



VIA ELECTRONIC MAIL: comments@osc.gov.on.ca, consultation-en-cours@lautorite.qc.ca

August 29, 2012

British Columbia Securities Commission
Alberta Securities Commission
Saskatchewan Financial Services Commission
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
New Brunswick Securities Commission
Superintendent of Securities, Prince Edward Island
Nova Scotia Securities Commission
Superintendent of Securities, Newfoundland and Labrador
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Yukon Territory
Superintendent of Securities, Nunavut

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Re: Proposed Amendments to National Instrument 31-103: Cost Disclosure and Performance Reporting

We are writing to provide the comments of the Members of The Investment Funds Institute of Canada to the second publication of proposed amendments to *National Instrument 31-103 Registration Requirements, Exemptions and Ongoing Registrant Obligations: Cost Disclosure, Performance Reporting and Client Statements* (the "Proposals"), published on June 14, 2012.

Our Members support the general principles of the Proposals to provide clients with clear and

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transparent reporting on performance and costs, and welcome the opportunity to respond. In this letter we re-state the concerns raised in our response to the previous draft – that the Proposals are:

- unfair in their treatment of mutual funds relative to other investment products,
- are costly to implement, and
- fail to provide any evidence of a proportionate benefit accruing to investors from their application.

The CSA's failure to respond to these concerns in the current draft suggests that our position that the rules are inconsistent with securities commission mandates to foster fair and efficient capital markets may not have been fully understood. We spell that out in greater detail in the **General Comments** below. Each of the following topics is discussed under **Specific Comments** below:

- Time-weighted vs. Dollar-weighted Performance Reporting;
- Account Reporting;
- Client Statement Format;
- Original Cost vs. Book Cost;
- Inappropriate switches; and
- Duplication with existing Referral Fee Rules

General Comments

Unfair Treatment of Mutual Funds in Trailer Commission Reporting:

The CSA acknowledges that the Proposals regarding disclosure of trailing commissions are unfair to mutual funds relative to disclosures required for other products.

The Notice states:

“We acknowledge that investment products sold by financial services firms that are not under CSA or CSA and SRO oversight would not have the same requirement to disclose their compensation. While we are sympathetic, we note that we can only make rules within our jurisdiction. The fact that other segments, including banks and insurance companies, would not be required to comply with corresponding requirements for non-securities investments is not a reason to reduce the level of disclosure that we believe is necessary for securities investors.”

We respectfully disagree with the above statement. Investors utilize a broad range of financial products. That broad usage is demonstrated in the following table, taken from ***Investor Economics - Household Balance Sheet - Breakdown of Financial Wealth***. Mutual funds occupy 25.5% of the

household balance sheet. This leaves 74.5% of the household balance sheet in other types of investments.

Household Balance Sheet – Breakdown of Financial Wealth		
	Assets (\$bn)	As a % of Financial Wealth
Deposits and Cash Equivalents	1217	40.73%
Equities and Fixed Income	885	29.62%
Mutual funds	762	25.50%
Seg Funds	120	4.02%
Other financial assets	4	0.13%
	Financial Wealth	2,988
		100%

Source: Investor Economics, December 2011

These Proposals would mislead investors to believe that there are costs of distribution for mutual funds, roughly a quarter of their portfolio, that are not present for the financial products that make up the remaining three quarters of their portfolio. The unfairness of this is amplified by the fact that distribution costs for mutual funds are already disclosed in other prescribed disclosure documents provided to the client whereas the distribution costs for many of the other financial products, including deposit products, are not disclosed at all.

We believe this will result in investors being misinformed and misled with regard to the cost of their investments, with potential inappropriate impacts on their investment choices.

No Evidence that Benefits Outweigh Costs:

While the June 14, 2012 **Notice and Request for Comments (the “Notice”)** acknowledges the concerns we have raised in a number of areas, the CSA has chosen not to change the proposals materially. With respect to provisions which the CSA acknowledges will raise costs to industry, and thereby to investors, there is no evidence provided, or attempt to establish, that the benefits of the proposed regulations would outweigh these costs. We do not believe therefore that these Proposals are consistent with the purpose and principle of securities regulation as laid out in securities law.

Section 1.1 of the Ontario Securities Act (the "Act") states that:

"1.1 The purposes of this Act are, ... (b) to foster fair and efficient capital markets and confidence in capital markets."

The Act goes on to say in Section 2.1 that:

"2.1 In pursuing the purposes of this Act, the Commission shall have regard to the following fundamental principles: 6. Business and regulatory costs and other restrictions on the business and investment activities of market participants should be proportionate to the significance of the regulatory objectives sought to be realized."

We respectfully note that no quantitative cost-benefit analysis has been disclosed which demonstrates that the business and regulatory costs of the Proposals would be proportionate to the significance of the regulatory objectives sought.

The lack of attention to the matter of costs and benefits is evident in the following CSA response to the issue concerning the disclosure of trailing commissions:

"Most industry comments suggested that requiring registrants to disclose the dollar amount of trailing commissions was unnecessary, would be confusing to investors and would result in a sizable cost to industry without providing an overall benefit. We do not agree. We acknowledge the potential costs to industry, but believe that informing the investing public is worth this cost."

The above statement regarding costs and benefits is an opinion. There is no consideration of monetized costs or benefits as required by law.

In our response to the first publication of these Proposals, we commented specifically on the significant costs and complex technology requirements for implementation. The CSA's response has been to provide additional transition time to complete the required changes. This however does not mitigate the acknowledged potential costs to the industry and investors, or illustrate why it believes the provision of the required information, in the form and format prescribed, is worth the cost.

Overlap with Point of Sale NI 81-101 Changes:

As noted above, and in our previous submissions on this Proposal, there is significant overlap with the Point of Sale (POS) disclosure requirements. Disclosure of mutual fund costs, charges and commissions is now required to be made in the Fund Facts document. Components of the Management Expense Ratio, trailing commissions and other fees and expenses related to the product and its distribution are fully disclosed in Fund Facts which will be provided to investors with the implementation of Point of Sale Phase 2.

These changes to NI 81-101 will ensure that the costs of investing in mutual funds are fully disclosed to investors. It is our view that disclosure of mutual fund fees and commissions should continue to be mandated through NI 81-101.

We support the clear and simple disclosure of costs and commissions that is in the Fund Facts document. We do not believe it is necessary to provide the additional disclosure related to trailing commissions, especially when, for reasons stated above, it will mislead investors, put the mutual fund industry at an unfair disadvantage, and raise costs for the industry and investors for a benefit that is asserted, but not demonstrated, to be "worth the cost".

Specific Comments

Performance Reporting must include Approximation Methods:

The CSA has proposed a single method for performance reporting to promote consistency across registrants. We note, however, that the SROs, who are mandated to regulate the activities of dealers, have not favoured prescribing a single method of calculation for performance reporting. They have acknowledged the need for flexibility in recognition of different investor needs. A competitive marketplace is sufficient to ensure that registrants will choose the best method of performance reporting for their clients.

The CSA has not taken this view. It has proposed the dollar-weighted methodology, believing it to most accurately reflect the actual return of a client's investments after accounting for deposits and withdrawals over the performance period. However this choice does not take into account the fact that not all investors are identical. Some investors may be more concerned with the actual performance of the underlying investments so they can decide how to allocate future investments. Others may be more interested in annual gain/loss information.

Although performance reporting has not been mandated to date for mutual fund dealers, many dealer registrants have already implemented performance reporting measures using methodologies best suited to their clients' needs. These include time-weighted and dollar-weighted methods, as well as a common methodology known as Modified Deitz, which approximates the more computationally intensive internal rate of return dollar-weighted methodology. Some of these registrants have gone beyond regulatory requirements to provide the reporting method that best suits the needs of their clients. It would be unfortunate to bring additional costs to these registrants by imposing a standard not wanted or confusing to their clients.

Offering the option for registrants to provide more than one performance measure is not a viable option due to operational challenges. Registrants will have to duplicate their statement production processes which will impact the timeliness of information, increase costs that will ultimately be borne by investors, and increase opportunities for error and confusion. Mandating a single performance measure for registrants not currently using that method will have the same

operational challenges and cost implications without necessarily providing a corresponding benefit to investors.

We recommend that the CSA provide registrants with the option of choosing a recognized time-weighted or dollar-weighted performance reporting methodology as long as the dealer clearly discloses to the client the reporting method and explains what the reporting method represents. If the CSA chooses to mandate a dollar-weighted methodology we would like confirmation that commonly used dollar-weighted methods, such as Modified Deitz, would comply with that requirement and that approximation methods in calculations are permitted.

Account Reporting:

The Proposals as drafted do not give a clear definition of account. A dealer may define an account according to the number of KYC forms they have for the client. In client name a mutual fund company will have an account for each client that holds funds with them. Under these two definitions the number of accounts in the industry will differ. If dealers are required to aggregate across client name accounts there will be enormous operational challenges to aggregate the quantity of information as well as maintain data integrity. Clarification on the definition of account is required for the industry to assess the operational challenges and cost implications of cost disclosure and performance on a per account basis.

Client Statement Format:

We note the importance of providing investors with clear and meaningful client statements. Within the proposals contemplated in paragraph 14.14 the CSA has suggested that these statements maintain distinct sections for transactions, client name accounts, and nominee held accounts. We do not see any value in providing investors with transaction information that is separated from their related accounts. For many registrants this requirement may add additional costs for statement reprogramming, without any apparent investor benefit, and may lead to actual confusion for the clients.

Original Cost vs. Book Cost:

We recognize the importance of giving investors accurate cost disclosure. We believe that prescribing one method in preference to the other, however, does not accomplish that goal and may invariably lead to client confusion. Our members have different approaches to the use of original cost or book cost.

Some members have concerns with mandating original cost for the account statement as they do not believe original cost represents an accurate cost method as it does not include such items as return on capital, distributions or dividends, and is not the most favourable way of reporting on tax-advantaged items such as mortgage-type securities.

Other members favour original cost as it gives their clients information about how their investment has performed over time or recognizes that calculating tax is the responsibility of the client's tax advisor. On the issue of reporting cost after a transfer there is the potential for confusion and errors in calculating tax payable for investors if market value at the time of the transfer is used as book value. Original cost addresses the issue of dealers not having accurate book costs on transfers. 'Amount invested' or 'transfer in cost' are better terms than 'book cost' for transfers. Registrants should have flexibility on how to manage the issue as their clients have different reporting needs.

We recommend that the CSA provide dealers with the option of choosing between original cost and book cost as long as the dealer discloses clearly to the client the reporting method and explains what the reporting method represents.

Inappropriate Switches:

The section on inappropriate switches in the Companion Policy is another example of duplication and bias towards the fund industry. The issue of inappropriate switches is already dealt with in SRO rules and there is regulatory guidance on the issue. The Companion Policy is a frequently consulted document and applies to all registrants so it is inappropriate to single out mutual fund dealers and to comment on a single transaction. The description of switches is incomplete and potentially misleading as it only highlights a few forms of switches. We recommend that this section of the Companion Policy be removed.

Duplication with existing Referral Fee Rules:

The requirement to report noted in CP 31-103 on paragraph 14.15(1)(g) on referral fees is problematic as referral fees are not always associated with a specific client account, which will make it difficult to disclose on an annual basis on account statements. The requirement to disclose referral arrangement fees is already covered in Division 3 of NI 31-103. Prior to paying any referral fee, written disclosure of the method of calculating the referral fee and, to the extent possible, the amount of the fee is already required disclosure under 13.10 of NI 31-103. For example, a dealer may not have a client account but receive a fee from an IC/PM to whom the client has been referred. There is also a potential privacy issue as referral fees may be calculated on a percentage of a client's assets held in the account of the firm to which the client was referred. Clients may not want the mutual fund dealer to know or report on how much is held in the client's assets at the other firm. MFDA rule 2.4.2 also requires disclosure to the client of the referral fee and an example or explanation to the client as to how the fee is calculated. It is our submission that the requirement to report on referral fees on an annual basis creates complications for registered firms with no apparent additional benefit to a client, given that disclosure of referral fees is already required under NI 31-103 and the MFDA rules.

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We also note that it will be difficult to report on all amounts contemplated by the proposed paragraph 14.15(1)(g) which are not specifically associated with an account. We ask that these amounts be specifically excluded from 14.15(1)(g).

Conclusion:

We urge the CSA to reflect on its recognition of the unfairness issues towards mutual funds and work towards a common performance reporting and cost disclosure practice across financial products that do not disadvantage individual industry sectors.

I would be pleased to discuss our comments in greater detail - please contact me directly by phone at 416-309-2300 or by email at jdelautentiis@ific.ca.

Yours truly,

The Investment Funds Institute of Canada



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