

MEMO# 21344

July 10, 2007

Canadian Regulators Propose New Mutual Fund Point of Sale Disclosure Requirements

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TO: INTERNATIONAL OPERATIONS ADVISORY COMMITTEE No. 12-07 RE: CANADIAN REGULATORS PROPOSE NEW MUTUAL FUND POINT OF SALE DISCLOSURE REQUIREMENTS

Canada's Joint Forum of Financial Market Regulators [\[1\]](#) has published for comment a proposal regarding point of sale disclosure for mutual funds and segregated funds (the "Proposal"). [\[2\]](#) Adoption of the Proposal would result in significant changes to mutual fund sales practices in Canada. The centerpiece of the Proposal is a mandatory two-page "Fund Facts" document meant to highlight key fund information that would have to be delivered to investors *before* or at the point of sale. Delivery could be accomplished electronically or by hand, facsimile, or mail. The new disclosure and delivery requirements would be accompanied by a modified "cooling off" right for an investor to cancel a fund purchase. Comments on the Proposal are due by October 15, 2007.

I. Fund Facts

The [Fund Facts](#) document plays the central role in the proposed disclosure system. Its content and format would be strictly prescribed, and a separate Fund Facts would be required for each class or series of a fund with a different expense ratio. The Fund Facts would not replace the current simplified prospectus, but dealers would be able to satisfy their delivery obligation by delivering only the Fund Facts. Dealers would still be permitted to provide investors with advertising or marketing materials in addition to the Fund Facts, and existing rules relating to advertising and marketing would continue to apply. A copy of the model Fund Facts document is attached to this memorandum.

Content of Fund Facts

The proposed Fund Facts document must be written in plain language and contain prescribed information in a rigid layout. It is designed using a question-and-answer format intended to make it easy for investors to find information and contains a number of statements intended to help investors understand the risks of investing in a fund.

Mandatory aspects of the Fund Facts include:

- the information items and their order;
- which items appear on the first and second pages;
- the section headings and certain language in each section;
- minimum font size; and
- maximum Flesch-Kincaid grade level of 5.0.[3]

The first page of the Fund Facts contains basic information about the fund; the second page contains information about sales charges, intermediary compensation, and the cooling-off right. A brief summary of the information items required on each page of the Fund Facts is provided below:

Page One (fund information)

- quick facts: the fund creation date, total assets, investment manager, and expense ratio
- investments: types of securities, top 10 investments, and investment mix
- performance: average and year-by-year returns
- overall “risk”: a statement of the fund’s risk level and where the risk fits on a scale based on the Investment Funds Industry of Canada’s *Recommendations for Fund Volatility Risk Classification*
- whether the fund is guaranteed
- who the fund is suitable for

Page Two (purchase information)

- sales charges: a description of sales charge options and a listing of the charges in percentage terms and dollar amount (per \$1,000 invested)
- intermediary compensation: a standardized description of how intermediaries are generally paid, including what a trailing commission is and how it works
- cooling-off right: how investors can cancel their purchase and what amount is returned
- where investors can get more information

The Proposal states that limited flexibility would be allowed in certain sections to describe the fund’s features, such as the fund’s investments and the types of investors the fund is suitable for.

Delivery of Fund Facts

The proposed delivery requirement for the Fund Facts is a significant departure from current practice. Currently, dealers must send the simplified prospectus to fund investors within two days after the purchase transaction. Under the Proposal, dealers would have to deliver the Fund Facts before or at the point of sale. The delivery requirement would apply to (i) initial purchases, (ii) subsequent purchases, except for pre-authorized payment plan purchases, and (iii) exchanges (known in Canada as “switches”), except for exchanges

under asset allocation services. Investors would not be permitted to waive receipt of the Fund Facts, and the delivery requirement would apply whether a sale is made in person, by telephone, or over the Internet. The delivery requirement would also include an obligation to bring the Fund Facts to the attention of the investor when it is delivered. Dealers would no longer have to deliver the simplified prospectus except when specifically requested by an investor.

Delivery could be accomplished electronically or by hand, facsimile, or mail. Oral delivery of the Fund Facts would not be permitted. The Proposal defines electronic delivery as “sending a copy of the document directly to the investor,” but does not elaborate further except to say that there is no provision for “access equals delivery.” The Proposal states that dealers would not be required to have investors acknowledge receipt of the Fund Facts, but may impose their own requirements as part of their compliance policies and procedures for delivery obligations.

Investors that do not receive the Fund Facts before or at the point of sale would be able to cancel their purchase at any time and receive their original investment plus any fees paid.

Regulatory Review and Updating of Fund Facts

The Fund Facts would be filed with securities regulators annually with the rest of the fund manager’s prospectus documents and would be incorporated by reference into the simplified prospectus. Accordingly, existing securities laws would provide investors with a statutory right to take action against a mutual fund for any misrepresentation in the Fund Facts.

Fund managers would have to update and file the Fund Facts when they file their annual and interim continuous disclosure documents. Fund managers could update and file the Fund Facts more often to provide more current information, but no more frequently than quarterly unless there is a material change to the information. As noted above, dealers would still be permitted to provide investors with advertising or marketing materials in addition to the Fund Facts, which should allow dealers to provide investors with more up-to-date performance information.

II. Cooling-Off Right

One more important aspect of the Proposal is a rationalization and uniform application of the cooling-off right that applies to fund purchases in Canada. Currently, the law differs depending on the province or territory where a fund sale is made. Most Canadian provinces or territories have both a *right of withdrawal* and *right of rescission*. [\[4\]](#)

Under the Proposal, current rights of withdrawal and rescission would be replaced with a uniform cooling-off right that would allow an investor to cancel a purchase within two business days after giving the dealer instructions to purchase the fund. An investor exercising the cooling-off right would receive the lesser of the amount of the original investment or the net asset value on the day the cooling-off right is exercised, plus any sales commissions or fees. The cooling-off right would apply to all circumstances where delivery of the Fund Facts is required, namely (i) initial purchases, (ii) subsequent purchases, except for preauthorized payment plan purchases, and (iii) exchanges, except for exchanges under asset allocation services.

If you have any questions or would like to discuss the Proposal, please contact Glen Guymon at 202-326-5837 or gguymon@ici.org or Susan Olson at 202-326-5813 or solson@ici.org.

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[Attachment](#)

endnotes

[1] The Joint Forum of Financial Market Regulators consists of representatives from the Canadian Securities Administrators (CSA), the Canadian Council of Insurance Regulators, and the Canadian Association of Pension Supervisory Authorities. The CSA is a forum for the 13 securities regulators of Canada's provinces and territories to coordinate and harmonize regulation of the Canadian capital markets.

[2] Joint Forum of Financial Market Regulators, Proposed framework 81-406: Point of sale disclosure for mutual funds and segregated funds (June 15, 2007), available at www.csa-acvm.ca/pdfs/81-406_Proposed_Framework-Paper.pdf. The model Fund Facts document is available at www.osc.gov.on.ca/Regulation/Rulemaking/Current/Part8/rule_20070615_81406-fund-facts_en.pdf.

[3] Flesch-Kincaid is a simple measure of readability that is calculated based on words per sentence and syllables per word. A grade-level score of 5.0 would indicate that the text is expected to be understandable by an average student in 5th grade. Many word processing programs (including Word and WordPerfect) can calculate a Flesch-Kincaid score for a document.

[4] The right of withdrawal allows a fund investor to cancel a fund purchase within two business days of receiving the fund's prospectus. An investor exercising this right receives the amount of the original investment, plus any sales commissions or fees. The right of rescission allows a fund investor to cancel a fund purchase within 48 hours of receiving the written purchase confirmation. An investor exercising this right receives the lesser of the amount of the original investment or the net asset value at the time of rescission, plus any sales commissions or fees.