



Canadian Foundation *for*
Advancement *of* Investor Rights

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RE: Notice and Request for Comment - Implementation of Stage 2 of Point of Sale Disclosure for Mutual Funds

FAIR Canada is pleased to offer comments on the CSA's Notice and Request for Comment on Implementation of Stage 2 of Point of Sale Disclosure for Mutual Funds, Proposed Amendments to National Instrument 81-101 *Mutual Fund Prospectus Disclosure*, Form 81-101F3 and Companion Policy 81-101CP *Mutual Fund Prospectus Disclosure* and Consequential Amendments (the "Proposed Amendments") published as (2011) 34 OSCB 8561 on August 12, 2011 (the "Notice").

FAIR Canada is a national, non-profit organization dedicated to putting investors first. As a voice of Canadian investors, FAIR Canada is committed to advocating for stronger investor protections in securities regulation. Visit www.faircanada.ca for more information.

FAIR Canada Comments and Recommendations – Executive Summary:

1. It appears that the Canadian Securities Administrators (the "CSA") has lost sight of the core objective of Fund Facts. The point of sale initiative was originally aimed at providing investors with more meaningful and effective disclosure and was held out to be a significant investor protection initiative. The purpose of the point of sale disclosure framework was to provide a plain language document that would assist investors in their decision-making process prior to purchasing a mutual fund.
2. The Proposed Amendments will require delivery of the Fund Facts within two days of being sold a mutual fund. The Proposed Amendments will also permit the delivery of the Fund Facts to satisfy the current prospectus delivery requirements under securities legislation.

3. FAIR Canada does not support the proposed amendments to NI 81-101 to allow delivery of the Fund Facts to satisfy the prospectus delivery requirements at this stage. Not only are we concerned that the Fund Facts document is flawed, but we also view the prospectus to provide important information that is not available in Fund Facts. Fund Facts is not intended to be a comprehensive disclosure document; instead, it is meant to highlight key information that is important to investors, including objectives of the fund, past performance, risks and the costs of investing in a mutual fund. We suggest that the CSA should only consider permitting the Fund Facts to satisfy the simplified prospectus requirements after the defects have been remedied and the document is required to be provided at or before the point of sale.
4. Similarly, we do not support the CSA's consideration of applications for exemptive relief to permit the early use of the Fund Facts document to satisfy the current prospectus delivery requirements. FAIR Canada strongly believes that the CSA should not have allowed for substituted delivery prior to a full public consultation, given that prospectus delivery is an obligation under provincial securities laws and is fundamental to investor rights. In so doing, the CSA is permitting a use of the Fund Facts document for which it was not intended or designed.
5. Fund Facts was never intended to be delivered after the point of sale – it was intended to be provided to investors “when they need it most – before they make their decision to invest”. FAIR Canada disagrees that provision of the Fund Facts following the purchase of a mutual fund would be considered to be “at a time that is relevant to their investment decision.”
6. FAIR Canada views the current version of the Fund Facts document to be deficient in several respects. We urge the CSA to address these issues as soon as possible, given that Fund Facts are already being delivered to mutual fund investors under exemptions granted by securities regulators. We are very concerned that the CSA is ignoring serious flaws in the current iteration of the Fund Facts document at the same time it is proposing changes which will decrease the amount of information provided to investors.

In particular, we are concerned with the following Fund Facts information:

- a) Deficient risk disclosure;
 - b) Lack of benchmark information;
 - c) Inadequate conflicts of interest provision; and
 - d) Lack of currency and hedging policies.
7. A key facts document should be developed for other investment fund products, including structured products, ETFs (including leveraged, inverse and commodity ETFs), and listed funds within six to twelve months.

1. Fund Facts cannot and should not replace delivery of simplified prospectus

- 1.1. **FAIR Canada does not support the proposed amendments to NI 81-101 to allow delivery of the Fund Facts document to satisfy the prospectus delivery requirements. Not only are we concerned that the Fund Facts document is flawed, but we also view the simplified prospectus to provide important information that is not available in the Fund Facts.** Fund Facts is not intended to be a comprehensive disclosure document; instead, it is meant to highlight key information that is important to investors, including objectives of the fund, past performance, risks and the costs of investing in a mutual fund. While a simplified prospectus is required under

the provincial Securities Acts to provide **full, true and plain disclosure of all material facts**, there is no similar requirement of Fund Facts.

- 1.2. FAIR Canada believes that the Fund Facts must be improved before investors are encouraged to rely on it in place of existing protections. Recognizing that many investors may not use the information in the simplified prospectus, we believe that the simplified prospectus continues to be the only disclosure document that contains all the information investors need to assess a particular product. If the information contained in the simplified prospectus is in a format or language that is inaccessible to most investors, consideration should be given to changes that could be made to make the simplified prospectus more investor-friendly and useful.
- 1.3. According to the Ontario Securities Commission’s Investor Advisory Panel (the “IAP”),

While not widely read, the simplified prospectus remains an essential tool for investors that mutual funds should be required to deliver to their investors. Once the Fund Facts document is strengthened, removing the requirement to provide the simplified prospectus could then be considered. Mutual funds should further simplify the prospectus and move from laundry list and boiler-plate disclosure to more meaningful and more easily understood essential information.¹
- 1.4. We agree that the Fund Facts document does not contain sufficient information to substitute it for delivery of the simplified prospectus. Delivery of Fund Facts should not replace the requirement to deliver a simplified prospectus. Additionally, FAIR Canada feels strongly that the requirement to deliver a simplified prospectus under provincial securities laws is a major policy change and should not be supplanted without a full public consultation and legislative amendments.
- 1.5. **FAIR Canada strongly suggests that Fund Facts not be permitted to satisfy the prospectus delivery requirements until 1) Fund Facts deficiencies are remedied; and 2) Fund Facts are required to be delivered at or before the point of sale.**
- 1.6. FAIR Canada does not support the CSA’s consideration of applications for exemptive relief to permit the early use of the Fund Facts to satisfy the current prospectus delivery requirements. We sent a letter to the CSA stating our opposition and urging the CSA to suspend such considerations until the concerns and interests of retail investors were solicited and provided due consideration.² FAIR Canada firmly believes that the CSA should not have allowed for substituted delivery prior to a full public consultation, given that simplified prospectus delivery is an obligation under provincial securities laws and is fundamental to investor rights.
- 1.7. **FAIR Canada recommends that a mutual fund’s simplified prospectus continue to be provided to investors either at the point of sale or with the trade confirmation. Eliminating the simplified prospectus delivery requirements runs counter to fundamental principles of securities regulation.**

2. Fund Facts should be delivered prior to or at the point of sale

- 2.1. FAIR Canada strongly opposes the proposal to require delivery of the Fund Facts within two days of being sold a mutual fund. Investors should receive the Fund Facts prior to or at the point of sale. Principle 2 under IOSCO’s Point of Sale consultation is “[k]ey information should be delivered, or made available, for free, to an investor before the point of sale, so that the investor has the

¹ See the OSC’s Investor Advisory Panel’s submission on the OSC’s draft Statement of Priorities, online:

² See FAIR Canada letter to Bill Rice dated July 27, 2011, online: <http://faircanada.ca/content/uploads/2011/07/110727-Letter-to-Rice-et-al-re-FF-final1.pdf>.

opportunity to consider the information and make an informed decision about whether to invest.”³

- 2.2. **It is clear from the original Point of Sale consultation document issued by the Joint Forum in 2003⁴ that the Fund Facts (then called the fund summary document) were only intended to be used “during the sales process” and were never envisioned to be provided following an investment decision, much less as a replacement for disclosure through prospectus delivery after being sold a mutual fund. The purpose of Fund Facts was to provide the information before investors make their decision to buy.**
- 2.3. **In the Joint Forum Proposed Framework 81-406⁵, the Fund Facts document was to be delivered “when [investors] need it most – before they make their decision to invest”. Under the Proposed Amendments, the focus is now on “a time that is relevant to their investment decision.” Despite the weakening of the language, we would still disagree that any time following the sale is a time relevant to an investor’s decision, since the decision has already been made. Fund Facts testing by the OSC has confirmed that “[i]nvestors want to receive [Fund Facts] before they make a decision to invest in a fund...”⁶ and that “[i]t would not be useful to receive [Fund Facts] after the sale.”⁷**
- 2.4. FAIR Canada is concerned that the introduction of Fund Facts as a document which is delivered following an investment decision could create the perception that it is intended to be a disclosure-type document for the purpose of protecting issuers and sales representatives, rather than a tool intended to be used to inform purchase decisions. Investors will be much less likely to review the Fund Facts critically if they have already purchased the mutual funds.
- 2.5. Given the reliance retail investors place on the individuals who provide them with advice, receiving the Fund Facts at or prior to the point of sale is essential for the document to be used as intended. Once the investor has had a recommendation provided to him or her and made an investment decision, they will not be able to use the Fund Facts document to inform their decision. Furthermore, it is expected that confirmation bias will affect the investor’s reading of the Fund Facts document after the investment decision has been made, thus rendering it useless for its intended purpose.
- 2.6. If the CSA’s intention in staging the implementation was to evaluate investors’ use and understanding of the document as it was intended to be used, we submit that this may not be possible, given that investors will use the document differently (if at all) following their investment decision as compared with the time at which they need it most – before they make their decision to invest.

³ Technical Committee of the International Organization of Securities Commissions, “Principles on Point of Sale Disclosure - Consultation Report” (November 2009), online: <<http://www.iosco.org/library/pubdocs/pdf/IOSCOPD310.pdf>>, Principle 1 (Key Information) at 25.

⁴ Joint Forum of Financial Market Regulators, “Consultation Paper 81-403: Rethinking Point of Sale Disclosure for Segregated Funds and Mutual Funds” (February 13, 2003), online: <http://www.jointforum.ca/en/init/point_of_sale/final%20consultation%20paper%20with%20appendices%20E.pdf>.

⁵ Joint Forum of Financial Market Regulators, “Proposed framework 81-406: Point of sale disclosure for mutual funds and segregated funds” (June 15, 2007), online: <http://www.jointforum.ca/en/init/point_of_sale/proposed_framework_81-406.pdf>.

⁶ Research Strategy Group, “Fund Facts Document Research – Report” (October 25, 2006), online: <http://www.jointforum.ca/en/init/point_of_sale/Appendices_4-5.pdf> at 141 (Appendix 5).

⁷ *Supra* note 6 at 197.

3. Fund Facts deficiencies need to be remedied

- 3.1. FAIR Canada fully supports the concept of a concise, meaningful, plain language document that highlights the key information investors need to make informed investing decisions. However, FAIR Canada views the current version of the Fund Facts document to be deficient in several respects. We urge the CSA to address these issues as soon as possible, given that Fund Facts are already being delivered to mutual fund investors under exemptions granted by securities commissions. We are very concerned that the CSA is ignoring serious flaws in the current iteration of the Fund Facts document at the same time it is proposing changes which will decrease the amount of information provided to investors.

Risk Disclosure

- 3.2. FAIR Canada is concerned that, as it is currently being presented, the risk scale on most mutual fund products' Fund Facts only captures volatility risk and does not explain what the scale means or how to use it. We are also wary that the current risk disclosure requirements produce inconsistent results between funds. The CSA has not proposed a uniform methodology for calculating risk, leaving this task up to individual fund managers to self-determine their risk rating.
- 3.3. **FAIR Canada questions how regulators can effectively delegate the development of a methodology for risk disclosure to an industry lobby group in a non-public document.** In practice, many fund companies state that the risk rating provided for a particular fund is calculated based on a non-public methodology provided by the Investment Funds Institute of Canada ("IFIC"), the fund industry's lobbyist, which was developed without public consultation. IFIC's methodology, developed outside of securities regulation and without investor input, only measures volatility risk, measured as the three-year standard deviation of returns. Given that mutual fund investors are encouraged to invest for the long term, a three-year standard deviation may not even adequately capture the volatility of a particular fund. Industry studies have demonstrated that even the IFIC methodology can be unreliable and inconsistent between funds.
- 3.4. Other fund managers used different methodologies, resulting in more inconsistent risk ratings. As stated by Ken Kivenko in Canadian MoneySaver (Oct. 2011), "The lack of a regulated standard risk assessment methodology between firms prevents investors from robustly comparing funds between mutual fund manufacturers and goes against the goal of allowing comparability".
- 3.5. According to IOSCO's Principle 1, "[r]isk disclosure should include the material risks for the product. This may include performance risk/volatility, credit risk, liquidity risks and operational risks."⁸
- 3.6. FAIR Canada views the CSA's approach with respect to risk ratings to be a dangerous one. We continue to suggest that the CSA follow the approach taken by other leading jurisdictions and set a standard methodology, for example as was prescribed by the Committee of European Securities Regulators in CESR/10-673⁹, and adopt the principles and best practices for point of sale disclosure of IOSCO.
- 3.7. Fund Facts are intended to allow investors to compare different funds, so it would only make sense to have a prescribed risk rating methodology, developed through the public consultation process. In order to compare funds, there must be one prescribed methodology. To arrive at the

⁸ *Supra* note 3 at 24.

⁹ Committee of European Securities Regulators, "CESR's guidelines on the methodology for the calculation of the synthetic risk and reward indicator in the Key Investor Information Document (1 July 2010), online: <<http://www.cesr.eu/popup2.php?id=6961>>.

best methodology, or arrive upon a single methodology, a process which involves public consultation must be followed. It is also essential that Fund Facts provide guidance on how to interpret the scale, which would only be meaningful if a uniform methodology were imposed.

- 3.8. The OSC is currently undertaking a focused review of the investment risk classification methodology in the simplified prospectus to see whether the prospectus disclosure is adequate and whether the investment risk classifications are appropriate¹⁰. FAIR Canada suggests that this review (a) would not be as critically necessary had the CSA prescribed one methodology at the outset and (b) should be completed before disclosure to investors is decreased through proposed Stage 2. **It is imperative that the risk of a mutual fund not be misleading, and be clearly described to investors before they make a decision to invest.**
- 3.9. The IAP has stated that “Fund Facts uses a vague low to high risk measure self-assessed by the fund sponsor that means little to the average investor. Investors need a concrete, specific measure such as the worst quarterly/annual loss in the previous 10 years.”¹¹ **Investors want to know how much money they can lose.** FAIR Canada agrees with the IAP that risk should also be presented as the worst one-month, three-month and twelve-month performance of the fund or category of funds during the previous ten years, as **investors tend to view risk to be the amount of money they stand to lose.**
- 3.10. Additionally, we would suggest that risk information be presented on the Fund Facts document prior to historical performance information. Given that historical performance is not a good indication of future performance, we view the risk disclosure to be much more important information, and it should thus precede performance information. We note that Fund Facts does not follow IOSCO’s arrangement of locating risk disclosure ahead of performance on disclosure documents.¹²

Benchmarks

- 3.11. **Benchmarks should be required to be provided in the Fund Facts document. Benchmarks would allow investors to compare the fund’s historical rate of return to the performance of a relevant benchmark or a risk-free rate of return such as GICs or Canadian Government bonds, which would provide context in assessing its historical performance.**
- 3.12. In addition, a warning should also be included in the past performance information, stating that past performance is not a useful predictor of future returns, instead of the less-clear statement that “[l]ike most mutual funds, this fund doesn’t have any guarantees.” IOSCO requires that past performance disclosures should include a “warning that historical performance is not an indicator of future performance”¹³.
- 3.13. According to the IAP, “[f]und returns compared to returns of sub-groups and of a larger industry benchmark such as the main market index are the most meaningful and impactful performance measures for investors. Industry protestations that such information is difficult to provide are simply not credible.” We agree.
- 3.14. FAIR Canada believes that benchmarks are essential to providing a framework within which investors can assess the relative performance of a given fund, and its associated risk (since different benchmarks will have different levels of risk (five year GIC versus S&P/TSX Composite

¹⁰ OSC Staff Notice 81-716, “2011 Summary Report for Investment Fund Issuers”, online: <http://www.osc.gov.on.ca/en/SecuritiesLaw_sn_20111104_81-716_sum-rpt-ifi.htm>.

¹¹ *Supra* note 1.

¹² *Supra* note 3 at 24.

¹³ *Supra* note 3 at 24.

Index for example)) and make a more informed decision financial decision about whether to purchase it or not.

Conflicts of interest disclosure

- 3.15. The Fund Facts document should disclose any conflict of interest that could give the intermediary (the broker-dealer or bank, for example) or its salespersons a financial incentive to sell a particular fund over others. Principle 1 of IOSCO’s Principles on Point of Sale Disclosure states: “Key information should include disclosures that inform the investor of the fundamental benefits, risks, terms and costs of the product and the **remuneration and conflicts associated with the intermediary through which the product is sold.**” The SEC Fund Summary Prospectus explicitly provides this important disclosure and is a good example of adherence to IOSCO principles and best practices:

Payments to Broker-Dealers and Other Financial Intermediaries. If you purchase the Fund through a broker-dealer or other financial intermediary (such as a bank), the Fund and its related companies may pay the intermediary for the sale of Fund shares and related services. These payments may create a conflict of interest by influencing the broker-dealer or other intermediary and your salesperson to recommend the Fund over another investment. Ask your salesperson or visit your financial intermediary’s Web site for more information.

- 3.16. The Fund Facts document is evasive, and only says “[i]nvestment firms may pay part of the trailing commission to their representative.” Any prospective conflict of interest should be made clear for Canadians.
- 3.17. FAIR Canada therefore recommends that clear language be provided in the Fund Facts document to explicitly state that either (a) there is no payment of a trailing commission; or (b) there is a trailing commission paid (and disclose the percentage or amount) which creates a conflict of interest and which may influence the broker-dealer or other intermediary and the salesperson to recommend that fund over another investment. The amount of trailing commissions for various funds is advertised to registrants in newspaper advertisements, so the disclosure about the payment of a trailing commission creating a conflict of interest and the amount of the commission should be made clear to Canadian investors in the Fund Facts document. Consumers have a right to know the dollar amount of the trailing commission since it is a commission which they are paying to the salesperson who recommends the fund to them.

Currency and hedging policies

- 3.18. FAIR Canada also believes it is important to add a requirement for mutual funds to state their hedging policy and whether they have significant exposure to currency fluctuations. Exposure to currency fluctuations can have a very significant impact on the performance of a fund.

4. Other investment fund products

- 4.1. FAIR Canada also believes that the CSA should immediately begin to expand its point of sale disclosure initiative to other investment fund products, including ETFs, structured products, CFDs, and closed-end funds. The initial point of sale initiative has been drawn out far too long and we do not want to wait another decade for point of sale disclosure for other products. If the CSA cannot agree on a proposal within six to twelve months, we suggest that individual commissions like the OSC and the AMF proceed with an Ontario and/or Québec proposal.

We thank you for the opportunity to provide our comments and views in this submission. We welcome its public posting and would be pleased to discuss this letter with you at your convenience. Feel free to contact Ermanno Pascutto at 416-572-2282/ ermanno.pascutto@faircanada.ca or Marian Passmore at 416-572-2728/ marian.passmore@faircanada.ca.

Sincerely,

A handwritten signature in blue ink, appearing to read "Ermanno Pascutto".

Canadian Foundation for Advancement of Investor Rights