



Advocis
350 Bloor Street East, 2nd floor
Toronto, Ontario M4W 3W8

T 416.444.5251
1.800.563.5822
F 416.444.8031
www.advocis.ca

Via e-mail – original to follow via mail

May 13, 2003

Mr. Stephen Paglia
Senior Policy Analyst
Joint Forum Project Office
5160 Yonge Street
Box 85 17th Floor
North York, Ontario
M2H 6L9

Dear Mr. Paglia:

Thank you very much for giving Advocis the opportunity to comment on Consultation Paper 81 – 403 Rethinking Point of Sale Disclosure for Segregated Funds and Mutual Funds, which was prepared by the Canadian Securities Administrators and the Canadian Council of Insurance Regulators. The proposals contained in this consultation paper will impact most, if not all, of our 17,000 members across Canada.

As you may be aware, in January 2003 Advocis commenced operations as the merged association of the Canadian Association of Financial and Insurance Advisors (CAIFA) and the Canadian Association of Financial Planners (CAFP). The legal name of Advocis is the Financial Advisors Association of Canada.

Our association traces its origins to the founding of the Life Underwriters Association of Canada (LUAC) in 1906. CAFPA was founded in 1981. Advocis continues to serve the Canadian financial advisors community and their clients, as its predecessor organizations have done. Our 17,000 voluntary members are financial advisors licenced to sell life and health insurance, mutual funds and other securities to over 10 million people across Canada.

The objectives of Advocis are to maintain proficiency standards through educational programs, to uphold standards of market conduct through the enforcement of a Code of Professional Conduct and to participate in the development of policy and regulation affecting financial advisors and their clients.

We would like to commend you on your efforts to improve point of sale disclosure information. It is a laudable objective that requires considerable time, effort and co-ordination.

In the attached response, we have provided some general comments based on consultations with our members. We have then provided a detailed response to each of the consultations

paper's thirteen recommendations. We hope that you find our responses useful. We would be very pleased to meet with you to further discuss our views on these issues with you.

Thank you again for providing us with an opportunity to discuss our views with you.

Sincerely,

A handwritten signature in black ink, appearing to read "Brian Mallard". The signature is fluid and cursive, with a long horizontal stroke at the end.

Brian Mallard, CFP, CLU
Chair, Advocis

A handwritten signature in black ink, appearing to read "Steve Howard". The signature is fluid and cursive, with a large loop at the end.

Steve Howard, CA
President and CEO, Advocis

Rethinking Point of Sale Disclosure for Segregated Funds and Mutual Funds

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

Preliminary Responses to Consultation Paper Recommendations

Overall Comments

We strongly support providing consumers with point of sale disclosure information that is articulated at a simpler more understandable level than that of the current documents, which include the information folder and prospectus.

As you will read in the sections below, our suggestions in terms of making the information more understandable differs from the paper's recommendations but we are both attempting to achieve the same goal. We both agree that the disclosure documents are being given to the consumer at the wrong time and it is therefore difficult for the consumer to incorporate this information in the decision making process. We would also agree that the existing point of sale disclosure information is too cumbersome and needs to be streamlined to one or two pages and focus on specific questions and issues which are summarized below.

We wish to emphasize that professional financial advisors view the client advisor relationship as much longer than merely one point of sale contact. In order to retain and build a client base, advisors realize the importance of providing their clients with the appropriate information and educating them over the long run.

Another issue we would like to address is that there is no standard in the industry for assessing risk. This is made more complicated by the fact that the client often has several accounts at different dealers, banks, etc. and, therefore, has different risk tolerances for different portfolios at different institutions. The only way the advisor is able to know of all the client's investments and acceptable risk levels is if the client decides to fully disclose all his or her investments that are held elsewhere.

Your consultation paper states your recommendations are based on the assumption that "access equals delivery". Unfortunately, in most cases experience has revealed that the consumer does not read the documents and, moreover, even if the consumers read them, they do not understand them. Establishing this link probably represents your greatest challenge.

The paper also appears to make the assumption that one point of sale disclosure regime should apply nationally. Such a system would be difficult to implement given that there are ten separate insurance departments across Canada. Would Quebec, who has long been fiercely independent in terms of its financial services regulatory regimes, agree to the suggested changes?

Many of the issues on which you focus define the relationship between the advisor and the client and are issues, which are also addressed by the so-called "fair dealing model" proposed by the Ontario Securities Commission. We are of the view that by satisfactorily resolving many of the issues identified in your paper, we could move some way to establishing some principles for the fair dealing model that would be acceptable to our members.

Responses to Specific Recommendations

1) Do you agree with our description of the disconnect between theory and practice in this part of the consultation paper? Are there differences between segregated funds and mutual funds that we should keep in mind as we work to improve their respective disclosure regimes?

We do agree with your description that there is a disconnect between theory and practice in terms of the current point of sale disclosure information being ignored by consumers, not used by sales representatives and denounced as costly by fund companies.

We, too, would support that different point of sale disclosure information is required. We also question the utility of the Know Your Client document in that the information gathered in this form is not sufficient for the representative to make decisions in terms of accurately determining the client's acceptable risk level and, consequently, suitable products for the consumer.

We would propose that such documentation be very short (one or two pages), cover five common questions that most clients ask when they purchase segregated or mutual funds and enable them to make a more informed choice:

- How much is the segregated or mutual fund company going to charge me?**
- How much is the advisor going to charge me? How is the advisors' compensation structured?**
- What is the cost of risk i.e. what might I lose? (Some of our members have emphasized that we need to go beyond a general discussion of risk and present an historical numerical analysis i.e. if you have invested between certain years you would have made (lost) specific percentages.)**
- Is my capital guaranteed?**
- What has been the past performance of this fund?**

Moreover, certain concepts related to the cost of mutual funds should be explained such as the following:

- A management expense ratio is not equivalent to a load charge**
- A deferred sales charge is equal to a load charge**
- A no load fund is not free – an MER is still charged annually**
- An MER is paid annually regardless of whether the fund makes money**

The client should be required to sign the document underneath a statement that indicates the client has read and understood the document and is aware, but does not wish to read, the information in the prospectus or information folder.

One point that should be kept in mind is that in some cases there is less downside risk in segregated funds than in mutual funds. Segregated funds usually guarantee some percentage of the principle, such as 100% or 75%, upon maturity or death. Of course, those segregated funds that guarantee 100% of the principle are offered at a higher cost to the consumer. Even with a 100% of principle guaranteed, the consumer of a segregated fund would experience a loss if the fund did not make more than the rate of inflation since the value of the fund upon maturity would be less than the original value plus the rate of inflation. Mutual funds do not guarantee that a percentage of the original value will be returned to the consumer after a certain amount of time. Many studies have shown that consumers are far more sensitive to losses than to the same amount of gain.

2) If you are a mutual fund industry participant (either fund manager or representative) please comment on your experiences with the rights of rescission and withdrawal. Have you or your client ever experienced 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 ever used them.

Although rights of rescission and withdrawal are used in a small percentage of mutual fund transactions, we are of the view that it is very important to preserve these rights. Even if consumers do not use them frequently, we do not think that there would be any advantage to removing the rights. There would probably be little change in investor behaviour with or without those rights. However, we believe that they provide assurance to the minority of investors who are aware of them. Rescinding these rights at this time could be negatively perceived by consumers especially in a post-corporate malfeasance environment where corporate governance and investor protection are so strongly emphasized. Purchasers of segregated funds should be subject to similar rights, to remove conspicuous inconsistency in the regulation of mutual and segregated funds.

3) Our proposals will require operators to post the foundation document and the continuous disclosure documents for each fund that they manage on their web sites. The IVIC used by an insurance company for its

segregated funds will also be available electronically and in paper (on demand). Please comment on the pros and cons of this approach.

Pros

Information would be easily available for those consumers with access to a computer and knowledge of how to use the internet. Such availability may increase consumer awareness, although as we pointed out previously in this response there is no reason to believe that there is a link between access and delivery.

Cons

This recommendation assumes that all consumers have access to the internet, which is not necessarily true, especially in the case of elderly clients. Moreover, the majority of elderly clients do not know how to access the internet even if they have access to a computer at their local library. Cost is also a factor as most libraries charge for internet access and information print outs. Requiring each fund operator to post the documents on their web site would also be time consuming and expensive.

4) We recommend that consumers have access (either electronically or if they wish, in paper) to an individual foundation document for the fund of their choice. 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?

If a foundation document describes more than one fund it will become quite lengthy and the original problem i.e. too much information, will reoccur. Would each foundation document be available in English and French? Other languages? Given the proliferation of funds, such a requirement will generate an incredible amount of paper. Again, regardless of the information available there unfortunately is no incentive or motivation offered in the proposed model for the consumer to read it.

5) We propose that mutual fund managers make the various documents available on their own web site, notwithstanding their availability on SEDAR. Are SEDAR postings alone sufficient? Is the SEDAR system structured appropriately to fulfill this function? Please comment on the usefulness of SEDAR for accessing individual disclosure documents about a mutual fund.

Point of sale disclosure information should be available in both hard copy and on the web. We view the SEDAR postings as sufficient for web access. Making it available on individual company web sites is not going to encourage consumers to read it.

6) Please give me feedback on the practical issues we outline:

a) Operators will be required to prepare a separate fund summary document for each fund. How will they ensure that sales representatives receive copies of these documents? How can this aspect of our proposals be handled administratively? Will technology assist? For example, can operators make these documents available on their web sites for sales representatives to access?

b) How will operators update these documents? How will they ensure the updated versions of the documents are used appropriately by sales representatives?

c) 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? We think there are several options. A sales representative could tell a consumer the information in the fund summary. We think that consumers who make their own investment decisions without further advice from sales representatives will already have done their homework and won't need anything further.

d) What about consumer investing on a periodic basis – what are their information needs? We do not think consumers need to receive a fund summary before each periodic purchase. Won't consumers be kept informed about their fund through access to continuous disclosure?

e) These documents will be filed with the regulators. Should they be reviewed and receipted.

Please explain how marketing brochures or other sales communications are distributed and kept up-to date today, both at the operator and sales representative levels.

- a) We have previously recommended that we view the availability of summary documents on SEDAR as sufficient. If summary documents were to be available on fund companies' web sites, we would need to allow a reasonable transition time for these companies to create and load this information on their web sites.
- b) Operators should be required to update the information periodically, perhaps every three months.
- c) Your suggestions are based on the assumption that all consumers require disclosure documents. Your recommendations concerning over the phone sales appear to assume that these consumers are more educated, which may or may not be the case.
- d) We would agree that consumers who purchase periodically do not need a fund summary for each purchase.
- e) If the summary document has additional information it is probably best to review and receipt it as well as the foundation document and the continuous disclosure document in order to protect the consumer.

7) Please tell us about your business practices now using the existing documents. Do you use them in the sales process? Do you give them to consumers before a sale is completed? 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? What about telling consumers what the fund summary says rather than giving them a printed copy? Can we achieve our objective of empowering consumers to make informed investment decisions without mandating a fund summary?

Most members use the existing documents (prospectus and annual report in the case of mutual funds although most advisors only provide the prospectus) in the sales process and give them to the consumer before a sale is completed. If the sales representative was required to give a summary before completing a sale i.e. "please go and read this document and then return and we will complete the transaction" such a process would have a detrimental effect on the sale. We could require mutual and segregated sales representatives to verbally summarize point of sale disclosure information for their clients. We could empower consumers by giving them the kinds of information that we identified in the first question. We think that such information would be more helpful than a fund summary.

8) Please give us your views on the proposed content of the fund summary document.

Again, we would suggesting focusing more on the information that we suggested under our response to recommendation 1.

9) What are the pros and cons of a fund summary document that includes information on more than one fund? Why is the consolidated document desirable having regard to the potential for consolidated documents becoming unwieldy?

Pros

Including information on more than one fund enables the consumer to compare funds before he/she makes the purchasing decisions.

Cons

This will result in a lengthy document, which is one of the identified as one of the main current problems.

10) Please provide us with feedback on the practical questions we note in the text above:

- 1) How would guide be updated?**
- 2) How would it be made available?**
- 3) Who would make the decision as to which consumers are offered to document?**

4) What would be the consequences when the consumer is not offered to document?

We regard the suggested consumers' guide as merely additional documentation that the industry will have to provide. In our view, there is no reason that the mutual or segregated fund client, who does not read the currently provided information, would read this consumer guide. Merely changing the information is not going to result in a more informed consumer. This guide is more suitable for investor education material that should be offered on the CSA and provincial securities commissions' web sites.

11) Please comment on the content of the draft consumers' guide in Appendix 1.

The information on segregated and mutual funds is too lengthy. Moreover, if the consumer is already in the process of purchasing a fund it is highly unlikely that the consumer is going to read it when it is given to him or her. We would hope that you seek more advisors' input on this document.

12) 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. How should a cooling off period work given the changes in market value of funds? How can we prevent market players from using a cooling off period to play the markets? What would be a correct period for consumers to reconsider their investments?

In our response to your second recommendation, we emphasized that the rights of rescission and withdrawal be retained in their current form. Even if these rights are still available in the case of misrepresentation, the public perception will be that the consumer has lost existing rights. We do not support replacing these rights with a cooling off period. We think such a cooling off period is too long and would enable some to benefit from market fluctuations. As you correctly indicate in your consultation paper, this would be the equivalent of giving the consumer a put option. The objective of this entire exercise is to create a more savvy, but not manipulative, consumer. In our view, implementing the suggested cooling off period would have the opposite effect i.e. less penalties for the consumer who refuses to become more educated.

13) Although we will be preparing a formal cost benefit analysis, we are interested in your views on the costs verses the benefits of our proposals. Please comment and explain your analysis.

The industry is already providing a significant amount of information but what is needed is information in a more understandable form for the consumer that corresponds with the questions most frequently asked by consumers (in our response to your first recommendation). Costs will be incurred when transitioning to a new system but in the medium and long run costs may be reduced substantially as required information decreases.