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CSA NOTICE AND REQUEST FOR COMMENTS SCHOLARSHIP PLAN PROSPECTUS FORM

Ref: July 24, 2008 HRSDC REPORT on RESP's

http://www.hrsdc.gc.ca/eng/publications_resources/evaluation/2008/industry_practices/page08.shtml

We congratulate the CSA on this long overdue initiative for crisper disclosure. Kenmar welcomes the opportunity to comment on these proposals.

By way of introduction, Kenmar Associates is an Ontario- based organization focused on investor education and protection via on-line research papers hosted at www.canadianfundwatch.com. Kenmar also publishes ***the Fund OBSERVER*** on a bi-monthly basis discussing investor protection issues primarily for retail investors. Kenmar routinely submit comments and ALERTS on proposed regulatory changes that could impact Main Street.

An advertised feature of Group Scholarship Plans is that the investment income earned on the monies contributed by subscribers for beneficiaries who fail to qualify for payments from the plan is distributed to the beneficiaries who remain in the plan at maturity and qualify for Education Assistance Payments. This feature could, in theory at least, lead to sales to marginally qualified investors because of sales commissions and enhanced reported performance as a marketing tool. As an aside, we note the Appendix refers to *child* , should this not be **student** ?

Kenmar understand that in recent years there have been instances where clients of Group Scholarship Plans have suffered significant and unexpected losses as a result of investing in these Plans. According to the referenced HRSDC report, a shocking **3.2%** of group RESP plans were canceled or terminated in 2006. This suggests to us that some combination of inadequate disclosure, deficient KYC and/or unsuitability were present. We have seen this type of salesperson behavior in the mutual fund industry and brokerage industry. Unsuitable investments is the

1 cause of investor complaints. Most often , the inappropriate sales were made as a result of sales commission incentives. These commissions could lead to an attempt to make sales even to those unlikely to maintain contributions over the committed time horizon. Hence our emphasis on a robust KYC and supervision/ compliance process in addition to prospectus disclosure.

We like the idea of including an attrition statistic to highlight the fact that some not insignificant fraction of subscribers end up spinning their wheels with this investment. We recommend a fraction be used say, *1 out of 50* rather than 2 %. If given adequate prominence, it could act as a red flag to potential investors.

As we understand it, the enrollment fee (in effect, a front-end load) is not part of the investment base. It therefore is a cost of the investment even if 50-100 % returned at contract maturity. It does not earn any income and is partially returned after many years (typically 13), in deflated dollars. Disclosure should highlight this as it does materially impact performance. See <http://www.canadiancapitalist.com/the-mer-on-group-scholarship-plans/> for an impact analysis.

Additionally, 1.9% of group scholarship plans were closed by the group RESP vendors in 2006 alone and subscribers paid the price. Quoting from the HRSDC Report -: "When the group scholarship provider closes a group plan, the subscriber can reclaim the contributions, and these are then returned net of fees and without the investment income. Closing also means the grant and bond are repaid to the government, and these cannot be earned back later if new contributions are made for the same beneficiary." We understand that the reason a significant portion of plans are closed by providers is mainly because the subscriber has consistently missed scheduled contributions-in these cases the plans are generally converted by the provider to individual plans, where the subscriber has more flexibility in the contribution schedule. Nevertheless, this is a not-insignificant risk that regulators should try to protect against.

Group scholarship plans are characterized by a voluminous prospectus- the CST prospectus is 124 pages long albeit covering several products. The referenced HRSDC report notes that in 2006, some 20% of gross contributions went towards fees suggesting the Prospectus was either not read or understood because its size was daunting or its importance understated. A simplification will help reduce misunderstandings.

We are not aware of the governance regime applicable to Scholarship plans but assume they require fiduciary duties under various provisions of provincial Securities and other Acts. As a general comment, we do not find IRC's to be

adequate investor protection.

"I believe retail investors should be provided clear, simple, meaningful disclosure at the time they are making an investment decision - disclosure that includes comprehensible and comparable information about the securities products and services being offered. At the end of the day, our investor . . . just wants to know the facts, so he is not taken advantage of by hidden fees or questionable motivations. And he needs this information when it is most meaningful - at the time he is making his investment decision." - U.S. SEC chairman Mary Shapiro in a Dec.3, 2009 speech

The Instrument contemplates delivery of the prospectus, which consists of the Plan Summary document and the remaining parts of the prospectus within two (business) days of the purchase. We urge the CSA to require the physical delivery of the scholarship plan prospectus before or at the point of sale. Our experience with mutual funds strongly supports the view that post- purchase delivery of key documents is not in the best interests of investors. For a multi-year locked in commitment like these Plans and a vulnerable subscriber base we believe front-running the mutual fund POS disclosure initiative is in the public interest.

In these plans, a certain product investment risk is omnipresent given that investors may have trouble understanding their unique features, restrictions and complexity. Furthermore, we agree that for a subset of these investors, a scholarship plan is the only security they will ever purchase. Some of these investors have little to no financial literacy or numeracy leaving them vulnerable to abusive sales practices. For immigrants, their primary language may not be one of Canada's 2 official languages, thus complicating disclosure. This is why we argue that prospectus delivery should be in advance of sale so that friends or family can help the investor interpret the documents and ask more informed questions before purchase. We like the clear articulation of the right of cancellation in Appendix A.

Another issue is fee stability. The investor is committing to a series of payments over a period of years yet it seems that there is no corresponding commitment to maintain management fees and operating expenses fixed during the period. If they can increase, this would decrease returns. Thus we believe, this risk, *Fee Risk*, should be highlighted in the disclosure.

If there is a Investor Protection Fund or Provincial Contingency Trust fund applicable to this product, core documents should point this out and the nature of the coverage. If none, this should be explicitly stated. Dealer or fund insolvency (or even fraud) are of course real risks that ought to be disclosed. We recommend that the language under *No Government Guarantees* be changed to: **No**

Guarantees: Unlike bank accounts, guaranteed investment certificates, investments in scholarship plans are not covered by the Canada Deposit Insurance Corporation or any other government deposit insurer. Unlike stock and mutual fund dealers, Scholarship Plan dealers are not insured by any Government or industry insurer.

We believe the Sample Plan Summary Document will be helpful but recognize that for many even this plain language disclosure may prove inadequate. Presumably, this concern would be addressed by applicable NAAF/KYC /Suitability obligations. The NAAF form for these Plans should focus on such items as ability to sustain payments, financial literacy, literacy, time horizon, loss tolerance etc.

We respond to the 3 questions posed:

- 1. We are considering requiring the detailed disclosure set out in the prospectus form under Part C – Plan Specific Information for unregistered education savings accounts. These accounts currently have various names, such as escrow accounts or advance deposit accounts. In our view, these accounts appear to be securities because they evidence the investment contract. We agree with this view.*
- 2. To make the prospectus document shorter and more accessible for investors, we are considering allowing Part D – Information about the Organization of the Prospectus Form to be made available on request. This is similar to the Annual Information Form for conventional mutual funds. We agree with this approach but recognize that, like mutual funds, very few people will make a request.*
- 3. We are considering requiring additional disclosure in the Prospectus Form about the trustee of the scholarship plan, including information about the trustee's policies on business practices and conflicts of interest, proxy voting and particulars of existing or potential conflicts of interest related to the scholarship plan. We don't disagree with this approach but note that lengthy disclosures are not adequate investor protections especially for such complex products.*

As regards disclosure, we feel that conflicts-of-interest should be disclosed by the sales representative (and the nature of the conflicts) in writing. [We've been told that sales reps and their companies subscribe to the RESPDAC Code of Business Conduct and Code of Sales Practices which establish ethical standards in dealing with clients and potential clients]. The titles of these representatives should be constrained by some Rule so as to properly characterize their role in the distribution chain. See <http://www.chambresf.com/en/members-continuing-education/professions-toolbox/>

Additionally we suggest the CSA review the RESPDAC salesperson licensing program to ensure it is adequate to protect investors, updated to reflect new CSA regulations and effectively administered by an unbiased third party. (The industry

does not have an SRO entity so training by individual firms may vary). As we understand it, only in Quebec are salespersons required to take ongoing training in order to retain their professional licence.

As regards taxation issues, it might be a good idea to add some tighter language. For new prospectuses, it should be made clearer that the GST and the new HST will apply to the management fee, thus reducing returns. When fixed income securities are dominant in a portfolio, fees are the single biggest factor in impairing performance.

We believe the proposed disclosures, if implemented and enforced, will help prevent problems and reduce investor complaints. We especially like Appendix A's style, plain language and format and the Para *Who is this plan for?*. Kenmar have found that certain key cautions should be printed in BOLD RED to draw attention to bear traps. The impact of failing to qualify for EAP's deserves such special highlighting.

We also believe that POS document package should include some reference as to how complaints will be handled. As we understand it, since the RESP Dealers Association of Canada (RESPDAC) is an OBSI participant, that complaints from its member institutions can be referred to them (after 90 days). For non-RESPDAC members, can it be assumed that provincial regulators will act as dispute resolvers with restitution powers?

To the extent it can, the CSA should try to reduce the negative consequences of missing deadlines and reducing restrictions on delays in completion of studies inherent in these plans. The CSA should also attempt to require these Plans to better reveal, a priori, the Institutions and courses of study that are eligible and non-eligible.

We recommend that the OSC's (and other provinces) Education arm [<http://www.getsmarteraboutmoney.ca/Pages/default.aspx>] beef up and update its material on these Plans (including a basic Checklist formulated in part from a review of complaint data). It appears to us that the marketing of these Plans is fairly aggressive so that regulators should do as much as possible to inform investors (subscribers) in plain language of the pros and cons from an independent, unbiased perspective.

We also recommend that the CSA request that OBSI issue post a Scholarship Plan Case Study on its website based on complaints it has received. This would help investors understand some of the pitfalls.

We urge the CSA to implement as many improvements (including NP 15

revisions) as quickly as possible since the more sequential phases; the greater chance small investors could unduly lose money in the interim. Since these Scholarship plans resemble a tontine in that payments of investment income to beneficiaries who “survived” are enhanced by proceeds earned in plans that closed, they expose the most vulnerable, low income earners, to the greatest harm.

Should you require any additional information, do not hesitate to contact us.

We agree with the public posting of this Submission.

Sincerely,

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Saskatchewan Financial Services Commission

Manitoba Securities Commission

Ontario Securities Commission

Autorité des marchés financiers

New Brunswick Securities Commission

Registrar of Securities, Prince Edward Island

Nova Scotia Securities Commission

Superintendent of Securities, Newfoundland and Labrador

Registrar of Securities, Northwest Territories

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