



INVESTMENT INDUSTRY ASSOCIATION OF CANADA  
ASSOCIATION CANADIENNE DU COMMERCE DES VALEURS MOBILIÈRES

October 5, 2007

Mr. Neil Mohindra, Acting Policy Manager  
Joint Forum Project Office  
5160 Yonge St.  
Box 85, 17<sup>th</sup> Floor  
North York, Ontario M2N 6L9

Dear Mr. Mohindra:

**Re: Proposed Framework 81-406; Point of sale disclosure for mutual funds and segregated funds (Proposed Framework)**

Thank you for providing us with the opportunity to comment on the Proposed Framework. The Investment Industry Association of Canada (IIAC or Association) is the professional association representing over 200 investment dealers in Canada. Our mandate is to promote efficient, fair and competitive capital markets for Canada and assist our member firms across the country.

Our members represent a major distribution channel for the mutual fund industry. In 2006, the securities industry generated \$1.97 billion in revenue from mutual fund sales. This represents 32% of industry commissions and 12% of total brokerage industry revenues.<sup>1</sup> Furthermore, of the \$900 billion in assets our members manage on behalf of retail clients, over \$200 billion is invested in mutual funds.<sup>2</sup> It is clear then, that our members have a strong interest in the Proposed Framework.

The Association generally supports the Joint Forum's initiative to create a meaningful, more simplified form of disclosure for mutual fund and segregated fund investors. On behalf of our members, however, we would like to express concerns with some of the proposals surrounding the Fund Facts document and its delivery, which are outlined below.

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<sup>1</sup> IIAC, Securities Industry Performance Report Q4 2006.

<sup>2</sup> Investor Economics.

## Methods of Delivery

The IIAC has a number of issues with the current proposal with respect to the method of delivery which is extremely limited and is not practical for our members or investors. The IIAC suggests that delivery options be made more flexible so that it does not dramatically affect how our members operate and investors are serviced.

### *Delivery Options: Mail Only*

The Proposed Framework document suggests that the methods of delivery of the Fund Facts document could be by hand, by fax, by mail or electronically. However, our members conduct a significant amount of transactions over the phone and investors will not appreciate that before they can proceed with their transaction, they must wait for the Fund Facts to be mailed/faxed/e-mailed to them and the dealer then has to ensure that it has been brought to the attention of the investor.

More importantly, a number of our members have indicated that they have internal policies that prohibit the distribution of client documents via e-mail. These policies are in place to safeguard clients from on-line fraud, particularly where individuals are asked to provide their account numbers and/or log-on using a password. To ensure that clients are not exposed to these frauds, many members tell their clients that they never e-mail documents unless, for example, clients have asked to receive their statements online. Even in those situations, clients would receive an e-mail stating that their account statement is waiting for them, but would then have to sign on to the member's secure website to access it. However, in this situation the information is not time sensitive. Similarly, some members have chosen not to transmit client documents via fax because that too, presents security concerns. For example, client fax numbers may change or be given incorrectly to the adviser causing advisers to inadvertently send documents to unintended parties.

This therefore means that for firms that conduct a large part of their business over the phone or via the internet rather than in person, the Fund Facts document would have to be sent by regular mail to clients. Regular mail delivery takes between 1 to 5 days and impairs the client's ability to transact on a timely basis. Clients who do not meet their adviser in person therefore, are disadvantaged with respect to receipt of the Fund Facts document. Further, many clients are price sensitive and time sensitive and when they call their adviser, expect their trade to be executed immediately. This of course, can have serious implications during fast moving markets. For example, one firm indicated that during the market down-turn during the week of August 13, 2007, they received 9,600 mutual fund transaction orders in a single day. How would this have been handled if all of the clients had to wait for their mail before making the trade?

There are also serious technological impediments for mutual fund transactions that occur over the internet. The Proposed Framework document suggests that the investor may click through the Fund Facts before submitting the purchase order on line. However, if a member were to provide access to third-party Fund Facts it would raise security and

leakage issues surrounding the appropriate technology that might be necessary to leave the firm's secured website and then return after reading the Fund Facts. This would therefore suggest that member firms would potentially have to house the Fund Facts documents on their own secured websites. This is cause for concern for some firms which offer close to 5,000 different mutual funds. The maintenance of such a huge database would be enormous. Furthermore, some firms indicated that having to administer all these funds in-house would be too great and as a consequence, may have no choice but to reduce its offering of funds. The result is less choice for the investor.

### *Access Equals Delivery*

In order to deal with the limited options of delivery under the Proposed Framework, the IIAC believes that the principle of access equals delivery should be applied to the Fund Facts document. We understand that the Joint Forum received investor feedback which did not support an access equals delivery provision, however only 13 consumers were interviewed regarding segregated funds and 17 consumers for mutual funds. Further, the investor research posed questions concerning investors' overall impressions of the Fund Facts document but did not include questions surrounding how the Fund Facts would be incorporated in the account opening process or when a transaction was conducted via the internet or over the phone. We believe that investors would have a very different response if various scenarios were presented which indicated that a transaction may take days to complete and would likely support an access equals delivery model. The Securities and Exchange Commission (SEC) will be coming out with a point of sale initiative later this year and is considering a format similar to an access equals deliver approach.<sup>3</sup>

Speed, efficiency and prompt customer service are attributes that many clients value when choosing to conduct a mutual fund transaction and this is exemplified in a call centre or discount brokerage environment. For example, one member firm indicated that calls to their mutual fund call centre average less than 390 seconds per client. This indicates that clients value such attributes when calling to buy or redeem a mutual fund. A discussion surrounding a Fund Facts document between the adviser and client over the phone, even simply to indicate that it will be sent to the client for their review and that the client will have to call back to execute the transaction after receipt of the Fund Facts document will significantly impact the service that clients expect. In addition, one firm indicated to the IIAC that for every 10 seconds added to a phone conversation with the client that translates into added costs of \$500,000 per year for the dealer, representing the hiring of approximately seven additional investment representatives. This would be a disadvantage to smaller dealers, and the increased costs in all types of firms will ultimately be borne by clients.

Consequently, we believe that the provision of access equals delivery would adequately balance the regulators' concerns as to the provision of meaningful disclosure to investors and the members' concerns surrounding customer satisfaction and operational issues. In order to achieve an access equals delivery model a change could be made to the account

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<sup>3</sup> Securities and Exchange Commission, 17 CFR Parts 239, 240 and 274, Release No. 33-8544.

opening document which informs the investor that a Fund Facts document exists and that they are entitled to a copy of it. The Fund Facts documents could be made available to those clients who wish to look at it through an industry centralized database, similar to SEDAR where all Fund Facts could be stored. Members could also offer to deliver a hard copy of the Fund Facts document to clients who wish to receive a copy. The SEC has recently adopted a similar protocol with respect to delivery of proxy materials. Under the mandated E-Proxy Rules, issuers and others can satisfy their delivery obligations by posting proxy material on a publicly accessible website and sending a notice of availability informing that such materials are available and how to access them. In addition to the Fund Facts document being referenced in the account opening documentation and directing clients to the centralized database, it could also be mailed to all investors with their confirmation statement following their purchase.

In our suggested model above, the investor would receive adequate disclosure in a timely fashion with the ability to review the details before the transaction if they so choose or after the decision to buy a fund has been made. As such, the IIAC supports an access equals delivery approach as described above.

#### Timing of Delivery

We also question the timing of delivery of the Fund Facts document. The Proposed Framework sets out that delivery may occur before or at the point of sale. We query whether any consideration has been given to how long before the purchase can the Fund Facts document be delivered. For example, can delivery occur three months before the purchase? Could delivery occur six months before the purchase? What happens if the investor receives the Fund Facts document but takes a few weeks or months to decide whether to execute the transaction? We would appreciate further guidance on this important issue.

While the IIAC strongly encourages the Joint Forum to adopt an access equals delivery model, we provide the following suggestions with respect to the current proposal in the event that the current proposal is endorsed following receipt of comments.

#### Exemption from Delivery Requirement

The Proposed Framework states that the Fund Facts document is required to be delivered for initial purchases, subsequent purchases and for switches. The IIAC requests that an exemption be provided from the requirement to deliver the Fund Facts document for subsequent purchases in the same fund. The rationale for the Fund Facts documents is to make sure investors are kept informed. Since they will have already received the Fund Facts document with the initial purchase, and are pleased with the fund and as such are making additional purchases, there is no logic to having a requirement to provide the document for each subsequent purchase where it was previously received. If a client wishes to see it again and no longer has a copy they may request one from their adviser. With the high costs of producing the Fund Facts documents and additional audit requirements being proposed, there needs to be a specified purpose for requiring the

document be delivered to a client who has already been informed adequately when they purchased the fund. As such, the IIAC requests that an exemption be permitted for subsequent purchases in the same fund.

Similarly, an exemption should also be granted when the purchase is a switch from an existing mutual fund investment into another mutual fund. These switches may be often undertaken as a defensive move in a declining market, for example, when timing and speed are critical for the investor. If the investor is required to delay making a switch in order to receive the Fund Facts, it is possible that in a volatile market, investors may suffer significant losses. Clients in these situations would have the expectation of timely service and execution of their trades.

Requiring that the Fund Facts document be given to investors for subsequent purchases and switches also raises some questions with respect to segregated funds. Under the proposal a signature is required from the client for initial purchases of segregated funds which is also a requirement under insurance law. However, under insurance law no signature is required for subsequent purchases of the same fund or for switches and as such we request clarification if a signature would be required under this proposal.

The IIAC also proposes that the Fund Facts document not be required in situations where an investor has a discretionary or managed account, as under this type of account relationship, the adviser or a third party portfolio manager is making decisions on the client's behalf. Currently, such investors would not necessarily receive disclosure materials but under the proposal would be required to receive the Fund Facts therefore changing the nature of this type of relationship.

#### Accredited Investor Exemption

Proposed National Instrument 31-103 *Registration Requirements* currently proposes an exemption under subsection 5.8(2) from providing a Relationship Disclosure Document to an accredited investor. Presumably, this is due to the fact that a sophisticated investor does not need a document to properly understand the client-adviser relationship, and the costs, conflicts and compensation involved in such a relationship. Based on this rationale, the IIAC proposes that an accredited investor be exempt from having to receive a Fund Facts document at or before the point of sale. We believe it would be sufficient for such an investor to receive the document at the time that a confirmation is delivered.

#### Use of Waiver

If an access equals delivery approach is not taken, in the alternative, we encourage the Joint Forum to allow investors the ability to waive receipt of the Fund Facts for initial or subsequent purchases. Members constantly hear that clients do not want to receive certain documents. If the client specifically asks not to receive it, then it should not be mandatory as many clients have experience with mutual funds and should have the right to choose whether or not they receive the Fund Facts.

At the very least, a waiver should be available for clients who wish to conduct a trade, but are at a remote location, such as a cottage without internet access. If this client calls their adviser wishing to redeem or purchase a mutual fund, they would have to wait for receipt via mail of the Fund Facts document under the current proposal. The purchase could be negatively impacted due to price fluctuations over the days it takes to receive the Fund Facts. In such a scenario, clients should have the option to waive receipt of the Fund Facts document and an audit process would need to be implemented to document such waiver.

### Application for Discount Brokers

The IIAC requests some clarification as to the application of the Proposed Framework on discount brokers who operate in an environment where clients place their trades directly via the internet or over the phone to a call centre. Mutual fund transactions conducted through a discount brokerage channel account for a significant amount of transactions. Discount brokerage firms in 2006 accounted for approximately \$33 billion of mutual funds assets. One discount brokerage firm indicated to the IIAC that they received on average, 3,677 mutual fund trades on a daily basis. They are all initiated by the client and self-directed. Of these trades, 35% were over the telephone, with the remainder, 65%, via the internet.

Currently, discount brokers have relief from the suitability obligation under securities legislation and SRO requirements. The basis for such relief arises when no recommendations are provided by the dealer to the client. In those situations where the dealer does not provide a suitability determination, the suitability obligation is not applicable. The dealer is merely acting as an order-taker for a client on a particular transaction who, on their own initiative, executes a trade without a recommendation.<sup>4</sup> Similarly, the Association would submit that with respect to the purchase of a mutual fund through a client's discount brokerage account, the obligation to deliver the Fund Facts document should not apply.

### Rescission Rights and Verification of the Delivery Requirement

Under the Proposed Framework, a purchaser will have the ability to cancel a purchase at any time if they do not receive the Fund Facts document. This requirement will require firms to have a very detailed compliance regime in order to be able to track whether the delivery of the Fund Facts has in fact occurred. This means that if the adviser gives the document to a client during a face to face meeting, there must be some means to ensure that the delivery has occurred, likely through a client signature or acknowledgement. Similarly, if the document is sent via e-mail, there must be some audit trail of the e-mails. So although the Proposed Framework states that the only delivery requirement imposed is for the dealer to bring the Fund Facts to the attention of the investor, members must impose more stringent operation and compliance systems to ensure that they can review whether the client has in fact received the Fund Facts. This is the only method by which

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<sup>4</sup> Investment Dealers Association of Canada - Proposed By-laws to Provide Trade-by-Trade Relief from the Suitability Requirement (2001) 24 O.S.C.B. 2923.

the firms can provide evidence if an investor claims, at some later point in time, that they never received the Fund Facts document.

This rescission right is also problematic as records are generally only kept for five years to ensure compliance with SRO rules, so if a client returns years later and claims they did not receive the Fund Facts document, a firm may not be able to defend their position after the five years have elapsed.

A suitable compliance framework to address these issues will take significant time to be developed by the mutual fund distributors. As such, a suitable lead time will be needed if the requirements of the Proposed Framework, as currently drafted, come into force. In addition, we suggest that greater clarity be provided in the rule or possible companion policy.

#### Audit Trails

We suggest some additional clarification as to the responsibility of general compliance with the Proposed Framework and what type of audit trail may be required. Will the self-regulators, such as the Investment Dealers Association of Canada, have the responsibility to supervise adequate compliance with the requirements? What sort of sales compliance reviews will be undertaken by the IDA in these situations? As stated above, the audit trails that will be required to limit the liability to firms is a huge undertaking given the consequences of failing to show that the client did indeed receive the Fund Facts document. As such, we reiterate our suggestions mentioned above that a shift in focus to access equals delivery may help reduce the burden that is likely to exist under the current proposal with respect to audit trails.

#### Sales at Client's Location

Many transactions with advisers occur in person at the client's residence or place of business. In the course of discussions with the client, the adviser may become aware of information and circumstances that may lead to recommending a different product which the adviser had not thought of and as such does not have the appropriate Fund Facts document with him or her. As currently drafted, the client would not be able to make a purchase at that time of a fund where the adviser does not have the corresponding Fund Facts. In such a scenario, investors will become extremely frustrated that they are unable to proceed with an agreed upon course immediately. Alternatively, advisers may start to only recommend investments where they are carrying the appropriate Fund Facts document, limiting options and focusing on pre-determined solutions which may not be in the best interest of the client.

#### Details Related to Fees and Compensation

Page two of the Fund Facts document as currently drafted includes a section on "How much does it cost?" The information as currently proposed is misleading to clients as it leaves the impression that a client or in some cases, an individual adviser, has a say in the cost to buy a fund with respect to sales charges. Such decisions are determined at the dealer level and are not options that can be negotiated. Furthermore, the section "How

does my adviser get paid?” is also misleading. The Fund Facts does not give an exhaustive list of options and for example, some advisers receive a salary while other members determine on a firm-wide basis how the adviser will be compensated. We suggest removing such specific information from the document to avoid giving a misleading impression to clients.

In closing, we commend the Joint Forum for taking the initiative to look at ways to create a meaningful, more simplified form of disclosure for mutual fund and segregated fund investors. However, as our submission has shown, the Proposed Framework needs to be revisited by members of the Joint Forum to ensure that the issues we have outlined are addressed.

We would be pleased to discuss this submission should you have any questions.

Yours truly,

A handwritten signature in cursive script that reads "M. Alexander".

Michelle Alexander  
Director, Policy