
- If one is adopted, make it short (e.g. 24 hrs) to minimize losses to the fund.

Other suggestions for the operation of the cooling-off period

The following suggestions were made:

- The particular investment should be “new” to the consumer (i.e. not already held in their portfolio, or not purchased under the same fee structure as before).
- There should be no arbitrary upper limit to the amount subject to the cooling-off period.
- The fund summary document should refer to the cooling-off period.

Joint Forum response

We believe the existing rights of withdrawal and rescission should be collapsed into a single cooling-off period for purchasers of segregated funds and mutual funds. Consumers who are purchasing a fund for the first time will have 48 hours from the point of sale to give notice to the dealer from whom the purchase was made of their intent to undo the transaction. The amount the consumer is entitled to recover will not exceed the net asset value of the securities purchased plus all sales charges. The consumer should be liable for any adverse market changes in the underlying investment but should be reimbursed for all sales charges paid and not be subject to surrender or redemption fees.

Consumers should be notified of the cooling-off period in the fund summary document. The consumers' guide should also inform consumers of their rights. We intend to highlight to consumers the importance of reading these documents and will make sure that information pertaining to the cooling-off period is clearly written and easily accessible.

How our proposals interact with other initiatives

Public comments

Joint Forum Capital Accumulation Plan initiative

We were asked to monitor the interaction between this initiative and the one on Capital Accumulation Plans to ensure there is no overlap or duplication.

CSA Fund Governance project

Fund governance bodies need to monitor compliance with the disclosure requirements, according to one consumer advocate.

Sarbanes-Oxley

One respondent noted that our proposals appear to be diametrically opposed to our investor education initiatives and Sarbanes-Oxley.

OSC Fair Dealing Model

We were told that resolving the issues identified in the Consultation Paper will go a long way to establishing some principles for the Fair Dealing Model that would be acceptable to dually-licensed sales representatives.

Joint Forum response

We are keeping apprised of these and other initiatives as we further develop our proposals.

How our proposals relate to the regulation of investment funds other than conventional mutual funds

Public comments

The proposed regime should apply to all investment funds

We were advised that the point of sale documents should be used by all packaged securities products (excluding pooled funds), wrap accounts, ETFs and labour sponsored funds.

Group RSP Plans

We were also asked to ensure that Group RSP Plans are included in our proposals because it is important to ensure that all these different sales channels, involving basically the same product, are regulated in a harmonized way.

Pooled funds

Mutual fund operators stress that National Instrument 81-102 mutual funds continue to be at a competitive disadvantage to securities sold in the secondary market place that do not require any point of sale disclosure.

Commodity pools

It was suggested to us that the Joint Forum consider extending the disclosure regime discussed in the Consultation Paper to commodity pools because:

- Commodity pools are a growing area of investment. There are more and more of these available and they are becoming increasingly mainstream.
- The derivatives and leverage strategies used by commodity pools are difficult to understand.

- Long form prospectuses are even more unwieldy and difficult to use than the simplified prospectus. Sales people dislike them.
- Consumers will be able to compare products across the investment fund spectrum.

The regime should not apply to the pension area

According to one letter, many features of the retail market are not applicable to the pension area because of the active role of the plan sponsor in selecting and monitoring investment options.

Joint Forum response

At the moment, this project is focused on mutual fund and segregated fund disclosure.

The costs versus the benefits of our proposals

Public comments

Question: 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 consumer's perspective

I suspect cost-benefit is a handy whipping post for the insurance industry to delay much-hated change. While it may be possible to estimate costs from the industry side, how are we to assess the benefit of better informed consumers making appropriate choices based on full, true and plain disclosure? The benefit of transparent, fair and effective institutions such as honest courts and the rule of law is enormous and well known in economics, so it is perfectly reasonable to expect transparent, fair and effective investment regulation to be equally significant to investors and the economy as a whole. But both benefits are extremely difficult to "measure", and there is no identifiable pressure group in favour of them that will provide impressive estimates.

A First Benefit Estimate. Here is a first attempt to quantify the huge benefit opportunity to consumers from good regulation, knowledge and education. If good information, regulation and education caused consumers to shop around a little more carefully, understanding the fees they pay, then perhaps they could save ON AVERAGE, say 30 bp per year (10-15% of fees), or about \$1B per year. This also approximates the net benefit to the economy because consumers would most likely reinvest those savings in additional funds. If good information caused consumers to choose appropriate asset mixes that reduced their portfolio variability to a comfortable level, then they would decrease the characteristic prevalence of buying high and selling low (trend chasing) – a behavior costing them at least 200 bp per year in long run return. If good information could stop 15% of this behavior, consumers would benefit by another net 30 bp or \$1B. Compared to this, printing a few smarter documents seems a pretty good investment for the economy as a whole – and the sooner the process can begin, the better.

Consumer parallels to other goods. To the extent we can align investor rights with those of other purchasers in today's society, ensuring consistency not only between seg funds and mutual funds, but also between buying funds, houses, cars or holidays, we contribute to a natural ethical framework that defines western societies. That framework, in general, is moving toward more ethical behaviour – albeit in fits and starts – so I hope that fund regulation can, too.

The issue is not cost-benefit; it is about doing what is right for consumers. Investors need protection from the LifeCos of the world – not shady fly-by-night operations but big brand name firms with questionable practices that became entrenched over time without anybody noticing. Consumers pay for everything in the end anyway – through fees, misallocated investments, taxes to support regulators, etc. Politicians and employers are as ill-equipped to consider the issues as consumers. Consumers are counting on the regulators to counter balance industry stonewalling.

Costs of the existing regime

We were told that an informal survey shows that IDA member firms spend on average \$300,000 to \$700,000 a year on distributing mutual funds and segregated funds.

Time demands inherent in the four document system

One respondent drew our attention to the fact that investors will incur costs (time) as they seek out the more detailed information in the foundation and continuous disclosure documents.

Benefits that will come with use of the Internet and access-equals-delivery

A number of respondents told us that:

- Broad use of the internet will diminish costs for investors.
- Technology will level the playing field for smaller players.
- The cost of implementing technological changes should be offset by savings in printing and delivery costs.
- The concept of “access-equals-delivery” offers the potential for meaningful cost savings.
- There will be reductions in the cost of printing. The proposals will reduce costs but not materially since most of the cost of printing comes up front.
- There will be reductions in the cost of mailing. Delivery of paper copies at reduced frequencies would reduce costs.

The potential costs of relying on the Internet and access-equals-delivery

At the same time, we heard that requiring operators to post documents on their websites would be time-consuming and expensive. Some were concerned that the industry will have to maintain two channels of disclosure (paper and electronic) and that the costs will be passed onto investors.

It was also pointed out to us that consumers will need to print their own documents.

Benefits of a fund family approach

The insurance industry feels its recommended “contract plus all funds” approach for the foundation document and summary document offers the potential for meaningful cost savings.

Costs of a per fund approach

Any cost savings could disappear, according to respondents, if the foundation document and fund summary document are prepared on an individual fund basis. In fact, that could actually lead to an increase in costs. The costs will be due to:

- the duplication of providing the feature information (guarantees, etc.) in each foundation document, and in all the fund summary documents.
- maintenance and refiling where an amendment is made to the product.
- liability to the insurer if advisors do not provide disclosure of the consumers’ full contractual rights to the consumer.¹¹

The benefits of evergreen documents

The letters informed us that evergreen documents will reduce legal and regulatory filing fees.

Costs to intermediaries

We were told that intermediaries could face a new cost due to increased workload and legal exposure

Loss of identity for segregated funds

One insurance industry letter told us there is a risk that the segregated fund industry will lose the ability to highlight the differences between segregated funds and mutual funds.

¹¹ These rights include accessibility of all funds. To protect themselves, insurers may be forced to incorporate all the single-fund summaries into one point of sale document. Based on the current proposal for a one- or two-page fund summary, this would result in documents often in excess of 100 pages. If issuers do not have the flexibility of using a single foundation document to describe the funds and the contract, the industry will have duplication of the contractual features of the product—contract version plus foundation document version. This is no different than what is done today with the Information Folder and Contract being separate documents with identical information contained within. (CLHIA, Maritime Life, Great-West Life, Lutheran).

The costs of transition

We were reminded that the mutual fund industry completely modified its disclosure documents in order to comply with the requirements of NI 81-101. It will be a burden to the industry to require yet another document to be produced and provided to investors when so much effort has already been put into development and filing of the simplified prospectus.

Other industry participants recognized the transition costs should be reduced substantially by some of the cost saving features of the proposals.

Joint Forum response

These comments will be considered by the OSC Chief Economist as he completes his cost-benefit analysis.

Appendix 1: List of Respondents

Organization	Description
ADP Investor Communications	Provider of investment communications services
Advocis. The Financial Advisors Association of Canada.	The trade association for 17,000 financial advisors who are licensed to sell life and health insurance, mutual funds and other securities.
Association of Canadian Pension Management (ACPM)	The national trade association for public and private sector pension plan sponsors and the professional advisory firms they retain. Its membership represents 80% of Canadian pension fund assets.
Canadian Shareowners Association	Investment club
Benoit Chenette	Individual consumer
The Canadian Life and Health Insurance Association (CLHIA)	The trade association for the North American life and health insurance industry. Its membership represents virtually all of the segregated fund business in Canada.
Ethical Funds	Mutual fund manager
Fidelity Investments	Mutual fund manager
Robert Findlay	Individual consumer
Franklin Templeton Investments	Mutual fund manager and portfolio adviser
Great-West Life Assurance, London Life Insurance and Quadrus Investment Services	Life insurance companies Mutual fund dealer
Derek Hill	Individual consumer
Investment Dealers Association of Canada (IDA)	The national self-regulatory organization and representative of the investment dealer industry. The Association regulates the activities of investment dealers.
The Investment Funds Institute of Canada (IFIC)	The national trade association for the investment funds industry. Membership is mainly composed of fund managers and represents almost 100% of total mutual fund assets under management in Canada.
Joe Killoran	Investor advocate
Lang Michener	Law firm
Lang Michener for First Horizon Capital and Mondiale Asset Management	Law firm for hedge fund manager and portfolio adviser (i.e. through law firm)
Lutheran Life Insurance Society of Canada	Life insurance company
Manulife Financial	Life insurance company and mutual fund manager
Maritime Life Assurance	Life insurance company

Organization	Description
Moshe A. Milevsky, Ph.D.	Professor of Finance at Schulich School of Business at York University and Executive Director of the Individual Finance and Insurance Decisions Centre at the Fields Institute.
Mouvement des caisses Desjardins	Mutual fund manager and life insurance company
Osler, Hoskin & Harcourt	Law firm
Tony Paine	Individual consumer
Phillips, Hager & North Investment Management	Mutual fund manager and portfolio adviser
Primerica Life Insurance Company of Canada and PFSL Investments Canada	Life insurance company and mutual fund dealer
Public Interest Advocacy Centre (PIAC)	Organization representing consumer interests in matters that affect a broad cross-section of Canadians, including financial services and electronic commerce
Small Investor Protection Association (SIPA)	Investor advocacy organization representing 400 small investors in 9 provinces
SSQ Groupe Financier	Financial group including mutual fund manager and insurance company
TD Asset Management	mutual fund manager and portfolio adviser