1.1.6 OSC Staff Notice 81-720 – Report on Staff's Continuous Disclosure Review of Sales Communications by Investment Funds

OSC STAFF NOTICE 81-720
REPORT ON STAFF'S CONTINUOUS DISCLOSURE REVIEW OF
SALES COMMUNICATIONS BY INVESTMENT FUNDS

July 18, 2013

PURPOSE

This notice sets out guidance from staff of the Investment Funds Branch of the Ontario Securities Commission (Staff or we) based on our findings from a targeted continuous disclosure (CD) review of the advertising and marketing materials of publicly offered investment funds.

OBJECTIVE AND SCOPE OF OUR REVIEW

Starting May 2012, Staff conducted targeted CD reviews of sales communications from a sample of investment funds. These reviews were in addition to the ad hoc reviews Staff conduct on a regular basis.

Each quarter, we selected 4 or 5 investment fund managers and asked for their sales communications for the previous three months. These included all published and non-print advertising in newspapers, presentations, brochures, internet ads, social media, fund manager websites, television and radio ads, email blasts, green sheets and any other marketing materials.

The fund managers included in our sample offer a range of fund types, including conventional mutual funds, closed-end funds, exchange-traded funds, commodity pools and labour sponsored investment funds. As the advertising of conventional mutual funds is primarily targeted to retail investors, we chose to focus a higher proportion of our CD reviews on this type of investment fund.

Included in our review were 8 medium to large mutual fund groups. Together, these fund groups have assets under management (AUM) of more than $270 billion, or about 30% of the industry total, and offer more than 800 mutual funds to the public. We also selected 4 smaller fund groups, as well as some specialty funds. The ETF providers included in our sample represent approximately 20% of the ETF industry AUM.

Two key objectives of our CD reviews are to raise the awareness of market participants that Staff monitor the advertising and marketing materials of publicly offered investment funds on an ongoing basis, and to provide staff guidance that supplements existing rules and staff publications.[1] We recognise that sales communications play an important role in the business of investment fund issuers. Staff expects the marketing of investment funds to provide clear, accurate and balanced messages, particularly when directed at retail investors.

We worked closely with, and followed similar approaches of staff in the Compliance and Registrant Regulation Branch who regularly conduct reviews of sales communications as part of their oversight of registrants.

SUMMARY OF FINDINGS

Overall, we noted general compliance with disclosure requirements related to sales communications. However, we did observe that some basic requirements, such as providing the date of first publication for a written sales communication,[2] were frequently not met. Also, some sales communications did not contain all the information mandated for a sales communication, but rather referred to another source, such as the fund's website or prospectus, for more information.

The targeted CD reviews yielded the following key outcomes:

- Marketing, legal and/or compliance departments of fund managers initiated reviews of their current policies and procedures relating to marketing, and conducted training sessions with their staff on sales communications.

---

1 See Part 15 of National Instrument 81-102 *Mutual Funds* (NI 81-102) and Part 13 of National Instrument 41-101 *General Prospectus Requirements*, as well as Parts 2 and 13 of Companion Policy 81-102CP (CP). See also CSA Staff Notice 31-325 - Marketing Practices of Portfolio Managers, OSC Staff Notice 81-716 - 2011 Summary Report for Investment Fund Issuers and the November, 2007, January, 2010 and April, 2012 editions of the Investment Funds Practitioner.

2 As required by section 15.4(1) of NI 81-102.

- Fund Managers committed to more frequent reviews of older marketing materials to ensure they remain in compliance with current requirements and ongoing staff guidance.

- Potentially misleading performance charts in sales communications were removed or replaced with more balanced charts.

- Potentially misleading headlines or slogans were removed from advertisements and marketing materials.

- Standard performance data was moved from the general disclaimer and placed in closer proximity to other performance data in the sales communication.

- Potentially misleading statements were removed from sales communications.

Staff guidance based on our observations from the targeted CD reviews is provided below.

1. WHEN IS A COMMUNICATION A "SALES COMMUNICATION"?

A "sales communication" is defined in NI 81-102.[3] The definition is very broad in terms of the content of the sales communication – it applies to communications that "relate to" mutual funds, fund managers, companies providing services to them, or a number of other entities. A sales communication can include a reference to a specific fund or to a family of funds. Short communications, including tweets or internet banners, can also be sales communications, if one of the purposes of the communication is to induce someone to buy one or more investment funds.

When assessing whether a communication with respect to an investment fund is a "sales communication" we encourage fund managers, whether or not the investment fund is a mutual fund, to look to the definition of "sales communication" in NI 81-102 for guidance. When assessing sales communications of mutual funds and non-redeemable investment funds, Staff will look to the parameters in Part 15 of NI 81-102 to inform our reviews. Staff consider the NI 81-102 principles to serve as best-practice standards for the marketing materials of all types of investment funds.

Branding

If a communication is intended to promote a corporate identity or the expertise of a fund manager, it falls outside the definition of a sales communication. Staff will generally take the view, however, that any time marketing material is about one or more investment funds, it becomes a sales communication and no longer falls within the branding exception.[4]

"For Advisor Use Only"

For marketing directed at dealers, Staff are of the view that labelling the document "for advisor use only" may not be sufficient. Staff also expect, in combination with the statement, a more pro-active effort to restrict broad distribution for any document that is intended to be for internal use and is not designed as a sales communication to a potential investor.

In Staff's view, internal or confidential communications, while not generally considered to be sales communications, should nonetheless be guided by the general parameters in Part 15 of NI 81-102. This is particularly important if distribution of the communication to potential investors may occur, or in instances where dealers and their sales representatives may be relying on the communication to convey information about a particular investment fund to investors.

2. FAIRNESS OF SALES COMMUNICATIONS

When assessing whether a sales communication is fairly presented, Staff will look at the sales communication from the perspective of the retail investor. In Staff's view, the sales communication should be in plain language, and not rely on the use of industry jargon, defined terms, or acronyms not easily understood by retail investors. We expect important facts and risks associated with the investment fund to be clearly outlined and not buried within the disclaimer or fine print.

Warnings, disclaimers and qualifications

In Staff's view, any warnings, disclaimers or qualifications used in sales communications should be consistent with the content of the sales communication, including any headline claims.

[3] See section 1.1 of NI 81-102 and section 2.15 of the CP.

[4] See section 2.15(3) of the CP.

Yield and distributions

We remind fund managers that if a distribution or yield is quantified in a sales communication, the disclosure should specify: the basis of the calculation, the percentage of total distributions comprising reinvested units, whether the yield is calculated based on the net asset value or market price of the fund's securities, the time period covered by the distributions, the key assumptions and the impact of any changes to the key assumptions on the target distribution or yield.[5] In Staff's view, return of capital distributions should not be marketed so as to suggest that they represent investment returns.

3. MISLEADING SALES COMMUNICATIONS

When assessing whether a sales communication of an investment fund may be misleading, Staff generally will consider whether a particular term, phrase, description, illustration or other statement may create an unrealistic expectation or an unjustified sense of safety, particularly from the perspective of the retail investor.

Commodity Pools

For sales communications regarding commodity pools, Staff are of the view that any sales communication must clearly identify the issuer as a commodity pool, and further, must explain how the commodity pool differs from a conventional mutual fund.

In Staff's view, a commodity pool should not be referred to as a mutual fund in sales communications. Commodity pools are a specialized type of mutual fund that use certain alternative investment strategies involving specified derivatives or physical commodities beyond what is permitted by NI 81-102. As a result, the investment returns and investment risks of commodity pools may be significantly different from those of conventional mutual funds.

Benchmarks

We remind fund managers of mutual funds and non-redeemable investment funds to look to Part 15.3 of NI 81-102 in assessing whether a sales communication that compares the fund to a benchmark, investment or ranking may create an unrealistic expectation for the retail investor.

Exaggerated and unsubstantiated claims

We remind fund managers that sales communications should not contain statements that are vague or exaggerated, or that cannot otherwise be verified. For example, Staff would consider statements such as "superior proven performance" or "superior risk adjusted performance" to be both vague (superior to what?) and exaggerated (is the performance repeatable or does it imply certain future returns?).

"Bait and switch"

In Staff's view, sales communications for publicly offered investment funds must convey the attributes and performance of the investment fund that is actually being offered for distribution. If the sales communication highlights the attributes and investment returns of a similar fund offered by the fund manager or an affiliate, but that fund is not available for sale in Canada, we would expect key information about the investment fund that is being offered for distribution to be given equal prominence in the sales communication.

If a sales communication includes a comparison to another investment fund not being offered for distribution by the fund manager, we would expect the sales communication to include: all facts that, if disclosed, could materially alter the conclusions reasonably drawn or implied by the comparison, data for each subject of the comparison for the same time periods, and a clear explanation of any factors necessary to make the comparison fair and not misleading.

Presentation of risk disclosure

In marketing, advertisements and other types of communications, Staff expect that the risks associated with the investment fund will be clearly disclosed and easily visible.

It is critical that the risk disclosure in any sales communication be given equal prominence to disclosure about the potential investment returns and benefits of the fund, and that the tone of the sales communication not detract from the significance of the risks. In Staff's view, if a particular benefit is highlighted in the sales communication, any potential risks associated with the investment strategy in achieving the benefit should also be pointed out.

[5] See the April, 2012 edition of the Investment Funds Practitioner.

If an investment fund has a high level of risk or special risk factors that may not be immediately apparent to the retail investor, Staff are of the view that the sales communication should clearly disclose the nature of these risks. If the investment fund has a particular feature or investment strategy that makes it significantly different from other similar funds, we would expect the sales communication to convey the unique characteristics of the fund, particularly if specific risks are associated with the unique feature.

Client lists and endorsements

In Staff's view, any representative client list included in a sales communication should only include the clients of the fund manager's asset management business, and should not list the clients the fund manager may deal with in another capacity. There should always be some nexus between the representative clients listed in the sales communication and the investment fund that is being promoted. Staff expect that the clients listed should be investors in the same fund that is the subject of the sales communication or in a similar fund.

4. PERFORMANCE DATA

When assessing performance data in sales communications, Staff take the view that placing standard performance data in the disclaimer at the end of the sales communication is not consistent with the spirit and intent of Part 15 of NI 81-102. If standard performance data is provided, Staff expect the standard performance data to be given equal prominence to any other performance data disclosed in the sales communication.

We remind fund managers that standard performance data and general market data used in sales communications should be regularly updated, so as to not become stale or misleading.

Performance Awards

We consider performance awards in sales communications, such as the Lipper or Morningstar awards, to be performance ratings or rankings, which must comply with certain disclosure requirements.[6] Fund managers are reminded to comply with the requirements, or to seek discretionary relief, before using such awards in sales communications.

Staff are of the view that only awards that the investment fund has won should be used in sales communications. If the sales communication refers to an award won more than two years ago, the award must still be relevant to the investment fund's current investment objectives and strategies.

Some awards are not based on fund performance, but rather are awards to the fund manager or portfolio manager. Awards to the fund manager can be referred to in the sales communications of the fund manager's family of funds, provided the award was not for a specific investment fund. When used in a fund's sales communication, the type of award should be clearly disclosed so that it is not confused with an award for fund performance. Staff would expect such details as the name of the award provider, the ranking (if any) and where to go for additional information about the award (including the criteria upon which the award is based) to be included in the sales communication.

Hypothetical data

In Staff's view, investment funds should refrain from using hypothetical data in sales communications intended for retail investors. Our concerns with hypothetical data include:[7]

- there is often little indication that the performance shown is hypothetical;
- retail investors may not have the investment knowledge to fully understand the risks and limitations of the hypothetical performance data; and
- the disclosure does not or cannot adequately describe the underlying methodology and the risks and limitations of the hypothetical performance data in a manner that is clear and easily accessible to the retail investor within the space limitations of the sales communication.

It can be appropriate to present hypothetical performance data in marketing materials for dealers and their sales representatives. In these instances, we expect there to be clear and meaningful disclosure regarding the methodology and assumptions used to calculate the hypothetical performance data, as well as any other relevant factors.

---

[6] See section 15.3(4) of NI 81-102.

[7] See CSA Notice 31-325 - Marketing Practices of Portfolio Managers and OSC Staff Notice 81-716 - 2011 Summary Report for Investment Fund Issuers.

5. ALTERNATIVE MEDIA

Internet advertising can take a variety of forms, including webpages, banner advertisements, video streaming (such as YouTube), discussion forums, social networking and micro-blogging (such as Twitter).

We encourage fund managers to consider the appropriateness of certain new media formats if content limitations prevent the fund manager from providing clear, accurate and balanced messages in the sales communication or insert the required warning language. In Staff's view, warning language must be visible on the same page as the sales communication or within "one click". Some internet sites provide lengthy disclaimers that scroll quickly. Staff expect that all information, including disclaimers, should be easily comprehensible to the retail investor on their first viewing of the advertisement.

CONCLUSION

We recognize the importance of sales communications to a fund manager's business. While a certain degree of creativity is to be expected, Staff remind fund managers to be mindful of the target audience for marketing and advertisements, particularly when it's the retail investor. In addition to the requirement that sales communications be technically compliant with existing requirements, we expect that they also conform with the spirit and intent of the rules as outlined in this guidance and other staff publications. Staff will continue, in the normal course of our prospectus reviews and on a targeted basis, to review the sales communications of publicly offered investment funds.

We encourage fund managers to consider the guidance in this notice when preparing sales communications for investment funds.

Questions may be referred to:

Sarah Oseni
Senior Legal Counsel
Investment Funds Branch
(416) 593-8138
soseni@osc.gov.on.ca

Vera Nunes
Manager
Investment Funds Branch
(416) 593-2311
vnunes@osc.gov.on.ca