Appendix A

Summary of Comments and Responses
CSA Request for Comment 81-405 – Proposed Registration and Prospectus Exemption for Trades in Certain Capital Accumulation Plans

List of Commenters
The University of British Columbia Faculty Pension Plan
Desjardins Financial Security
Phillips, Hager & North
University of Western Ontario
Canadian Association of Retired Persons
Morneau Sobeco
GRS Securities Inc
The Investment Funds Institute of Canada
Association of Canadian Pension Management/Pension Investment Association of Canada

In this summary of comments and responses, we grouped similar comments together and have provided a single response. We categorized these comments into broad themes and described these themes in the headings to the comments. Following our discussion of these themes, we set out the comments we received on our specific questions, together with our responses.

Overall support for the proposed exemption
Commenters supported the CSA in our efforts to harmonize the regulatory regimes between mutual funds and segregated funds.

Preference for a national rule
A number of commenters said that while they supported the proposed *Registration and Prospectus Exemption for Trades in Certain Capital Accumulation Plans* (the proposed exemption), they wanted it to take the form of a national rule, adopted by all members of the CSA. They were concerned that implementing the proposed exemption separately in each jurisdiction might result in different treatment of CAPs in different provinces, and would not be a cost-effective response to participants in the CAP marketplace. Implementing the proposed exemption separately might also mean that members in different provinces in the same CAP are treated differently.

One commenter suggested that the OSC implement the proposed exemption in Ontario as a local rule either by making appropriate amendments to the existing corporate-sponsored plan rule (OSC Rule 32-503) or by incorporating the CAP exemptions into the exempt distribution rule (OSC Rule 45-501). This commenter is of the view that this would be a more efficient and cost-effective solution for both CAP industry participants and the OSC than implementation through *ad hoc* discretionary relief. This commenter also suggested the OSC have only one rule (the proposed exemption) rather than retaining Rule 32-503, leaving one rule to provide all necessary exemptions for CAPs. Other commenters asked the OSC to clarify who could or should apply for a registration or a prospectus exemption, whether the applicant could apply only for a particular plan or multiple plans, and how an applicant would determine the application fee.

Another commenter said that requiring CAPs to apply for an exemption in Ontario continues the existence of inequality between the securities and insurance regulatory regimes.

Other commenters encouraged Alberta and Ontario to retain their existing exemptions, because there may be industry participants who are relying on them who may not want to, or be able to, rely on the proposed exemption. They noted that the existing exemption in Alberta provides relief for some additional securities that may be in a CAP.

Response
Making the exemption a rule
Using a variety of methods to introduce the proposed exemption enables CSA members to implement it more quickly then by engaging in the formal rule-making process. While this process can be completed quickly in some provinces (such as Alberta), in others (such as British Columbia) complying with the requirements to make the proposed exemption a rule would significantly delay its implementation. To make the proposed exemption available more quickly, the CSA intend to incorporate the proposed exemption into National Instrument 45-106 *Prospectus and Registration Exemptions* (NI 45-106).

How the Ontario Securities Commission will address the exemption
The Ontario Securities Commission notes that its existing capital accumulation plan rule, OSC Rule 32-503 *Registration and Prospectus Exemption for Trades by Financial Intermediaries in Mutual Fund Securities to Corporate Sponsored Plans* has a number of requirements that do not apply in the proposed exemption. Since the OSC'S existing rule and the proposed exemption address two different situations, the OSC intends to keep its existing rule, and consider discretionary relief applications for CAP plans on the basis outlined in the proposed exemption.

The OSC expects to adopt the proposed exemption as part of NI 45-106 together with the rest of the CSA.

Harmonize other aspects of mutual fund and segregated fund regulation
Some commenters submitted that we could enhance the efficiency of the CAP investment market if there were true harmonization across all distribution channels for investments. They said that the proposed exemption did not harmonize treatment of mutual funds, segregated funds and different types of plans in a number of ways including:

(a) investment restrictions remain different between insurance regulation, pension regulation and securities regulation for mutual funds
(b) limiting relief to tax-assisted plans
(c) not permitting mutual funds to directly use pooled funds that do not comply with the investment restrictions of National Instrument 81-102 *Mutual Funds* (NI 81-102)
(d) rights of rescission and damages that differ between segregated funds and mutual funds
(e) imposing offering memorandum requirements for documents in some provinces

Commenters urged us to harmonize and achieve a more comprehensive information disclosure system regardless of the underlying investment(s) made available under the plan.

Response
The proposed exemption was intended only to address inequalities in regulatory treatment for certain types of investment products. Most members of the CSA have other exemptions that, for example, permit employers to offer stock purchase plans that issuers and plan sponsors rely on. Other issues, such as a lack of harmonization between the investment restrictions between insurance products, pension funds, and mutual funds, are not part of our mandate, but are being considered by the Joint Forum of Financial Market Regulators as a separate project.

Some of these comments are also addressed more specifically in responses elsewhere in this summary.

What securities does the exemption apply to?
One commenter asked us to revise the terms of the proposed exemption to clarify whether it would apply to funds that were redeemable only under restricted circumstances, such as termination of employment or retirement, or alternatively, to publish or provide written guidance as to our interpretation of the definition of "mutual fund" and, in particular, the phrase "on demand or within a specified period after demand." Other commenters questioned whether the proposed exemption would apply to pooled fund.

Response
The proposed exemption is available to all mutual funds. Securities legislation in most provinces provides a definition of mutual fund. Any fund that meets that definition would be eligible to use the proposed exemption. By examining its particular attributes, a fund would need to assess whether or not it meets the definition of mutual fund.

The CSA are not expanding the proposed exemption beyond mutual funds at this time. A fund that did not meet the requirements of the definition, but has similar attributes to a mutual fund should consider whether it might have other exemptions available to it, and if not, could apply for an exemption based on their specific facts.

The proposed exemption does not prohibit using pooled funds as an investment alternative in a CAP, provided that the pooled fund (if it is a mutual fund) either has another exemption available to is, or it meets the conditions set out in the proposed exemption. For example, in order to be eligible to be used as an investment in a CAP, a condition of the exemption is that pooled fund would need to comply with the investment restrictions in NI 81-102. If the pooled fund has another exemption that it is currently relying on, then the proposed exemption will not mandate that those pooled funds stop using those other exemptions. A mutual fund is not required to use the exemption if it can otherwise distribute its securities in compliance with securities legislation.

Expanding the relief to other plans
Commenters suggested expanding the proposed exemption to apply to non-registered and after-tax, group saving and investment plans, provided that sponsors administer such plans in accordance with the *Guidelines for Capital Accumulation Plans* (the Guidelines). They said that we would not achieve harmonization if the dealer registration exemption were limited to tax-assisted plans because the same service provider would still need to be registered to provide services for an after-tax plan of the same sponsor. They made similar observations about the prospectus exemption.

Response
The Guidelines apply only to tax-assisted capital accumulation plans. We believe it is appropriate to limit the proposed exemption to these types of plans to be consistent with the scope of the Guidelines. There are a number of other existing registration and prospectus exemptions that certain other plans can continue to rely on.

Reporting requirement
Those who commented on the proposed requirement that a mutual fund file an annual report with securities regulators disclosing information about the trades to a CAP, were opposed to completing this report. They explained that they did not understand its purpose, it would be costly, and it was not something that segregated funds were required to do under insurance legislation. They also indicated that this information would be hard to compile, and that existing record-keepers may not have this data available.

Response
Securities regulators require that issuers disclose their trades in securities under a number of other exemptions. The CSA considered imposing this requirement in order to monitor who was using the proposed exemption, and how. Annual reporting would have help us assess the effectiveness of the proposed exemption, the extent to which the exemption is being used in each jurisdiction, and whether its use increases over time.

However, after considering the comments, the CSA have removed the reporting requirement from the proposed exemption and have decided to obtain this information through a notice instead. Under this notice requirement, a mutual fund manager that wishes to use the proposed exemption to distribute securities of funds it manages would have to file a notice in the prescribed form in each jurisdiction where they will offer their funds.

Dealing with former employees and their spouses
One commenter said that the proposed exemption does not adequately address the circumstance where a CAP participant ceases to be an employee of the plan sponsor even though the former employee member's assets are no longer technically held in the CAP. The commenter believes that the proposed exemption should still be available where the former employee member has the same investment options as are offered to the CAP, to allow the former employee to make investments pursuant to pre-authorized purchase plans and to switch among investment options.

Response
The proposed exemption defines "member" to include a former employee, and his or her spouse and is therefore available to these individuals.

Incorporating the Guidelines
Some commenters indicated that instead of imposing separate requirements for the proposed exemption, we should incorporate the Guidelines by reference into the exemption or should refer to the Guidelines without repeating or changing their provisions.

Response
While the CSA supports the practices described in the Guidelines, not all parts of this document are relevant to securities regulation. Since a person or company will not be

able to rely on the exemption unless they comply with all of the conditions of the proposed exemption, we should only impose the requirements that are necessary to ensure that plan members receive the information and assistance necessary for them to make an informed investment decision for their plan. This is the purpose of the conditions set out in the proposed exemption.

Increased role for plan members
One commenter suggested that the decision regarding the choice of mutual funds or mutual fund company(ies) be made by a committee consisting of an equal number of representatives from the "sponsoring company" and representatives selected by the investors, so that the interests of both major participants be protected and harmonized.

Response
The CSA agrees that it is desirable to improve informed decision-making. We encourage plan members to discuss this suggestion with their plan sponsor. However, while this may assist in plan governance, we do not believe that imposing such a requirement is necessary for effective securities regulation. We note that nothing in either the Guidelines or the proposed exemption would restrict plan sponsors from involving plan members in a variety of ways.

Plan members should receive information from both the plan sponsor and the mutual fund company
One commenter recommended that investors receive information from both the plan sponsor as the mutual fund company(ies). In this way, investors will be afforded the broadest and deepest information and protection.

Response
We agree that it is important that investors receive useful and relevant information about their investment choices. While mutual fund companies, through a fund's prospectus and other disclosure documents provide comprehensive, and largely well-written information about a mutual fund, research has indicated that many mutual fund investors still find this information difficult to understand. The proposed exemption would enable plan members to receive information that is more directed at helping them make an investment decision.

The CSA also note that the exemption we are adopting specifically permits a service provider (as defined in the exemption) to provide members with most of the information the plan sponsor must provide, on behalf of the plan sponsor.

Impact on other national instruments and policies
One commenter said that there is a conflict between the monthly valuation of investments requirement in the Guidelines and the 10-business days redemption requirement that they note is in 81-102. Another commenter indicated that the proposed rule is silent on the impact on other national instruments and policies that govern the sale of mutual funds.

Response
The CSA note that any requirements to redeem within a certain period of time that are imposed by NI 81-102 apply only to mutual funds that are regulated by that instrument. Pooled funds that are otherwise not required to comply with NI 81-102 need not follow any other requirements of that instrument, except those specifically required by the

proposed exemption. The CSA note that that the redemption requirements in NI 81-102 do not impose a 10-day redemption period and refers readers to Part 10 of NI 81-102 for a discussion of the redemption requirements for mutual funds that are subject to NI 81-102.

The CSA note that the proposed exemption is a registration and prospectus exemption only. Any other rules that currently apply to the mutual fund or the person doing the trade would continue to apply.

Drafting comments
Two commenters provide a number of drafting comments on the proposed exemption that addressed technical aspects of the proposed exemption.

Response
We have considered the drafting comments and have incorporated most of the commenters' suggestions.

Comments about Specific Questions
1. Does the proposed replacement by the Alberta Securities Commission with the proposed exemption improve the circumstances for those who trade or distribute mutual fund securities to a CAP when compared to the existing exemption in Alberta, or does it create concerns?

Comment
The only comment received on this question did not support repealing the existing Alberta exemption, since its application is broader than the proposed exemption.

Response
The Alberta Securities Commission will eliminate the capital accumulation plan exemptions found in sections 68 and 123 of the ASC Rules (General) (ASC CAP exemption) and ASC Policy 5.5 – *Capital Accumulation Plans*. Some of the securities described under the ASC CAP exemption are securities that are already exempt under other provisions. Other securities under the ASC CAP exemption are exempt if they are securities for which an insurance company or a trust company may invest in. The legislation that governs what insurance companies and trust companies may invest in has been broadened beyond what was originally intended for capital accumulation plans.

2. The CSA invite comments on whether plan sponsors should be able to aggregate fees when reporting to plan members. If the answer is yes, under what circumstances.

Comments
Most commenters said that we should permit plan sponsors to aggregate fees and expenses when reporting to plan members because it is what most segregated funds and conventional mutual funds do today, and that this approach would enhance comparability of funds for plan members. Another suggested that we should consider the CFA presentation standards.

Some of these commenters indicated that certain fees should not be aggregated. These fees included fees for discretionary transactions such as withdrawal and transfer fees, fees associated with the use of an investment or educational tool, record keeping fees

and administration fees. True harmonization would provide the CAP administrator with the ability to report fees on a basis similar to the insurance industry.

One commenter opposed aggregating expenses because other regulatory initiatives, such as proposed National Instrument 81-106 *Investment Fund Continuous Disclosure,* require detailed line item disclosure of mutual fund expenses and complete transparency regarding costs was recommended by the proposed OSC Fair Dealing Model.

Another commenter said that the costs from both the mutual fund companies (such as MERs) and from the "sponsoring companies" should be itemized - and distinguished because the ability of "sponsoring companies" to aggregate their own administrative or other costs along with other fees could lead to abuse. Other commenters indicated that CAP members are most concerned with the cost of participating in the plan, whether it would be an administrative cost or an investment management cost.

Response
We have clarified the terms of the proposed exemption in order to make the fee disclosure that plan sponsors must provide to members more consistent with that required in the Guidelines. We believe that this disclosure is consistent with existing requirements found in NI 81-102 and will provide plan members with a sound base to determine what the direct and indirect fees are for.

3. Staff in Quebec have concerns about the impact of the proposed exemption on the protection generally afforded to investors under securities legislation. For example, the Quebec Securities Act provides for different types of recourse that normally flow from the dealer registration and prospectus requirements under the Act. This includes recourse in damages for misrepresentation in a prospectus. This recourse, in certain cases, may no longer be applicable for members that acquired mutual fund securities through a capital accumulation plan. In these circumstances, members would only be able to rely on the general recourses available under the Civil Code of Quebec.

In addition, members of a capital accumulation plan that acquire securities under the proposed prospectus exemption would not have certain other rights, such as the right of withdrawal from a purchase of securities pursuant to a prospectus.

Finally, other mechanisms that investors may use when there are issues of dealer misconduct such as mediation and investor protection funds, in some instances may also not be available to members of capital accumulation plans.

The CSA requested comment on these investor protection issues.

Comments
One commenter said that the additional investor protection measures that Quebec is asking about should not be of material concern in the CAP context as plan sponsors will have specified obligations under the Guidelines with respect to the selection of the funds to be available to the CAP members subject to on-going monitoring. If Quebec insists that certain recourses that would normally flow from the dealer registration and prospectus requirements continue to be available, the same remedies should be expressly imposed on segregated funds to harmonize the treatment of mutual funds and segregated funds.

Two other commenters indicated that the Guidelines provide sufficient provisions for the protection of plan members. One commenter added that that members participating in the group plans are unlikely to require a 48-hour withdrawal right.

Response
We interpret existing securities laws to mean that if a prospectus is delivered to a plan member, the member will be relying on that prospectus when deciding to buy the particular mutual fund. In this circumstance plan members who receive a prospectus, and retail investors who receive that same prospectus, will be treated the same under securities laws and more particularly, will have the same statutory rights. In other cases, the CSA note that commenters are generally of the view that the protection normally afforded to investors through securities legislation is not necessary, given the structure of CAPs and the obligations imposed on CAP sponsors in the Guidelines.

In Saskatchewan and Nova Scotia, where some of the documentation provided under the exemption may constitute an offering memorandum under their legislation, the local exemption they are each adopting in their respective blanket orders, provides specific exemptions from these requirements, and the rights of action that investors would have if the disclosure were an offering memorandum.

It is our understanding that this will harmonize Saskatchewan and Nova Scotia with the rights of action in the other jurisdictions who are adopting this exemption.

In addition, when this exemption is incorporated into NI 45-106 *Prospectus and Registration Exemptions*, in certain provinces there may be additional recourses that investors can use.