

# FAIR

Canadian Foundation *for*  
Advancement *of* Investor Rights

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September 14, 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: 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 (2<sup>nd</sup> Publication, June 14, 2012)**

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FAIR Canada is pleased to offer comments on the proposed amendments to NI 31-103 and Companion Policy 31-103CP relating to cost disclosure and performance reporting (the “Proposed Amendments”) prepared by the Canadian Securities Administrators (the “CSA”), contained in the Notice and Request for Comment (the “Notice”) published on June 14, 2012.

FAIR Canada is a national, non-profit organization dedicated to putting investors first. As a voice of Canadian investors, FAIR Canada is committed to advocating for stronger investor protections in securities regulation. Visit [www.faircanada.ca](http://www.faircanada.ca) for more information.

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### **FAIR Canada Comments and Recommendations – Executive Summary:**

1. **FAIR Canada supports the proposed cost disclosure and performance reporting requirements and the commitment that the CSA is thereby making to the provision of crucial financial information to consumers in a way that they can understand and use. We support requiring financial intermediaries to provide essential financial information to consumers so that consumers can answer two basic questions about their investments: (1) What did I pay? and (2) How did my investments perform?**
2. To achieve the provision of clear, meaningful information so that consumers can assess the performance of their investments and the associated costs and thereby come to an assessment of value, FAIR Canada believes that the Proposed Amendments, while a step in the right direction, need to go further.
3. FAIR Canada urges the CSA to consider requiring one single report rather than two separate reports so that it is easier for investors to compare costs to performance and make an informed assessment. Furthermore, we recommend that the CSA also include the following information in respect of the reports currently proposed:
  - a) Each investment's performance and cost should be disclosed, not simply account-wide performance and costs.
  - b) The liquidation value of each investment (that is, the market value net of all charges and fees that would be payable as of the date of the report, if the investment were sold) should be reported.
  - c) The five-year GIC rate should be mandated as a benchmark in the performance report rather than its use being encouraged.
  - d) Reports should be required to be provided every six months.
  - e) The format of the performance report should be prescribed so that there is a standardized, uniform presentation of the information.
  - f) The performance report should break out the data item "change in the market value of your account" to show the amount of interest, the amount of dividends, and the change in the market value of the investments, in a year.

4. FAIR Canada responds to the specific aspects of the Proposed Amendments and certain “Issues for Comments” listed in the Notice:
- Disclosure of Trailing Commissions (in section 4 below)
  - Disclosure of Fixed-Income Commissions (in section 5 below)
  - the Expanded Client Statement and the Performance Reporting of Exempt Market Securities (in section 6 below)
  - Dollar-weighted versus time-weighted method to calculate the percentage return on a client’s account (in section 7 below)
  - Transition Period (in section 8 below)
  - Market valuation methodology (in section 9 below)
  - Group Scholarship Plans (in section 10 below)
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## 1. General Comments

- 1.1. FAIR Canada supports the proposed cost disclosure and performance reporting requirements and the commitment that the CSA is thereby making to the provision of crucial financial information to consumers in a way that they can understand and use. We support requiring financial intermediaries to provide essential financial information to consumers so that consumers can answer two basic questions about their investments: (1) What did I pay? and (2) How did my investments perform? The Notice states that research it has conducted shows that investors often do not know the answers to these two fundamental questions.<sup>1</sup>
- 1.2. We believe that the provision of aggregate performance reporting and of information on charges and compensation (ultimately paid by consumers) will assist retail investors in understanding basic facts about the cost and performance of their investments. The fact that the CSA does not have jurisdiction to regulate all financial products (such as insurance products) does not lessen the need and importance of providing this information to investors.
- 1.3. Given the asymmetry of information and resources between financial intermediaries and retail investors, a responsibility must be placed on financial intermediaries to promote the financial awareness of their clients by providing clear, complete and meaningful cost disclosure and account performance reporting. This obligation is contained in the G20’s High-Level Principles on Financial Consumer Protection, endorsed by Canada’s Finance Minister.<sup>2</sup>

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<sup>1</sup> See CSA Notice (2012) 35 OSCB 5430.

<sup>2</sup> The “G20 High-Level Principles on Financial Consumer Protection” (October, 2011), which were endorsed by the G20 Finance Ministers, including Canada’s Finance Minister, has as one of its principles ‘Financial Education and Awareness’. It states that “Financial education and awareness should be promoted by all relevant stakeholders... Appropriate mechanisms should be developed to help existing and future consumers develop the knowledge, skills and confidence to appropriately understand risks, including financial risks and opportunities, make informed choices, know where to go for assistance, and take effective action to improve their own financial well-being... All relevant stakeholders should be encouraged to implement the

- 1.4. The provision of clear and accurate information by financial intermediaries should improve the competitive marketplace by enabling market participants, including retail investors, to better understand the risk-return characteristics of different types of investments and thereby improve the efficient flow of capital.<sup>3</sup> The combination of poor financial literacy and inadequate or confusing information about costs and investment performance causes harm to investors as a whole.
- 1.5. The International Organization for Securities Commissions (“IOSCO”) stresses that “...ensuring transparency in [the area of fees and expenses] encourages competition among fund operators. Competition leads to a more efficient market from which investors eventually benefit.”<sup>4</sup>
- 1.6. According to IOSCO’s Technical Committee, as a best practice, “[i]nformation delivered must be simple, concise and set out in clear language. It should avoid overloading investors with details which are not relevant for them.”<sup>5</sup> It also states that “[f]ee information disclosed should be aimed at enabling investors to understand the impact of fees and expenses on the performance of the fund.”<sup>6</sup> “The recent crisis in the financial markets has highlighted the critical role that accurate, understandable and meaningful disclosure can play.”<sup>7</sup>
- 1.7. Research and modelling by economists has laid the blame for higher fees at least partially on poor financial knowledge on the part of investors.<sup>8</sup> This occurs due to the fact that high-fee mutual funds (which tend to be poor performers) tend to be held by investors who are “performance-insensitive”. Poor financial knowledge can result from poor financial literacy, but it can also arise as a result of (or be compounded by) inadequate or confusing information provided about investment performance and costs. This allows a pool of high-fee, poorly-performing funds to survive, which then compete in the marketplace using expensive advertising, expansive promises, and the like to win over more investors.

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international principles and guidelines on financial education developed by the OECD International Network on Financial Education (INFE).” Principle 6 of the OECD’s Principles and Good Practices for Financial Education Awareness (July 2005) reads:

*6. The role of financial institutions in financial education should be promoted and become part of their good governance with respect to their financial clients. Financial institutions’ accountability and responsibility should be encouraged not only in providing information and advice on financial issues, but also in promoting financial awareness [of their] clients, especially for long-term commitments and commitments which represent a substantial proportion of current and future income.*

online: <<http://www.oecd.org/finance/financialeducation/35108560.pdf>>.

- <sup>3</sup> Organisation for Economic Co-operation and Development, “Improving Financial Literacy: Analysis of issues and policies” (2005) at page 37.
- <sup>4</sup> Technical Committee of the International Organization of Securities Commissions, “Final Report on Elements of International Regulatory Standards on Fees and Expenses of Investment Funds” (November 2004), online: <[http://www.sec.gov/about/offices/oia/oia\\_investman/element-stand.pdf](http://www.sec.gov/about/offices/oia/oia_investman/element-stand.pdf)>, at page 3.
- <sup>5</sup> *Supra* note 4.
- <sup>6</sup> *Ibid.* at page 4.
- <sup>7</sup> Technical Committee of the International Organization of Securities Commissions, “Principles on Point of Sale Disclosure: Final Report” (February 2011), at page 4.
- <sup>8</sup> See especially Javier Gil-Bazo and Pablo Ruiz-Verdú, “The Relation between Price and Performance in the Mutual Fund Industry”, *Journal of Finance*, vol.64, October 2009, Issue 5, available online: <<http://e-archivo.uc3m.es/bitstream/10016/7474/1/The%20relation%20between%20price%20and%20performance%20in%20the%20mutual%20fund%20industry.pdf>>.

- 1.8. A pool of performance-sensitive investors will force a marketplace to compete more strenuously (since such investors will be more likely to move from funds which charge higher fees and/or perform poorly). If reports or advertising material are not clear and do not provide benchmarks or other rigorous reporting standards that allow for direct comparison, then investors will be less sensitive to performance and price (that is, fees). This reduces the incentive for the industry to compete on performance and price, which can harm investors.
- 1.9. To achieve the desired result, that is the provision of clear, meaningful information so that consumers can assess the performance of their investments and what it has cost and thereby come to an assessment of value, FAIR Canada believes that the Proposed Amendments, while a step in the right direction, need to go further.

## 2. **Prescribed Reports**

- 2.1. FAIR Canada urges the CSA to consider requiring one single report rather than two separate reports so that it is easier for investors to compare costs to performance and make an informed assessment (discussed further below at section 2.18, and 4.3). Furthermore, we recommend that the CSA also include the following information in respect of the reports currently proposed:
  - (a) Each investment's performance and costs should be disclosed, not simply account-wide performance and costs.
  - (b) The liquidation value of each investment (that is, the market value net of all charges and fees that would be payable as of the date of the report, if the investment were sold) should be reported.
  - (c) The five-year GIC rate should be mandated as a benchmark in the performance report rather than its use being encouraged.
  - (d) Reports should be required to be provided every six months.
  - (e) The format of the performance report should be prescribed so that there is a standardized, uniform presentation of the information.
  - (f) The performance report should break out the data item "change in the market value of your account" to show the amount of interest, the amount of dividends, and the change in the market value of the investments, in a year.

We provide below our explanation why the additional information is needed.

### ***(a) Performance for Each Investment***

- 2.2. FAIR Canada considers account-wide reporting to be of limited value to investors in the absence of a further breakdown of performance of each of the client's investments in their account. Summary, account-wide information is necessary for big picture analysis; position-by-position analysis is necessary in order to evaluate prior investment decisions. An investor

must be able to determine which investments have performed adequately and which have not in order to determine whether further action is necessary.

- 2.3. Performance reporting which only makes the investor feel good or bad about their portfolio will not translate into meaningful action on the investor's behalf. However, reporting only on the performance of an account as a whole may result in general feelings rather than concrete plans for action and concrete analysis. If an account as a whole is performing poorly, yet the investor is not provided with performance reporting on each investment within the account, the investor must then seek out further information in order to determine whether he or she should take further action. Investors should not be forced to ask for further information when it is clear it is needed at the outset.
- 2.4. Similarly, the reporting of costs for each investment (alongside its performance) is necessary in order for the investor to come to an assessment of value. Without a means to determine the cost in relation to the performance of the investment, its value is difficult (if not impossible) to determine.

***(b) Liquidation Value of an Investment***

- 2.5. FAIR Canada reiterates its recommendation (made in section 2 of its September 23, 2011 submission to the CSA) that the CSA mandate performance reporting on the basis of the liquidation value of an investment in addition to performance reporting on the basis of the market value of that investment.
- 2.6. The reporting of the market value of a position is not necessarily a reporting of the practical value of that position to a particular investor. For example, major charges for the liquidation of a position (which include unexpunged deferred sales charges and penalties within financial contracts for early withdrawal) can create a major drag for any investor seeking to sell or transfer the position.
- 2.7. It may be, that if certain conditions are fulfilled (for example, if the investor holds the mutual fund until the deferred sales charge is reduced to zero (usually seven years)) the investment will be worth more. However, such conditions may or may not occur. A report of an account statement should give an accurate picture of value to the investor of each investment as at the date of the statement. In our view, an account statement should generally not make assumptions about what the investor will or will not do at some future time. Investors should be shown the liquidation value which includes the major charges for liquidating the position.

***(c) Benchmarking – 5 Year GIC***

- 2.8. It is essential that investors be provided with benchmarking information to provide them with the appropriate context within which to understand and assess the relative performance of their investments.

- 2.9. The CSA's Companion Policy encourages "providing in performance reports an historical five-year GIC rate as a benchmark that represents a very low-risk investment alternative. We expect firms to discuss how the low-risk alternative relates to the client's investment goals and risk tolerance."
- 2.10. FAIR Canada believes that most investors know what a GIC is. A five-year GIC is simple and easy to understand. We recommend that the CSA mandate (rather than encourage) the inclusion of a five-year GIC benchmark in performance reports as it will help investors to understand the relative performance of their account. A GIC benchmark is proposed in the latest iteration of the Fund Facts document which will help cement its familiarity with investors. A simple, understandable benchmark will help investors make sense of the cost and performance of their account.
- 2.11. Providing the five-year GIC benchmark will give the client a point of comparison so that the client can consider the asset mix, risk level and relative performance of their investments. Such information is vital to making informed financial decisions. Mandating a simple and understandable benchmark will allow investors to become more comfortable with benchmarking in general.
- 2.12. It is FAIR Canada's view that benchmark information, in addition to the five-year GIC rate, should be provided to investors. Other benchmarks provide points of comparison which could prompt clients to ask questions and provides an opportunity for financial intermediaries to educate their clients. This should increase the investor's financial awareness and assist the investor to make more informed financial decisions. In FAIR Canada's view, it is crucial information that the investor should be provided with regardless of whether they understand it at the outset.
- 2.13. FAIR Canada notes that the Allen Research Corporation report "Canadian Securities Administrators Performance Report Testing" (the "Allen Report") found that very few registrants provide benchmarks; where they are provided it is usually only to high net worth clients, upon request. FAIR Canada believes that simply encouraging registrants to provide benchmarks is likely to not be enough to get registrants to provide this information.
- 2.14. The Allen Report also found that retail investors, even so-called sophisticated investors, often do not know what they can or should ask for when it comes to account reporting.<sup>9</sup> Securities regulators therefore have a responsibility (as do financial intermediaries) to ensure that vital and relevant information is provided, rather than placing the onus on the investor to request such additional disclosure. We therefore urge the CSA to require performance reports to include, at a minimum, a five-year historical GIC as a benchmark.
- 2.15. The CSA, in its Companion Policy, has included requirements for the use of other benchmarks, should a registered firm choose to present benchmark information. FAIR

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<sup>9</sup> Allen Research Corporation, Canadian Securities Administrators Performance Report Testing (February 2011), online: <[http://www.osc.gov.on.ca/documents/en/Securities-Category3/rpt\\_20110622\\_31-103\\_csa-performance-rpt-testing.pdf](http://www.osc.gov.on.ca/documents/en/Securities-Category3/rpt_20110622_31-103_csa-performance-rpt-testing.pdf)>, at pages 10 and 25.

Canada is supportive of such requirements, including that such other benchmark information should not be misleading, and should be reasonably reflective of the composition of the client's portfolio.

***(d) Provide Reports Every Six Months***

2.16. FAIR Canada believes that the CSA should increase the frequency of required performance reporting from once every twelve months to once every six months in light of the investor research survey prepared for the CSA by the Brondesbury Group (the "Report") which demonstrated a clear expressed investor preference for receiving such reports at least every six months.<sup>10</sup>

***(e) Standardized Form of Cost Disclosure and Performance Reporting***

2.17. FAIR Canada continues to recommend that the CSA prescribe the format of the cost disclosure and performance reports. A standardized, uniform presentation of such information will make it more accessible and meaningful to investors, as they develop familiarity with the format and content, and will facilitate comparability, both year-over-year and between reports received from different registrants.

2.18. FAIR Canada urges the CSA to consider requiring one single report rather than two separate reports so that it is easier for investors to compare costs to performance and make an informed assessment. As stated by the CSA: "We believe it is important for the information contained in the two annual reports to be included in the same package as the client statement – either in the same envelope or fully integrated into a single document – because together, they will allow clients to assess the status of their investments, the costs associated with them, progress toward their investment goals and the value added by their registrant." FAIR Canada believes that having the information integrated into one report will allow the investor to do that, but keeping them in separate reports makes that task too difficult. FAIR Canada recommends that the reports be meaningfully integrated, preferably through a mandatory reporting format. This will allow, in one document, the client to review three important aspects of their financial management: costs and expenses, the activity associated with the account, and its growth and value.

2.19. FAIR Canada does not expect that the form of reporting will be time-consuming to develop nor do we believe it should involve any delay in the implementation of the Proposed Amendments. As Kenmar Associates points out in their submission<sup>11</sup>, industry can act very quickly when motivated to do so. The industry has already had considerable time to prepare for the impending reporting requirements. Investor advocates have been requesting the

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<sup>10</sup> Nine out of ten of those investors who expressed a preference stated that they would prefer to receive performance reporting at least semi-annually. See Dr. Edwin L. Weinstein, "Report: Performance Reporting and Cost Disclosure", prepared for: Canadian Securities Administrators (September 17, 2010), online: <[http://www.osc.gov.on.ca/documents/en/Securities-Category3/rpt\\_20110622\\_31-103\\_performace-rpt-cost-disclosure.pdf](http://www.osc.gov.on.ca/documents/en/Securities-Category3/rpt_20110622_31-103_performace-rpt-cost-disclosure.pdf)> at page 21.

<sup>11</sup> Letter from Kenmar Associates to the CSA dated June 19, 2012, available online at <[http://www.osc.gov.on.ca/documents/en/Securities-Category3-Comments/com\\_20120619\\_31-103\\_kivenkok.pdf](http://www.osc.gov.on.ca/documents/en/Securities-Category3-Comments/com_20120619_31-103_kivenkok.pdf)> at page 3.

provision of this basic information since 2001 and the OSC's 2003 Fair Dealing Model made it clear that this information was necessary.

2.20. FAIR Canada also strongly believes that making information accessible and meaningful to investors, and requiring that it be comparable, is far more important than the concern set out by the CSA that firms should be able to distinguish themselves with the format and presentation of their reporting. Firms can always distinguish themselves by providing reports which are in addition to those that are required, which would help set themselves apart from their competitors.

2.21. The CSA states that it anticipates that the information will be combined by some registered firms but that, for other firms, it will be challenging to change legacy systems to accomplish this. FAIR Canada recommends that the CSA mandate that registered firms overhaul their systems in an efficient way to deal with future changes, including a requirement to integrate the reports into one report. We are strongly of the view that there are significant benefits to an integrated document. We do not want any extension of the transition period in order for the changes to be made. The idea that providing an integrated report will require more time and lengthy delays is unacceptable.

### ***(f) Change in the Market Value of Your Account***

2.22. FAIR Canada believes that it is important to break out the information contained in the item "change in the market value of your account" set out in the Performance Report (at Appendix D) to provide key information to the investor. We believe that it is important to show separately the amount earned in interest for the year, the amount earned in dividends for the year, and the change in the market value of the account for the year. FAIR Canada notes that the sample performance report presented in the Allen Report broke out "interest and dividends" separately from "increases or decreases in the value of your investments". Our suggestion is to have separate items for "change in the market value of your investments", "interest" and "dividends". A separate chart or the use of the terminology we have suggested should reduce the confusion noted in the Allen Report. The performance report used in the Allen Report used the term "increase or decrease in the value of your investments" which is unclear.<sup>12</sup>

## **3. Investor Testing**

3.1. FAIR Canada encourages the CSA to conduct further testing with investors of the cost disclosure and performance reporting reports, namely the Annual Charges and Compensation Report (Companion Policy Appendix D) and the Investment Performance Report (Companion Policy Appendix E) so that the most clear, comprehensive and meaningful format to present the information to investors is developed. We are not aware of any further testing of the reports with retail investors since the CSA's February 2011 "Allen Report" which utilized the December 31, 2010 version of the performance report. We

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<sup>12</sup> Allen Report at page 36.

do not suggest that such testing should result in the delay of the implementation of the Proposed Amendments.

- 3.2. We do acknowledge that, since the 2011 Proposal, the CSA has had research conducted with retail investors in the exempt market, focussing on what securities should be included in client reporting. This research, while important, did not necessarily canvass the opinions of retail investors who do not invest in the exempt market, such as those investors who purchase listed securities, mutual funds, or fixed income products.

#### 4. Reporting of Trailing Commissions

##### *Disclose the Dollar Amount of Trailing Commissions*

- 4.1. FAIR Canada fully supports a requirement for registered firms to disclose the amount of trailing commissions that they have received which, in respect of mutual funds, is charged to the investor through the management fee (“MER”). Retail investors have a very low awareness of trailing commissions<sup>13</sup>, and do not understand the extent to which such commissions diminish their investment returns. It is thus essential that this information be provided in a clear, plain language and meaningful manner so that investors can make an informed assessment.
- 4.2. We agree with the CSA that compensation that their dealers and advisors receive needs to be transparent to investors and that the disclosure needs to be “complete, upfront and understandable to the average investor. A one-time mention in an offering document of trailing commissions expressed as a percentage of the client’s investment in a single fund does not meet this test.”<sup>14</sup>
- 4.3. The Proposed Amendments contemplate permitting registered firms to deliver this disclosure separately from performance reporting; FAIR Canada is of the view that separate reports will lack the impact of an integrated report. It is most helpful for investors to see fees and charges alongside the performance reporting, because only in the context of the performance of products, funds or accounts can the quantum of fees be meaningful to investors. Allowing for separate reporting de-contextualizes the amounts that firms and individual registrants make from their clients.
- 4.4. **FAIR Canada notes that other jurisdictions have not simply moved to improve disclosure to consumers to make it clear and meaningful but have moved to ban embedded commissions or otherwise imposed substantive changes to remove and/or minimize conflicts of interest and misalignment of incentives for financial firms and their intermediaries vis a vis their clients.**<sup>15</sup> FAIR Canada, therefore, sees the Proposed Amendments as a *de minimis* step for regulators to take to help fulfil their mandate.

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<sup>13</sup> The Brondesbury Group, “Investor behaviour and beliefs: Advisor relationships and investor decision-making study” (2012), prepared for the Investor Education Fund, at page 27.

<sup>14</sup> CSA Notice, (2012) 35 OSCB 5431.

<sup>15</sup> Those jurisdictions include Australia and the U.K.

***Discount Brokerages Should Also Provide the Same Disclosure***

- 4.5. We believe that it is very important for consumers who have accounts at order-execution-only brokerages to also be able to see in a transparent manner the trailing commissions that they pay when they hold mutual funds (or other investment products that have embedded commissions). We do not think that these consumers should have to wait for the CSA to determine the applicability of the new disclosure rules to discount brokerages at some future time.
- 4.6. The Investment Industry Regulatory Organization of Canada (“IIROC”) Dealer Member Rules allow for discount brokerages to provide order-execution-only services where intermediaries do not provide advice to the client about their investment decisions.<sup>16</sup> As a result, discount brokerages do not provide recommendations to the investor and the investor is fully responsible for the investment decisions. Research reports, marketing materials and generic information is made available to clients of discount brokerages.
- 4.7. The rationale for the payment of a trailing commission is that, in theory, the intermediary provides valuable ongoing services to the client, in particular, ongoing investment advice. However, discount brokerages that are not required to comply with Rule 1300.1(p) of IIROC’s Dealer Member Rules and are not permitted to provide recommendations regarding investment decisions of their clients.
- 4.8. While there are some funds offered by some fund companies which do not charge a trailing commission to investors that do not receive advice<sup>17</sup>, most do include a trailing commission. The amount of the trailing commission can range from 25 basis points to 150 basis points, with the typical trailing commission being 50 basis points for a deferred sales commission and 100 basis points for a front-load commission. Many retail investors who purchase mutual funds through discount brokerage firms are not aware of the existence of the trailing commission nor are they aware that the trailing commission will negatively impact their real rate of return in respect of the units of the mutual fund that they hold.
- 4.9. FAIR Canada sees no reason why investors at discount brokerages should not also be provided with cost disclosure and performance reporting information. Investors at discount brokerages should be made aware of the amount it is costing them in trailing commissions in order to allow these investors to determine whether they are receiving value for the fees they are incurring.

***Notice to Investors Regarding Trailing Commissions Needs Improvement***

- 4.10. FAIR Canada is disappointed that the proposed note in Appendix D regarding the payment of trailing commissions has been modified since the 2011 proposals, and believes that the

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<sup>16</sup> IIROC Dealer Member Rules 1300.1 and 3200.

<sup>17</sup> See the Globe and Mail article “A simple formula points to bargains” at <<http://www.theglobeandmail.com/globe-investor/investment-ideas/a-simple-formula-points-to-bargains/article4192184/?page=all>>.

revised language is confusing and unclear to investors. The language has been changed from:

“...The amount of the trailing commissions depends on the sales charge option you chose when you purchased the fund. As is the case with any investment fund expense, trailing commission affect you because they reduce the amount of the fund’s return to you.”

to:

“The amount of the trailing commissions depends on the sales charge option you chose when you purchased the fund. You are not charged the trailing commission or the management fee. But, as is the case with any investment fund expense, trailing commissions are likely to affect you because, in most cases, they reduce the amount of the fund’s return to you. Information about management fees and other charges to your investment funds is included in the prospectus or Fund Facts document for each fund.”

**4.11. The notice clarifying how trailing commissions affect investor returns needs to be clear rather than evasive and vague. Trailing commissions do affect the investor and stating that they “are likely to” is virtually meaningless. Trailing commissions reduce the fund’s return to the investor in all cases rather than “in most cases”. In addition, the trailing commission is charged to the investor through the MER of the fund, so to state that “You are not charged the trailing commission or the management fee” is misleading and confusing to investors and should be removed.**

4.12. Finally, investors should not be referred to the prospectus or fund facts document when they are attempting to understand the costs associated with their investments as going to those documents will not help investors determine what they have paid. If the CSA insists upon cross-referencing to another document (presumably, in an attempt to help investors understand how mutual fund fees work) FAIR Canada recommends that a cross-reference to the CSA’s “Understanding mutual funds” brochure be provided, which should be expanded to include information explaining compensation structures, different fee models, and any potential inherent conflicts of interest as we recommend in our letter to the CSA dated September 6, 2012 on Implementation of Point of Sale Disclosure for Mutual Funds.

## **5. Disclosing Fixed-Income Commissions**

5.1. FAIR Canada is pleased that the CSA is adopting new rules to ensure that commissions on fixed-income securities are properly and accurately reported. FAIR Canada is sceptical of claims made during the consultation process that such commissions are somehow particularly tricky to track or to account for. Given that these commissions are received, tracked and distributed by registered firms, such firms should not encounter difficulties in attributing them to client accounts in which those securities are held.

- 5.2. The CSA asked specifically whether in the interest of making fixed-income transactions more transparent... *[is it] feasible and appropriate to mandate the disclosure of all of the compensation and/or income earned by registered firms from fixed-income transactions. This would include disclosure of commissions earned by dealing representatives as well as profits earned by dealers on the desk spread and through any other means.* For the reasons detailed above, FAIR Canada considers it both feasible (since all of these income streams must already be accounted for by the registered firm in order to report income) and appropriate and desirable (since this information can be used by investors to assess the value of transactions recommended to them). Simply mentioning that there is other compensation embedded in the price of a fixed-income security, through a notification on the trade confirmation, is not sufficient in our view.
- 5.3. Finally, FAIR Canada would like to caution against further delay in the adoption of any of the cost reporting measures to deal with the issue of fixed-income commissions. Additional delays will only serve to harm the interests of clients and benefit those of high-cost or poor-performing advisers. FAIR Canada believes that if a registered firm can recognize, track and receive a stream of income, it can account for such income to a client account from where that income derives.

## **6. FAIR Canada Supports the CSA on its Expanded Client Statement**

- 6.1. FAIR Canada supports the CSA's proposed expanded client statement where investors will see transactions carried out during the reporting period in the first section; reporting on securities held by the registrant in nominee name or certificate form in the second section; and reporting on some securities held in client name in the third section.
- 6.2. First we would like to offer a comment on the specific issue raised by the CSA, namely *we understand that all securities transactions are carried out through an account, even when the securities are not held in that account. We have drafted the Rule on this understanding and invite comments on the practicality of this or other approaches to including the securities listed in section 14.14(5.1) in client statements and performance reports.* FAIR Canada notes that there is no subsection 14.14(5.1) of the Proposed Amendments, and therefore assumes that subsection 14.14(6.1) is what is meant, relating to securities in circumstances where:
- a. the registered firm has trading authority over the security or the account of the client in which the security is held or was transacted;
  - b. the registered firm receives continuing payments related to the client's ownership of the security from the issuer of the security, the investment fund manager of the security or any other party;
  - c. the security is a mutual fund or an investment fund that is a labour-sponsored investment fund corporation or labour sponsored venture capital corporation under legislation of a jurisdiction of Canada and was purchased for the client by the registered firm.

- 6.3. FAIR Canada's view is that, given that for any of these three circumstances to apply, a client will either have asked the registered firm to trade in these securities (which seems necessary for the circumstances in (b) or (c) to apply), or expect the registered firm to trade in them (given that trading authority has been ceded to the registered firm), that client would ordinarily expect to have those securities listed as part of their account statement. Clients, in our view, think of an account statement from a registered firm as “a statement of my investments with my dealer” (or broker, or advisor, and so on). As the CSA has indicated, many retail investors do not understand the ways in which their investments may be held and therefore they will not generally be aware that technically some of these are held outside the account. Investors nonetheless think that the investment is in some sense “with the dealer”. FAIR Canada's view is that where this may cause confusion for clients, and investments are not part of an account, registered firms are in the best place to explain this fact to investors. The proposals provide a mechanism for doing so.
- 6.4. It should be made clear to investors which securities are held by a custodian and thereby protected by CIPF and which are not. In the event of insolvency of the registrant, the investor must know whether it will have recourse in respect of a given investment or not.
- 6.5. Regarding exempt market securities, FAIR Canada's view is that the CSA's consideration that “investors in the exempt market... are generally satisfied with the level of reporting they receive”<sup>18</sup> is not necessarily borne out by a careful review of the research conducted. While this may be reflective of an overall answer to survey questions, when the actual views are canvassed, satisfaction appears quite a bit less. The following statements were obtained by the Brondesbury Group from exempt market investors and were described in their report:

*“Basically you’re going to get an account statement every month if there’s any activity whatsoever. And as a default, you get it every 3 months, and it looks like something you would write in a piece of legislation. Is it comprehensive enough to be of any real use? I don’t know. It’s definitely minimal.”*

*“Now why would there only be a statement when there’s a transaction? I mean, you’d want to know what’s going on. Whether it’s going up or down, not whether you bought something because if you didn’t buy it or sell it, it could be way down and you don’t know about it for three months.”<sup>19</sup>*

- 6.6. Furthermore, investors appear to want more detail in reporting (including market values) than is currently mandated. A clear majority (reported as “60-70%” by Brondesbury) want this information. Although most apparently do receive this, there is no onus to provide it, leaving it open to registrants to pick and choose when and where (and how) to provide the valuation data. It is equally clear, given this clearly stated preference, that exempt market investors think such data is important, since 70% of them want the data reported regardless

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<sup>18</sup> See CSA Notice at page 7.

<sup>19</sup> Result of Investor Focus Groups and Personal Interview; Background Report for Online Survey of Exempt Market Investors Prepared for the CSA by The Brondesbury Group, at page 7, available online at [http://www.osc.gov.on.ca/documents/en/Securities-Category3/rpt\\_20120614\\_31-103\\_background-rpt-survey.pdf](http://www.osc.gov.on.ca/documents/en/Securities-Category3/rpt_20120614_31-103_background-rpt-survey.pdf).

of how (and in what account) their exempt market securities are held. Clearly investors consider their broker, dealer or adviser an important *source* of data.

## 7. Dollar-Weighted versus Time-Weighted Performance Reporting

- 7.1. FAIR Canada's view is that the CSA's approach, "not [to prohibit] the use of the time-weighted method, but if a registered firm uses such a method, it must be in addition to the dollar-weighted calculation" is the correct starting point.
- 7.2. Both economists<sup>20</sup> and financial columnists who commonly provide advice to retail investors<sup>21</sup> agree that although, for active managers, dollar-weighted figures generally show them in a worse light because of the typical patterns of fund flows in and out of funds, dollar-weighted returns give investors a better picture. Time-weighted returns help judge a manager's performance, and are easier to benchmark to an index (since these indices are also time-weighted). FAIR Canada agrees that the dollar-weighted method most accurately reflects the actual return of the client's account over the reporting period. This value should therefore be mandated for performance reporting.
- 7.3. A time-weighted figure should also be required, clearly marked as such with the difference in meaning explained in plain language. Allowing an advisor to include this at their discretion encourages cherry-picking. Mandating the figures for all, with clear statements of what each is attempting to measure would be of more benefit to investors. If, as we suggest, benchmarking should be mandated as part of performance reporting, time-weighted figures should be provided for comparison to the benchmark, since standard benchmarks will generally be calculated on a time-weighted basis. FAIR Canada considers this likely to allay some industry fears regarding benchmarking, as it ensures like-for-like comparisons. As noted by the Canadian Advocacy Council for Canadian CFA Institute Societies' submission dated August 30, 2012, "[u]sing both methods of calculation on the same performance report will result in similar values most times, but if any differences arise they should be explained in the performance report in plain language."<sup>22</sup>

## 8. The Transition Period

- 8.1. The CSA states that "our consultations with industry have convinced us that the effort required to build systems and train personnel is a substantial undertaking. As a result, we have decided to lengthen the proposed transition period for the implementation of some requirements of the 2012 Proposal to three years. The transition period for some other requirements will be one or two years."

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<sup>20</sup> Iliia D. Dichev, Gwen Yu. (2011) "Higher risk, lower returns: What hedge fund investors really earn" *Journal of Financial Economics*, 100: 248–263.

<sup>21</sup> See [http://www.usatoday.com/money/perfi/columnist/krantz/2006-06-27-tota-return\\_x.htm](http://www.usatoday.com/money/perfi/columnist/krantz/2006-06-27-tota-return_x.htm) and <http://www.verisi.com/resources/dollar-weighted-returns.htm>

<sup>22</sup> Letter from The Canadian Advocacy Council for Canadian CFA Institute Societies to the CSA dated August 30, 2012, available online at <[http://www.osc.gov.on.ca/documents/en/Securities-Category3-Comments/com\\_20120830\\_31-103\\_litvinova.pdf](http://www.osc.gov.on.ca/documents/en/Securities-Category3-Comments/com_20120830_31-103_litvinova.pdf)> at page 3.

8.2. Given the length of time that investors have been waiting to answer the two basic questions: What did I pay? and How did my investments perform? and given the long lead time that registered firms have had to overhaul their systems so as to meet the impending requirement, a three year transition period for any of the requirements is unnecessary and unacceptable. Changes to recordkeeping and tracking systems can be accomplished extremely quickly where a firm's bottom line is impacted. Firms are eager and willing to act quickly to take advantage of the market opportunity. It is unfortunate that providing crucial information to investors is not given equal importance.

## 9. Market valuation methodology

9.1. FAIR Canada supports the approach to determining market value of securities that registrants are required to adhere to in proposed section 14.11.1, including the hierarchy of methodologies that reflects available information and the requirement that registrants act reasonably using professional judgment. The Companion Policy should be consistent with the rules in this regard and require that professional judgement be exercised at all times in determining valuation methods rather than stating that the "process will often require a registrant to exercise professional judgement."

9.2. The notification required in proposed section 14.11.1(2) in cases where the values have been determined other than on a public market, should be clear and visible and not buried in a footnote to the reporting.

9.3. FAIR Canada notes that book cost has not been included in the hierarchy of valuation methodologies. It may be the case that it is included in "available market data or inputs" and it may be helpful for the CSA to clarify its views in this regard in the Companion Policy.

## 10. Group Scholarship Plans

10.1. We agree with the CSA that there is no compelling reason to exempt scholarship plan dealers from the proposed requirements for the disclosure of charges. We support the addition of a specific requirement for the disclosure of unpaid enrolment fees or other instalment fees. We also support the disclosure of how much would be returned if the investor stopped paying into the plan. This is consistent with our recommendation that the liquidation value of an investment be reported to investors. The amount that the investor would receive if the group scholarship plan was sold or unwound as of the date of the report is the key value that should be disclosed.

10.2. FAIR Canada disagrees with the reporting of how much the beneficiary might receive if the investor stays in the plan to maturity and if the beneficiary attends a designated education institution (and meets all the other requirements to obtain the maximum out of the plan that is possible). Including such a figure simply allows the group scholarship plan to provide an expected value which may or may not happen in the future.

10.3. FAIR Canada has provided an earlier submission to the CSA on group scholarship plans and

urges the CSA to consider its recommendations, including the need for substantial regulation. Disclosure alone is insufficient; it will only create the illusion of consumer protection and cannot be an end in itself given the problems with the design of these plans, the aggressive manner in which they are marketed and advertised and the misalignment of incentives between the salespersons and consumers. The OSC's recent orders against three different group scholarship dealers are the result of compliance reviews conducted by OSC staff which identified a number of serious deficiencies<sup>23</sup>.

10.4. Many consumers who are sold these plans are modest or low income Canadians who often have low financial literacy and are urged to invest in these plans (and do so) in order to take advantage of the government grants associated with them without being aware of other available options. FAIR Canada is of the view that these plans are generally poor savings vehicles with little or no benefits to consumers. Consumers of group scholarship plans are clearly in need of meaningful disclosure of the cost and performance of their investments.

We thank you for the opportunity to provide our comments and views in this submission. We welcome its public posting and would be pleased to discuss this letter with you at your convenience. Feel free to contact Ermanno Pascutto at 416-572-2282/[ermanno.pascutto@faircanada.ca](mailto:ermanno.pascutto@faircanada.ca) or Marian Passmore at 416-214-3441/[marian.passmore@faircanada.ca](mailto:marian.passmore@faircanada.ca).

Sincerely,



Canadian Foundation for Advancement of Investor Rights

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<sup>23</sup> See the OSC's temporary orders issued against Global RESP on July 26, 2012, Knowledge First Financial Inc. on August 10, 2012 and Heritage Education Funds Inc on August 13, 2012, available online at [http://www.osc.gov.on.ca/en/Proceedings\\_enr\\_20120726\\_global-resp.htm](http://www.osc.gov.on.ca/en/Proceedings_enr_20120726_global-resp.htm), [http://www.osc.gov.on.ca/en/Proceedings\\_enr\\_20120810\\_knowledge.htm](http://www.osc.gov.on.ca/en/Proceedings_enr_20120810_knowledge.htm) and [http://www.osc.gov.on.ca/en/Proceedings\\_rad\\_20120813\\_heritage-education.htm](http://www.osc.gov.on.ca/en/Proceedings_rad_20120813_heritage-education.htm).