

CSA Notice and Request for Comment

Implementation of Stage 3 of Point of Sale Disclosure for Mutual Funds *- Point of Sale Delivery of Fund Facts*

Proposed Amendments to National Instrument 81-101 *Mutual Fund Prospectus Disclosure* and Companion Policy 81-101CP to National Instrument 81-101 *Mutual Fund Prospectus Disclosure* (2nd Publication)

March 26, 2014

Introduction

The Canadian Securities Administrators (the CSA or we) are publishing for second comment changes to proposed amendments to National Instrument 81-101 *Mutual Fund Prospectus Disclosure* (the Rule or NI 81-101) and Companion Policy 81-101CP to National Instrument 81-101 *Mutual Fund Prospectus Disclosure* (the Companion Policy). We refer to the proposed amendments to the Rule and the proposed changes to the Companion Policy together as the Proposed Amendments.

The Proposed Amendments represent an important step in the final stage of implementation of the CSA point of sale disclosure initiative. They set out requirements aimed at implementing pre-sale delivery of the fund facts document (the Fund Facts) for mutual funds.

The Fund Facts is central to the point of sale disclosure framework. It is in plain language, no more than two pages double-sided and highlights key information to investors, including risk, past performance and the costs of investing in a mutual fund.

Pre-sale delivery of the Fund Facts will provide investors with the opportunity to make more informed investment decisions by giving investors key information about a mutual fund, in a language they can easily understand, at a time that is most relevant to their investment decision.

An earlier version of the Proposed Amendments was published by the CSA on June 19, 2009 (the 2009 Proposal). The 2009 Proposal included proposed amendments aimed at implementing

all of the elements of the point of sale disclosure regime set out in Framework 81-406 *Point of Sale Disclosure for mutual funds and segregated funds* (the Framework), published in October 2008 by the CSA and the Canadian Council of Insurance Regulators, as members of the Joint Forum of Financial Market Regulators (the Joint Forum).¹

The text of the Proposed Amendments follows this Notice and is available on the websites of members of the CSA.

We expect the Proposed Amendments to be adopted in each jurisdiction of Canada.

Background

Following the publication of the Framework by the Joint Forum and the CSA's 2009 Proposal, on June 18, 2010, the CSA published CSA Staff Notice 81-319 *Status Report on the Implementation of Point of Sale Disclosure for Mutual Funds* (the Staff Notice), which outlined the CSA's decision to implement the Framework in three stages.

- Stage 1, which came into force January 1, 2011, requires mutual funds to produce and file the Fund Facts and for it to be available on the mutual fund's or mutual fund manager's website. Since July 2011, every mutual fund has had a Fund Facts for each class and series of the mutual fund.
- Stage 2 was completed with the publication of final amendments on June 13, 2013. The amendments are phased-in, with the amendments to Form 81-101F3 *Contents of Fund Facts Document* effective as of January 13, 2014. The amendments that require delivery of the Fund Facts and allow for the Fund Facts to satisfy the current prospectus delivery requirement under securities legislation to deliver a prospectus within two days of buying a mutual fund take effect on June 13, 2014.
- In Stage 3, the CSA conveyed it would publish the Proposed Amendments aimed at implementing pre-sale delivery of the Fund Facts.

As part of Stage 3, the CSA is also proceeding with two other concurrent workstreams: (i) the development of a CSA mutual fund risk classification methodology, which was published for comment on December 12, 2013, and (ii) the development of a summary disclosure document for ETFs, similar to the Fund Facts, and a requirement to deliver the summary disclosure document within two days of an investor buying an ETF, which we anticipate publishing for comment in Fall 2014.

You can find additional background information and other Joint Forum publications on the topic of point of sale disclosure for mutual funds on the websites of members of the CSA.

¹ The goal of the Joint Forum is to continuously improve the financial services regulatory system through greater harmonization, simplification and co-ordination of regulatory activities. Under the framework, investors would receive more meaningful information about a mutual fund or segregated fund at a time that is relevant to their investment decision.

Substance and Purpose

The principles underlying the CSA point of sale disclosure initiative are:

- providing investors with key information about a fund;
- providing the information in a simple, accessible and comparable format; and
- providing the information before investors make their decision to buy.

These principles keep pace with developing global regulatory standards,² including the International Organization of Securities Commissions (IOSCO) Principles on Point of Sale Disclosure published in February 2011.³

We think the Proposed Amendments will provide investors with the opportunity to make more informed investment decisions, by giving investors key information about a mutual fund, in language they can easily understand, at a time that is most relevant to their investment decision. We also think the Fund Facts will assist investors in their discussions with their representatives, and highlight for investors where they can find further information about a mutual fund, before they make their investment decision.

Feedback on the 2009 Proposal

We received 54 comment letters on the 2009 Proposal. Copies of the comment letters have been posted on the Ontario Securities Commission website at www.osc.gov.on.ca. You can find the names of the commenters and a summary of the comments relating to the pre-sale delivery elements of the 2009 Proposal and our responses to those comments in Annex C to this Notice.

Generally, commenters agreed with the benefits of providing investors with the Fund Facts. We did, however, receive significant comments related to operational and compliance concerns in respect of pre-sale delivery of the Fund Facts. The concerns were primarily related to costs and complexity. Commenters also generally supported allowing a waiver from pre-sale delivery requirements for the Fund Facts in certain circumstances.

² In the United Kingdom, Australia, Hong Kong and Malaysia, disclosure documents must generally be provided before a product is purchased.

³ See, for example: Principles on Point of Sale Disclosure, Final Report, Technical Committee of the IOSCO, February 2011; G20 High-level principles on Financial consumer protection, Organization for Economic Co-operation and Development (OECD), October 2011; and Regulation of Retail Structured Products, Consultation Report, IOSCO, April 2013.

Principle 2 of the IOSCO Principles on Point of Sale Disclosure specifies: “*key information should be delivered, or made available, for free, to an investor before the point of sale, so that the investor has the opportunity to consider the information and make an informed decision about whether to invest.*”

Changes to the 2009 Proposal

We have revisited the approach taken in the 2009 Proposal with respect to pre-sale delivery of the Fund Facts, informed by the regulatory regimes of other jurisdictions that have implemented pre-sale delivery requirements,⁴ by IOSCO principles,⁵ and by the comments received on the 2009 Proposal.

To address the feedback we received related to complexity and cost of compliance, the CSA has decided to proceed with a simpler, more consistent approach to pre-sale delivery of the Fund Facts. Accordingly, we are proposing a number of changes to the 2009 Proposal, specifically:

- for all purchases of mutual funds securities, the Funds Facts will be required to be delivered or sent to the purchaser before a dealer accepts an instruction, if the most recent Fund Facts has not previously been delivered;
- subject to certain conditions, an exception from pre-sale delivery of the Fund Facts will be allowed if the purchaser indicates that they want to complete the purchase immediately or by a specified time, and it is not practicable for the dealer to complete pre-sale delivery of the Fund Facts. In such circumstances, the Fund Facts must be delivered or sent within 2 days of purchase; and
- there are no longer exceptions from pre-sale delivery for purchases of money market fund securities, for purchases through an order execution-only account, or for purchases that are not recommended.

We have made a number of other changes to the 2009 Proposal to simplify the pre-sale delivery regime for Fund Facts. An overview of the changes we have made to the 2009 Proposal is set out in the chart at Annex A to this Notice.

We are requesting feedback on all aspects of the Proposed Amendments, and in particular, specific questions in Annex B to this Notice. The CSA continue to be committed to consulting with investors, representatives from the mutual fund industry, dealers, sales representatives and service providers on implementation issues related to pre-sale delivery of Fund Facts. The CSA will continue to work with Self-Regulatory Organizations (SROs) on issues arising from the transition to pre-sale delivery of Fund Facts.

Summary of the Proposed Amendments

Application

The Proposed Amendments apply only to mutual funds subject to NI 81-101.

⁴ See footnote 2 above.

⁵ See footnote 3 above.

Pre-Sale Delivery

The Proposed Amendments require delivery of the most recently filed Fund Facts to a purchaser before a dealer accepts an instruction for the purchase. The delivery requirement is for all purchases, without any distinction based on the type of mutual fund security purchased or the distribution channel. Consistent with securities legislation in some jurisdictions today, the Proposed Amendments do not require delivery of the Fund Facts if the purchaser has already received the most recently filed Fund Facts. However, in some jurisdictions, such as Quebec, a legislative amendment may be required to maintain the right of rescission for subsequent trades.

The method for delivery of the Fund Facts is consistent with the method for delivery of a prospectus under securities legislation. For example, it can be in person, by mail, by fax, electronically or by other means. Access will not equal delivery, nor will a referral to the website on which the Fund Facts is posted.

Exception where Delivery Impracticable

The CSA acknowledge that there may be circumstances that make pre-sale delivery of the Fund Facts impracticable. The Proposed Amendments contemplate an exception to pre-sale delivery of the Fund Facts in limited circumstances where the purchaser indicates that they want the purchase to be completed immediately, or by a specified time, and it is not reasonably practicable for the dealer to complete pre-sale delivery of the Fund Facts within the timeframe specified by the purchaser. In such circumstances, the dealer would be required to inform the purchaser of the existence and purpose of the Fund Facts and explain the dealer's obligation of pre-sale delivery of the Fund Facts. The dealer must also provide a general overview of the content of the Fund Facts, verbally, including the applicable rights of withdrawal or rescission that the purchaser is entitled to under securities legislation.

In such circumstances, the Fund Facts would then be required to be delivered or sent to the purchaser within two days of buying the mutual fund. This exception is on a purchase by purchase basis. A dealer cannot rely on standing instructions from the purchaser to effect post-sale delivery of the Fund Facts.

Exception for Pre-Authorized Purchase Plans

For pre-authorized purchase plans, the requirement for pre-sale delivery of the Fund Facts would not apply to subsequent purchases of securities of a mutual fund provided that the dealer provides initial and subsequent annual notices to the purchaser that includes information on how to access and request the Fund Facts and that the purchaser will not have a right for withdrawal of the purchase. A purchaser of a pre-authorized plan will continue to have a right of action for rescission or for damages if there is a misrepresentation in the prospectus of the mutual fund, including any documents incorporated by reference into the prospectus, such as the Fund Facts.

No Effect on Investor Rights

We are not proposing any changes to existing investor rights under securities legislation.

If the investor does not receive the Fund Facts, the investor has a right to seek damages or to rescind the purchase. The rights of the investor for failure of pre-sale delivery of the Fund Facts are the same rights under securities legislation today for failure to deliver the Fund Facts within two days of purchasing securities of a mutual fund.

The investor's right of withdrawal of purchase within two business days after receiving the Fund Facts remains unchanged. Consistent with securities legislation today, depending on the timing of delivery of the Fund Facts and the timing of the trade, the investor may or may not have the right of withdrawal of purchase.

The right for misrepresentation related to the Fund Facts has also not changed. The Fund Facts is incorporated by reference into the prospectus. This means that the existing statutory rights of investors that apply for misrepresentations in a prospectus also apply to misrepresentations in the Fund Facts.

In some jurisdictions, investors also currently have a right of rescission with delivery of the trade confirmation for the purchase of mutual fund securities. This right also remains unchanged under the Proposed Amendments.

Transition

The CSA propose a one year transition period for pre-sale delivery of the Fund Facts following the effective date of the Proposed Amendments. This means, from the time of publication of the Proposed Amendments in final form, a mutual fund will have one year to make any changes to update information delivery systems as well as to make changes to compliance systems for the oversight of pre-sale delivery.

Anticipated Costs and Benefits

We think the pre-sale delivery requirements for the Fund Facts, as set out in the Proposed Amendments, would benefit both investors and market participants by helping address the "information asymmetry" that exists between participants in the mutual fund industry and investors. Unlike industry participants, investors often do not have key information about a mutual fund before they make their investment decision, and may not know where to find the information. Providing pre-sale delivery of the Fund Facts would help bridge this information gap.

However, the extent to which investors and the mutual fund industry would be affected in terms of benefits and costs is difficult to quantify.

Benefits

The benefits of a more effective disclosure regime can be subtle and difficult to measure. It is difficult to quantify the value of investors having the opportunity to make more informed investment decisions. Research suggests that certain behavioral biases of investors may impact

the effectiveness of policy initiatives that are designed to encourage better choices about financial products.⁶ However, research on investor preferences for mutual fund information, including our own testing of the Fund Facts, indicates investors prefer a concise summary of the information to be offered before the sale so that they can use the information to make a decision.⁷

Some anticipated benefits of pre-sale delivery of the Fund Facts include:

- less risk of investors buying inappropriate products or not fully benefitting from the advice services they pay for;
- investors being in a position to better understand, discuss, and compare one mutual fund to another, particularly the costs of investing in the mutual funds, before making their investment decision; and
- investors becoming better informed overall, which reinforces investor confidence in mutual funds.

Costs

We think the costs of pre-sale delivery of the Fund Facts fall into two main categories: the one-time costs of change in moving to the new regime and the ongoing costs of maintaining the new system, in comparison with the cost of the existing regime.

We anticipate that costs to industry stakeholders will fall into the following general categories:

- updating information delivery systems; and
- compliance and staff costs in overseeing the delivery regime.

As industry stakeholders have already had to develop programs and systems to comply with recent pre-trade costs disclosure requirements in National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations*, we think the costs to implement pre-sale delivery of the Fund Facts will be incremental in nature.

We also note that technology has advanced considerably since the 2009 Proposal. There are now service providers who have created the automated programs and applications for pre-sale delivery of the Fund Facts. These innovations facilitate pre-sale delivery of Fund Facts to investors.

Overall, we continue to believe that the potential benefits of the changes to the disclosure regime

⁶ Financial Services Authority, July 2008 *Financial Capability A Behavioural Economics Perspective* – Consumer Research 69.

⁷ OSC, October 2006 *Fund Facts Document Research Report*; Investment Company Institute, August 2006 *Understanding Investor Preferences for Mutual fund Information*; Securities and Exchange Commission, April 2004 *Results of Focus Groups with Individual Investors to Test Proposed Rules 15c2-2 and 15c2-3*.

for mutual funds, as contemplated by the Proposed Amendments, are proportionate to the costs of making them. We are committed to reviewing the impact of pre-sale delivery of the Fund Facts following its implementation.

Local Matters

Annex F to this Notice is being published in any local jurisdiction that is making related changes to local securities laws, including local notices or other policy instruments in that jurisdictions. It also includes any additional information that is relevant to that jurisdiction only.

Some jurisdictions may require amendments to local securities legislation, in order to implement the Proposed Amendments. If statutory amendments are necessary in a jurisdiction, these changes will be initiated and published by the local provincial or territorial government.

Unpublished Materials

In developing the Proposed Amendments, we have not relied on any significant unpublished study, report or other written materials.

Request for Comments

We welcome your comments on the Proposed Amendments. To allow for sufficient review, we are providing you with 60 days to comment. In addition to any general comments you may have, we also invite responses to the specific questions for comment identified in Annex B to this Notice.

We cannot keep submissions confidential because securities legislation in certain provinces requires publication of a summary of the written comments received during the comment period.

Please submit your comments in writing on or before May 26, 2014. If you are not sending your comments by email, please send a CD containing the submissions (in Microsoft Word format).

Where to Send Your Comments

Address your submission to all of the CSA as follows:

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

Office of the Yukon Superintendent of Securities
Office of the Superintendent of Securities, Nunavut

Deliver your comments **only** to the addresses below. Your comments will be distributed to the other participating CSA.

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Contents of Annexes

The text of the Amendments is contained in the following annexes to this Notice and is available on the websites of members of the CSA:

Annex A – Changes to 2009 Proposal

Annex B – Issues for Comment

Annex C – Summary of Public Comments on the 2009 Proposal (relating to Pre-Sale Delivery of the Fund Facts)

Annex D – Proposed Amendments to National Instrument 81-101 *Mutual Fund Prospectus Disclosure*

Annex E – Proposed Changes to Companion Policy 81-101CP to National Instrument 81-101 *Mutual Fund Prospectus Disclosure*

Annex F – Local Information

Questions

Please refer your questions to any of the following:

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