

**Proposed framework 81-406**

# **Point of sale disclosure for mutual funds and segregated funds**

**Prepared by:  
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# CONTENTS

<b>Introduction</b> .....	<b>1</b>
<b>Background</b> .....	<b>3</b>
2003 consultation paper .....	3
Comments on the 2003 consultation paper .....	3
What we said we would do .....	4
What we have done.....	4
<b>Fund Facts</b> .....	<b>6</b>
Investor research.....	6
Plain language approach.....	6
Content.....	7
Document testing .....	8
<b>Delivering the Fund Facts</b> .....	<b>9</b>
Time of delivery .....	9
Methods of delivery .....	10
<b>Investor rights</b> .....	<b>12</b>
Cooling-off right .....	12
Right for misrepresentation .....	12
If the Fund Facts is not delivered .....	13
<b>Regulatory requirements</b> .....	<b>14</b>
Preparing the Fund Facts .....	14
Filing and review .....	15
Meeting the delivery requirement .....	16
Providing other materials at point of sale .....	17
<b>Next steps</b> .....	<b>18</b>
How to send us your comments .....	18
For more information .....	18
<b>Appendix 1: Fund Facts for mutual funds</b> .....	<b>23</b>
<b>Appendix 2: Fund Facts for segregated funds</b> .....	<b>27</b>
<b>Appendix 3: Key Facts for segregated funds</b> .....	<b>31</b>
<b>Appendix 4: Investor research and other sources</b> .....	<b>125</b>
<b>Appendix 5: Research Strategy Group Fund Facts Document Research Report</b> .....	<b>129</b>



# Proposed Framework 81-406

## Point of sale disclosure for mutual funds and segregated funds

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### Introduction

Mutual funds and segregated funds are required to disclose a great deal of information to investors in various documents. Among them are the simplified prospectus for mutual fund investors, and the information folder and insurance contract for segregated fund investors.

While these documents are intended to provide critical information to investors who are considering whether to buy a fund, we know that many investors do not use this information when making purchase decisions.

#### Why the current regime isn't working

Many investors have trouble finding and understanding the information they need because it is buried in these long and complex documents. Investors also find it difficult to compare information about different funds.

In addition, investors may not receive the documents before they make their purchase decision. Dealers must send the prospectus to mutual fund investors within two days after the purchase transaction. Segregated fund investors must receive the information folder at the point of sale, but may not receive the insurance contract until after the sale.

#### Our vision

The current disclosure regime does not meet our vision of providing investors with meaningful information when they need it most—before they make their decision to buy a fund.

The framework that we are proposing addresses the shortcomings of the current regime by focusing on three principles:

- providing investors with key information about a fund
- providing the information in a simple, accessible and comparable format
- providing the information before investors make their decision to buy

We want investors to have a basic and correct understanding of the potential benefits, risks and costs of investing in a fund and to be able to meaningfully compare one fund with another.

To do this, we need to make sure the information is presented so that most investors will choose to read it. It must be short, informative, friendly and in plain language.

The information must be given to investors when they are making their decision to buy a fund—in other words, before the investor gives instructions to buy the fund.

This document describes the elements of our proposed point of sale disclosure framework, including a new fund summary document, delivery options, investor rights and the regulatory requirements for preparing, filing and delivering the document.

We welcome your comments on the proposed framework. Please see the *Next steps* section for details on how to send us your comments.

**This document reflects the ideas of the regulators that are members of the Joint Forum and its member associations. It does not necessarily represent the views of any government.**

# Background

The Joint Forum of Financial Market Regulators (Joint Forum) consists of representatives from the Canadian Association of Pension Supervisory Authorities (CAPSA), the Canadian Council of Insurance Regulators (CCIR) and the Canadian Securities Administrators (CSA). 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.

## **2003 consultation paper**

In 2003, the Joint Forum published Consultation Paper 81-403: *Rethinking Point of Sale Disclosure for Segregated Funds and Mutual Funds*. You can find the consultation paper on the Joint Forum website at [www.jointforum.ca](http://www.jointforum.ca).

The consultation paper set out our proposals to bring information to investors at the right time, in the right form, and in a cost-effective and practical way. The proposals envisioned a disclosure system consisting of four fundamental documents for a fund:

1. a foundation document containing all of the static information about the fund features and fund manager
2. a continuous disclosure record of the fund's financial statements and management reports of fund performance
3. a fund summary of one or two pages with key information that is unique to the fund that investors would receive before or at the time a purchase decision is made
4. a standardized consumers' guide containing educational information about mutual funds and segregated funds

The proposals were designed to rework the point of sale disclosure regimes to create material that investors would read and be able to understand.

The consultation paper also asked for comments on cooling-off rights for mutual fund and segregated fund purchases.

## **Comments on the 2003 consultation paper**

In April 2004, the Joint Forum published its report on the consultation paper, which summarized the comments received and set out our responses to those comments. The following is a summary of the main comments we received. The full report is available on the Joint Forum website at [www.jointforum.ca](http://www.jointforum.ca).

Everyone who commented on the consultation paper agreed that the point of sale disclosure regimes for mutual funds and segregated funds need to be changed. The comments made it clear that investors do not read mutual fund prospectuses or segregated fund information folders. Most of the respondents agreed with the logic of the proposed four-document disclosure system.

- **Fund summary document.** Most of the respondents were in favour of a short fund summary document delivered before the purchase decision is made. Investors were in favour of documents prepared on a per fund basis. In contrast, industry wanted to have the freedom to create combined fund summary documents for all funds in a fund family.
- **Consumers' guide.** The idea of a standardized consumers' guide was popular with investors and industry. Investors said they would like mandatory delivery of a document designed with their input. Industry said it would like to contribute to the contents of a consumers' guide but use it on a voluntary basis only.

Respondents, however, felt the sample document included in the consultation paper was too long, was too detailed and provided too much information for some investors and not enough for others.

- **Delivery.** Investors were strongly opposed to replacing the requirement to deliver the foundation document and continuous disclosure record with electronic access to these documents. Industry was strongly in favour of this approach.

Investors said many people do not have the ability or the desire to receive information electronically. They also said we should give investors the option to use electronic access or delivery, or to decline receipt of the disclosure altogether, but leave physical delivery as the default option.

- **Cooling-off right.** The consultation paper suggested that the rights of withdrawal and rescission attached to the purchase of mutual funds might be eliminated if disclosure was provided before the point of sale. The industry agreed with this approach.

Investors were strongly opposed and reminded us that they hold very few cards and are sometimes subjected to high-pressure sales tactics. Investors said they wanted a meaningful cooling-off period that would apply to all fund purchases.

### **What we said we would do**

In the report, we said that we would approach the work in the consultation paper in two phases.

In the first phase, we would refine the consumers' guide, develop a new right of withdrawal, develop and test a fund summary document, and develop new delivery requirements. We would also publish for comment the proposed fund summary document, the consumers' guide and the necessary amendments to any rules or guidelines.

In the second phase, we would review the need to create a new foundation document to replace the existing simplified prospectus and annual information form for mutual funds.

### **What we have done**

We have developed a new right of withdrawal, developed and tested a fund summary document, and developed new delivery options and the regulatory requirements for preparing and filing the document. These are the cornerstones of our proposed framework and are described on the following pages.



We revisited the concept of the consumers' guide after developing and testing the fund summary document. While we agree that investor education is a key aspect of investor protection, we decided that regulators would not create a consumers' guide as part of this project because:

- The testing concluded that the fund summary document provides a self-explanatory and complete description of a fund.
- Investors told us in the testing that they would go elsewhere if they wanted more information.
- There are already many excellent sources of general educational material in the marketplace about both mutual and segregated funds.

# Fund Facts

This section describes the research we reviewed and the conclusions we reached that informed the development of the fund summary document, called “Fund Facts”. It also describes the testing we conducted.

We created two versions of the Fund Facts—one for mutual funds and one for segregated funds. The documents are substantially similar, but take into account certain differences between the two investment products. You will find prototypes of these Fund Facts documents in Appendix 1 and Appendix 2.

The CCIR has separately developed an additional two-page prototype document called “Key Facts”. This document summarizes the key features of the insurance contract under which segregated funds are offered. See Appendix 3 for more information about the Key Facts.

## Investor research

We reviewed many research studies and academic papers from around the world to understand how investors make investment decisions and what information they want to make a decision. They are listed in Appendix 4.

The research told us that:

- Investors want clear disclosure of fees and returns or past performance.
- Investors want information about the risks of investing in a fund, the fund’s investments, the portfolio manager and how the adviser is paid.
- Overall knowledge of basic investment concepts is low.
- Many investors are overconfident and overestimate their investment knowledge and abilities.
- A one- or two-page document that summarizes the key features of a fund can help investors make informed purchase decisions.
- Investors have certain behavioural biases that decrease the likelihood that they will:
  - read disclosure if they receive it after they have made their purchase decision
  - exercise their right to cancel their purchase even after receiving information that tells them their original purchase decision was unwise.
- The vast majority of Canadian mutual fund investors consult with their adviser before making a purchase decision.

We concluded that investors currently receive all the information they say they want in the simplified prospectus and information folder, but we know that many of them do not read these documents. Information overload and dense, complex language are two of the reasons why investors do not read the disclosure documents.

We determined that we needed to develop a short and simple point of sale disclosure document to help investors make an informed decision.

## Plain language approach

We decided that using a plain language approach to develop the document would help meet our goal of ensuring that investors have a basic and correct understanding of the potential benefits, risks and costs of investing in a fund.

Plain language is communicating in a way that ensures the audience can immediately understand what you tell them. The plain language approach focuses on the needs and abilities of the audience to ensure that the content of a communication is relevant, the organization of the information is logical, the language is appropriate and the presentation is visually appealing.

### **Our audience**

The primary audience for mutual funds and segregated funds disclosure is adult Canadians who have money to invest. In preparing the document, we considered the research and the following facts about the Canadian adult population:

- Our population is aging.
- About one-fifth of Canadians have a language other than French or English as their mother tongue.
- About one-half of adult Canadians have serious problems dealing with printed materials or can deal only with simple reading tasks.

To connect with this audience, we wrote the point of sale disclosure document according to the following principles:

- Avoid legal or financial jargon.
- Use simple examples, tables and graphics to illustrate concepts.
- Use bold headings and white space to make the document easier to read and navigate.
- Write at a Flesch-Kincaid grade level of 5.0.
- Recognize the role of the adviser in the sales process.

### **Content**

The Fund Facts highlights key information that is important to investors. The information fits on both sides of one page and is organized in a way that makes sense to investors. It is designed using a question-and-answer format that makes it easy for investors to find information. It contains a number of statements that help investors understand the risks of investing in a fund.

### **Page one**

The first page of the Fund Facts contains basic information about the fund:

- quick facts about the fund: creation date, total value, portfolio manager, annual expenses/management expense ratio (MER)
- what the fund invests in: types of securities, top 10 investments, investment mix
- how the fund has performed: average and year-by-year returns (after deducting the MER)
- overall risk of the fund: a statement of the fund's risk level and where the risk fits on a scale that is based on the Investment Funds Industry of Canada (IFIC) *Recommendations for Fund Volatility Risk Classification*
- whether the fund is guaranteed
- who the fund is suitable for

### **Page two**

The second page contains information about costs, adviser compensation and the cooling-off right:

- sales charge options: how each option works and the effect each option could have on their investment

- adviser compensation: how advisers are generally paid, including what a trailing commission is and how it works
- cooling off right: how investors can cancel their purchase
- where investors can get more information

The sales charge and adviser compensation sections contain additional questions that an investor may want to ask their adviser.

### **Document testing**

In the fall of 2006, we tested two versions of the Fund Facts with investors and advisers, one for mutual funds and one for segregated funds. We tested each version in English and in French. We wanted to evaluate the documents for:

- clarity of language and format
- relevance and completeness of content
- layout and design
- usefulness in making investment decisions
- desired role in the sales process
- overall appeal

You will find the *Fund Facts Document Research Report* prepared by Research Strategy Group in Appendix 5.

The research report says that the Fund Facts was very well received by the investors and the advisers who we tested. The investors described it as informative, relevant and easy to read. Investors said they want to receive the document before they make a decision to invest. The advisers said they would use it with clients as a presale document and that it would be helpful in explaining things.

The research report also includes suggestions for changes to the Fund Facts. After reviewing the research report, we made changes to clarify or expand the information in the Fund Facts. The Fund Facts documents in Appendixes 1 and 2 reflect these changes.

# Delivering the Fund Facts

This section describes when and how investors will receive the Fund Facts under our proposed framework. Dealers and insurers will be responsible for meeting these delivery obligations and for making sure that the advisers who work for them deliver the Fund Facts.

## Time of delivery

Investors told us they want the information in the Fund Facts to help them make their purchase decision. Accordingly, the Fund Facts will be delivered to investors before or at the point of sale.

Dealers and insurers will have to deliver the Fund Facts for:

- initial purchases
- subsequent purchases, except for pre-authorized payment plan purchases
- switches, except for switches under asset allocation services

For segregated funds, the initial purchase takes place when an investor signs the application for the insurance contract and selects one or more funds.

There is no provision in the proposed framework for investors to waive receipt of the Fund Facts. Investors can choose how much time they want to spend reviewing the document or discussing it with their adviser.

### Questions about subsequent purchases

1. Investors: If you make a subsequent purchase in a fund you own, we recognize you will already have received the Fund Facts. Should we consider waiving the requirement to deliver the Fund Facts for all subsequent purchases of a fund that you own or only for a certain period after the last purchase? If only for a certain period, what is a reasonable amount of time?
2. Investors: If you are buying a fund under a pre-authorized payment plan, you will only receive the Fund Facts for the first purchase. However, information in the Fund Facts will change over time, which could influence your decision to continue buying the fund. Would you want to receive an updated Fund Facts? If so, how frequently would you want to receive the updated document?
3. Investors: Does the other disclosure information that you can choose to receive, such as fund annual reports, provide you with enough information to make a subsequent purchase decision?

**Methods of delivery**

The table below outlines the methods of delivery that will be available for different types of sales under our proposed framework.

Method of sale	Method of delivery	
	Before point of sale	At point of sale
In person	<ul style="list-style-type: none"> <li>• by hand</li> <li>• by fax</li> <li>• by mail</li> <li>• electronically</li> </ul>	<ul style="list-style-type: none"> <li>• by hand</li> </ul>
By telephone	<ul style="list-style-type: none"> <li>• by hand</li> <li>• by fax</li> <li>• by mail</li> <li>• electronically</li> </ul>	<ul style="list-style-type: none"> <li>• by fax</li> <li>• electronically</li> </ul>
On the internet	<ul style="list-style-type: none"> <li>• by hand</li> <li>• by fax</li> <li>• by mail</li> <li>• electronically</li> </ul>	<ul style="list-style-type: none"> <li>• click through the Fund Facts before submitting the purchase order</li> </ul>

By electronic delivery, we mean sending an electronic copy of the document directly to the investor.

Based on feedback we received from investors in the consultation paper and through the testing that we did, there is no provision in the proposed framework for access equals delivery as a delivery option.

There is also no provision for oral delivery because we doubt that investors could receive and understand all the information in the Fund Facts in a meaningful way over the telephone. For example, it would be difficult for people to understand an oral description of the investment mix or year-by-year returns bar chart.

**Questions about delivery**

We are seeking comments on a number of issues relating to delivery of the Fund Facts because we recognize that the requirement to deliver the document before or at the point of sale represents a significant change to the way that mutual funds, and to some extent segregated funds, are currently sold.

We believe that a flexible approach to delivering the Fund Facts will help address the differing needs and expectations of investors while meeting our goal of providing information at the time most relevant to their investment decision. We are willing to work with industry to help make the transition in as reasonable and cost-effective manner as possible.

4. Do the delivery methods described above give investors and industry enough flexibility to make and execute investment decisions in a timely manner?
5. Are there other delivery methods or options that we should consider that are consistent with our objective of providing investors with disclosure before or at the point of sale?

6. Dealers and insurers: What changes would you need to make to your existing processes to comply with our proposed delivery requirements? How long would it take to make these changes? What costs would be involved? Approximately how much would these costs be?
7. Investors: If your adviser did not have the Fund Facts immediately available, would you be willing to wait until you receive it to make your purchase? If you had to wait, would you be likely to choose an investment other than a mutual fund or segregated fund?

# Investor rights

This section describes the rights investors will have under the proposed framework.

## Cooling-off right

Investors in mutual funds and segregated funds will have a cooling-off right that allows them to cancel their purchase. Investors will have two business days to exercise this right.

The cooling-off right will apply to:

- initial purchases
- subsequent purchases, except for pre-authorized payment plan purchases
- switches, except for switches under asset allocation services

The two-day cooling-off period starts when the investor gives instructions to the dealer or insurer to buy the mutual fund or segregated fund.

## Exercising the cooling-off right

Investors will have to give written notice to the dealer or insurer if they want to exercise their cooling-off right.

For mutual funds, the investor will exercise the cooling-off right with the dealer. This means that the dealer will have to return the money to the investor. If the fund manager has received payment from the dealer or fund units have been issued, the fund manager will have to return to the dealer the money it has received or the value of the units it has issued at the time the investor exercises the cooling-off right.

For segregated funds, the investor will exercise the cooling-off right with the insurer.

## Amount received on exercising cooling-off right

The investor will get back the lesser of:

- the amount of their original investment and
- the value of the fund on the day they exercise the cooling-off right

If the value of the fund goes down during the cooling-off period, the investor will get back less than their original investment. The purpose of the cooling-off period is to let investors change their minds if they have been sold a fund they really do not want. It is not intended to protect investors from a short-term decline in market value.

The investor will also get back any sales charges or other fees paid to buy the fund. The investor will not pay any redemption fees.

## Right for misrepresentation

### Mutual funds

The Fund Facts will be incorporated by reference into the simplified prospectus. This means that the existing securities laws will apply and any misrepresentation in it will result in the investor having a statutory right to take action against the mutual fund.



**Segregated funds**

The Fund Facts will be incorporated by reference into the insurance contract. This means that if there is a misrepresentation in the Fund Facts, the existing laws will apply and the investor will have the right to take action against the insurer for breach of contract.

**Question about misrepresentation in Fund Facts for segregated funds**

8. Are there other ways to ensure investors have a meaningful remedy for any misrepresentation in the Fund Facts document for segregated funds?

**If the Fund Facts is not delivered****Mutual funds**

Investors will be able to cancel their purchase at any time if they do not receive the Fund Facts before or at the point of sale. They will receive the amount of their original investment, plus any fees they have paid.

**Segregated funds**

The existing insurance laws will apply. Where applicable, it will be an unfair or deceptive act or practice for insurers to fail to deliver the Fund Facts when they are required to do so. This means that although investors will not be able to cancel their purchase, they can complain to their provincial regulator who may take action against the insurer.

# Regulatory requirements

This section describes the standards that fund managers, dealers and insurers will have to meet when preparing, filing and delivering the Fund Facts under the proposed framework.

## Preparing the Fund Facts

Investors told us they want to easily compare funds and they want a document that is easy to read and understand. Accordingly, many aspects of the Fund Facts will be mandated, including:

- the items and their order
- the items that are on the first page
- the items that are on the second page
- the section headings and certain language in each section
- minimum font size
- maximum Flesch-Kincaid grade level of 5.0

However, we recognize that companies need some flexibility to accommodate different kinds of funds. Companies will have flexibility in certain sections to describe the fund's features, for example, the fund's investments and the types of investors the fund is suitable for.

A separate Fund Facts will be required for each class or series of a fund that has a separate MER. Because performance and sales charge information may be different if the MER is different, it would be difficult to produce a Fund Facts with different sets of performance and sales charge information that is as short and easy to read as the prototype documents. The document would certainly be more complex for investors.

### **Question about funds with multiple classes, series or guarantee options**

We recognize that there could be many versions of the Fund Facts for a fund that has more than one class, series or guarantee option with a separate MER. We also recognize that an investor may receive only one version of the Fund Facts for the fund, based on their adviser's discretion. As a result, the investor might only be made aware of one option for them to purchase the fund. Advisers should tell investors about all the options that might be suitable.

9. Are there other ways of disclosing the information in the Fund Facts for a fund with multiple classes, series or guarantee options that are consistent with our objective of providing investors with a two-page document that is easy to understand?

Investors told us that they do not want to read long documents. We want to make it easy for investors to review and refer to the Fund Facts for the funds that they have bought, which is easier to do with a short document. Accordingly, the proposed framework does not permit the Fund Facts to be consolidated into a fund family document or other grouping.

## **Filing and review**

Under the proposed framework, the Fund Facts will be subject to the requirements described below.

### **Mutual funds**

#### **Filing requirements**

The fund manager will have to file Fund Facts with securities regulators. The Fund Facts will have to be filed annually, together with the rest of the fund manager's prospectus documents, for receipt by the regulators. Fund managers will continue to prepare and file the simplified prospectus, annual information form, financial statements and management reports of fund performance according to current practice.

Fund managers will have to update and file the Fund Facts when they file their annual and interim continuous disclosure documents. If fund managers want to provide more current information to investors, they may update and file the Fund Facts more often, but no more frequently than quarterly, unless there is a material change.

#### **Material changes**

Fund managers will have to update and file a new or revised Fund Facts if there is a material change to the information in the Fund Facts. These material changes will be treated the same way that any other material change to the prospectus is currently treated. This means the fund manager will have to obtain a receipt for the Fund Facts amendment before using the amended Fund Facts.

#### **Certificate requirements**

The certificate requirements for mutual fund prospectuses will be amended so that the certificates are forward looking. This is similar to the requirements for the short form prospectus offering system in National Instrument 44-102 *Shelf Distributions*.

The forward-looking certificates will apply to all updates of the Fund Facts. If a mutual fund files a prospectus amendment because of a material change to the simplified prospectus or to the Fund Facts, new certificates will be needed.

#### **Regulatory review**

Securities regulators will review the Fund Facts the same way they review other documents that are currently incorporated by reference into the simplified prospectus.

When the review has been completed, the regulator will issue a receipt for the prospectus. The mutual fund may not be sold until the regulator in each province where the fund will be offered has issued a receipt or where there is a deemed receipt under the passport system in provinces where this system is available.

Regulators may review updates of the Fund Facts as part of a continuous disclosure review, but will not receipt them.

### **Segregated funds**

#### **Filing requirements**

The insurer will have to file Fund Facts with insurance regulators in provinces where filing is required. The Fund Facts will have to be filed annually, together with the other documents that form part of the insurance contract, for receipt in provinces where receipting occurs.

Insurers will have to update and file the Fund Facts semi-annually in provinces where filing is required. Insurers may update and file the Fund Facts no more frequently than quarterly, unless there is a material change.

### **Material changes**

Insurers will have to update and file a new or revised Fund Facts in provinces where filing is required if there is a material change to the fund. 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.

### **Regulatory review**

The Fund Facts will form part of the information folder that insurance regulators will review according to their current practices.

When the review has been completed, the insurance regulator will issue a receipt in provinces where receipting occurs.

Regulators will review updates to the Fund Facts that result from material changes according to their current practices and will receipt them in provinces where receipting occurs.

### **Questions about updating the Fund Facts**

The proposed framework allows fund managers and insurers to update the Fund Facts no more frequently than quarterly. Although we want to give industry the ability to disclose reasonably current investment and performance information by allowing quarterly updates, we also want to ensure that investors can easily compare funds. A comparison might be difficult if information in one Fund Facts document is more current than information in another Fund Facts document.

10. Fund managers and insurers: How often would you want to update the Fund Facts? If more or less frequently than quarterly, with what frequency and why?

11. Investors: How current do you want the Fund Facts to be? Would a document that contains investment and performance information that is no more than 6 months old meet your information needs?

### **Meeting the delivery requirement**

Dealers and insurers will have two obligations for meeting the delivery requirement:

- The dealer or insurer will have to deliver the Fund Facts to the investor before or at the point of sale.
- Once delivered, the dealer or insurer will have to bring the Fund Facts to the attention of the investor.

These obligations are designed to give investors an opportunity to review the information and ask questions before they make a purchase.

## **Changes to current delivery requirements**

### **Mutual funds**

The existing delivery requirements will be amended to allow dealers to meet their delivery obligation for the simplified prospectus by delivering only the Fund Facts. Dealers will have to deliver the simplified prospectus to investors only on request.

### **Segregated funds**

Fund Facts will become part of the information folder (see Appendix 3). The current requirements for delivering it will not change.

## **Proving receipt of the Fund Facts**

### **Mutual funds**

Dealers will not be required to have investors acknowledge receipt of the Fund Facts. Dealers may impose their own requirements as part of their compliance policies and procedures for delivery obligations.

### **Segregated funds**

Insurers will have to include a signature line on the insurance contract application for the investor to acknowledge that they have received the Fund Facts for all segregated funds selected on the application. Investors will not have to acknowledge receipt for subsequent purchases.

## **Providing other materials at point of sale**

The proposed framework permits dealers and insurers to provide investors with advertising or marketing material before or at the point of sale. If other materials are provided, the adviser will still have to bring the Fund Facts to the attention of the investor. The existing rules relating to advertising and marketing material will continue to apply.

## Next steps

We welcome comments generally and on any aspect of our proposed point of sale disclosure framework from investors and industry participants. We will accept comments until October 15, 2007.

We will review and consider all comments, and conduct any additional consultation that we think is necessary. We will then finalize our proposed framework, subject to government review and approvals and, in the jurisdictions where it may be required, changes to laws.

### How to send us your comments

Please send your comments to Neil Mohindra at the address below by **October 15, 2007**.

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All comments we receive are public and will be posted on the Joint Forum's website at [www.jointforum.ca](http://www.jointforum.ca).

### For more information

If you have questions about the proposed framework, please contact the Joint Forum Project Office.

## **Joint Forum Point of Sale Committee**

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