

Kenmar Associates
The voice of the retail investor

June 19, 2012

John Stevenson, Secretary
Ontario Securities Commission
20 Queen Street West, Suite 1903, Box 55
Toronto, ON M5H 3S8
Fax: 416-593-2318
E-mail: jstevenson@osc.gov.on.ca

Me Anne-Marie Beaudoin
Corporate Secretary
Autorité des marchés financiers
800, square Victoria, 22e étage
C.P. 246, tour de la Bourse
Montréal (Québec) H4Z 1G3
Fax : 514-864-6381
E-mail: consultation-en-cours@lautorite.qc.ca

Kenmar Associates Comment Letter

**NOTICE AND REQUEST FOR COMMENT ON PROPOSED AMENDMENTS TO
NATIONAL INSTRUMENT 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
(2nd Publication)**

Cost Disclosure, Performance Reporting and Client Statements

http://www.osc.gov.on.ca/en/SecuritiesLaw_rule_20120614_31-103_proposed-amendments.htm

Kenmar Associates will yet again comment on the proposed amendments. We are however dismayed to see that another year has passed with no regulatory decision on individual account performance

and cost reporting. Except perhaps for HNW investors, prevailing account statements are usually incomplete, confusing and near useless. This works to the disadvantage of retail investors especially seniors and retirees. The prevailing mess is NOT in the Public Interest and should be resolved without further delay or another round of consultations.

Good reporting on Client Statements can prevent/reduce complaints, disputes and litigation by highlighting issues quickly before major losses are incurred. Several provinces have reduced the period of time clients have to file a civil claim. Most of these Limitations Acts , including Ontario, now have periods as low as 2 years. It's more important than ever to stay on top of things before they get out of hand. We therefore agree with Section 14.4 (1) requiring registered dealers to deliver statements to clients at least once every three months. We note that the CSA has now clarified that electronic access with link is , with client approval, considered acceptable delivery.

Cost Disclosure

We like the rule requiring dealers to provide clients with annual reports that show in dollar terms, what the dealer or rep was paid for the products and services provided during the year. Exposing some of the hidden costs and embedded charges that investors pay by requiring disclosure of trailer commissions in dollar terms and the like is an obviously necessary action. Adding in the costs of fixed-income investments, including both the commissions earned by Reps, and the spread taken by bond desks is a nice-to-have initiative. BUT, we would not want to see this requirement be on the critical path towards providing investment performance returns on account statements, the most important, in our view, information variable to the retail investor.

Personal Rates of return

Meaningful account statements are an essential component of increasing the awareness and knowledge of investors and their ability to make informed personal financial and economic decisions and detect abusive practices such as account churning. It is inconsistent to be in the advisory business and not be able to tell investors how their

accounts are performing. It is not an add-on service as some have suggested ; it is integral to the advice business.

Indeed , Steadyhand investments , a fund company rated as Grade A in stewardship , had this to say in its excellent Jan. , 2011 Report: *How is My Portfolio Doing...And What Should I do About it?*

*" In cases where it's not possible to get your returns, there are two things you can do. **First, consider changing the firm you work with. Assessing performance is too important to be ignored...**"*

A growing number of firms already have the core capability. RBC Direct Investing makes it available online. For those dealers who don't currently provide personalized rates of return, a short transition time should be permitted since this is neither rocket science nor an unexpected requirement. Debate on this subject has been ongoing since the mid-nineties. Articles, surveys and research have been published pointing out this reporting gap since at least 1995 .SIPA www.sipa.ca has been asking for this information since 2001, over 11 years ago. In 2003 , the OSC's Fair Dealing Model made it clear this was a necessary component of a relationship. Thus, three years for implementation is far too long for such a basic capability.

About 5 years ago when TFSA's became available the industry demonstrated its impressive capabilities. With blinding speed new forms were developed, new accounts designed , marketing materials launched and the IT infrastructure put into place. When motivated ,the investment industry can move at warp speed.

Technology and contemporary data bases now allows mass customization of the necessary information at a very reasonable cost at high speed. We do however appreciate that implementation does require numerous changes to system architecture.

Accordingly, we recommend 18 months for automated performance reporting implementation. Any firm that could not meet this deadline should be required to at least provide performance information by manual or semi-automated means for those who request it.

We have no problem with the revised proposals that would allow a registered firm to provide a consolidated portfolio performance report for a client *instead* of account-by-account reports, if the client consents and the consolidation method is mathematically and logically reasonable. We assume however registered accounts and non-registered accounts would not be lumped together.

Given all this history ,we are disappointed that information will only be required to be reported on a go-forward basis .

We note that IIROC has suspended its improvement initiatives pending finalization of CSA requirements for performance reporting and disclosure of charges and other compensation .Thus ,the CSA schedule is the pacing item for implementation. We urge the CSA to make a definitive decision by Dec. 31, 2012 which is another 2.5 months after the Sept. 14 submittal deadline. The endless chain of consultation must come to an end.

Issue for comment: Making fixed-income transactions more transparent
Comment : We are not in a position to assess whether it is feasible and appropriate to mandate the disclosure of all of the compensation and/or income earned by registered firms from fixed-income transactions. We can say that bond cost transparency would be welcome but it should not be in the critical path of cost and performance reporting disclosure implementation.

Issue for comment We too understand that all securities transactions are carried out through an account, even when the securities are not held in that account. Comment: Investors are not interested in back office classifications of accounts/securities. To them, the account is THE account.

Issue for comment Use of the dollar-weighted method of return calculation. Comment :A dollar- weighted return measure is based on assumptions regarding amount and timing -it measures how much an investor's investment dollars returned on average . Such a rate of return will therefore allow an investor to see if his/her personal rate of return is above or below the returns anticipated in his/her long term return objective/IPS . We note that the MFDA website www.mfda.ca

,the MFDA considers the Modified Dietz ,
http://en.wikipedia.org/wiki/Modified_Dietz_Method (and
<http://wheredoesallmymoneygo.com/modified-dietz-return-calculations/>), as their standard for performance reporting. We recommend that the CSA define the acceptable method of calculation and not leave it to each dealer to determine the return calculation methodology. Dealers should describe the methodology used in detail on their websites and/or in print .

Dollar-weighted Return: Dollar-weighted return for fund i ($r_{i,dw}$) is the rate of return that equates the discounted ending assets-under-management ($AUM_{i,t}$) to the sum of the initial assets-under-management ($AUM_{i,0}$) and the present value of realized capital flows as follows

$$\frac{AUM_{i,t}}{(1+r_{i,dw})^t} = AUM_{i,0} + \sum_{t=1}^T \frac{\text{Capital flow}_{i,t}}{(1+r_{i,dw})^t},$$

where $\text{Capital flow}_{i,t} = AUM_{i,t} - (1 + \text{return}_t)AUM_{i,t-1}$

As we understand the proposals, the return calculations are to be provided on a pre-tax basis only.

Scholarship Group plans

We concur that there are some unique features to group plans offered by scholarship plan dealers (group scholarship plans). By requiring these Plans to spell out upfront the added risks inherent in these products (such as consequences of failing to keep up payments, or failing to choose a qualified course of study); along with annual cost and performance reporting, investors will be better protected . The proposed approach seems practical and useful. Again however ,we would not want this relatively small element of investor assets to slow down overall implementation timelines for investment and mutual fund dealers.

Benchmark information reporting

The CSA have added guidance in the Companion Policy that “encourages” firms to include an historical five-year GIC rate in performance reports as an easily understood comparator that shows how a very low-risk investment alternative performed vs securities investments. We recommend that this be made mandatory if no other benchmark is provided (any benchmarks a firm chooses to provide should be meaningful and relevant to the client and not be misleading)

We agree that requiring investment dealers to provide each client at account opening with a general description of benchmarks, the factors that should be considered when using them and whether the firm offers any options for benchmark reporting is not unacceptable .

General Comments

Some general comments on reporting/account statements

- There should be no discrete new charge or fee for cost/performance reporting .
- The word “Advisor” should be replaced by the words “ Dealing Representative” per NI31-103 in all client communications including account statements .
- Client statements should avoid industry jargon and acronyms and be in plain language.
- The foreign exchange rate used to convert to C\$’s, if applicable, should be delineated on the statement.
- We agree with minimum reporting periods of 1, 3, 5 and 10 years and the period since the inception of the account. Registered firms should be allowed to opt to provide more frequent performance reporting such as year-by-year.
- a risk measure for the portfolio keyed to the client's New Account Application Form / KYC is desirable but not recommended at this point if it detracts or delays from the primary objective of providing personalized pre-tax rate of return information. Knowing returns without knowing the risks taken to obtain the returns is a deficiency of most performance reporting regimes. We suggest a simple measure:- the worst 12 month performance for the account. It appears that dealers will be permitted to add this providing it is not misleading.

The sentence " *We anticipate exempting the SROs and their members from some or all of the proposed amendments if the SROs adopt materially harmonized requirements*" is of concern. We are constructively critical of all regulatory exemptions . We recommend deletion of this remark.

We like the sample performance presentation format provided .It's a huge improvement over what exists today.

Bottom Line

Overall, we feel these proposals are positive and strongly support their implementation without undue delay. The proposed 2016 implementation date for performance reporting is a shame on the investment industry that should not be tolerated. It is in fact a major Canadian socio-economic issue and should be prioritized accordingly. If the industry gives the project adequate resources and priority , eighteen months is more than reasonable for nearly all but the smallest firms. Non-compliant dealers should be prohibited from declaring or advertising that they provide investment advice and their staff and agents prohibited from using the term "advisor". A corresponding fine of ,say \$1.00 per day, per delinquent account should be levied for procrastinators beyond the 18th month milestone.

Permission is granted for public posting of this Comment letter.

Should you have any questions, do not hesitate to contact us.

Ken Kivenko P.Eng.
President, Kenmar Associates
kenkiv@sympatico.ca
(416)-244-5803

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