



Canadian Foundation *for*  
Advancement *of* Investor Rights

September 16, 2015

British Columbia Securities Commission  
Alberta Securities Commission  
Financial and Consumers Affairs Authority of Saskatchewan  
Manitoba Securities Commission  
Ontario Securities Commission  
Autorité des marchés financiers  
Financial and Consumer Services Commission (New Brunswick)  
Office of the Superintendent of Securities, Prince Edward Island  
Nova Scotia Securities Commission  
Office of the Superintendent of Securities, Newfoundland and Labrador  
Office of the Superintendent of Securities, Northwest Territories  
Office of the Yukon Superintendent of Securities  
Office of the Superintendent of Securities, Nunavut

The Secretary  
Ontario Securities Commission  
20 Queen Street West  
19<sup>th</sup> Floor, Box 55  
Toronto, ON M5H 3S8  
Sent via e-mail to: [comments@osc.gov.on.ca](mailto:comments@osc.gov.on.ca)

M<sup>e</sup> Anne-Marie Beaudoin  
Corporate Secretary  
Autorité des marchés financiers  
800, square Victoria, 22e étage  
C.P. 246, tour de la Bourse  
Montréal, QB H4Z 1G3  
Sent via e-mail to: [consultation-en-cours@lautorite.qc.ca](mailto:consultation-en-cours@lautorite.qc.ca)

**RE: CSA Notice and Request for Comment – Mandating a Summary Disclosure Document for Exchange-Traded Mutual Funds and Its Delivery**

---

FAIR Canada is pleased to offer comments on the Canadian Securities Regulators (“CSA”) Notice and Request for Comment regarding Mandating a Summary Disclosure Document for Exchange-Traded Mutual Funds and its Delivery (the “Notice”) which will require a short summary disclosure document known as “ETF Facts” to be made available to investors and that will be required to be delivered to investors within two days of the purchase (“ETF Facts”).

FAIR Canada is a national, charitable organization dedicated to putting investors first. As a voice of Canadian investors, FAIR Canada is committed to advocating for stronger investor protections in securities regulation. Visit [www.faircanada.ca](http://www.faircanada.ca) for more information.

## EXECUTIVE SUMMARY

1. FAIR Canada supports the development of concise, meaningful, plain language documents for various types of investment funds, including exchange traded funds (“ETFs”), that highlight key information of importance to investors so they can make more informed investing decisions. We have urged securities regulators to develop such documents and are pleased to see that this has been done for ETFs.
2. FAIR Canada also fully supports the requirement for delivery of the fund facts documents to retail investors so they can make more informed investing decisions. In order to be meaningful, delivery of ETF Facts should occur *before* the sale of the fund as is the case for mutual funds. If ETF Facts are to reach investors before the sale, securities regulators need to mandate the delivery of ETF Facts before sales occur.
3. We also encourage investor testing of the ETF Facts document after implementation of the ETF Facts (including the delivery requirement) in order to ensure that the ETF Facts document is meeting its disclosure objectives and that it is understood and used by investors as anticipated and expected. We recommend that any necessary changes be made in light of the findings.
4. FAIR Canada believes disclosure is important and the point of sale initiative is a worthwhile endeavour. However, disclosure is not a panacea for the existing gaps in financial consumer protection. We caution regulators against relying solely on disclosure and encourage continued progress on initiatives aimed at bolstering protection for retail financial consumers such as implementing a statutory best interest standard and banning embedded trailing commissions and other forms of conflicted remuneration. FAIR Canada recommends that members of the CSA consider the findings made in the area of behavioural economics, both in terms of designing ETF Facts and designing summary disclosure for other types of investment funds and also in considering how to ensure adequate investor protection.
5. FAIR Canada recommends that the CSA provide an unbiased brochure “Understanding Investment Funds” for ETFs, mutual funds and other commonly held investment funds that would replace the existing “Understanding Mutual Funds” brochure in light of the investor testing which, not surprisingly, found that investors have a low level of understanding of investment products including ETFs. The brochure should be designed so that it can be used to help investors understand what are mutual funds, exchange traded funds and other common investment funds sold to retail investors, how they are created and structured and their key differences, including the fact that, unlike mutual funds, ETFs are traded over an exchange. In addition, the brochure could help investors understand the information contained in the mutual fund facts and ETF Facts documents as well as provide, in plain language, information explaining compensation structures, different fee models, and any potential inherent conflicts of interest.
6. FAIR Canada makes specific comments on the ETF Facts document at section 3 below and on leveraged and inverse ETFs at section 4 below.
7. FAIR Canada recommends that rules be reformed so that ETF Fund managers cannot close the ETF or make material changes to the fund without a shareholder vote, similar to mutual funds.
8. FAIR Canada urges securities regulators to police fund names so that they are not misleading.

## 1. Require Delivery Prior to Point of Sale

- 1.1. In the Joint Forum Proposed Framework 81-4065<sup>1</sup>, the Fund Facts document for mutual funds was to be delivered “when [investors] need it most – before they make their decision to invest”. Under the current proposal, the focus is on “providing investors with the opportunity to make more informed investment decisions, by giving investors *access* to key information about an ETF, in language they can easily understand”<sup>2</sup>. The purpose of delivery of the ETF Facts appears to be to “help improve the consistency with which disclosure is provided to investors of ETFs and help create a more consistent disclosure framework between conventional mutual funds and ETFs”<sup>3</sup> and “...investors in conventional mutual funds and ETFs will be treated more equally with respect to the *disclosure available* in connection with a purchase of securities”<sup>4</sup> (our emphasis).
- 1.2. FAIR Canada does not believe that access amounts to delivery and does not believe that delivery any time following the sale is a time that is relevant to the investor’s decision, since the decision has already been made. The testing of summary disclosure or “fund facts” documents with investors has consistently confirmed that investors want to receive such disclosure (both Mutual Fund Facts and ETF Facts) before they make a decision to invest in a fund<sup>5</sup>. As the CSA is well aware, “[i]nvestors want to receive the Fund Facts sheet prior to the sale or have their financial adviser go over it with them. **It would not be useful to receive it after the sale.**”<sup>6</sup> [emphasis added] It is seemingly obvious that, in order to improve an investor’s decision-making, the ETF Facts document needs to be provided before the sale. Given the reliance retail investors place on the individuals who provide them with advice, receiving the ETF Facts at or prior to the point of sale is essential for the document to be used as intended. Once the investor has had a recommendation provided to him or her and made an investment decision, they will not be able to use the ETF Facts document to inform their decision.
- 1.3. Furthermore, investors’ behavioural biases also “...decrease the likelihood that they will... exercise their right to cancel their purchase even after receiving information that tells them their original purchase decision was unwise.”<sup>7</sup> It is expected that confirmation bias will affect the investor’s reading of the ETF Facts document after the investment decision has been made, thus rendering it useless for its intended purpose. Receiving it after the sale is not helpful.
- 1.4. FAIR Canada sees no reason (including the differences in the distribution model for ETFs as described in the Notice) that justifies not requiring delivery of the ETF Facts prior to sale as the CSA has mandated for the mutual fund facts document. From the perspective of the investor, it is

---

<sup>1</sup> Joint Forum of Financial Market Regulators, “Proposed framework 81-406: Point of sale disclosure for mutual funds and segregated funds” (June 15, 2007), online:

[http://www.jointforum.ca/en/init/point\\_of\\_sale/proposed\\_framework\\_81-406.pdf](http://www.jointforum.ca/en/init/point_of_sale/proposed_framework_81-406.pdf).

<sup>2</sup> CSA Notice (2015) 38 OSCB 5509 at page 5511.

<sup>3</sup> CSA Notice (2015) 38 OSCB 5509 at page 5509.

<sup>4</sup> CSA Notice (2015) 38 OSCB 5509 at page 5511.

<sup>5</sup> For mutual fund facts document, see: the Research Strategy Group, “Fund Facts Document Research – Report” (October 25, 2006), at 141 (Appendix 5), online:

[http://www.jointforum.ca/en/init/point\\_of\\_sale/Appendices\\_4-5.pdf](http://www.jointforum.ca/en/init/point_of_sale/Appendices_4-5.pdf). For the ETF Facts, “87% of investors want ETF Facts prior to purchase” and “52%...would read ETF Facts completely if considering investing in the ETF. See: CSA Point of Sale Disclosure Project - ETF Facts Document Testing, Prepared by: Allen Research Corporation, (January 2015) at page 28, online: <https://www.osc.gov.on.ca/documents/en/InvestmentFunds/etf-facts-document-testing.pdf>.

<sup>6</sup> Fund Facts Document Research – Report, at page 68.

<sup>7</sup> Joint Forum of Financial Market Regulators, “Proposed framework 81-406: Point of sale disclosure for mutual funds and Segregated Funds”, prepared by: Canadian Securities Administrators and Canadian Council of Insurance Regulators (June 15, 2007), at page 6, online:

[http://www.jointforum.ca/en/init/point\\_of\\_sale/proposed\\_framework\\_81-406.pdf](http://www.jointforum.ca/en/init/point_of_sale/proposed_framework_81-406.pdf).

just as important that the ETF Facts be delivered before the sale as it is the mutual fund facts document be so delivered. We urge the CSA to be consistent and require pre-sale delivery of the ETF Facts. If this requires other changes to securities laws and/or regulations, then those amendments should be sought.

#### **Require Pre-Sale Delivery to All Retail Investors**

- 1.5. FAIR Canada supports the requirement for pre-sale delivery of ETF Facts to all retail investors whether utilizing the services of a representative or a discount broker. The intended purpose of the ETF Facts document is to provide a plain language document to assist investors in their decision-making process and this should result in delivery before sale for all investors. Technology makes this easy for on-line purchases.

#### **Make Prospectuses More Readable and Require Delivery**

- 1.6. We continue to be concerned about non-delivery of the prospectus to investors. In FAIR Canada's view, the prospectus provides important information that is not available in a fund facts document. A fund facts document is not intended to be a comprehensive disclosure document; instead, it is meant to highlight key information that is important to investors. We encourage the CSA to require delivery of the prospectus following the sale of an investment fund, and to reform the prospectus into a more meaningful disclosure document for investors, which will compliment the key information provided in the fund facts document. We take issue with the CSA's response to evidence that investors do not read the prospectus. Instead of responding by not requiring delivery of the prospectus, we would prefer to see the CSA take steps to make the prospectus a more readable, and thus an actually useful, document for investors.

#### **Access to the ETF Facts**

- 1.7. The proposed amendments set out in the Notice include requiring that the ETF Facts be posted to the website of the ETF or ETF's family and "be displayed in a manner that would be considered prominent to a reasonable person." FAIR Canada strongly recommends that the CSA require ETF providers to post the ETF Facts on their websites as the primary document that investors will reference rather than require investors to navigate the ETF provider's website to find the document buried under "legal and regulatory documents". FAIR Canada notes that it is often very difficult to locate the fund facts document for mutual funds or the plan summaries for group scholarship plans on the provider's website.
- 1.8. Additionally, ETF providers should not be permitted to call marketing documents "Fact Sheets" or similar names that could easily be confused for the ETF Facts.

## **2. General Comments on Approach**

- 2.1. Investor testing of the ETF Facts reflects the low standard of financial literacy in Canada and highlights the challenges inherent in trying to help retail investors make better investment decisions through the use of a summary document. FAIR Canada is concerned that some of the findings from the testing of the document have been ignored rather than reflected in the final draft ETF Facts or elsewhere in the regulatory regime for ETFs. For example, the findings demonstrate that certain sections such as the highlighted textbox at the top of the ETF Facts were not read and were ignored and that a significant number of investors do not know what an ETF is (even after reviewing the document), do not understand what an index is, and do not understand how the investments for an index ETF are chosen. Such findings need to be addressed in the ETF Facts itself or through the creation of a separate "Understanding Exchange Traded Funds" brochure or through other means. If the CSA determined that the findings cannot be addressed in the ETF Facts but may be done elsewhere, it should discuss this approach in the Notice.

- 2.2. FAIR Canada believes that disclosure is important and that the point of sale initiative is a worthwhile endeavour. However, disclosure is not a panacea for the existing gaps in financial consumer protection. We caution regulators against relying solely on disclosure and encourage continued progress on initiatives aimed at bolstering protection for retail financial consumers such as implementing a statutory best interest standard and banning embedded trailing commissions. FAIR Canada recommends that members of the CSA consider the findings made in the area of behavioural economics, both in terms of designing summary disclosure documents (i.e. improving disclosure) and also in considering how to ensure investors are adequately protected.
- 2.3. It is our expectation that the ETF Facts and mutual fund facts documents will encourage retail investors to ask more questions about their investments, and we endorse the idea of the CSA providing an unbiased brochure for more information. FAIR Canada recommends that the CSA provide such an unbiased brochure in the form of “Understanding Investment Funds” for ETFs, mutual funds and other commonly held investment funds. This would replace the existing “Understanding mutual funds” brochure in light of the investor testing. The brochure should be designed so that it can be used to help investors understand what are mutual funds, exchange traded funds and other common investment funds sold to retail investors, how they are created and structured, and their key differences. In addition, the brochure could help investors understand the information contained in the mutual fund facts and ETF Facts documents as well as provide, in plain language, information explaining compensation structures, different fee models, and any potential inherent conflicts of interest. Likewise it should explain that mutual funds and ETFs are not insured by the Canadian Deposit Insurance Corporation, how costs impact the risk of a fund, and how costs impact long term performance (the best predictor of an investment fund’s returns is its expense ratio rather than its past performance<sup>8</sup> ). The brochure’s use of language should be consistent with that of the fund facts disclosure documents - for example, the term “representative” should be used rather than “advisor” as is currently used.

### **3. Comments on the ETF Facts Document (Form 41-101F4)**

#### **Passive ETFs**

- 3.1. Qualitative investor testing revealed that “some investors” did not know what the Index is or what ETF stands for and that only “a few investors understood this ETF is a passive fund.”<sup>9</sup> Quantitative testing demonstrated that, of ETF investors, 4 out of 10 incorrectly believed the Index is made up of all the stocks on the TSX and 3.4 out of 10 incorrectly thought the fund manager chooses stocks to make up the ETF.<sup>10</sup> Both ETF investors and non-ETF investors did not fully understand the core principles behind the choice of investments for the XYZ S7P/TSX 60 Index ETF.<sup>11</sup>
- 3.2. In light of the level of investor understanding, FAIR Canada makes the following recommendations to assist investors:
- (i) The “Quick facts” section of the ETF Facts should state whether the given ETF is active or passive. The fact that the name of the ETF includes the word “xyz index” is not sufficient to convey this information to investors.
  - (ii) The rules should require that the ETF Facts specify how the index works, including how it is comprised (whether it is based on market capitalization, equal weighted, an asset class

---

<sup>8</sup> Russel Kinnel, “How Expense Ratios and Star Ratings Predict Success” (August 9, 2010), available online at: <http://news.morningstar.com/articlenet/article.aspx?id=347327>.

<sup>9</sup> CSA Point of Sale Disclosure Project ETF Facts Document Testing, at page 39.

<sup>10</sup> *Ibid* at page 69.

<sup>11</sup> *Ibid* at page 68.

or some other basis)<sup>12</sup>. It should be pointed out that the composition of the index may change in the future and that the composition of the index is not determined by the fund manager. It should explain how the fund attempts to replicate the index (by direct investment in the constituents of the index, by stratified sampling or by synthetic exposure through a derivative). It is important to note that an investor cannot understand the fund if they don't understand the index it tracks.

- (iii) The "Quick facts" section should state when the index was created. There are well-established indices that are referenced by many in the industry, but there also are many indices that are created nearly at the same time as a given ETF meant to track that new index.

### **Actively Managed ETFs**

- 3.3. For actively managed ETFs, it should be clearly stated in the "What does the ETF invest in?" section, that the manager exercises discretion over the composition of the invested portfolio in an attempt to outperform a chosen benchmark and can adjust the portfolio composition without being subject to the set rules of an index.

### **Synthetic versus Physical Replication ETFs**

- 3.4. While we recognize that, at present, most ETFs in Canada are not synthetic, nonetheless, the "Quick facts" section should indicate whether the ETF is synthetic or is a physical ETF. Under the section "What does the ETF invest in?", a brief explanation of the synthetic nature of the ETF, if applicable, should be provided along with a clear statement that it involves the use of derivatives. For synthetics, it should also be made clear that the ETF will not receive dividends.

### **Risk Section**

- 3.5. FAIR Canada believes the risk section of ETF Facts should be reformed in accordance with our comments made by letter dated March 12, 2014 on the proposed risk calculation methodology<sup>13</sup>. Fund Facts for any type of investment fund should follow the principles and best practices of the International Organization of Securities Commissions ("IOSCO"), including IOSCO's Principle 1<sup>14</sup>. If a synthetic indicator such as volatility risk is used it should be supplemented by (a) a narrative explanation of the indicator and its main limitations, and (b) a narrative explanation of risks which are materially relevant to the mutual fund and which are not adequately captured by the synthetic indicator. At present, ETF Facts provide a narrative explanation of the indicator but does not mention its main limitations, nor does it provide any narrative explanation of risks which are relevant to the ETF and which are not adequately captured by the synthetic indicator.
- 3.6. Specific risks may arise from ETFs as a result of their use of derivatives, their synthetic nature (if applicable), securities lending agreements, or complex investment strategy. A narrative explanation of the key risks (counterparty risk, liquidity risk, currency risks, tracking error, etc.) should be provided. The issue of liquidity with ETFs (and the risk of illiquidity) and the disclosure of average daily volume and number of days traded being information that helps determine liquidity of the ETF, along with the risks involved given that ETFs trade on exchanges, all need to be explained to investors.

---

<sup>12</sup> This information should be specified as part of the requirement in Form 41-101F4 to "briefly describe the nature of that permitted index or those permitted indices."

<sup>13</sup> FAIR Canada Letter to CSA dated March 12, 2014; available online at: <http://faircanada.ca/wp-content/uploads/2011/01/FAIR-Canada-comments-re-CSA-risk-classification-methodology-proposal.pdf>.

<sup>14</sup> IOSCO Principles on Point of Sale Disclosure, Final Report (February 2011), at page 28.



- 3.7. FAIR Canada has observed that existing risk disclosure by some ETF providers in their summary disclosure document (the “Summary Document”) (which is provided to investors as a result of exemptive relief granted from the existing prospectus delivery requirements<sup>15</sup>) is inadequate. For example, it is not adequate to use boilerplate language such as: “All investments involve risks. When you invest in the ETF the value of your investment can go down as well as up. For a description of the specific risks of this ETF, see the ETF’s prospectus.”<sup>16</sup> The prospectus for this ETF provides that it is a commodity pool and is highly speculative. However, it is questionable whether an investor will read the prospectus given that it is not delivered automatically and the investor must specifically request it. Such deficient risk disclosure does not ensure adequate investor protection. Such disclosure should be corrected swiftly and long before the implementation date for ETF Facts.

### Performance Section

- 3.8. The ETF Facts section “How has the ETF performed?” provides an opportunity to help investors distinguish the index that the ETF is trying to track (if an index ETF) from the ETF fund itself and how large any tracking error is. Accordingly, we recommend that the ETF Facts provide a chart comparing the performance of the fund with that of the performance of the index.
- 3.9. Make it clear that the ETF’s returns “will likely not match the returns of the [insert name of index] rather than “may not match”. Returns of the ETF will likely be lower as a result of expenses and tracking error.
- 3.10. FAIR Canada believes that past performance should be shown based on both market value and Net Asset Value (NAV) as the difference between the two allow the investor to see the level of tracking error.

### Costs Section

- 3.11. The investor testing demonstrated that investor understanding of the various components of costs such as trailing commissions, brokerage commissions, fee-based accounts (and whether brokerage commissions are included in the fees paid in such an arrangement) was low. In addition, investors were confused by whether the ETF Facts was telling them information applicable to the specific ETF Fund or to ETFs in general. The section requires further work in order to be clear to investors.
- 3.12. FAIR Canada makes the following suggestions to improve the section:
- (i) Brokerage commissions – Advise investors here that the amount of the brokerage commission will depend on the type of account they hold – a fee-based account, a commission based account or an account at a discount brokerage – and that the amount of commission may be negotiable. Advise investors that they should review the documents they signed when opening the account or contact their representative to find out this information.
  - (ii) Impact on Costs if Buying or Selling in Small Units – Investors should be advised that it may cost them more in commissions if they purchase small amounts frequently rather than execute one larger “buy” or “sell” order, depending on the type of account they have.

---

<sup>15</sup> Pursuant to exemptive relief obtained, ETF providers such as Horizons are required to deliver to investors a summary disclosure document (the “Summary Document”) instead of being required to comply with prospectus delivery requirements under securities legislation. See the Notice, (2015), 38 OSCB 5509 at 5510 including note 6.

<sup>16</sup> Summary Document for Horizons Seasonal Rotation ETF dated August 25, 2014.

- (iii) ETF Expenses and the Trailing Commission:
- The trailing commission is not understood by most investors and the explanation provided in both ETF Facts and Mutual Fund Facts is deficient. FAIR Canada opposes the use of trailing commissions and urges securities regulators to ban them.
  - Investor testing showed that while 60% of ETF investors knew that ETFs may carry a trailing commission, only 48% of investors read the last sentence in the section that tells them whether or not this ETF has a trailing commission. This suggests the document's format needs to be improved.
  - FAIR Canada believes that if the ETF Fund has a trailing commission, it should be so indicated in the explanation of Management Expense Ratio "This is the total of the fund's management fee (**which includes the trailing commission**) ..." (my emphasis). A section should be added titled "More about the trailing commission" which sets out what the trailing commission is (in dollars and on a per cent basis). If there is no trailing commission, the explanation of Management Expense Ratio should omit the words "including the trailing commission" and the section "More about the trailing commission" should state "No trailing commission is charged" and indicate in dollars and cents that it is \$0. Investors wanted to see this shown<sup>17</sup>.
  - The "More about the trailing commission" section should have an explanation, at a minimum, similar to the mutual fund facts document explaining that the trailing commission is paid to the representative's firm from the management fee. At present, the ETF Facts omit any description that would alert the investor to the conflicts of interest and misaligned incentives produced through the use of trailing commissions for ETFs. While fewer ETFs may utilize trailing commissions as compared to mutual funds, they can still be a significant cost to investors and we have seen trailing commissions on ETFs of 0.75% and resulting MERs of 2.5%. As long as securities regulators continue to permit the use of trailing commissions, it is vitally important that they be clearly disclosed to investors and that they be described in an accurate manner. This is not the case presently.
- (iv) ETF Expenses - This should be called "Fund expenses" to be consistent with the mutual fund facts document and should consist of the MER (including trailing commission) and TER.
- (v) Other Fees - Any other fees that are charged and not included in the MER or the TER should be listed here, such as redemption fees. If there are no other fees, it should indicate that there are none under "Other Fees".

### Format of ETF Facts

- 3.13. We suggest the information be formatted in a fashion similar to that of the mutual fund facts document by providing separation in boxes rather than simply columns.
- 3.14. The document's title should be XYZ Exchange Traded Fund rather than XYZ ETF given that some investors do not know what an ETF is and the title was not always understood<sup>18</sup>. Similarly, the

---

<sup>17</sup> CSA Point of Sale Disclosure Project – ETF Facts Document Testing, at page 27.

<sup>18</sup> *Ibid* at page 18.



mutual fund facts document should have “mutual fund” at the top so people can quickly identify that it is a mutual fund.

- 3.15. The section “Who is this ETF for” should come earlier in the document and certainly before “How ETFs are priced” or “A word about tax”.
- 3.16. ETF Facts should specify if the ETF is a commodity pool versus a type of mutual fund, as this indicates that there may be much greater risk associated with the fund. The term ETF should not be permitted if the product is an exchange traded commodity (ETC), an exchange traded note (ETN) and exchanged traded instrument (ETI) or an exchange traded vehicle (ETV).

#### **4. Leveraged and Inverse ETFs and other Complex ETFs**

- 4.1. Investor testing of these types of ETFs was limited to the end of the session where a second ETF Facts for a leveraged ETF was briefly shown and investors were directed to read the initial textbox and the opening paragraph of “What does the ETF invest in?” It should be noted that when testing the first ETF Facts document (XYZ S&P/TSX 60 Index ETF), several investors did not read the textbox (the introductory paragraph), assuming it was a legal disclaimer or unimportant.<sup>19</sup> This makes it questionable whether investors will read this textbox if not prompted to do so, and regulators should not rely on textbox disclosure to adequately protect investors of leveraged and inverse ETFs or other types of investments. It should be noted that, under the existing regulatory framework, OBSI statistics reveal there continue to be retail investors who are inappropriately placed into leveraged and inverse ETFs<sup>20</sup>.
- 4.2. Even for those investors who were prompted to read it, only 77% understood that the fund is very risky and only 67% understood that it is a short-term investment.<sup>21</sup>
- 4.3. In order to provide more adequate investor protection, FAIR Canada recommends:
  - (i) ETF providers should not be able to suggest in their advertising and marketing that these products are suitable to be held as long-term investments, including being bought and held long-term in an RRSP or RESP account.
  - (ii) High risk products need pop-up risk warnings on the websites of their providers and on discount brokerage websites. The pop-up warning should inform the investor of the boxed risk warning and any unusual risks (for example, that a commodity ETF does not track the return of the relevant commodity over time periods long than a day). It should require the investor to agree that they understand the warning prior to permitting the transaction to take place.
  - (iii) Securities regulators should undertake empirical research as to how many retail investors have these products in their accounts, and in which type of accounts these investments are held.
  - (iv) Securities regulators need to ban embedded commissions and other forms of conflicted remuneration so that the interests of advisors and their clients are not subject to such profound misalignment of interests.

---

<sup>19</sup> CSA Point of Sale Disclosure Project – ETF Facts Document Testing, at page 38.

<sup>20</sup> OBSI 2013 Annual Report had 15 cases where the main issue involved leveraged ETFs and 6 where it was the secondary product. In their 2014 Annual Report this was 1 case where the main issue involved leveraged ETFs and 1 where it was the secondary product. Annual reports of OBSI are available online at <https://www.obsi.ca/en/news-and-publications/annual-report>.

<sup>21</sup> CSA Point of Sale Disclosure Project – ETF Facts Document Testing, at page 109.

- (v) A statutory best interest standard is urgently needed to adequately protect investors. An investment product should only be recommended if it is in the person's best interests.

## **5. Investor Testing After Implementation of Point of Sale Recommended**

- 5.1. FAIR Canada recommends that investor testing of the ETF Facts be conducted subsequent to implementation of pre-sale delivery to ensure that the ETF Facts document is meeting its disclosure objectives, is assisting investors in their decision-making process, and is being understood and used by investors as anticipated and expected.
- 5.2. In FAIR Canada's view, an essential benefit of the ETF Facts document is that it will allow investors to compare the risks, costs, benefits, and other characteristics of different ETFs in order to make informed investment decisions. However, in light of evidence of heavy reliance by investors on advice they receive from representatives, it remains to be seen what effect ETF Facts will have on investors' decisions. Testing should seek information on how the ETF Facts are used in the sales process and whether representatives' explanations help investors to better understand the information ETF Facts is meant to convey. We encourage the CSA to design its testing with this in mind.
- 5.3. In particular, as discussed in this submission, changes to improve clarity and the use of more precise language are needed in order to enhance its effectiveness. In addition to the sections noted above (including the risk section), we note the following areas may need improvement (although other areas may come to light as a result of the investor testing):
- "How much does it cost?" section
    - Do investors understand how representatives get paid upon reading this section? Do they understand how much it will cost to purchase and own the ETF (the initial and ongoing costs)?
    - The language used to disclose conflicts of interest and trailing commissions will likely not succeed in alerting investors to the fact that their representative does not have an obligation to act in their best interest and that conflicts of interest resulting from the payment of trailing commissions may skew recommendations.
    - The language stating "You don't pay these expenses directly. They affect you because they reduce the fund's returns..." may not be sufficiently clear to convey to investors that, as a result, investors' returns are reduced. We recommend that the CSA's investor testing include questions to determine whether investors understand the implications of reduced fund returns. If they do not, FAIR Canada recommends that the language be revised to make it clear that fund expenses reduce investors' returns and that investors pay these expenses, albeit indirectly.
    - The language stating "XYZ ETFs waived some of the fund's expenses. If it had not done so, the MER would have been higher." Such language could potentially be confusing or misleading to investors. We recommend that the annual rate of the MER be presented without language indicating that the MER could have been higher; alternatively, we would suggest adding language to the effect that, had the fund waived more of the expenses or managed the fund more economically, the MER would have been lower.
  - "What if I change my mind?" section

- Harmonization of withdrawal and rescission rights amongst CSA jurisdictions would allow for clear language stating rights of investors. Vague language regarding rights is not helpful and will likely not result in investors exercising those rights.

## 6. Other Recommendations

- 6.1. FAIR Canada recommends that rules be reformed so that ETF Fund managers cannot close the ETF or make material changes to the fund without a shareholder vote, similar to mutual funds.
- 6.2. FAIR Canada urges securities regulators to police fund names so that they are not misleading. We have seen funds that are almost entirely equities called “income” funds. While the use of the term “index” is used in the name if it is a passive fund, it would improve clarity to call ETFs that are not passive funds, “active” or “actively managed” in their name if not an index fund.

## 7. Transition Period

- 7.1. A transition period of two-years following the effective date of the Proposed Amendments to require delivery two days *after* the sale seems unduly long but in no event should it be further extended while other issues are being determined.

We thank you for the opportunity to provide our comments and views in this submission. We welcome its public posting and would be pleased to discuss this letter with you at your convenience. Feel free to contact Neil Gross at 416-214-3408 ([neil.gross@faircanada.ca](mailto:neil.gross@faircanada.ca)) or Marian Passmore at 416-214-3441 ([marian.passmore@faircanada.ca](mailto:marian.passmore@faircanada.ca)).

Sincerely,



Canadian Foundation for Advancement of Investor Rights