

OSC Investor Advisory Panel
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September 14, 2012

John Stevenson, Secretary
Ontario Securities Commission
20 Queen Street West, Box 1903
Toronto, ON M5H 3S8

Dear Mr. Stevenson,

Re: Notice and Request for Comments re Proposed Amendments to National Instrument 31-103: Cost Disclosure and Performance Reporting

The Investor Advisory Panel (“IAP” or “Panel”) is an independent body established by the Ontario Securities Commission in August, 2010. We are charged with representing the views of investors and providing input on the Commission’s policy initiatives, including proposed rules and policies, the annual Statement of Priorities, concept papers and other issues. The Panel is pleased to comment on the Canadian Securities Administrators’ (CSA) Notice and Request for Comments re Proposed Amendments to National Instrument 31-103: Cost Disclosure, Performance Reporting and Client Statements (“Notice” or “Proposed Amendments”).¹

OVERVIEW

The Investor Advisory Panel strongly supports the Proposed Amendments and the CSA’s continued efforts to redress the information imbalance between investment dealers/advisers and their clients. Canadian investors need transparent, detailed, and meaningful disclosure about the costs and performance of their investments. Disclosure of commissions (trailing or in relation to fixed income products) is particularly important given the conflict of interest that these payments

¹ We thank Chava Schwebel, J.D. for her valuable assistance in the research and preparation of this letter.

create and the absence of a legal fiduciary duty that would require advisers to prioritize their clients' interests. We are pleased that the proposed disclosure and reporting requirements will apply uniformly to dealer representatives regardless of their registration category or jurisdiction in Canada. All investors are entitled to the same quality of reporting; we endorse the CSA's rejection of "tiered" reporting which would reduce the reporting and disclosure obligations of smaller firms.² The Panel also supports enhanced scholarship plan disclosure, which will help particularly vulnerable investors understand the unique risks of these investment vehicles. Given the great importance of these initiatives, we see no reason to delay the implementation period of the Proposed Amendments by an additional year and are disappointed by the CSA's plans to do so. Our comments about specific issues and proposals contained in the Notice are set out below.

DETAILED SUBMISSIONS

Consistent with the Panel's previous submissions, we consider this initiative to be a critical step towards improving the transparency of the investment services industry in Canada and educating consumers about the costs and performance of their investments.³ We join other investor advocates in calling on the CSA to introduce these reforms as soon as possible.⁴ Our position regarding the substance of the Proposed Amendments is as follows:

Trailing commissions. The IAP supports the "complete, upfront and understandable" disclosure of fees through annual disclosure of all charges associated with an investor's account, including trailing commissions.⁵ Disclosure of fees and returns in total dollars should educate investors about the actual costs of their investments. This disclosure will encourage a more thorough and informed discussion about the value of the adviser's services and the risks that are undertaken to earn client returns.

Research regarding Canadians' knowledge of investing, including our own research study conducted last year, shows that most investors do not understand trailer fees, nor realize they are paying them.⁶ Yet financial services firms and trade associations assert that this cost information

² Notice, *supra* note 4 at 13.

³ See e.g., IAP, "Re: OSC Notice and Request for Comments re Proposed Amendments to National Instrument 31-103: Cost Disclosure and Performance Reporting" (Sept. 23, 2011); and, IAP, "Re: Draft Statement of Priorities 2012-2013" (May 29, 2012).

⁴ See e.g., the submissions of Christine Lucyk, Ken Kivenko (Kenmar Associates), and Audrey Sauder (Armstrong & Quail Assoc. Inc.) regarding the Notice, *supra* note 4, online: <http://www.osc.gov.on.ca/en/22871.htm>.

⁵ CSA, "Notice and Request for Comments – Proposed Amendments to NI 31-103 Registration Requirements, Exemptions and Ongoing Registrant Obligations and to Companion Policy 31-103CP Registration Requirements, Exemptions and Ongoing Registrant Obligations" (June 14, 2012) ("Notice") at 3.

⁶ See Report of the Brondesbury Group for the Investor Advisory Panel, "Focus Groups with Retail Investors on Investor Rights and Protection," (April 7, 2011) Appendix A to IAP, "Re: OSC's Notice 11-765 Statement of Priorities for Fiscal Year ending March 31, 2012" (April 27, 2011) at 7-8 ("Brondesbury Report"); and, e.g., Dr. Edwin L. Weinstein, "Report: Performance Reporting And Cost Disclosure – Prepared for the Canadian Securities Administrators" (September 17, 2010) at 3, 15, 16, and 27 ("Weinstein Report").

is available elsewhere or would lead to double-counting of investment charges.⁷ These claims do not hold up to scrutiny, in our view; industry pressure should not cause further delay or any dilution of the proposed cost disclosure requirements.

Fixed income commissions. The proposal to require disclosure of the dollar amount of commissions is an important first step to provide protection for fixed income investors, who historically have received almost no information about the costs of their investments. We are skeptical of claims that such information is difficult to obtain and supply,⁸ and believe that the financial services industry has a very good idea of which bonds are most profitable and the source of their profits.⁹ It's time for investors to have access to this information as well. We encourage the CSA to mandate additional disclosures, such as the extension of the proposed point-of-sale (POS) disclosure requirements to fixed income products.¹⁰

Percentage return calculation method. We support the CSA's proposal to mandate the use of dollar-weighted performance as the standard return calculation. This method best addresses the primary concern of investors, how their investments have performed net of deposits and withdrawals. A uniform method of calculation should also deepen investors' understanding and allow for easier comparisons between different investments. However, the time-weighted method of performance measurement is also important as it illustrates the contribution of the investment adviser and is recommended as the preferred approach within the industry.¹¹ We encourage financial services representatives to provide this information as well.

⁷ See e.g., the submissions of Joanne De Laurentiis, the Investment Funds Institute of Canada (IFIC) (September 7, 2011) at 5, Sandra L. Kegie, Federation of Mutual Fund Dealers (September 23, 2011) at 3, and John Novachis, Investment Planning Council (September 23, 2011) at 5 regarding OSC, "Notice and Request for Comments re Proposed Amendments to National Instrument 31-103: Cost Disclosure and Performance Reporting" (July 22, 2011), online: <http://www.checkbeforeyouinvest.ca/en/13596.htm>.

⁸ See e.g., Ian C. Russell, Investment Industry Association of Canada, "Re: Proposed Amendments to National Instrument 31-103: Cost Disclosure and Performance Reporting" (September 20, 2011) at 7 and 8.

⁹ See e.g., Sauder submission, *supra* note 3.

¹⁰ See, among other publications associated with the POS initiative: CSA, "Re: Notice and Request for Comments re Implementation of Stage 2 of Point of Sale Disclosure for Mutual Funds – Proposed Amendments to NI 81-101 Mutual Fund Prospectus Disclosure, Form 81-101F3 and Companion Policy 81-101CP Mutual Fund Prospectus Disclosure and Consequential Amendments"; and, "Notice and Request for Comment: Implementation of Stage 2 of Point of Sale Disclosure for Mutual Funds – Proposed Amendments to NI 81-101 Mutual Fund Prospectus Disclosure, Form 81-101F3 Contents of Fund Facts Document and Companion Policy 81-101CP Mutual Fund Prospectus Disclosure – 2nd Request for Comments," (June 21, 2012). See also the IAP's submissions regarding these proposals: IAP, "Re: Notice and Request for Comments re Implementation of Stage 2 of Point of Sale Disclosure for Mutual Funds – Proposed Amendments to NI 81-101 Mutual Fund Prospectus Disclosure, Form 81-101F3 and Companion Policy 81-101CP Mutual Fund Prospectus Disclosure and Consequential Amendments" (November 10, 2011) ("IAP Re: POS Stage 2 – 1st Request for Comments"); and, IAP, "Re: Notice and Request for Comment: Implementation of Stage 2 of Point of Sale Disclosure for Mutual Funds – Proposed Amendments to NI 81-101 Mutual Fund Prospectus Disclosure, Form 81-101F3 Contents of Fund Facts Document and Companion Policy 81-101CP Mutual Fund Prospectus Disclosure – 2nd Request for Comments," (September 6, 2012) ("IAP Re: POS Stage 2 – 2nd Request for Comments").

¹¹ For example, the Global Investment Performance Standards (GIPS) require a time-weighted return on the basis that it "best reflects the firm's ability to manage the assets according to a specified strategy or objective, and is the

Scholarship plan disclosure. We strongly endorse the CSA’s proposal to require special reporting for group scholarship plans. These plans are generally subject to different and narrower rules than self-directed RESP accounts and thus have unique risks that are not well understood by investors. Group scholarship plans are often proactively marketed to small investors, typically families with young children who may be newcomers to Canada.¹² Mandatory pre-purchase disclosure of front-loaded fees is critical and would help clarify the potentially high costs of these plans. The CSA should take additional steps to protect group plan investors. We recommend that simplified point-of-sale disclosure similar to the requirements for mutual funds be immediately extended to group scholarship plans.¹³ Other steps are necessary to further educate consumers and ensure that (commissioned) sales agents do not provide prospective investors with boilerplate disclosure that obscures the true costs, risks, and limitations of these plans.¹⁴

Benchmark comparisons. The Panel recognizes that investors need to understand how comparable investments performed, and the risks that were assumed in order to generate their investment returns. The aim of these reforms should be to redress the current information imbalance between investors and their advisers by improving the transparency of this relationship and empowering investors to ask questions and seek additional information about their investments. We have noted that while we consider benchmarks to be a useful tool in enhancing investor understanding, they can also be complex and even misleading. Given low levels of financial and particularly investor literacy in Canada, it is not surprising that many investors find benchmarks confusing.¹⁵

The Proposed Instrument offers a sensible compromise: mandating the provision of a risk-free benchmark (the 5-year GIC rate) while encouraging the use of other benchmarks tailored to the

basis for the comparability of composite returns among firms on a global basis”: GIPS, *Guidance Statement on Calculation Methodology (Revised)* CFA Institute (2008) at 1, online: <http://www.gipsstandards.org/standards/guidance/archive/pdf/GSCalcMethRevised.pdf>. However, we understand that there is disagreement about the relative merits of dollar- and time-weighted return methodologies: see e.g., [dailyvest](http://www.dailyvest.com/PRR/prr_calcmeths.aspx), “Personal Rate of Return/Investment Performance Calculation Methodologies & Assumptions”, online: http://www.dailyvest.com/PRR/prr_calcmeths.aspx; and, Preet Banerjee, “Modified Dietz Return Calculations” (December 9, 2009), online: <http://wheredoesallmymoneygo.com/modified-dietz-return-calculations/> Explanatory information regarding the differences between these calculation methodologies should be included if more than one return measure is provided.

¹² See [Review of Registered Education Savings Plan Industry Practices](http://www.hrsdc.gc.ca/eng/publications_resources/evaluation/2008/industry_practices/page06.shtml)” (archived) (finding numerous problems with the marketing practices and disclosure materials of group scholarship plan providers) (“HR Report”), online: http://www.hrsdc.gc.ca/eng/publications_resources/evaluation/2008/industry_practices/page06.shtml

¹³ See e.g., IAP Re: POS Stage 2 – 2nd Request for Comments, *supra* note 9.

¹⁴ HR Report, *supra* note 11.

¹⁵ See e.g., [Allen Research Corporation](http://www.allenresearch.com), *Canadian Securities Administrators Performance Report Testing* (February, 2011) at 13 (“ARC”); and, Weinstein Report, *supra* note 5 at 29. See also IAP Re: POS Stage 2 – 1st Request for Comments, *supra* note 9, and IAP, “Re NI 31-103 Cost Disclosure and Performance Reporting” (September 23, 2011), online: http://www.checkbeforeyouinvest.ca/en/Investors_iap_submissions_index.htm.

client's account. We believe that with further study this approach should evolve over time to provide more detailed information and guidance. We repeat our call on the CSA to undertake additional research on the use of benchmarks to strengthen the impact of ongoing performance reporting.

Extension to similar investments. We recognize that the Proposed Amendments do not cover investment products such as GICs, other bank products, Canada Savings Bonds, and all insurance-related investment products. Rather than maintain the current “race to the bottom” of inadequate disclosure, we call on the regulators of the banks, life insurance companies and other financial services providers to follow the CSA's lead and implement similar reporting and disclosure requirements. All should share a common goal: a uniformly high level of transparency regarding all financial products sold in Canada.

Third party commissions. We are not confident that mandating consistent and simplified disclosure about investment costs and performance will ensure that investors read such material and make more informed or intelligent investment decisions; disclosure by itself may not be sufficient. Regulators in the European Union, the United Kingdom and Australia are moving to ban third party commissions rather than merely compel disclosure of them on the basis that these payments are incompatible with the provision of independent investment advice.¹⁶ These jurisdictions are also working to refine or introduce a fiduciary or best interests standard for financial services professionals.¹⁷ While there seems to be little progress in the United States on the issue of commission payments or the introduction of a prescribed framework for cost and performance reporting, the U.S. Securities and Exchange Commission is working to introduce a uniform fiduciary standard for investment advisers and broker-dealers.¹⁸ The CSA should not dismiss the possibility of banning commissions outright.¹⁹ We believe that the issue merits

¹⁶ See, e.g., Article 24(5) and (6) European Commission, *Proposal for a Directive of the European Parliament and the Council on Markets in Financial Instruments* repealing Directive 2004/39/EC of the European Parliament and of the Council (COM (2011) 656/4) (recast) (“MiFID II”); FSA, *Retail Distribution Review*, online:

<http://www.fsa.gov.uk/rdr>; and, Ch. 2.3, FSA *Conduct of Business Sourcebook* (COBS); Australian Government – The Treasury, *Future of Financial Advice, FAQ* (“Future of Financial Advice”), online: <http://futureofadvice.treasury.gov.au/content/Content.aspx?doc=faq.htm>; and, Parliament of the Commonwealth of Australia, Corporations Amendment (Future of Financial Advice) Bill 2012 (Corporations Amendment) online: http://www.aph.gov.au/Parliamentary_Business/Bills_Legislation/Bills_Search_Results/Result?bId=r4689.

¹⁷ For the E.U., see Article 19(1) of the European Parliament and Council Markets in Financial Instruments Directive (“MiFID”) 2004/39/EC; and, MiFID Implementing Directive (2006/73/EC) and Implementing Regulation (EC/1287/2006); see also MiFID II, *ibid*. For the U.K., see Ch. 2.1.1 of the U.K. Financial Services Authority's *Conduct of Business Sourcebook* (COBS) (consistent with the MiFID requirements, *ibid*). Australia has introduced a legal fiduciary standard as part of the “Future of Financial Advice” reforms, which went into effect as a voluntary requirement on July 1, 2012, and will become mandatory as of July 1, 2013; see “Future of Financial Advice”, *ibid*. See also IAP, “Re: OSC's Notice 11-765 Statement of Priorities for Fiscal Year ending March 31, 2012” (April 27, 2011) at fn. 15 (“Re: SOP 2011-2012”).

¹⁸ See § 913 *Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010*, Pub. L. No. 111-203, 124 Stat. 1376 (2010) (“Dodd-Frank”).

¹⁹ Notice *supra* note 4 at 3 (“Some regulators in other countries are moving to ban compensation models such as those involving trailing commissions altogether. We are not proposing to do so. We believe different dealer

additional study to ensure that investor interests are safeguarded and that Canadian investors are at least as well protected as investors in other developed markets.

CONCLUSION

The Investor Advisory Panel is pleased that the CSA is taking the lead internationally in mandating more detailed and consistent reporting to clients of investment fees and performance.²⁰ This initiative is especially important in the continued absence of a fiduciary obligation for financial advisers and salespeople. Our primary concern is the now three-year delay in implementing these measures, which we believe is unnecessary and unduly compromises investors' interests. We otherwise support these measures and commend the CSA for generally upholding the integrity of these requirements in the face of industry pressure to dilute them.

We thank you for considering our comments.

Sincerely,

The Investor Advisory Panel

Anita Anand, Nancy Averill, Paul Bates, Stan Buell, Lincoln Caylor, Steve Garmaise and Michael Wissell.

compensation models can offer benefits to investors. However, it is essential that there be a significant increase in the transparency to investors of the compensation their dealers or advisers receive. We think this means disclosure that is complete, upfront and understandable to the average investor.”)

²⁰ Given the high cost of mutual fund ownership in Canada, perhaps more should be done to regulate investment charges themselves rather than the technical manner in which they are reported to clients: see Ajay Khorana, Henri Servaes & Peter Tufano, “Mutual Fund Fees Around the World,” (2008) 22 Rev. Fin. Stud. at 1279, 1280 (noting that Canadian investors pay some of the highest mutual fund fees in the world); see also the Canadian Foundation for Advancement of Investor Rights (FAIR Canada) “Re: Notice and Request for Comment on Proposed Amendments to National Instrument 31-103 Registration Requirements and Exemptions and to Companion Policy 31-103CP Registration Requirements and Exemptions – Cost Disclosure and Performance Reporting” (September 23, 2011) at 5, online: http://www.checkbeforeyouinvest.ca/documents/en/Securities-Category3-Comments/com_20110923_31-103_pascuttoe.pdf.