

## CSA Notice and Request for Comment

### Implementation of Stage 2 of Point of Sale Disclosure for Mutual Funds

#### *Draft Regulation to Amend Regulation 81-101 respecting Mutual Fund Prospectus Disclosure*

#### *Draft Amendment to Policy Statement to Regulation 81-101 respecting Mutual Fund Prospectus Disclosure*

#### and Consequential Amendments

August 12, 2011

#### Introduction

The members of the Canadian Securities Administrators (the CSA or we), are publishing for a comment period of 90 days a draft Regulation to amend *Regulation 81-101 respecting Mutual Fund Prospectus Disclosure* (Regulation 81-101), including Form 81-101F3 *Contents of Fund Facts Document* and draft amendments to *Policy Statement to Regulation 81-101 respecting Mutual Fund Prospectus Disclosure* (the Proposed Amendments).

The Proposed Amendments, together with consequential amendments, set out Stage 2 of the CSA's implementation of the point of sale disclosure framework published in October 2008 by the Joint Forum of Financial Market Regulators (the Joint Forum), which includes the CSA.<sup>1</sup>

The Fund Facts document (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 that is important to investors, including past performance, risks and the costs of investing in a mutual fund. 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.

The Proposed Amendments will require delivery of the Fund Facts within two days of buying 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. Although delivery of the simplified prospectus will no longer be required, it will continue to be available to investors upon request.

This is an important step in the implementation of this investor-focused initiative. We think delivery of the Fund Facts would provide investors with access to key information about a mutual fund, in language they can easily understand, at a time that is relevant to their investment decision.

Prior to implementing the Proposed Amendments, some jurisdictions may require legislative amendments to preserve an investor's right to withdraw from a purchase within two business days after receiving the Fund Facts and to claim damages or to rescind the purchase if the investor does not receive the Fund Facts.

The CSA remains committed to implementing point of sale disclosure for mutual funds. A staged implementation allows us to make the Fund Facts available to investors and market participants sooner, while we continue to consult with stakeholders and consider the issues a large number of commenters have raised related to point of sale delivery for mutual

<sup>1</sup> 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.

funds and the applicability of the point of sale regime to other types of publicly offered investment funds.

The text of the amendments follows this Notice and is available on the websites of members of the CSA. We are also making consequential amendments to *Regulation 81-102 respecting Mutual Funds*.

We expect the Proposed Amendments and consequential amendments to be adopted in each jurisdiction of Canada. In some jurisdictions, legislative amendments may need to be sought and enacted prior to implementing the Proposed Amendments and consequential amendments.

## **Background**

Concurrently with the Joint Forum's publication of the framework in October, 2008, we published CSA Notice 81-318 *Request for Comment Framework 81-406 Point of Sale Disclosure for Mutual Funds and Segregated Funds* seeking feedback from all stakeholders on issues related to implementation of the framework and its principles. The CSA considered these comments in developing its proposed amendments, which were published on June 19, 2009.

These amendments were aimed at implementing all of the elements of the point of sale disclosure regime set out in the framework, including the new Fund Facts, pre-sale delivery options, investor rights and the regulatory requirements for preparing, filing and delivering the Fund Facts.

The comments showed that stakeholders generally agreed with the benefits of providing investors with a more meaningful and simplified form of disclosure, and supported the Fund Facts as a way of providing concise, plain language information that describes key elements of the mutual fund under consideration. However, we received significant comments related to operational and compliance concerns with point of sale delivery for mutual funds. A large number of commenters also asked the CSA to implement a point of sale disclosure regime for other types of publicly offered investment funds and other securities at the same time as mutual funds.

Consequently, on June 16, 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 point of sale disclosure framework in three stages.

Stage 1 was completed on January 1, 2011 when amendments to Regulation 81-101 came into force. These amendments, published on October 6, 2010, require mutual funds subject to Regulation 81-101 to produce and file the Fund Facts and for it to be available on the mutual fund's or mutual fund manager's website. The Fund Facts must also be delivered or sent to investors free of charge upon request.

Stage 2, now underway, proposes amendments to Regulation 81-101 to allow delivery of the Fund Facts to satisfy the current prospectus delivery requirements under securities legislation to deliver a prospectus within two days of buying a mutual fund.

The Staff Notice also specified that, while work on Stage 2 is underway, the CSA would consider applications for exemptive relief to permit the early use of the Fund Facts to satisfy the current prospectus delivery requirements. On February 24, 2011, we published CSA Staff Notice 81-321 *Early Use of the Fund Facts to Satisfy Prospectus Delivery Requirements*, which provides guidance on key terms and conditions that the CSA will look for when considering these types of applications. One such condition is that any exemptive relief granted will include a 'sunset clause', in recognition of the public comment process.

Once the CSA has completed its review and consideration of the issues related to point of sale delivery, in Stage 3 the CSA will publish for further comment any proposed requirements that would implement point of sale delivery for mutual funds. As part of Stage 3, we will consider point of sale delivery for other types of publicly offered investment funds.

As the CSA's implementation of the point of sale disclosure framework continues to progress, we should achieve the Joint Forum's vision for the point of sale disclosure regime described in the framework. This vision focuses on three principles:

- 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 standards on point of sale disclosure and delivery, which we consider essential to the continued success of the Canadian mutual fund industry.

You can find additional background information and other Joint Forum publications on the topic of point of sale disclosure for mutual funds and segregated funds on the Joint Forum website at [www.jointforum.ca](http://www.jointforum.ca) and on the websites of members of the CSA.

### **Substance and Purpose of the Proposed Amendments**

We know that many investors do not use the information in the simplified prospectus because they have trouble finding and understanding the information they need. Research on investor preferences for mutual fund information, including our own testing of the Fund Facts, indicates investors prefer to be offered a concise summary of key information.<sup>2</sup> Financial literacy research further reinforces the need for clear and simple disclosure.

The CSA designed the Fund Facts to make it easier for investors to find and use key information. The format provides investors with basic information about the mutual fund, followed by a concise explanation of mutual fund expenses and fees, adviser compensation and the investor's rights. Introductory text specifies that more detailed information about the mutual fund is available in its simplified prospectus.

While the CSA agrees that further review and consideration of issues related to point of sale delivery for mutual funds is necessary, we also think that it would be beneficial for the Fund Facts to be made available to investors and market participants as soon as possible.

The Proposed Amendments and consequential amendments should enhance investor protection by providing investors with the opportunity to make more informed investment decisions. Investors will be able to review key information about the potential benefits, risks and costs of investing in a mutual fund in an accessible format at a time that is relevant to their investment decision. We also think familiarity with the Fund Facts may assist investors in their decision-making process and in discussions with advisers, and highlight for investors who may want more detail where they can find further information about the mutual fund.

The Proposed Amendments and consequential amendments are not intended to detract from a dealer's existing obligation to 'know your client' and to determine suitability of all purchases of mutual funds. We expect dealers and their representatives will continue to conduct due diligence reviews, including a review of the simplified prospectus, to properly

<sup>2</sup> You can find a list of the research, studies and other sources that the Joint Forum reviewed and relied on in developing the point of sale disclosure framework in Appendix 4 to the proposed framework (the proposed Framework), published in June 2007. The proposed Framework is available on the Joint Forum website and on the websites of members of the CSA. The *Fund Facts Document Research Report* prepared by Research Strategy Group can be found in Appendix 5 to the proposed Framework.

discharge their 'know your product' obligations.<sup>3</sup> We anticipate that dealers will use the Fund Facts as a tool in making investment recommendations.

## **Summary of the Proposed Amendments**

### **Application**

The Proposed Amendments and consequential amendments apply only to mutual funds subject to Regulation 81-101.

### **Delivery of Fund Facts instead of the simplified prospectus**

Currently, under Regulation 81-101, the requirement under securities legislation to deliver a prospectus of a mutual fund may be satisfied by delivery of the simplified prospectus. The Proposed Amendments will require delivery of the Fund Facts in all instances where the prospectus would otherwise be required to be delivered. The most recently filed Fund Facts for the applicable class or series of securities of the mutual fund will be required to be delivered and will satisfy the current prospectus delivery requirements under securities legislation.

The Proposed Amendments will restrict the documents that may be attached to, or bound with, the Fund Facts on delivery.

We have not made any changes to a mutual fund's obligation to file its simplified prospectus and annual information form with the CSA. These documents will continue to be made available to investors on a website and upon request, at no cost.

The delivery provisions in the Proposed Amendments are drafted to reflect current differences in the legislative authority of members of the CSA. While drafting may differ among the members of the CSA, each jurisdiction will achieve the same outcome of requiring delivery of the Fund Facts to satisfy legislative requirements to deliver the prospectus. Prior to implementing the Proposed Amendments, legislative amendments may be sought and enacted in some jurisdictions to achieve a harmonized provision.

### **Effect on Investor rights**

#### **Right for failure to deliver the Fund Facts**

If the Fund Facts is to be delivered instead of the simplified prospectus, as noted previously some jurisdictions may require legislative amendments in order to preserve an investor's right to damages or to rescind the purchase if the investor does not receive the Fund Facts.

#### **Right for withdrawal of purchase**

If the Fund Facts is to be delivered instead of the simplified prospectus, some jurisdictions may require legislative amendments in order to preserve an investor's right to withdraw from the purchase within two business days after receiving the Fund Facts.

#### **Right for misrepresentation**

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

<sup>3</sup> For further guidance, see CSA Staff Notice 33-315 *Suitability Obligation and Know Your Product*.

### **Amendments to Fund Facts**

We are proposing minor edits and clarifications to Form 81-101F3 *Contents of Fund Facts Document* at this time. For example, we have clarified that all fees and expenses payable directly by the investor when buying, holding, selling or switching units or shares of the mutual fund must be disclosed in the Fund Facts. We have also introduced the option of the mutual fund to include the fund code for the class or series.

As the CSA moves forward with its review and consideration of the issues related to point of sale delivery for mutual funds, we intend to seek further feedback on the content of the Fund Facts, in particular the presentation of risk and the inclusion of a benchmark.

### **No change to filing requirements**

The filing requirements related to the Fund Facts have not changed. The Fund Facts must continue to be filed concurrently with the mutual fund's simplified prospectus and annual information form. The certificate for the mutual fund, which verifies the disclosure in the simplified prospectus and annual information form, applies to the Fund Facts just as it applies to all documents incorporated by reference into the simplified prospectus.

If a material change to the mutual fund relates to a matter that requires a change to the disclosure in the Fund Facts, an amendment to the Fund Facts must be filed. If managers want to provide more current information in the Fund Facts, they may choose to amend the Fund Facts at any time. In all instances, an amendment to a mutual fund's Fund Facts must be accompanied by an amendment to the mutual fund's annual information form.

Any Fund Facts filed after the date of the simplified prospectus is intended to supersede the Fund Facts previously filed. Once filed, the Fund Facts must be posted to the mutual fund's or the mutual fund manager's website.

### **Alternatives Considered**

The earlier publications by the Joint Forum outlined the alternatives we considered, as members of the Joint Forum, in developing the point of sale disclosure regime for mutual funds contemplated by the Proposed Amendments. These publications also set out the pros and cons to each alternative. You can find these documents on the Joint Forum website and on the websites of members of the CSA.

### **Anticipated Costs and Benefits**

We think that allowing delivery of the Fund Facts instead of the simplified prospectus to satisfy the current prospectus delivery requirements under securities legislation would benefit both investors and the capital markets by helping to begin to 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. We also know that many investors do not use the information in the simplified prospectus because they have trouble finding and understanding the information they need.<sup>4</sup> The CSA designed the Fund Facts to make it easier for investors to find and use key information. Providing investors with basic information about a mutual fund at a time that is relevant to their investment decision should help bridge this information gap.

The earlier publications by the Joint Forum and CSA outlined some of the anticipated costs and benefits of implementation of the point of sale disclosure regime for mutual funds contemplated by the framework. We consider the costs and benefits set out in the CSA's June 2009 proposals to still be valid. Overall, we continue to believe that the potential benefits of

<sup>4</sup> See footnote 2 for where to find a list of the research, studies and other sources that the Joint Forum reviewed and relied on in developing the point of sale disclosure framework.

the changes to the disclosure regime for mutual funds as contemplated by the Proposed Amendments are proportionate to the costs of making them.

You can find these documents on the Joint Forum website and on the websites of members of the CSA.

### **Consequential Amendments**

#### **National amendments**

Proposed amendments to *Regulation 81-102 respecting Mutual Funds* are published with this Notice.

#### **Local rule amendments**

If necessary, we propose to amend elements of local securities legislation, in conjunction with the implementation of the Proposed Amendments. The provincial and territorial securities regulatory authorities may publish these proposed local changes separately in their jurisdictions. These local changes may be to rules or to statutes. If statutory amendments are necessary in a jurisdiction, these changes will be initiated and published by the local provincial government.

Proposed consequential amendments to rules or regulations in a particular jurisdiction or publication requirements of a particular jurisdiction are set out in an annex to this Notice published in that particular jurisdiction.

Some jurisdictions may need to modify the application of the Proposed Amendments using a local implementing rule. Jurisdictions that must do so will separately publish the implementing rule.

#### **Unpublished Materials**

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

#### **Request for Comments**

We would like your input on the Proposed Amendments and consequential amendments. To allow for sufficient review, we are providing you with 90 days to comment. While we recognize that stakeholders may have an interest in commenting more broadly on other aspects of the point of sale disclosure regime, at this time we are seeking feedback only on the amendments contemplated by the Proposed Amendments.

#### **Deadline for Comments**

Your comments must be submitted in writing by **November 10, 2011**.

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. All comments will be posted on the OSC website at [www.osc.gov.on.ca](http://www.osc.gov.on.ca).

Please send your comments electronically in Word, Windows format.

#### **Where to Send Your Comments**

Please address your comments to the following CSA members:

British Columbia Securities Commission  
Alberta Securities Commission  
Saskatchewan Financial Services Commission

Manitoba Securities Commission  
 Ontario Securities Commission  
 Autorité des marchés financiers  
 New Brunswick Securities Commission  
 Registrar of Securities, Prince Edward Island  
 Nova Scotia Securities Commission  
 Superintendent of Securities, Newfoundland and Labrador  
 Superintendent of Securities, Northwest Territories  
 Superintendent of Securities, Yukon  
 Superintendent of Securities, Nunavut

Please send your comments **only** to the addresses below. Your comments will be forwarded to the other CSA members.

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### Questions

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The text of the Proposed Amendments and consequential amendments follows or is available on the websites of members of the CSA.