ETF Facts Now Required for Canadian Exchange-Traded Funds — Two-Year Phased-In Implementation

December 21, 2016

The Canadian Securities Administrators (the CSA) continue to refine the disclosure regime applicable to investment funds, with final rules released on December 8, 2016 requiring ETF facts documents to be prepared and delivered post-trade. The final rules codify the requirement for exchange-traded funds (ETFs) to prepare, and for dealers to deliver, a summary document in the form of "ETF Facts" prescribed by the new Form 41-101F4 *Information Required in an ETF Facts Document,* and provide for a statutory right of action for failure to deliver the ETF Facts. However, there are a few differences between the proposed rules and the new regime that we highlight below. The final rule amendments to National Instrument 41-101 *General Prospectus Requirements,* Companion Policy 41-101CP, and Form 41-101F4, are available here. These amendments come into force on March 8, 2017, with a two-year phased-in implementation period for both ETF managers and dealers.

ETF Facts

The amendments to NI 41-101 require ETFs to produce and file ETF Facts in conjunction with the filing of their prospectus documents. The content of what is required to be disclosed in the ETF Facts is set out in new Form 41-101F4. There are few differences from what was initially proposed, although the CSA made some positive changes in response to comments, particularly around the inclusion of certain quantitative data in the ETF Facts.

Discarding Average Premium/Discount to NAV

Commenters took issue with the proposal that ETFs disclose the average premium/discount to net asset value, given that this data is likely difficult for investors to understand and may not be meaningful, as it is drawn from end of day data, ignoring the trends throughout the trading day. Notwithstanding the CSA's explanation that this metric was intended to help investors assess market quality, given the complexities associated with interpreting this metric, the CSA dropped this disclosure element.

Deciphering Average Bid-Ask Spread

Another source of considerable comment was the proposed inclusion of the daily average bid-ask spread for an ETF over a 12-month period. Commenters noted that this

data may be difficult for investors to understand, may be misleading, and may favour cheaper or more established ETFs over more expensive products or new market entrants. Some of the comments focused on the technical difficulty of calculating this figure, and the sheer volume of data required by the calculations. These comments did not dissuade the CSA from including this metric in the final Form 41-101F4. The method to be used in calculating the daily average bid-ask spread is articulated in detail. The CSA provides sample disclosure for an existing ETF that has insufficient data to calculate the average bid-ask spread as required.

Delivery Requirement

The amendments tweak the existing regime for buy-side dealer delivery of the summary documents. The amendments to NI 41-101 explicitly provide that the obligation to deliver a prospectus under securities legislation does not apply in respect of ETFs. Instead, a dealer that receives an order to purchase ETF securities must, unless the dealer has previously done so, deliver or send to the purchaser the most recently filed ETF Facts within two days of purchase. Some provinces2, including Ontario, require legislative amendments to perfect this delivery requirement. It is anticipated that all necessary amendments will be effected in advance of the expiry of the applicable transition period.

The existing relief that permits dealers to deliver a summary document in lieu of the ETF prospectus requires the delivery of the summary document to an investor who is entitled to receive a trade confirmation. This relief recognizes the exemptions in various rules and discretionary exemptions relating to the delivery of trade confirmations, and applied these exemptions to the prospectus delivery. Despite receiving comments alluding to the costly changes required to accommodate the expanded scope of delivery that arises from decoupling delivery of the trade confirmation and the ETF Facts, the CSA mandates delivery by dealers of the ETF Facts to all purchasers of ETF securities (and not just those who are entitled to receive a trade confirmation). Accordingly, dealer infrastructure that links delivery of the summary documents to trade confirmations will have to be reconfigured to ensure delivery of ETF Facts to all purchasers of ETF securities.

We note also troublesome commentary in the CSA Notice (which has not been included in the rules or the Companion Policy) suggesting that dealers must deliver ETF Facts (and Fund Facts for mutual funds) to managed account clients of portfolio managers. We consider that this commentary is not reflective of industry practice, investor expectations and the legal delivery obligations that apply to dealers and portfolio managers, and expect to discuss this issue further with the staff of the CSA.

Finally, while the amendments mandate post-trade delivery of the ETF Facts, the CSA broadly hint that pre-sale delivery is not off the regulatory drawing board, and that they continue to explore the feasibility of pre-trade delivery for ETF Facts to match the delivery requirements applicable to trades in mutual fund securities.

Investor Rights

The rule amendments provide investors with a right of action for damages or rescission if the ETF Facts is not delivered within the prescribed time. Because the ETF Facts is incorporated by reference into the prospectus, ETF investors continue to have the same statutory rights in respect of a misrepresentation in the ETF Facts that currently apply to a misrepresentation in the prospectus. Investors also will have a right of rescission

associated with the delivery of the trade confirmation and a right of action for a misrepresentation in secondary market disclosure in certain jurisdictions. The amendments do not extend to ETF investors the right of withdrawal that is available to investors in mutual funds. These final rules on investor rights are unchanged from the proposed rules.

Transition

The CSA provide for a staged transition of the new rules. Below we have set out the implications of the relevant transition dates for managers and dealers:

	March 8, 2017	September 1, 2017	November 12, 2018	December 10, 2018
Managers	Managers can start filing ETF Facts, rather than summary documents.	Summary documents can no longer be filed for new or existing ETFs. Managers that file their final renewal prospectus after March 8, 2017 and before September 1, 2017 can choose to transition to ETF Facts in 2017 or wait until the next renewal cycle in 2018.	All existing ETFs must have filed ETF Facts by this date. Managers that did not transition to ETF Facts before September 1, 2017 must do so before November 12, 2018.	N/A
Dealers	For ETFs that start using ETF Facts, dealers relying on the existing dealer relief3can start delivering ETF Facts rather than summary documents. Dealers can continue to rely on the dealer relief to send or deliver a summary document or ETF Facts to an investor to whom a trade confirmation is required to be delivered (rather than all purchasers).			Dealers must deliver ETF Facts to all investors.

It will be important for ETF managers — and dealers — to consider a transition plan well in advance of the transition deadline on November 12, 2018.

ETF managers should note that the CSA also recently finalized amendments to National Instrument 81-102*Investment Funds* to mandate a prescribed risk classification methodology for use in Fund Facts and ETF Facts. The final amendments to NI 41-101 cross-refer to the methodology, which is provided for in NI 81-102, and require ETF managers to adopt the new methodology by September 1, 2017, which coincides with the date that ETF Facts must be filed for new or renewal filings made on or after that date. Please watch for our Investment Management Bulletin describing the risk classification methodology.

Please contact your usual lawyer in BLG's Investment Management practice group, the authors of this Bulletin or one of the leaders of the Investment Management practice

group if you would like our assistance in drafting a new form of ETF Facts to use as a template or if you have any questions on the final rules.

2 Ontario, Alberta, Manitoba, New Brunswick, Nova Scotia, Québec and Saskatchewan have either obtained the necessary legislative amendments or have determined that they are not required.

3 The original Dealer Relief issued in 2013 was reissued in the fall of 2015 and contemplates that if a manager of an ETF files an ETF Facts, the dealer will use the ETF Facts instead of a summary document to satisfy its obligations under the Dealer Relief.

By

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