PMAC
PORTFOLIO MANAGEMENT ASSOCIATION OF CANADA
Advancing Standards™

June 10, 2013

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Alberta Securities Commission

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Chair and Chief Executive Officer
British Columbia Securities Commission

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Chair, Manitoba Securities Commission

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Service Newfoundland and Labrador

Ms. Sarah P. Bradley
Chair, Nova Scotia Securities Commission

Mr. Gary MacDougall
Superintendent of Securities
Government of Northwest Territories

Mr. Louis Arki
Superintendent of Securities
Government of Nunavut

Mr. Howard I. Wetston
Chair, Ontario Securities Commission

Ms. Katharine Tummon
Superintendent of Securities, Consumer, Corporate and Insurance Services Office of the Attorney General

Mr. Mario Albert
President and Chief Executive Officer
Autorité des marchés financiers

Mr. Dave Wild
Chair, Financial and Consumer Affairs Authority

Mr. Fred Pretorius
Superintendent of Securities, Yukon

Dear Sirs/Mesdames:

Re: Cost Disclosure, Performance Reporting and Client Statements under the Client Relationship Model (CRM II) -- Request to Permit Choice between Time-Weighted and Money Weighted Performance Reporting

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The Portfolio Management Association of Canada ("PMAC", formerly the Investment Counsel Association of Canada ("ICAC")), through its Industry, Regulation and Tax Committee, is writing on behalf of its Members to request the Canadian Securities Administrators (CSA) to reconsider the new requirement under the CRM II rules to report performance on a money-weighted rate of return basis. Set out below is a summary of our continued position on the importance and desirability of allowing registrants the option of choosing to use either a time-weighted rate of return ("TWRR") or a money-weighted rate of return ("MWRR") calculation methodology with respect to performance reporting to clients. As you know, we have advocated for choice in performance reporting since the initial CRM II proposals were published. During our in person meetings with CSA staff and within our various submissions we have explained some of the significant concerns with mandating MWRR. These are further described below. In light of the CSA's recent decision to move forward with mandating MWRR, and despite the fact that the rule is now final, we respectfully request a reconsideration of this approach.

As background, PMAC represents investment management firms registered to do business in Canada as portfolio managers. We have over 170 members from across Canada that are comprised of both large and small firms managing total assets in excess of $800 billion (excluding mutual funds assets) for institutional and private client portfolios. Our mission is to advocate the highest standards of unbiased portfolio management in the interest of the investors served by Members. Member firms are in the business of managing investments for clients in keeping with each client's needs, objectives and risk tolerances. For more information about PMAC and our mandate, please visit our website at www.portfoliomanagement.org.

General Comments

Despite the concerns raised in this letter, we continue to support the general principles of the CRM II rules, including the objective of ensuring that all investors, irregardless of what type of investment professional they are dealing with, receive clear and complete disclosure of all charges associated with the products and services they receive, and meaningful reporting on how their investments perform. The comments set out in this letter relate specifically to the CSA's decision to mandate the use of MWRR.

The objective of the CRM II rules is to help investors understand and assess the costs and benefits of the advice they receive and assess the value of the advice added by the registrant. PMAC Members (together with what we understand to be the large majority of the investment industry) have, and continue to, provide clients with performance reporting calculated using TWRR methodology that meets this objective. Very simply, mandating the use of MWRR is not only contrary to this objective but may have significant unintended consequences:

- It obscures critical decision-making information in regards to how the advisor is performing;
- It can be materially impacted by the timing and amount of contributions and/or withdrawal's from an account thereby impacting the investor's ability to evaluate the investment management services received (i.e. creating an inaccurate picture of what the registrant achieved for the client);
- It creates an apparent conflict between Canadian securities regulations and CFA Institute Global Investment Performance Standards (GIPS). For instance, firms that claim GIPS compliance must use TWRR; and
- It is contrary to the main objective of the CFA Principles of Investment Reporting[1] (the "CFA Principles") published this year, which is to harmonize the understanding and needs of both investment report creators and those for whom the report is intended. The CFA Principles are premised on ensuring that the client's preferences are reflected in the information contained in the report. This allows for flexibility in reporting, which is the underlying foundation of the CFA Principles. In other words, they are not meant

[1] The purpose of the Principles for Investment Reporting is not to restrict or define what elements should be in a report but to address that having created a report, it should include sufficient information or indicate where the information can be readily obtained so that the recipient understands the contents of the report and the reasons behind the selection presented.

to restrict or define what is included in the report but to ensure the client understands the contents of the report and the reasons behind the selection presented. Secondly, the principles require investment reports to provide appropriate comparative data – such as index data, a customized benchmark, peer group data, or a GIPS composite. Benchmarks are calculated on a TWRR basis and cannot be compared to a calculation on a MWRR basis.

In light of the above, mandating the use of only one among two credible rate of return calculation methods will disadvantage investors.[2] As explicitly acknowledged in the OSC's recent publication of its draft Statement of Priorities, investors need to determine the value of the professional advice they receive and "*whether they are getting good value from their adviser*" [emphasis added]. Investors should be given information that helps them understand whether they have realistic expectations for their investment returns. This can only be done rationally and objectively if investors are provided with information on the performance of their investments on a TWRR basis, which:

- allows comparisons to other investments advisers;
- simplifies the investors ability to compare returns on various investments in and outside Canada and on a year to year comparison basis;
- allows comparisons to benchmarks (S&P and FTSE); and
- is presented in accordance with GIPS.

While we acknowledge that nothing prevents a portfolio manager from also providing performance reports on a TWRR basis (in addition to MWRR), we believe this will cause the investor confusion by the different presentations and the volume of documentation. It will also add an unnecessary duplication of work for the registrant in maintaining two separate performance tracking systems and creating a new system for MWRR that is complex and operationally onerous. In addition, both returns could be materially different dependent on cash flows in and out of an investor's account.

We note that we are very supportive of the new requirement to provide information on opening market value of an account, plus deposits into the account, less withdrawals from the account, in order to determine the change in the market value of investor accounts over the reporting period. This information will provide investors with a clear representation of the actual dollar amount of investment return of their accounts. We believe that the CSA's objective of providing investors with performance figures on actual returns is achieved by this new reporting requirement. However, showing this information on a percentage basis through MWRR completely distorts the consistency and comparability of the reporting between advisors, against benchmarks and against different time periods. We acknowledge the importance of the investor seeing the final value of their holdings however, we do not see the purpose of mandating that this information be provided to investors twice and on a percentage basis, in a potentially distorting and misleading way.

For these reasons and the reasons set forth below, we respectfully urge the CSA to reconsider mandating MWRR in light of these prevailing concerns.

<u>Misleading Presentation</u>

One of the key concerns we have identified is the potential for misleading presentation of performance results if portfolio managers are forced to present performance on an MWRR basis. Particularly, the lack of consistency, objectivity and transparency (for example, a

[2] We are in agreement with the IIAC's position on this issue and support the comments made in their submission dated May 30, 2013.

portfolio manager could be underperforming and the client that is contributing large amounts to their portfolio, would not realize it). By contrast, TWRR does not factor in cash flows in and out of the account thereby neither penalizing nor benefiting the rate of return calculation. In addition, since there are different ways of calculating MWRR, the ability to distort numbers increases if the methodology switches. In our view, it would be much easier to ensure the consistency and accuracy of reporting if TWRR is used since there is already a consistent global framework by which to do so. With mandating MWRR, the ability to test and audit for consistency is diminished. Ultimately, MWRR presents information that is related to a specific time period but has no comparability from an account to account basis, manager to manager basis, period to period basis or against benchmarks.

Investor Confusion

TWRR reporting is something clients of portfolio managers have become accustomed to and have historically used to assess the performance of their accounts. As such, we believe there would be significant investor confusion (and not increased clarity) from a change in performance return calculation methodology, even if investors were to receive both TWRR and MWRR performance reporting going forward. Despite any efforts to discuss the differences with investors, we believe that investors will invariably feel both overwhelmed and inundated with confusing and duplicative documentation relating to their accounts and the presentation of both methods will do no more than confound them.

Capability to Compare Managers

While portfolio manager performance is important to prospective investors, we believe that it is also important to existing investors. Investors who wish to move their investments typically bring their last performance report to a prospective portfolio manager. Portfolio managers, whether they are complying with CSA marketing requirements and guidance and/or claim GIPS compliance, will have historical information on their firm's performance which is reported on a TWRR basis. The investor will be unable to compare their MWRR to the prospective manager's past performance given it will be distorted with their cash flow adjustments. The investor will need a report that is provided on a TWRR basis in order to objectively assess the recent returns with that of a prospective portfolio manager. TWRR ensures fair comparisons between investment management firms and is an essential benefit of TWRR. As the decision to either remain with or terminate a portfolio manager is heavily influenced by the returns an investor is receiving, TWRR provides the best way for investors to make informed decisions about their portfolio manager.

Capacity/Ability to Provide Multiple Performance Reports

We understand from our Members that it is unlikely that portfolio managers will be in a position to provide both MWRR and TWRR reporting. Practically and economically, it will be difficult to support and offer parallel MWRR and TWRR performance reporting despite the ability to do so under CRM II. This is particularly relevant in respect of recreating a MWRR for any historical performance reporting previously provided using TWRR. For example, if it is not feasible to recreate historic MWRR calculations, the effect of the new rules would appear to be to "set" the commencement of all MWRR reporting periods to July 15, 2016. However, if a client continues to be provided with TWRR reports that reflect historical performance commencing at an earlier date (e.g., at account inception), existing clients could conceivably be receiving reporting of TWRR performance calculations that encompass periods prior to July 15, 2016 in addition to MWRR performance calculations based on July 15, 2016 as the starting point.

In addition, if portfolio managers no longer provided TWRR, investors would ultimately lose the performance data that has been provided to date using TWRR and that they are accustomed to receiving. This would remove the most important tool the investors have to evaluate the performance of the investment management firms representing them and the ability to compare their performance to benchmarks.

Use of Benchmarks

The use of benchmarks are critical for investors to understand how they are doing relative to their stated investment objectives along with providing the ability to compare the performance of portfolio managers and to establish whether managers are adding value. Notwithstanding the additional confusion to clients if they receive performance both on a MWRR and TWRR basis, if portfolio managers are mandated to use MWRR, clients will lose the ability to easily compare performance against benchmark returns, mutual funds, index funds and exchange-traded funds. For example, benchmarks, especially blended benchmarks (e.g., 65% S&P/TSX and 35% S&P500), are, by definition, time-weighted rates of return. As a result, it will not be possible to present benchmark information that is not misleading if firms are mandated to report on a MWRR basis.

Another important consideration on the continued use of benchmarks is the importance of their use during different economic cycles. For example, benchmark comparisons during the recent global financial crisis provided investors with perspective on how their investments performed relative to the markets in general. This comparison was an important tool for portfolio managers to illustrate how the portfolios they managed were performing in order to help mitigate the collective impact that period had on the investment management industry.

Our view continues to be TWRR, unlike MWRR, is the most relevant for investors because of the ability to compare individual investment performance to relevant benchmarks (such as indices). Conversely, MWRR performance calculations place disproportionate emphasis on client cash withdrawal and contribution decisions and actions which portfolio managers and advisors typically have little or no control over (e.g., the client's external cash flow and deposits and withdraws of funds).

Finally, we note the inherent conflict in mandating portfolio managers to report in a methodology that is at odds with what is currently mandated by the CFA Institute, through the Global Investment Performance Standards. For instance, firms that claim GIPS compliance must use TWRR. The GIPS standards require TWRR because it removes the effects of external cash flows, which are generally client-driven. Therefore, TWRR best reflects the firm's ability to manage the portfolios according to a specified mandate, objective, or strategy, and is the basis for the comparability of composite returns among firms on a global basis. The GIPS standards favour TWRR when analyzing or presenting results to investors and do not consider MWRR a recommended form of return calculation for investment portfolios. The global investment industry has devoted significant resources and research to refining performance methodology to allow for comparability between firms and ensure and promote global comparability (i.e. GIPS). The trend has been and continues to be that portfolio managers move to GIPS and become independently verified. Mandating MWRR in Canada undermines the positive trend towards the adoption of a global standard that ensures standardized methodology and more transparency to investors.

Recommendation

We ask the CSA to consider the concerns raised above so that the investor experience is in fact enhanced and the impact on registrants is manageable and not damaging. We support the new performance reporting requirement to provide investors with clear and accurate information on the actual dollar amount of investment return of their accounts. We do not believe that an additional requirement of MWRR is necessary given that the new reporting requirement provides this information. We also support providing investors with performance information that assists in managing their expectations for their investment returns and determining whether they are getting good value from their advisor. To this end, we believe that a reconsideration of mandating MWRR is warranted. We recommend that the CSA reconsider its position and permit the flexibility for registrants to choose between TWRR and MWRR and allow registrants to report in a method that meets their client's needs while also adhering to global reporting standards. We would be more than pleased to meet to discuss these comments at your convenience. We are hopeful that a solution can be achieved to respond to our (and other investment industry advocates) concerns.

If you have any questions regarding the comments set out above, please do not hesitate to contact Katie Walmsley at (416) 504-7018 or Julie Cordeiro at (416) 504-1118.
Yours truly,

PORTFOLIO MANAGEMENT ASSOCIATION OF CANADA

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