

## Capital Markets - Canada

### Full Disclosure: Proposed Changes to Mutual Fund and Segregated Fund Sales

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#### Background

The Joint Forum of Financial Market Regulators is a representative committee of financial regulators from across the country, including representatives of pension supervisory authorities, insurance regulators and securities administrators. The forum recently assessed disclosure of mutual funds and segregated funds.

The forum's view is that the current disclosure regime is inadequate. Specifically, it found that the current disclosure regime does not give meaningful information to fund investors before investors make purchase decisions, which is when this information is most required. As information tends to be buried in the simplified prospectus (for mutual funds) or the insurance contract (for segregated funds), the information is not readily available, written clearly or easily comparable between funds. The forum concluded that while the information is intended to provide necessary information to potential investors when these investors are making their investment decisions, many investors do not use this information when making their decisions.

Thus far, the changes are in proposed form only. This update outlines the six principal proposed changes to the disclosure regime and the process for implementing these proposed changes into practice.

#### Proposed Changes and New Requirements

##### **'Fund facts' statement**

The key change in the point of sale disclosure system in the forum's recommendations is the introduction of a 'fund facts' statement.

The fund facts statement is a two-page document organized in a question-and-answer format designed to provide investors with basic information about the fund. The fund facts statement will:

- avoid using legal and financial jargon;
- be written at a simple reading level using simple examples, tables and graphics;
- use bold headings; and
- recognize the role of the investment adviser in the sales process.

Typical topics covered in the fund facts statement include:

- an overview of the fund, including management expense ratio, the date of fund creation, assets under management and minimum investment (initial and additional);
- the types of investment of the fund (including the use of pie charts);
- past fund performance, including a statement that net returns for an investor will depend on that investor's tax situation;
- the level of risk taken by the fund;
- whether there are any guarantees;
- all fees and expenses associated with the fund;
- contact information for the fund; and
- the right of the investor to avail of the cooling-off period discussed below.

While many aspects of the fund facts statement are expected to be prescribed by

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provincial regulators, there will be some flexibility with respect to the description of the fund's features, such as the fund's investments and the types of investor for whom the fund is suitable.

Fund managers and insurers will be required to produce a unique fund facts statement for each series or class of a fund.

#### ***Timing of delivery of fund facts statement***

The delivery obligation of investors will vary based on:

- the type of investor account;
- how the purchase was initiated; and
- whether the investor has other investments in the fund.

While the specific rules are discussed below, the general rule is that, where an investor is not expected to have a lot of information about the fund, delivery of the fund facts statement is required to be effected before the purchase of the fund.

Investors with full-service investment accounts, but who initiate the purchase of a fund of their own volition, are required to be issued the fund facts statement before or at the point of sale. The investor may choose to have this provided with confirmation of the trade, which will expedite the closing of the trade.

Investors with full-service accounts who execute a trade based on the recommendation of an adviser are required to be issued the fund facts statement before or at the point of sale. However, where the purchased fund is a money-market fund, the investor may opt to have the fund facts statement provided with trade confirmation.

Investors with self-directed accounts are required to be issued a fund facts statement with confirmation of the initial purchase of a fund.

Investors, regardless of whether their account is full-service or self-directed, will not receive a fund facts statement with subsequent purchases of a fund in which they already are invested, but they will be given the option to receive annually the Fund Facts statement for each fund held.

#### ***Method of delivery of fund facts statement***

Where delivery of the fund facts statement is required before or at the point of sale, investment advisers have two obligations with respect to delivery of the statement. The adviser will have to deliver the statement to the investor and, once delivered, the adviser will have to bring the fund facts statement to the attention of the investor. Delivery is acceptable in person, by mail, by fax and electronically. Electronic delivery includes email or directing the investor to the relevant fund facts statement on the website of the fund manager or insurer. Oral delivery is not permitted.

Existing mutual fund delivery requirements will be amended to allow mutual fund dealers to meet their delivery obligations for the simplified prospectus by delivering only the fund facts statement. Mutual fund dealers will be required to deliver the simplified prospectus itself to investors only on request and will not be required to have investors acknowledge receipt of the fund facts statement.

Existing segregated fund delivery requirements will not change. As the fund facts statement will become part of the information folder, delivery of the folder to the client by an adviser will include delivery of the statement. Insurers will be required to include a signature line on the insurance contract application in order for the investor to acknowledge that the fund facts statement has been received for all requested segregated funds.

#### ***Cooling-off rights***

The forum proposed a two-business-day cooling-off period, which provides investors with the opportunity to change their mind after buying a fund. Investors also have recourse if the fund facts statement contains incomplete or inaccurate information, or if the investor does not receive the fund facts statement as required.

For mutual funds, the cooling-off period starts when the investor receives or is deemed to receive the trade confirmation. For segregated funds, the cooling-off period starts on the earlier of when the investor receives the trade confirmation or seven days after the trade confirmation is mailed.

Where a mutual fund investor seeks to exercise the cooling-off right, he or she must notify the dealer in writing. If the purchase was made in cash, the dealer will return the money to the investor. If the purchase was made by a switch from another fund, the dealer will instruct the fund manager to switch the investor back to the original investment. Where a segregated fund investor seeks to exercise the cooling-off right, this will be directly with the insurer. The investor may cancel their insurance contract within two days of entering into it.

Investors who exercise a cooling-off right will get back the lesser of their original investment amount or the value of the fund on the day the investor exercises the cooling-off right. The investor will also get back any costs associated with the transaction and will pay no redemption or short-term trading fees. Cancellation of the purchase will be processed the same way as a redemption.

### **Additional investor rights**

#### *Misrepresentation*

The fund facts statement will be incorporated by reference into the insurance contract (in the case of segregated funds) and the simplified prospectus (in the case of mutual funds). If the statement contains a misrepresentation, existing statute and contract laws will apply. This may include the investor taking action against the fund for damages.

#### *Failure to deliver fund facts statement*

In the case of segregated funds, a failure by an insurer to deliver the fund facts statement will be considered an unfair or deceptive act or practice. Although this failure to deliver will not *per se* permit the investor to cancel the purchase, the investor will be able to complain to the provincial regulator, which may take action against the insurer.

In the case of mutual funds, investors have a right of action where the fund fails to deliver the simplified prospectus. This right will apply if the fund facts statement is not delivered as required. The fund facts statement will typically be delivered in place of a simplified prospectus, with the simplified prospectus available to investors upon request.

### **Filing requirement**

The fund facts statement will need to be filed annually with securities or insurance regulators, as the case may be, in conjunction with other documents required by these regulators, such as prospectus documents in the case of mutual funds and insurance contracts in the case of segregated funds.

The fund facts statement will need to be updated and the revised statement filed with regulators if there is a material change to the information contained therein. These material changes will be treated in the same way as other material changes. In the case of segregated funds, if the material change requires an amendment to the insurance contract, the insurer will have to obtain a receipt for the amendment in provinces where receipting occurs before using the amended fund facts statement.

The applicable regulators will review the fund facts statement as part of their regular reviews. When the review has been completed, the regulator will issue a receipt as appropriate. Insurance regulators will review updates to the fund facts statement that result from material changes according to the current practice of those regulators.

### **Next Steps**

The forum's recommendations have been made to the Canadian Council of Insurance Regulators and the Canadian Securities Administrators to begin the process of making necessary changes to the relevant legislation, rules and guidelines. As part of the implementation process, there will likely be a transition period to allow sufficient time for insurers and mutual funds to produce and file fund facts statements and to develop procedures to meet delivery obligations discussed above.

One question that will need to be addressed is the issue of grandfathering and whether investors who purchase additional units of a fund will be considered to be purchasing the fund anew, and therefore will be entitled to the protection of the new regime, or whether they will not be considered to be entitled to this protection as purchasers of additional units, notwithstanding their lack of receipt of the fund facts statement.

While the forum's recommendations are not expected to become binding on insurers, mutual fund dealers and investment advisers for some time, these organizations are advised to:

- become familiar with the requirements for issuance and delivery of fund facts statements;
- review mutual and segregated fund offerings to ensure that the information required for the fund facts statements is accessible and available for production of the statements;
- ensure that those responsible for changes to mutual and segregated funds, as well as for the introduction of such new funds, are aware of the fund facts statement requirements;
- consider how fund retailers will ultimately be trained to describe and issue fund facts statements to customers; and
- consult with legal counsel if in doubt about the pending requirements.

For further information on this topic please contact [Hartley Lefton](#) or [Denno Chen](#) at Lang Michener LLP by telephone (+1 416 360 8600) or by fax (+1 416 365 1719) or by

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