Joint Forum of Financial Market Regulators

Forum conjoint des autorités de réglementation du marché financier

# Regulation of Point of Sale Disclosure for Segregated Funds and Mutual Funds

**A Background Research Report to Consultation Paper 81- 403**

**of the Joint Forum of Financial Market Regulators**

**Prepared by staff of the Ontario Securities Commission and the Financial Services Commission of Ontario**

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# Outline of this paper's contents

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# Executive summary

This paper summarizes the legal research we conducted while preparing the consultation paper entitled, *Rethinking Point of Sale Disclosure for Segregated Funds and Mutual Funds*. The consultation paper prepared for the Joint Forum of Financial Market Regulators (the Joint Forum) sets out proposals to improve and harmonize the way information about segregated funds and mutual funds is conveyed to consumers who are facing investment decisions.

Our primary focus in this paper is on the legal requirements governing how and when consumers receive information about their investment decisions and the rights that flow to them when they get this information. We do not evaluate the relatively unambiguous form and content of point of sale disclosure documents nor do we focus on the information that is available to consumers after the time that they complete their purchase of a segregated fund or mutual fund.

After we describe the general framework for point of sale disclosure documents, we analyze the law requiring market participants to give these documents to consumers. The delivery requirements differ from each other in a number of respects:

- The delivery requirements for segregated fund disclosure documents are harmonized across the country, while the delivery requirements for mutual fund documents vary among provinces.

- The insurance company is responsible for delivering segregated fund documents to consumers, while the dealer, not the mutual fund manager, is responsible for delivering mutual fund documents.

- Segregated fund documents must be delivered before the point of sale, while mutual fund documents are usually delivered shortly thereafter.

- Once a policyholder receives a segregated fund disclosure document and concludes a purchase, that decision is considered final. Mutual fund investors, on the other hand, have the right to review the disclosure document and reconsider their decision within certain time frames.

Finally, we analyse the extent to which our present laws contemplate physical, as opposed to electronic, delivery. We conclude here that our current system does not contain the concept of access-equal-delivery for current disclosure documents.

This paper reveals that the law is complex and confusing, particularly in a mutual fund context. Our laws bear little relation to the practical realities of fund sales and consumer behaviour. We believe this paper provides us with compelling evidence that regulatory reform is needed to clarify and harmonize the laws across Canada.

# A. Segregated funds

## A.1. Segregated fund point of sale disclosure and continuous disclosure

### The regulatory framework

To understand the requirements for segregated fund point of sale and continuous disclosure, you must look to the *Insurance Act* (Ontario), its regulations, and the Canadian Life and Health Insurance Association Guidelines on Individual Variable Insurance Contracts Relating to Segregated Funds (the CLHIA Guidelines). Although provincial insurance regulators regulate segregated funds, all provincial and territorial regulators have accepted the CLHIA Guidelines.[1] This means the requirements for disclosure documents are applied consistently across Canada.

### The CLHIA Guidelines

The CLHIA Guidelines set out:

1. the form and content requirements for information folders and also for individual variable insurance contracts
2. how insurance regulators review information folders prior to their use by insurance companies
3. annual filing requirements for information folders
4. consumer notice and filing requirements that are triggered when a material change to a segregated fund occurs
5. requirements for annual audited financial statements and semi annual unaudited financial statements of segregated funds
6. requirements for annual notices to consumers of specified information.

### The point of sale disclosure documents

The information folder is the point of sale disclosure document for segregated funds. An information folder for a segregated fund must contain the following information:

- a description of the IVIC
- the value of the units to be credited to the contract

[1] The CLHIA Guidelines were approved by the Canadian Council of Insurance Regulators and CLHIA's Board of Directors on March 4, 1997 and were amended on March 7, 2001. In Ontario, the requirements of the CLHIA Guidelines have the force of law in Ontario through the operation of subsection 6(1) of Ontario Regulation 132/97.

- continuous marketing information
- information on segregated fund management
- the fees and sales incentives charged against the assets of the segregated fund
- a summary of each segregated fund's investment policy[2]
- the investment restrictions
- the risk factors
- any significant holdings in other issuers
- annual audited financial statements of the segregated fund
- the name of the auditor

Although the information folder is intended to be the primary point of sale disclosure document, it must either contain or be accompanied by:

- specified financial highlights derived from the annual financial statements
- a summary fact statement for each segregated fund (containing a brief, narrative summary of a segregated fund's historical performance, investment policies and the ten largest single holdings).

The CLHIA Guidelines allow insurance companies to describe more than one segregated fund in an information folder. Insurance companies are required to present the information in clear and plain language and are largely given freedom to design the document as they see fit. However, the folder must describe the IVIC as its first item of information and a one-page executive summary of the contents of the information folder must immediately follow the face page of the document.

## The continuous disclosure documents

Continuous disclosure requirements are established by the CLHIA Guidelines. Segregated funds are required to prepare and make available annual audited financial statements and semi-annual unaudited financial statements. The CLHIA Guidelines require insurance companies to send to consumers annually a statement containing:

- a description of the IVIC
- the management expense ratio of the segregated fund, with an explanation
- the value of the consumer's benefits under the IVIC related to the market value of the segregated fund at the end of the period covered by the annual statement
- the amount, if any, allocated under the consumer's IVIC to a segregated fund under the applicable financial period
- the overall rate of return, calculated on a net basis, for the segregated fund for the last 1, 3, 5 and 10 years period, as applicable
- the most recent audited financial statements of the segregated fund
- a statement that unaudited semi annual statements are available on request
- specified information about changes in insurance fees.

Consumers must also receive specified information about defined proposed material changes to their segregated fund 60 days in advance of the proposed change taking effect.

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[2] The CLHIA Guidelines indirectly require insurance companies to prepare a detailed description of each segregated fund's investment policy, although no guidance is given on the contents of this document. Information folders must then summarize the investment policy in the manner contemplated by the CLHIA Guidelines and tell consumers how they can obtain the detailed investment policy.

# A.2 Analysis of the delivery requirements for segregated fund point of sale disclosure

The *Insurance Act* (Ontario), its regulations, and the CLHIA Guidelines establish the requirements for delivery of segregated fund point of sale disclosure documents.

## Relevant provisions from the *Insurance Act* (Ontario)

**Obligation to deliver information folder**
s. 110(5) No application for a variable insurance contract shall be accepted by an insurer until the insurer has delivered to the applicant therefor a copy of the latest information folder relating thereto that is on file with the Superintendent. R.S.O. 1990, c. I.8, s. 110(5)

## Relevant provisions from Ont. Reg. 132/97. as amended

**Failing to deliver is an unfair or deceptive act or practice**
s. 6(1) It is an unfair or deceptive act or practice for an insurer to accept an application for a variable insurance contract from a person before, (a) delivering to the person, along with the copy of the latest information folder required under subsection 110 (5) of the Act, a copy of all information that the CLHIA guidelines require to be provided to the person;

## Relevant sections from the CLHIA guidelines

**Delivery of Information Folder**
s. 6.1 Before an application for an individual variable insurance contract is signed by a prospective contractholder, a true copy of the corresponding information folder then on file with the Insurance Regulator of the particular jurisdiction, pursuant to Part IV of these Guidelines, shall be delivered to the prospective contractholder.

Where a contract is not an individual variable insurance contract at issue but is subsequently amended to become an individual variable insurance contract upon application by the contractholder for such amendment, a true copy of the corresponding information folder then on file, pursuant to Part IV of these Guidelines, shall be delivered to the contractholder prior to the effective date of such amendment, if not previously delivered.

**Acknowledgement of Receipt of Information Folder**
s. 6.2 The insurer shall, at the time of delivery, obtain from any person to whom an information folder is delivered in compliance with Section 6.1 of these Guidelines a signed statement in writing acknowledging that he or she has received a copy of such information folder.

## a. What must be delivered? What must be available upon request?

### Information folders, detailed investment policies and financial statements

Consumers must receive an information folder for a segregated fund and, unless the information is included in the information folder, documents containing a summary fact statement and specified financial highlights. Although they are not delivered as a matter of course, consumers may ask insurance companies for detailed investment policies and semi-annual financial statements. The information folder informs consumers that these documents are available and describes how they can be obtained.

### The IVIC

The fact that a consumer enters into an IVIC when he or she invests in a segregated fund introduces legal considerations that are unique to segregated funds. We discuss these legal considerations below.

## b. Who is responsible for delivering the information folder?

### The insurance company

The obligation to deliver the information folder rests with the insurance company according to subsection 110(5) of the *Insurance Act*.

## c. When must the information folder be delivered?

### Prior to accepting the application

The information folder must be delivered *prior* to the insurance company accepting an application for an IVIC. Section 6.2 of the CLHIA Guidelines requires the insurer to obtain a written acknowledgement from the prospective purchaser that he or she has received the information folder. In practice, the agent obtains the acknowledgement from the client before submitting the client's application, receipt, and money to be invested to the insurance company.

## d. What are the consequences of failing to deliver?

### Statutory remedies

Insurance regulation does not offer express rights to consumers when their insurance company or its agent fails to deliver the information folder.

Failure to deliver the information folder in accordance with section 110(5) is an unfair and deceptive act and practice under Regulation 132/97. It also constitutes a contravention of the *Insurance Act*. The Superintendent can take two actions where he or she finds unfair and deceptive acts and practices to have occurred:

1. Following an investigation and the right of hearing process, outlined in the *Insurance Act*, the Superintendent has the authority to make orders pursuant to subsection 441(2). These orders can include restitution.

2. The Superintendent can also file charges against the insurer pursuant to section 447. Subsection 447(5) enables the court to make a restitution order.

Thus far, there have been no allegations of failure to deliver, and, accordingly, the Superintendent's power has not yet been exercised in this way. However, we believe the exercise of these powers likely would be based on a pattern of behavior, rather than on an isolated case of failing to deliver, and would involve additional circumstances such as fraud or misrepresentation.

## A.3. Analysis of the delivery requirements for IVICs

Although delivery of the IVIC (the individual contract of insurance entered into by the consumer and the insurance company) is not dealt with by the CLHIA Guidelines, the delivery requirements for IVICs in Ontario are substantially similar to those elsewhere in Canada.

**Relevant provisions from the *Insurance Act* (Ontario)**

180. (1) Subject to any provision to the contrary in the application or the policy, a contract does not take effect unless,

(a) the policy is delivered to an insured, the insured's assign or agent, or to a beneficiary;

(b) payment of the first premium is made to the insurer or its authorized agent; and

(c) no change has taken place in the insurability of the life to be insured between the time the application was completed and the time the policy was delivered.

**Delivery to agent**
(2) Where a policy is issued on the terms applied for and is delivered to an agent of the insurer for unconditional delivery to a person referred to in clause (1) (a), it shall be deemed, but not to the prejudice of the insured, to have been delivered to the insured. R.S.O. 1990, c. I.8, s. 180.

## a. Who is responsible for delivering the IVIC?

### The insurance company

The obligation to deliver the IVIC rests with the insurance company. But once a policy is delivered to an agent of the insurer for delivery to the insured, it is deemed to have been delivered to the insured, but not to his or her prejudice.

## b. When must the IVIC be delivered?

### After the point of sale

The IVIC is delivered to the policyholder after he or she has made a decision to enter into the agreement (and make the investment). However, important information about the terms of the contract and the features of each segregated fund option is disclosed prior to the sale in the information folder. Consumers are not generally provided with a copy of the IVIC before making their decision.

## c. What are the consequences of failing to deliver?

### The contract does not take effect

The contract must be delivered if the contract is to take effect, according to section 180(1) of the *Insurance Act* (Ontario).

# A.4. Analysis of the rights attached to entry into an IVIC

Once the IVIC is entered into and becomes effective, it governs the relationship between the consumer and the insurance company. Consumers have no specific *regulatory* remedies or rights related to the point of sale disclosure documents or the IVIC, although the CLHIA Guidelines require any two named senior officers or directors of the insurance company to certify the information folder. Although no specific rights flow from this certification under the CLHIA Guidelines or insurance regulation, a consumer has remedies against the insurance company at common law, including breach of contract, negligent misrepresentation, coercion and undue influence.

The Superintendent has the right to issue a cease and desist order under section 441 of the *Insurance Act* (Ontario) if he or she determines that an information folder contains a misrepresentation.

# B. Mutual funds

## B.1. Mutual fund point of sale disclosure and continuous disclosure

### The regulatory framework

The Canadian securities regulators have each adopted National Instrument 81-101 Mutual Fund Prospectus Disclosure (NI 81-101) and therefore have uniform point of sale disclosure requirements for mutual funds. Canadian provincial securities regulation requires new issuers of securities to prepare a prospectus. Because mutual funds are in continuous distribution they must always be sold under a prospectus.

### The point of sale disclosure documents

Through the operation of NI 81-101, a mutual fund's prospectus within the meaning of securities regulation includes its simplified prospectus, annual information form, annual audited financial statements and semi-annual financial statements. The latter three documents are incorporated by reference into the mutual fund's simplified prospectus, which means that all four documents together form the prospectus for the mutual fund. All investors must receive a simplified prospectus. This document alerts investors to the fact that they can ask for an annual information form and financial statements of the fund if they want additional information.

A simplified prospectus for a mutual fund is to be a clear, concise document that provides the typical investor with the necessary information to make an informed investment decision. The annual information form for a mutual fund is a supplemental disclosure document intended to provide consumers with information above and beyond that given in the simplified prospectus.

A simplified prospectus for a mutual fund must contain the following information:

- a general description of investment risks associated with mutual fund investing
- organization and management details
- a description of how to purchase, switch or redeem investments
- optional services provided to investors
- fees and expenses payable by the fund and by investors
- dealer compensation and sales practices
- income tax considerations
- investors' statutory legal rights
- specified fund details
- fundamental investment objectives and investment strategies
- top ten holdings and past performance details
- distribution policies
- financial highlights

NI 81-101 allows mutual fund management companies to describe more than one mutual fund in a simplified prospectus and annual information form.[3] If a multiple SP format is used, a catalogue approach is taken when providing the fund specific details for each fund.

[3] These are referred to as "multiple SPs" in NI 81-101.

Filing requirements for mutual fund prospectuses are set by provincial securities regulation which generally require an annual refiling by mutual funds of their simplified prospectuses and annual information forms.

Mutual funds must amend their prospectuses if material or significant changes occur to them.[4] This requirement is established by securities regulation in each province and by the requirements of National Instrument 81-102 Mutual Funds (NI 81-102).

### The continuous disclosure documents

Securities legislation also establishes the form and content requirements for annual and semi-annual financial statements of mutual funds, together with the filing and delivery requirements for these documents. The Canadian securities administrators have recently published for comment proposals to significantly update and bolster the continuous disclosure regime for mutual funds. Proposed National Instrument 81-106 Investment Fund Continuous Disclosure (NI 81-106) was published for comment on September 20, 2002. Proposed NI 81-106 introduces requirements for annual and quarterly management reports of fund performance for a mutual fund and revises and updates the content of annual and interim financial statements. Proposed NI 81-106 sets out the filing and delivery requirements relating to these documents.

NI 81-102 prohibits a fund manager from making certain defined fundamental changes to a mutual fund unless a majority of the unitholders of that fund have voted at a special meeting to allow that change to occur.

Securities regulation also requires filing of press releases and material change reports by mutual funds if material or significant changes occur.

All point of sale disclosure and continuous disclosure documents are filed with the Canadian securities regulators via the electronic filing system (SEDAR) maintained by the regulators. As a result, investors in mutual funds have immediate internet-based access to all documents filed with the regulators.

## B.2. Analysis of the delivery requirements for mutual fund point of sale disclosure in Ontario

The delivery requirements for mutual fund point of sale disclosure documents are contained in the securities legislation for each province and territory and are augmented by provisions in NI 81-101. The provincial and territorial requirements for prospectus delivery are not uniform (although they are largely consistent with requirements in Ontario) apart from NI 81-101. In this part of the paper, we examine the legal requirements in Ontario. We note that these requirements apply to prospectuses for all issuers of securities. Although these provisions also apply to mutual fund prospectuses, they are not tailored to their unique characteristics.

[4] These terms are defined in securities regulation.

## Relevant provisions from the *Securities Act* (Ontario)

**Obligation to deliver prospectus**
71. (1) A dealer not acting as agent of the purchaser who receives an order or subscription for a security offered in a distribution to which subsection 53 (1) or section 62 is applicable shall, unless the dealer has previously done so, send by prepaid mail or deliver to the purchaser the latest prospectus and any amendment to the prospectus filed either before entering into an agreement of purchase and sale resulting from the order or subscription or not later than midnight on the second day, exclusive of Saturdays, Sundays and holidays, after entering into such agreement. R.S.O. 1990, c. S.5, s. 71 (1).

**Time of receipt**
(4) For the purpose of this section, where the latest prospectus and any amendment to the prospectus is sent by prepaid mail, the latest prospectus and any amendment to the prospectus shall be deemed conclusively to have been received in the ordinary course of mail by the person or company to whom it was addressed. R.S.O. 1990, c. S.5, s. 71 (4).

**Receipt of prospectus by agent**
(5) The receipt of the latest prospectus or any amendment to the prospectus by a dealer who is acting as agent of or who thereafter commences to act as agent of the purchaser with respect to the purchase of a security referred to in subsection (1) shall, for the purpose of this section, be receipt by the purchaser as of the date on which the agent received such latest prospectus and any amendment to the prospectus. R.S.O. 1990, c. S.5, s. 71 (5).

**Dealer as agent**
(7) For the purpose of this section, a dealer shall not be considered to be acting as agent of the purchaser unless the dealer is acting solely as agent of the purchaser with respect to the purchase and sale in question and has not received and has no agreement to receive compensation from or on behalf of the vendor with respect to the purchase and sale. R.S.O. 1990, c. S.5, s. 71 (7).

**Liability of dealer**
133. A purchaser of a security to whom a prospectus was required to be sent or delivered but was not sent or delivered in compliance with subsection 71 (1) …has a right of action for rescission or damages against the dealer… who failed to comply with the applicable requirement. R.S.O. 1990, c. S.5, s. 133.

**Limitation periods**
138. Unless otherwise provided in this Act, no action shall be commenced to enforce a right created by this Part more than,
(a) in the case of an action for rescission, 180 days after the date of the transaction that gave rise to the cause of action; or
(b) in the case of any action, other than an action for rescission, the earlier of,
(i) 180 days after the plaintiff first had knowledge of the facts giving rise to the cause of action,
(ii) three years after the date of the transaction that gave rise to the cause of action.

# a. What must be delivered? What must be available upon request?

## Simplified prospectuses, annual information forms and financial statements

Consumers must receive a simplified prospectus for a mutual fund. According to Part 3 of NI 81-101, the requirement under securities legislation to send consumers a "prospectus" will be satisfied if a simplified prospectus is delivered, either with or without the documents incorporated by reference.

Consumers may ask mutual fund management companies for the annual information form and the annual audited and semi-annual unaudited financial statements of the mutual fund. The simplified prospectus informs investors that these documents are available and are incorporated by reference into the simplified prospectus. The simplified prospectus also tells consumers how they can obtain these documents from the SEDAR Internet web-site and other sources.

# b. Who is responsible for delivering the simplified prospectus?

Section 71 of the *Securities Act* (Ontario) imposes the obligation on certain dealers[5] (rather than mutual fund managers) to deliver a mutual fund simplified prospectus to purchasers within two days of entering into an agreement of purchase and sale.

## The "dealer not acting as agent"

The obligation to deliver a simplified prospectus lies with the *dealer not acting as agent of the purchaser* who accepts the order to purchase securities according to subsection 71(1). Put another way, the obligation to deliver a simplified prospectus lies with the *dealer who is acting as agent of the vendor.*[6]

### *The test*

Subsection 71(7), which clarifies when a dealer is *not* considered to be acting as agent of the purchaser for the purposes of this section, sets out a two-part test.[7] In essence, a dealer is caught by the obligation to deliver a simplified prospectus unless the following arms of the test are satisfied:

1. That dealer must be acting solely as agent of the purchaser; and

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[5] Subsection 1(1) of the Act defines "dealer" to mean a person or company who trades in securities in the capacity of principal or agent. We use this term to refer to registered dealer firms, not salespeople.

[6] The language of subsection 71(6) implies that a dealer not acting as agent for the purchaser is, in fact, acting as agent for the vendor.

[7] Admittedly, the test as it is set out in the legislation is somewhat difficult to apply because it is framed in a convoluted manner (the first part of the test appears to be little more than a positive reformulation of the test itself: a dealer is not acting as agent of the purchaser, unless they are acting solely as agent of the purchaser) and its language is fraught with multiple negatives (a dealer is *not* acting as agent of the purchaser, *unless* the dealer has *not* received any compensation from the *vendor*).

2. That dealer must be compensated only by the purchaser, and by no one else.

If both arms of the test are not satisfied, then the dealer is deemed to be acting as agent of the *vendor* and is obligated to deliver the simplified prospectus to the client.[8]

The law draws a distinction based on who the dealer is acting as agent for. When dealers act as agents for the purchaser, and have no relationship to the vendor, the legislation does not require them to deliver the simplified prospectus to their clients, so long as they have received the simplified prospectus themselves. In other words, the dealer who acts as agent of the purchaser can receive a copy of the simplified prospectus on behalf of the purchaser in the dealer's capacity as agent. We believe the rationale for this exemption from the delivery requirement is rooted in the belief that a dealer acting as agent for the purchaser, who has reviewed the simplified prospectus, will communicate the necessary information to the purchaser. A purchaser who is not kept properly informed by his or her agent and who consequently suffers a loss has no statutory rights, but may have recourse against the agent under common law principles. The statutory protection appears to end where the common law protections begin.

### *Part 1 of the test: is the dealer acting solely as agent of the purchaser?*

The issue of whether the dealer is acting *solely* as agent of the purchaser is a question of fact—one must apply the common law principles of agency to the factual circumstances. The courts have offered no guidance on this matter in the mutual fund context.

#### *Part 2 of the test: how is the dealer compensated?*

The vast majority of dealers selling a mutual fund receive compensation from the mutual fund manager on behalf of the fund with respect to the purchase in question. It is not common practice for a dealer to be compensated only by the purchaser. Dealer compensation may vary based on the kind of sales charge attached to the fund that is sold. Funds may be sold with front load fees, which are deducted by the dealer from the amount paid by the purchaser, or deferred sales charges, which are deducted by the mutual fund manager from the amount invested if the purchaser redeems before a certain time, usually six years. These fees decline each year during that time. If a fund is sold under a deferred sales charge, the mutual fund manager pays the dealer a commission up-front. Some funds have neither front load fees nor deferred sales charges. These funds are called no load funds. With no load funds, any sales and marketing costs are rolled into the management expenses.

In the vast majority of cases involving the sale of mutual funds, dealers will not be acting as agents of the purchaser. In other words, dealers will almost always be obligated to deliver simplified prospectuses under subsection 71(1). Even in the rare case where a dealer can be said to be acting in this capacity, we believe it is good practice to deliver a simplified prospectus in connection with the initial purchase of every mutual fund.

#### *An aside: What are the obligations of the mutual fund manager with respect to simplified prospectus delivery?*

[8] In *Midland Doherty Ltd. V. Zonailo* (1983), 43 B.C.L.R. 138 (C.A.), the dealer was not considered to be "acting solely as the agent of the purchaser" because it was entitled to a split commission.

The legislation makes it clear that the registered dealer is responsible for delivering the simplified prospectus to purchasers. In the mutual fund context, the dealer may be one of a number of parties:

- the mutual fund manager, where registration has been obtained to sell directly to the public
- a dealer related to the mutual fund manager
- an unrelated dealer.

On the face of the statute, the mutual fund manager, who prepares—and is responsible for the information contained in—the simplified prospectus, has no obligation to ensure the simplified prospectus reaches purchasers, unless the manager is also acting as the dealer.

However, it is implied in the wording of subsection 71(6) that a dealer not acting as agent of the purchaser is actually acting as agent for the vendor. It may, therefore, be argued that the vendor/principal is ultimately accountable for delivery of the simplified prospectus. In other words, the mutual fund—and by extension, the mutual fund manager—may be responsible for ensuring that the simplified prospectus reaches purchasers under common law agency principles.

### *An aside: What are the obligations of the mutual fund manager to deliver documents incorporated by reference into the simplified prospectus?*

If a person requests the annual information form or financial statements of the mutual fund, the mutual fund (or the mutual fund manager on its behalf) must deliver those documents to that person free of charge within 3 business days according to section 3.3 of NI 81-101.

## c. When must the simplified prospectus be delivered?

### Within two days of placing the order

According to subsection 71(1), the simplified prospectus must be sent either before entering into a purchase agreement or no later than midnight on the second business day after entering into the agreement of purchase and sale. For example, if a purchase order is accepted on a Tuesday, the dealer has until midnight on Thursday to mail or deliver the simplified prospectus to the purchaser. The date the purchaser is deemed to have received the simplified prospectus is determined by subsection 71(4).

The wording of subsection 71(1) is curious because it explicitly contemplates both delivery-in-advance and delivery-after-the-fact regimes for mutual fund prospectus delivery. Despite the open-ended nature of the law, our delivery system requires delivery after the fact, for all practical purposes. As we explain below, the withdrawal rights contained in subsection 71(2) operate to make our delivery-after-the fact regime meaningful.

## d. What are the consequences of failing to deliver?

### A right of action for rescission or in damages

Section 133 creates a right of action in favour of the purchaser for rescission or in damages when a dealer fails to deliver the simplified prospectus as required in section 71. The right of action for rescission may be exercised during the 180 days after the date the purchaser should have received the simplified prospectus,

according to subsection 138(a). The right of action for damages is available for either three years from the date the purchaser should have received the simplified prospectus or 180 days following the date on which the purchaser first had knowledge of the facts giving rise to the cause of action, whichever is less. Of course, losses must be proven (see subsection 138(b)).

## B.3. Analysis of the delivery requirements for mutual fund confirmations in Ontario

The confirmation of trade for mutual fund purchases is of interest to us because a right of rescission in Ontario, and certain other provinces, is linked to the delivery of this document.

### Relevant provisions

**Confirmation of trade**
36. (1) Every registered dealer who has acted as principal or agent in connection with any trade in a security shall promptly send by prepaid mail or deliver to the customer a written confirmation of the transaction… R.S.O. 1990, c. S.5, s. 36 (1).

**Exemption - Mutual fund trades**
(7) A registered dealer need not send to its client a written confirmation of a trade in a security of a mutual fund where the manager of the mutual fund sends the client a written confirmation containing the information required to be sent under this section. 1997, c. 19, s. 23 (9).

## a. Who is responsible for delivering the confirmation?

### Either the dealer who has acted as principal or agent, or the mutual fund manager

The delivery obligation for trade confirmations rests with the registered dealer who has acted as principal or agent in connection with any trade in a security. This obligation is broader than the concept of a "dealer not acting as agent" which is used in the provisions dealing with delivery of the prospectus. A dealer who is not required to deliver the prospectus because it is considered to be a dealer acting as agent for the purchaser will, nonetheless, be required to deliver the trade confirmation.

This obligation to deliver a confirmation is also different from the obligation to deliver a prospectus because the dealer is relieved from its obligation if the mutual fund manager sends the confirmation to investors instead.

## b. When must the confirmation be delivered?

### Promptly

Although securities legislation requires that the confirmation of trade be delivered promptly, there are no time frames specified. This gives dealers (or mutual fund managers) more flexibility when delivering confirmations of trade than when delivering prospectuses.

## c. What are the consequences of failing to deliver?

### No express rights for the purchaser

Failure to deliver a confirmation does not give the purchaser any express rights under securities legislation. In this case, the Ontario Securities Commission itself may apply to the Ontario Court (General Division) for a declaration under subsection 128(1) that a person or company has not complied with Ontario securities law. If the court makes such a declaration, it may make any order it considers appropriate, including an order rescinding the purchase (see subsection 138(3)4) or an order that the company pay damages (see subsection 138(3)14). This process is not subject to any limitation periods.

This differs from the situation where a purchaser fails to receive a prospectus. In that case, securities legislation provides the purchaser with a direct remedy (the right to rescind) which is subject to limitations periods set out in section 138.

# B.4. Analysis of the rights attached to the purchase of mutual fund securities

When a purchaser buys mutual fund securities, he or she has a number of rights relating to that purchase under the securities laws in Ontario:

i. the right of withdrawal attached to receipt of the simplified prospectus

ii. the right of rescission, particular to mutual fund purchases, attached to receipt of the confirmation of trade and

iii. the rights triggered by misrepresentations in a prospectus.

# i. The right of withdrawal attached to receipt of the prospectus

**Relevant provisions**

**Withdrawal from purchase**
71(2) An agreement of purchase and sale referred to in subsection (1) is not binding upon the purchaser, if the dealer from whom the purchaser purchases the security receives written or telegraphic notice evidencing the intention of the purchaser not to be bound by the agreement of purchase and sale not later than midnight on the second day, exclusive of Saturdays, Sundays and holidays, after receipt by the purchaser of the latest prospectus and any amendment to the prospectus. R.S.O. 1990, c. S.5, s. 71 (2).

(3) Subsection (2) does not apply if the purchaser is a registrant or if the purchaser sells or otherwise transfers beneficial ownership of the security referred to in subsection (2), otherwise than to secure indebtedness, before the expiration of the time referred to in subsection (2). R.S.O. 1990, c. S.5, s. 71 (3).

**Time of receipt**
(4) For the purpose of this section, where the latest prospectus and any amendment to the prospectus is sent by prepaid mail, the latest prospectus and any amendment to the prospectus shall be deemed conclusively to have been received in the ordinary course of mail by the person or company to whom it was addressed. R.S.O. 1990, c. S.5, s. 71 (4).

**Receipt of notice by agent**
(6) The receipt of the notice referred to in subsection (2) by a dealer who acted as agent of the vendor with respect to the sale of the security referred to in subsection (1) shall, for the purpose of this section, be receipt by the vendor as of the date on which the agent received such notice. R.S.O 1990, c. S.5, s. 71(6)

**Onus of proof**
(8) The onus of proving that the time for giving notice under subsection (2) has expired is upon the dealer from whom the purchaser has agreed to purchase the security. R.S.O. 1990, c. S. 5, s. 71(8).

## a. How long do purchasers have to withdraw?

### Two business days

According to subsection 71(2), certain purchasers have the right to withdraw from the agreement of purchase and sale during the two-business-day period following receipt of the prospectus from the dealer. The right of withdrawal is automatic and may be exercised for any reason by certain purchasers.

To exercise this right, the purchaser must give the dealer written or telegraphic notice of his or her intention to withdraw. Receipt of this notice by the dealer is deemed to be receipt by the issuer. The dealer bears the onus of proving that the time for giving notice has expired. The dealer is aided by subsection 71(4), which deems conclusively that a prospectus sent by prepaid mail is received in the ordinary course of mail.

The right of withdrawal is directly tied to the fact that dealers are not required to deliver the prospectus until after the purchase agreement has been entered into. If delivery is to occur after the fact, some right of withdrawal is necessary to ensure that purchasers are given a reasonable opportunity to review the prospectus and consider their decision based on the important information contained in it. Although it is often said the right of withdrawal gives purchasers a "cooling-off" period after they make a purchase, we believe it is more accurate to say it gives purchasers an opportunity to understand what they have purchased by giving them time to read the prospectus.

## b. When does the right of withdrawal not apply?

### If prospectus not delivered

The purchaser is not entitled to the withdrawal right in four situations. First, if the dealer does not deliver a prospectus, in contravention of section 71, the purchaser's right of withdrawal is not triggered. Failure to deliver, as we describe above, turns the purchaser's two-day right of withdrawal into a 180-day right to sue for rescission or a right to sue for damages for up to three years, under the limitation periods in section 138.

### If prospectus received more than two days before purchase

Second, purchasers who receive the prospectus more than two days before placing an order are not entitled to withdraw from the purchase under subsection 71(2). The rationale is that the purchaser has had ample time to review the information contained in the prospectus.

### If purchaser is a registrant

Third, subsection 71(3) states that the right of withdrawal does not apply if the purchaser is a registrant. One commentator explains that given their investment expertise, it is presumed that registered dealers, underwriters and registered advisers purchasing securities for their own account do not require the protection of a cooling-off period. This commentator goes on to say that this exception does not affect the situation where a registrant places an order for securities, as agent of the purchaser, and takes the securities in his or her own name, but cautions that subsection 71(5) may result in a situation where the purchaser does not actually receive the prospectus.[9]

### If purchaser sells

Finally, subsection 71(1) also states that the right of withdrawal does not apply if the purchaser sells or otherwise transfers beneficial ownership of the security, otherwise than to secure indebtedness, before the expiration of the two-day period after receipt of the prospectus. Practically, this situation will not arise in the mutual fund context.

## c. What amount is the purchaser entitled to recover?

### NAV at time of purchase

The purchaser who exercises the right of withdrawal under subsection 71(2) is not bound by the purchase agreement. This means the amount returned to the purchaser is calculated according to the net asset value (NAV) of the securities at the time of the purchase.

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[9] V. Alboini, *Securities Law and Practice*, vol. 1 (Toronto: Carswell, 1986) at 16-21.

## ii. The right of rescission attached to receipt of the trade confirmation

### Relevant provisions

**Rescission of purchase of mutual fund security**
137. (1) Every purchaser of a security of a mutual fund in Ontario may, where the amount of the purchase does not exceed the sum of $50,000, rescind the purchase by notice given to the registered dealer from whom the purchase was made within forty-eight hours after receipt of the confirmation for a lump sum purchase or within sixty days after receipt of the confirmation for the initial payment under a contractual plan but, subject to subsection (5), the amount the purchaser is entitled to recover on exercise of this right to rescind shall not exceed the net asset value of the securities purchased, at the time the right is exercised. R.S.O. 1990, c. S.5, s. 137 (1).

(2) The right to rescind a purchase made under a contractual plan may be exercised only with respect to payments scheduled to be made within the time specified in subsection (1) for rescinding a purchase made under a contractual plan. R.S.O. 1990, c. S.5, s. 137 (2).

**Notice**
(3) The notice mentioned in subsection (1) shall be in writing, and may be given by prepaid mail, telegram or other means. R.S.O. 1990, c. S.5, s. 137 (3).

**Service**
(4) A confirmation sent by prepaid mail shall be deemed conclusively to have been received in the ordinary course of mail by the person or company to whom it was addressed. R.S.O. 1990, c. S.5, s. 137 (4).

**Reimbursement**
(5) Every registered dealer from whom the purchase was made shall reimburse the purchaser who has exercised the right of rescission in accordance with this section for the amount of sales charges and fees relevant to the investment of the purchaser in the mutual fund in respect of the shares or units of which the notice of exercise of the right of rescission was given. R.S.O. 1990, c. S.5, s. 137 (5).

Unlike subsection 71(2), which applies to purchases of all types of securities, subsection 137(1) applies only to the purchase of mutual fund securities. A purchase of mutual fund securities not exceeding $50,000 may be rescinded within 48 hours of receipt of the confirmation. Like subsection 71(2), the right to rescind is automatic and may be exercised for any reason.

To exercise this right, the purchaser must give the dealer written or telegraphic notice of rescission. The limitation periods begin to run from the date of receipt of the confirmation. The dealer is required by subsection 36(1) to send or deliver the confirmation "promptly" after the trade, unless the mutual fund manager sends it. Subsection 137(4) provides that a confirmation sent by prepaid mail is deemed to have been received in the ordinary course of mail by the person or company to whom it was addressed.

The right of rescission granted by section 137 gives all purchasers buying less than $50,000 in mutual fund securities an opportunity to reconsider their purchase for 48 hours after they receive their confirmation. We believe this right of rescission gives these purchasers a true "cooling-off" period. The right of rescission cannot be attached to receipt of the prospectus (like the right of withdrawal) because there is a possibility that the prospectus may be received prior to the purchase date.

## b. When does the right of rescission not apply?

### If confirmation not delivered

The purchaser of mutual funds is not entitled to rescind in two situations. First, if neither the dealer nor the mutual fund manager deliver the confirmation, in contravention of subsection 36(1), the purchaser's right of rescission is not triggered.

### If purchase exceeds $50,000

Second, the right of withdrawal does not apply if the purchase amount is more than $50,000. We believe this threshold amount is meant to be a proxy for sophistication. Purchasers who can afford to spend this amount on mutual funds are deemed not to need the protection of a "cooling-off period".

## c. What amount is the purchaser entitled to recover?

### NAV when right is exercised

The amount the purchaser is entitled to recover upon exercising this right is the NAV of the securities purchased at the time the right is exercised, rather than at the date of purchase. Subsection 137(5) clarifies that the dealer must reimburse the purchaser who has exercised the right of rescission for the amount of sales charges and fees paid in connection with the purchase.

## A note on contractual plans

Since NI 81-102 came into force, the references to contractual plans (which are a special category of investment plan defined in the *Act*) in section 137 of the *Act* have no relevance. Part 8 of NI 81-102 prohibits new contractual plans from being created. The references to contractual plans in section 137 no longer have any practical application because the 60-day period during which any purchaser of an existing contractual plan could have exercised his or her right of rescission has long expired.

## iii. The rights triggered by misrepresentations in the prospectus

**Relevant provision**

**Liability for misrepresentation in prospectus**
130. (1) Where a prospectus together with any amendment to the prospectus contains a misrepresentation, a purchaser who purchases a security offered thereby during the period of distribution or distribution to the public shall be deemed to have relied on such misrepresentation if it was a misrepresentation at the time of purchase and has a right of action for damages [against the issuer, underwriter who signed the certificate, director of the issuer…]
or, where the purchaser purchased the security from [the issuer or the underwriter who signed the certificate] or from another underwriter of the securities, the purchaser may elect to exercise a right of rescission against such person, company or underwriter, in which case the purchaser shall have no right of action for damages against such person, company or underwriter. R.S.O. 1990, c. S.5, s. 130 (1).

Section 130 gives a purchaser of a mutual fund a private right of action against a number of parties, including the mutual fund manager and the officers and directors of the fund manager who signed the prospectus certificates. The relevant certificates are contained in the annual information form and specifically cover the disclosure contained in the simplified prospectus and most recent annual and semi-annual financial statements of the fund.

Although this private right of action is not tailored to mutual funds, it will arise if the prospectus of the mutual fund (and here we mean the combination of the simplified prospectus, the annual information form and the financial statements incorporated by reference into the simplified prospectus) contains, at the time of purchase, a misrepresentation. A misrepresentation is defined by the *Act* and can include a positive misstatement of a material fact or an omission to state a material fact.

Section 130 imposes virtual absolute liability on the mutual fund and the mutual fund manager and its officers and directors signing the certificates. The section gives other signatories a so-called “due diligence” defence.

To prove misrepresentation, an investor has only to establish that there exists a misrepresentation and does not need to prove he or she relied on the misrepresentation in making his or her investment decision.

Section 130 also gives mutual fund investors the right to rescind their purchase from the mutual fund in the event of a misrepresentation.

Section 130 establishes important rights. These rights must be distinguished from the other rights of withdrawal and rescission given to mutual fund investors. Understandably given the identical names for these rights, some industry participants confuse these rights and their purposes in a mutual fund context. What follows in this paper is a discussion of the rights of withdrawal and rescission, other than the section 130 right of rescission in the event of a misrepresentation.

# Comparing the rights of withdrawal and rescission

Although the rights of withdrawal and rescission may overlap in practice, they are geared toward different ends and operate differently. The following chart draws some key comparisons.

| | **Right of Withdrawal** | **Right of Rescission** |
|---|---|---|
| **Why does the right exist?** | Gives purchasers an opportunity to review the simplified prospectus since the prospectus need not be delivered until after the investment decision has been made. | Gives less sophisticated purchasers of mutual fund securities an opportunity to "cool-off" after the investment decision has been made. |
| **Who is eligible to exercise the right?** | All purchasers, other than registrants and purchasers who sell the security before the right of withdrawal period ends. | All purchasers of less than $50,000 in mutual fund securities. |
| **What is the triggering event for the right?** | Receipt of the simplified prospectus from the dealer, provided the prospectus is delivered after the purchase agreement is completed. | Receipt of the trade confirmation from the dealer or the mutual fund manager. |
| **What can purchasers do if they don't receive the proper documents?** | They can sue to rescind the purchase for 180 days or sue for damages for up to three years. | They can ask the Commission to apply to the court for an order for damages or rescinding the purchase. There are no time limits on this process. |
| **How long does one have to exercise this right?** | Two business days. | 48 hours. |
| **What amount is one entitled to recover once the right has been exercised?** | The NAV of the securities at the time of the purchase, plus any fees paid. | The NAV of the securities at the time the right is exercised, plus any fees paid. |
| **Who is responsible for reimbursing the purchaser upon the exercise of the right?** | The Act is silent on this point. | The dealer must reimburse any sales charges and fees. The *Act* does not specify who is responsible for returning the purchase amount. |

# B.5. Comparison of the prospectus delivery requirements across Canada

Securities legislation is not the same in every province and territory of Canada. This part of the paper examines how each of the CSA jurisdictions regulate prospectus delivery. In a mutual fund context, the requirements to deliver a prospectus should be read as requirements to deliver the simplified prospectus of the mutual fund.

## a. Who is responsible for delivering the prospectus?

### The dealer not acting as agent of the purchaser

Like Ontario, most provinces settle the obligation to deliver the prospectus with the dealer[10] not acting as agent of the purchaser. The legislation of every jurisdiction—other than New Brunswick, Quebec, Northwest Territories, Nunavut, and the Yukon—contains the same two-part test discussed above for determining when a dealer is not acting as agent of the purchaser. In Quebec, the second arm of the test contains a further requirement that remuneration cannot be received "even indirectly" from the vendor if the dealer is to be considered to be acting as agent of the purchaser.

### All dealers

New Brunswick, Northwest Territories, Nunavut, and the Yukon do not distinguish between a dealer who is acting as agent of the purchaser and one who is not. The legislation of each of these jurisdictions states that "every person or company registered for trading in securities" must deliver a prospectus. As a result, dealers in these jurisdictions are simply required to deliver the prospectus, regardless of how the relationships to their clients are characterized.

## b. When must the prospectus be delivered?

### Within two business days of entering into the agreement of purchase and sale, unless previously delivered

In all jurisdictions—other than British Columbia, New Brunswick, Quebec, Northwest Territories, Nunavut, and the Yukon—a dealer who receives an order from a purchaser must send the prospectus to the purchaser within two days (excluding weekends and holidays) of entering into the agreement of purchase and sale, unless the dealer has already done so.

### Within two business days of entering into the agreement of purchase and sale, regardless of prior delivery

The legislation in British Columbia and Quebec requires the dealer to deliver the prospectus no later than two business days after entering into the agreement of purchase and sale. The legislation in British Columbia and Quebec does not contain the words "unless the dealer has previously done so." This

[10] The relevant provision in Manitoba refers to "a person or company not acting as agent of the purchaser," while the equivalent provision in PEI refers to "a broker not acting as agent of the purchaser."

suggests that the prospectus must be delivered to purchasers regardless of prior delivery. However, we query whether this distinction has any practical implications for dealers and purchasers.

### Before the delivery of the trade confirmation

In the Northwest Territories, Nunavut, and the Yukon, the dealer must deliver the prospectus *before* delivery of the trade confirmation. In each of these territories, the trade confirmation must be delivered within seven days of the trade.

### Dependant on whether the dealer solicited the purchaser or not

New Brunswick's legislation stands alone in the way it treats prospectus delivery. If the dealer solicited the purchaser, the dealer must deliver the prospectus *before* entering into the agreement of purchase and sale and *before* accepting any payment for the order. If the dealer did not solicit the purchaser, the dealer must deliver the prospectus *no later than* the delivery of the trade confirmation. The trade confirmation must be delivered *promptly* after the trade.

## c. What are the consequences of failing to deliver?

### Right of action for rescission or in damages

The legislation of most jurisdictions—other than Manitoba, New Brunswick, Northwest Territories, Nunavut, and the Yukon—contains a statutory provision creating a right of action in favour of the purchaser for rescission or in damages if a dealer fails to deliver the prospectus.

In the following provinces, the right of action for rescission is available for 180 days after the plaintiff should have received the prospectus:

- Alberta
- British Columbia
- Newfoundland
- Nova Scotia
- Ontario
- Prince Edward Island
- Saskatchewan

In Quebec, a purchaser who does not receive a prospectus may apply to the court to have the transaction rescinded or the price revised for three years from the date of the transaction.

The right of action for damages in British Columbia, Newfoundland, Nova Scotia and Ontario is available for the lesser of three years from the date the plaintiff should have received the prospectus or 180 days following the date on which the plaintiff first had knowledge of the facts giving rise to the cause of action.

The right of action in damages is subject to different limitation periods in different provinces:

- Alberta: Lesser of 180 days from the day that the plaintiff first had knowledge of the facts giving rise to the cause of action, or one year from the day of the transaction that gave rise to the cause of action.

- Prince Edward Island: Lesser of one year after the plaintiff first had knowledge of the acts giving rise to the cause of action or three years after the date of the transaction.

- Quebec: Three years from the date of the transaction.
- Saskatchewan: Lesser of one year after the plaintiff first had knowledge of the facts giving rise to the cause of action; or six years after the date of the transaction that gave rise to the cause of the action.

### Right to rescind *ab initio*

In New Brunswick, Northwest Territories, Nunavut, and the Yukon, if the prospectus and financial statements have not been delivered, the purchaser has the right to rescind the purchase if notice is given to the dealer within 60 days of the delivery of the trade confirmation.

### No statutory rights

*In Manitoba, purchasers have no right of rescission and no statutory right of action for rescission or damages.*

## B.6. Comparison of the delivery requirements for confirmations across Canada

## a. Who is responsible for delivering the confirmation?

### The dealer who has acted as principal or agent

Every jurisdiction, except Prince Edward Island, requires the dealer who has acted as principal or agent to deliver a written confirmation of trade to investors. Prince Edward Island does not require the delivery of trade confirmations.

### Either the dealer who has acted as principal or agent or the mutual fund manager

Like Ontario, each of British Columbia, Nova Scotia and Saskatchewan relieve the dealer of its obligation to deliver the confirmation of trade if the mutual fund manager delivers it instead.

## b. When must the confirmation be delivered?

### Promptly

All of the jurisdictions that require delivery of the confirmation of trade, other than the territories, require the dealer to deliver it promptly.

### Within 7 days of the order

In the territories, the confirmation of trade must be sent within seven days of the purchase order being made.

# B.7. Comparison of the rights attached to the purchase of securities across Canada

As noted above, securities legislation is not the same in every province and territory of Canada. This is particularly true when it comes to the rights of withdrawal and rescission. This part of the paper examines how each of the CSA jurisdictions handle, or don't handle, these rights. The table at the end of this section summarizes this complex area.

## a. Do purchasers have any rights attached to receipt of the prospectus?

### Right to withdraw if notice given two business days from receipt of the prospectus

Purchasers are given a right of withdrawal under the legislation of the following provinces:

- Alberta
- British Columbia
- Manitoba
- Nova Scotia
- Newfoundland
- Ontario
- Prince Edward Island
- Saskatchewan

The right of withdrawal is more or less the same in each of these jurisdictions. In Alberta, where mutual funds have been purchased on behalf of a party who is the beneficial owner (nominee accounts), the beneficial owner has the right of withdrawal and must be advised of that right by the dealer.

### Right to rescind if notice given within two days of receipt of prospectus

Although the equivalent right in Quebec is framed as a right of rescission rather than a right of withdrawal, the operation of the right is largely the same as that in other provinces. A purchaser may rescind a purchase by giving notice to the dealer within two business days after receipt of the prospectus.

### Right to rescind if notice given within seven days of delivery of the prospectus and financial statements

The equivalent right in New Brunswick is also called a right of rescission, rather than a right of withdrawal. In New Brunswick, purchasers have the right to rescind a purchase within seven days of delivery of the prospectus and financial statements by sending notice to the dealer, provided delivery of the prospectus occurred within 60 days of delivery of the trade confirmation. As we discuss below, if the prospectus was not delivered, the purchaser can rescind within 60 days of receipt of the trade confirmation.

### No right of withdrawal or rescission attached to receipt of the prospectus

The legislation of Nunavut, the Northwest Territories, and the Yukon contains no right of withdrawal or rescission attached to receipt of the prospectus.

## b. Do purchasers have a right of rescission attached to receipt of the trade confirmation?

### Right to rescind mutual fund purchases under $50,000 if notice given within 48 hours of receipt of trade confirmation

In all jurisdictions—other than Manitoba, New Brunswick, Prince Edward Island, Quebec, and the territories—a purchaser can rescind mutual fund purchases not exceeding $50,000 within 48 hours of receipt of the confirmation of trade.

### Right to rescind if notice given within 60 days of delivery of trade confirmation

The legislation of New Brunswick, Nunavut, the Northwest Territories, and the Yukon contains a right of rescission linked to delivery of the trade confirmation but this right is only triggered if the prospectus is not delivered. In this case, the purchaser may rescind by giving notice to the dealer within 60 days of receiving the trade confirmation. It should be noted that this right of rescission applies to the purchase of all securities, not just mutual funds, and is not limited by the value of the securities purchased.

### No right of rescission attached to receipt of the trade confirmation

There is no right of rescission for mutual fund purchases connected to the delivery of the trade confirmation in Manitoba, Prince Edward Island and Quebec.

# Joint Forum of Financial Market Regulators

# Forum conjoint des autorités de réglementation du marché financier

## Comparing some of the legal rights and obligations across Canada

| | AB, BC, ON, NS, NFLD, SASK | Manitoba | New Brunswick | Prince Edward Island | Quebec | Territories |
|---|---|---|---|---|---|---|
| **When must the dealer deliver the prospectus?** | Within 2 days of placing order | Within 2 days of placing order | If dealer solicited: before payment. If dealer did not: no later than delivery of confirmation. | Within 2 days of placing order | Within 2 days of placing order | Before delivery of trade confirmation |
| **When must the confirmation be delivered?** | Promptly after trade | Promptly after trade | Promptly after trade | Not required | Promptly after trade | Within 7 days of the order being made |
| **Do purchasers have any recourse if the prospectus is not delivered?** | A right of action for rescission is available for 180 days after the plaintiff should have received prospectus.<br><br>A right of action for damages is available for the lesser of 3 years from date prospectus should have been received or 180 days after the plaintiff first had knowledge of the facts giving rise to the action.* | Nothing express | A right of rescission (*ab initio*) so long as notice is given to the dealer within 60 days of delivery of the trade confirmation. | A right of action for rescission is available for 180 days after the plaintiff should have received prospectus.<br><br>A right of action for damages is available for lesser of 3 years from the date of the transaction or one year after plaintiff first had knowledge of facts giving rise to action. | A right of action for rescission is available for three years from date of transaction<br><br>A right of action for damages is available for 3 years from date of transaction | A right of rescission (*ab inito*) so long as notice is given to the dealer within 60 days of delivery of the trade confirmation. |
| **Do purchasers have any rights triggered by delivery of the prospectus?** | A right of withdrawal.<br><br>Must give notice no later than 2 days after receipt of prospectus. | A right of withdrawal<br><br>Must give notice no later than 2 days after receipt of prospectus. | A right of rescission.<br><br>Must give notice no later than 7 days after delivery of prospectus if it's delivered within 60 days of confirmation. | A right of withdrawal.<br><br>Must give notice no later than 2 days after receipt of prospectus. | A right of rescission.<br><br>Must give notice no later than 2 days after receipt of prospectus. | No |

* In **Alberta**, the right of action in damages is available for the lesser of 180 days from the day the purchaser first had knowledge of the facts giving rise to the cause of action or one year from the day of the transaction. In **Saskatchewan**, it is available for the lesser of one year after the purchaser first had knowledge of the facts giving rise to the cause of action or six years after the date of the transaction.

| | | | | | | |
|---|---|---|---|---|---|---|
| **Do purchasers have any rights triggered by delivery of the trade confirmation?** | A right of rescission for mutual funds under $50,000.<br><br>Must give notice within 48 hours of receiving confirmation. | No | A right of rescission, but only if prospectus is not received.<br><br>Must give notice within 60 days of receiving trade confirmation. | No | No | A right of rescission.<br><br>Must give notice within 60 days of delivery of trade confirmation. |

# C. Electronic or physical delivery?

## C.1 Analysis of how the law considers electronic delivery or access in lieu of delivery

### Segregated fund disclosure

The Canadian insurance regulators have not specifically addressed whether information folders can be delivered to segregated fund consumers using electronic means—whether via electronic mail or via postings to Internet web-sites (access-equal-delivery). There is no segregated fund equivalent to SEDAR (the securities regulators electronic filing system). Also segregated fund point of sale and continuous disclosure documents are generally prepared in paper format and are not widely available on Internet web-sites of insurance companies. The CLHIA Guidelines contemplate physical paper delivery and actual written acknowledgements from segregated fund consumers. However, the provisions of the *Electronic Commerce Act, 2000* (Ontario) would arguably allow segregated fund point of sale disclosure documents, as well as other documents, to be provided to consumers in an electronic form. Under that act, the document must be accessible by the recipient, so as to be usable for subsequent reference, and capable of being retained.

### Relevant provisions from the *Electronic Commerce Act, 2000*

**Legal requirement to provide information or document in writing**

6. (1) A legal requirement that a person provide information or a document in writing to another person is satisfied by the provision of the information or document in an electronic form that is,
(a) accessible by the other person so as to be usable for subsequent reference; and
(b) capable of being retained by the other person

**Whether information or document is provided**

10. (1) For the purposes of sections 6, 7 and 8, electronic information or an electronic document is not provided to a person if it is merely made available for access by the person, for example on a website.
(2) For greater certainty, the following are examples of actions that constitute providing electronic information or an electronic document to a person, if section 6 is otherwise complied with:
1. Sending the electronic information or electronic document to the person by electronic mail.
2. Displaying it to the person in the course of a transaction that is being conducted electronically.

**Consent of other persons**

14(4) Nothing in this Act authorizes a public body to require other persons to use, provide or accept information or documents in electronic form without their consent.

Subsection 10(1) of the *Electronic Commerce Act, 2000* appears to restrict an access-equal-delivery approach. However, it is unclear whether a document provided on a web-site, coupled with the consent of the recipient would be sufficient to constitute delivery of segregated fund information folders.

## Mutual fund disclosure

### Relevant provisions from National Policy 11-201

**2.1 Basic Components of Electronic Delivery of Documents**
(1) The securities regulatory authorities are of the view that electronic delivery of a document may be effected in a manner that satisfies the delivery requirements.

(2) There are four basic components to the electronic delivery of a document. Those components are as follows:
1. The recipient of the document receives notice that the document has been, or will be, sent electronically or otherwise electronically made available
2. The recipient of the document has easy access to the document
3. The deliverer of the document has evidence that the document has been delivered or otherwise made available to the recipient
4. The document that is received by the recipient is not different from the document delivered or made available by the deliverer

(3) An electronic delivery of a document would satisfy the delivery requirements if each of the four components were satisfied. If any one of these components were absent, however, the effectiveness of the delivery would be uncertain.

(4) A deliverer generally may satisfy the notice, evidence and… the access components of electronic delivery by obtaining the informed consent of an intended recipient to the electronic delivery of a document, and then delivering the document in accordance with the consent.

(7) An attempt to deliver documents by referring an intended recipient to a third party provider of the document, such as SEDAR, will likely not constitute valid delivery of the document, in the absence of consent given by the intended recipient to such method of delivery. However, the CSA are of the view that valid delivery can be made by a third party provider where it has agreed to act as agent for the deliverer in connection with the delivery of documents and actually effects the delivery.

The Canadian securities regulators have issued interpretive policy guidance on the issue of electronic delivery in National Policy 11-201 Delivery of Documents by Electronic Means (NP 11-201). The policy, indicates that, as a general principle, the delivery requirements of securities legislation may be satisfied by electronic means. [11] According to section 1.3 of that policy, NP 11-201 applies to any document required to be delivered under the delivery requirements. This includes prospectuses.

[11] However, if the method of delivery is specified in the *Act*, electronic delivery is not appropriate, according to subsection 1.3(3). The *Act* is silent on the exact method of delivery for prospectuses.

An issuer may deliver a document electronically if it satisfies the following criteria:

1. The recipient of the document receives notice that the document has been, or will be, sent electronically or otherwise electronically made available.

2. The recipient of the document has easy access to the document.

3. The deliverer of the document has evidence that the document has been delivered or otherwise made available to the recipient.

4. The document that is received by the recipient is not different from the document delivered or made available by the deliverer.

The first three components can be satisfied if a consumer consents to electronic delivery of documents. NP11-201 is consistent with the *Electronic Commerce Act, 2000* described above.

Subsection 2.1(7) of NP 11-201 implies that an access-equal-delivery approach is acceptable, provided the investor consents to it. It states that:

> An attempt to deliver documents by referring an intended recipient to a third party provider of the document, such as SEDAR, will not likely constitute valid delivery of the document, in the absence of consent given by the intended recipient to such method of delivery.

The Five Year Review Committee recommends in its draft report, *Reviewing the Securities Act (Ontario)* that the CSA consider alternative models for delivery of documents.[12]

> In considering the implementation of an alternative model for delivery of documents, the CSA should consider distinguishing between disclosure documents that contain corporate information but do not require any immediate action by a shareholder (such as financial statements) and disclosure documents that require shareholders to take some form of specific action in connection with a particular corporate transaction (such as a take-over bid circular). Such an alternative communication model might introduce the "access-equals-delivery" approach only with respect to documents that do not require the shareholder to take any specific action.

Prospectuses fall squarely within the category of documents that do not require the shareholder to take any specific action.

[12] Released May 29, 2002.