

Point Of Sale Rules Too Simplistic: Expert

BY MARK NOBLE

The Canadian Securities Administrators' National Instrument 81-406 is too simplistic and will cause a logistical headache for the primary distributor of investment funds, says a noted securities lawyer.

Announced last year, one of the lynchpins of NI 81-406's 216-page proposal is the implementation of a fund-facts document that must be shown to a client before the sale of mutual funds and segregated funds.

The two-page fund-facts document is written at a grade five level and is supposed to include basic information about the fund as well as about the advisor and fund companies' compensation. An announcement about whether NI 81-406 will be enacted is expected at the end of June.

Rebecca Cowdery explains that the CSA's proposed legislation seems to have been made in a vacuum, without taking into consideration other rules already governing the fund industry or the fact the majority of fund sales are conducted by advisors.

"There is no acknowledgment of the important role of a dealer. You can't buy a fund without going to a dealer. There are all sorts of regulations for mutual fund dealers," said Cowdery, partner with Borden Ladner Gervais' investment management group. "The MFDA regulates mutual fund dealers. They've got to do suitability – according to a recent 28-page MFDA suitability notice – they've got to recommend the fund that is suitable for your investment. What are you going to

get from a two-pager that's written at a grade five writing level?"

Other registration reform information will also be associated with NI 31-103, which the CSA wants to have implemented by March of 2009. Cowdery says there is criticism about why the fund-fact document is being developed separately from this legislation as well. It would make more sense to have the point of sale disclosure documents harmonized with the know-your-client process.

"There is an assumption that investors will make better decisions based on a two-pager that is too simplistic to give much information, let alone effective information," she said.

There are also the logistics of delivery of the fund-fact document, which once again seems to disregard the dealer model. Cowdery says the point-of-sale rules will require a fund-fact document for not only every mutual fund mandate, but also every class. They must be physically shown to

the investor before purchasing.

For a larger fund company with a multitude of mandates and classes, this could mean producing more than 2,500 unique fund-fact documents. An advisor will have to have hundreds of paper fund-fact documents on hand.

Cowdery also notes the insistence on physical paper seems an archaic rule for an increasingly electronic environment.

"When dealers are going out to their clients are they supposed to bring 200 of these fund-fact documents with them?" she said. "Is that really true, do investors want a piece of paper to read over? Why is this just for mutual funds?"

As such, Cowdery is also concerned that regulators are unfairly burdening mutual funds, which are a continuous offering – being held to onerous disclosure standards not even required in the publicly traded securities market (where most of the disclosure concepts were derived from).

"An investor buying a mutual

fund will have different remedies than somebody who bought an investment fund on the secondary market," she said. "[Traditionally] if you redeem a mutual fund you would have no rights. It's built into the statute now that there is liability when an investor wants to redeem, and there is misrepresentation in any of the continuous disclosure documents including sales communication. That redeeming investor will be able to use that right to sue for damages."

Although admitting it may be a bit of a "doomsday" scenario, Cowdery doesn't believe it's outside the realm of possibility mutual funds will cease to be a staple investment product for some, if the point-of-sale rules are implemented as is. If the regulators persist, "you know what dealers are going to focus on?" she asks. "They're going to focus on something that is easier to sell. They are going to recommend something that's easier to recommend." **AER**