Fund total cost reporting – Coming to investor statements by 2025?

June 29, 2022

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After a several years' hiatus to focus on the client-focused reforms, among other regulatory priorities, the Canadian Securities Administrators (CSA) have picked up the inevitable next steps to the investor statement changes that became effective in 2016, known as CRM2. The CSA's focus is now on registrant reporting of total costs of investing in investment funds.

In late April 2022, the CSA published for comment proposed amendments to National Instrument 31-103 – *Registration Requirements, Exemptions and Ongoing Registrant Obligations* (NI 31-103) and its companion policy. These amendments would require that dealers and advisers include new specified total cost reporting (TCR) information on investor statements in respect of the funds in which their clients invest. Registered investment fund managers of the applicable funds will be expected to provide TCR information to dealers and advisers so that they can prepare those statements for clients.

At the same time the CSA published its proposed amendments to NI 31-103, the Canadian Council of Insurance Regulators (CCIR) proposed a new CCIR Individual Variable Insurance Contract Ongoing Disclosure Guidance (the CCIR Guidance).

The CCIR Guidance is related to annual investor statement requirements, including TCR information, in respect of segregated funds and would apply to all insurers offering segregated funds through individual variable insurance contracts. Its intent is to add new reporting requirements, which will catch up to the CRM2 requirements, and also implement TCR for segregated funds. The CCIR Guidance aims to improve awareness of the rights of policy holders to guarantees and how their actions might affect those guarantees.

The CSA and CCIR proposals are the result of a joint committee effort involving members of the CSA, CCIR, Canadian Insurance Services Regulatory Organizations, the Investment Industry Regulatory Organization of Canada and the Mutual Fund Dealers Association of Canada.

The CSA and CCIR explain that the proposals are important investor protection initiatives, intended to improve investor awareness of ongoing fees and expenses for investments in investment funds and segregated funds. The CSA and CCIR acknowledge the work done to date in providing clear point-of-sale disclosure to investors about fees and expenses (e.g., in fund facts documents) and continuous disclosure (e.g., in financial statements and management reports of fund performance). They are concerned, however, that investors don't access point-of-sale disclosure after they make their investment and often do not review financial statements and MRFPs for the funds they invest in.

The CSA suggest that their research shows investors mistakenly believe that the statements they receive from their chosen registrant (dealer or adviser) provide them with all costs of investing, including the fees paid indirectly through investments in funds. The purpose of the TCR project is to ensure there is ongoing reporting of expenses and fees paid per fund, as well as aggregated annual reporting of the fees and expenses paid directly by the investor.

Next steps and implementation timing

The CSA and CCIR explain that they intend the amendments to NI 31-103 and the CCIR Guidance to be finalized at the same time and remain consistent in their requirements. They have also signalled a short transition period. Assuming the proposals become final in September 2024 the proposed implementation dates are as follows:

	First Monthly/Quarterly/Semi-Annual Report	First Annual Report
Securities Sector Reporting	Q4 2024	December 2025
Insurance Sector Reporting	June 2025, where the insurer sends periodic reports as well as annual ones	December 2025

Operational and legal commentary needed

In light of the signalling by the CSA and CCIR of the inevitability of these proposals, it is critical that industry participants review the requirements and provide comments on the proposals by the end of the comment period on **July 27, 2022**.

There are some legal and definitional issues with the proposals, as well as certain assumptions about investor needs, that we intend to comment on. Equally, if not more importantly, industry participants need to focus on the art of the possible with these proposals. Does what the CSA and CCIR propose make sense in light of the information available, and are the proposals operationally achievable – particularly within the proposed transition periods? The CSA and the CCIR also ask industry to consider and comment on the prescribed formulas/method fund managers and insurers must follow when calculating fund expenses.

Proposed changes

Securities sector

The proposed changes to NI 31-103 would require:

- The mandated monthly or quarterly client account statements to include information on the aggregate of the management expense ratio (MER) and the trading expense ratio (TER) as a percentage, (using the newly-coined phrase fund expense ratio) for each investment fund (by series) held by the client as at the end of the applicable statement period;
- The mandated annual cost and performance report to include the aggregate dollar amount of fund expenses for all investment funds held by a client during the applicable year, along with the aggregate dollar amount of any direct investment fund charges (e.g., redemption fees or short-term trading fees) the client incurs during the year;
- The above-noted disclosure in respect of all investment funds the client invests in, including publicly offered mutual funds, exchange-traded funds, scholarship plans, prospectus exempt funds and “foreign funds”;
- Mandatory disclosure about fees and expenses of investment funds in the applicable statements; and
- Investment fund managers to inform dealers and advisers on the daily cost per unit/share of the relevant class or series of an investment fund calculated in dollars, determined using a specified formula. The calculation requires the applicable fund expense ratio to be divided by 365, and then multiplied by the net asset value per share/unit of the applicable class or series for the day.

Investment fund managers would be allowed to provide approximations of the above-noted data by using publicly-available information in fund facts, ETF facts documents, prospectuses, or management reports of fund performance, unless the information was published more than a year ago, or the manager reasonably believes it would cause the information reported in the account statement or report to be misleading.

Further, if advisers or dealers do not believe the information received from the investment fund manager is reliable, they would be obligated to make reasonable efforts to obtain the information in another way. If that is not possible, the registered firm must exclude the information from the calculation of the amount of fund expenses or of the direct investment fund charges reported to clients, or, in the case of a fund expense ratio, not report the ratio and disclose the exclusions in the affected report.

There is little to no discussion about the probability of obtaining this information from non-Canadian managers of non-Canadian based funds.

We note that the existing exemptions for statements and reports for non-individual permitted clients would continue to apply.

Insurance sector

For clients who own segregated funds, the proposed CCIR Guidance requires insurers to give them specified information listed below at least once a year. They can provide this more frequently if desired:

- The fund expense ratio for each segregated fund the client held during the statement period;
- The aggregate amount of fund expenses, in dollars, for all segregated funds the client held during the statement period;
- The aggregate cost of insurance guarantees under the segregated fund contract, in dollars, for the statement period; and
- The aggregate amount of all other expenses under the segregated fund contract, in dollars, for the statement period.

Other disclosures will be required to bring segregated fund statements more in line with the CRM2 securities sector requirements.

Related publications

The consultation includes a sample prototype statement and report for both the securities and insurance sectors, as well as an annex explaining the differences between products, distribution channels and regulation between segregated funds and investment funds.

For the securities sector, the Ontario Securities Commission published a Regulatory Impact Assessment. It is important to give the OSC feedback on its assessment of the costs and the anticipated benefits of the proposals. If the benefits are overstated and the costs are understated, this imbalance will need to be addressed.

Next steps

We plan to provide comments on the proposals by the July 27 deadline and would be pleased to answer your questions and assist you in providing your comments.

Please contact your usual BLG Investment Management Group lawyer or your BLG Beyond AUM Law lawyer if you would like our assistance in understanding the proposals and their impact on your business. You may also contact the authors of this article or any of the key contacts noted below.

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