FAIR | Canadian Foundation *for* Advancement *of* Investor Rights

July 23, 2009

Corporate Secretary
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and

Sarah Corrigall-Brown, Senior Legal Counsel
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Re: Request for Comments - Proposed amendments to MFDA Rule 2.2 (Client Accounts), Policy No. 2 *Minimum Standards for Account Supervision,* Rule 5.3 (Client Reporting), and Rule 2.8 (Client Communications)

We are pleased to provide you with the comments of the Canadian Foundation for the Advancement of Investor Rights ("FAIR Canada") in response to the above request for comments on the proposed amendments to MFDA Rules 2.2 (Client Accounts), Policy No.2 *Minimum Standards for Account Supervision*, Rule 5.3 (Client Reporting), and Rule 2.8 (Client Communication) issued on April 27, 2009 in the MFDA Bulletin #0370-P.

FAIR Canada is a non-profit, independent national organization dedicated to representing the interests of Canadian investors. The mission of FAIR Canada is to be a voice for investors in securities regulation and a catalyst for enhancement of the rights of Canadian shareholders and retail investors. Visit www.faircanada.ca for more information.

OVERVIEW

The financial crisis has accelerated the trend throughout the developed world to re-examine the relationship between investors and their advisors.

- As usual the U.K.'s Financial Services Authority is leading the way. In a dramatic step to remove potential bias, the FSA has proposed banning sales commissions for financial representatives and moving to a fee-based model for advisor compensation.
- In the U.S., the Obama administration has proposed creating a Financial Consumer Protection Agency and imposing uniform fiduciary duty obligations on all financial salespeople, requiring them to put their clients' interests first. New SEC Chair Mary Shapiro has given speeches acknowledging that the SEC has lost its way and calling for a return to its roots as "the investor's advocate."
- The European Union, Australia and other countries have implemented or are in the midst of major and far-reaching initiatives.

Canada had been a pioneer examining a complete overhaul of the client/advisor relationship. Serious discussion of these issues produced the Ontario Securities Commission's Fair Dealing Model (FDM) proposals in 2004. The FDM sought a far-reaching overhaul of all the rules affecting retail financial services based on simplicity and maximising investor access to investment instruments regardless of the distribution channel. To further transparency the FDM called for timely and meaningful disclosure of investment characteristics, risks, account performance, and all advisor fees. The OSC had even considered prohibiting fund managers from paying sales incentives to investment dealers out of fund assets and instead requiring dealer firms to charge their clients directly for the services provided.

Sadly, the Fair Dealing Model was never implemented. The FDM has since been carved up into different areas of responsibility. Self-regulatory organizations for the investment dealers (IIROC) and the mutual funds (MFDA) have proposed rules about relationship disclosure, conflicts of interest, suitability of investments, client reporting and communications, and performance reporting. The Canadian Securities Administrators (CSA) are addressing registration reform and the complaints handling process.

Recommendation: FAIR Canada is generally supportive of the IIROC and MFDA proposals. These steps represent incremental improvements in the Client Relationship Model. However, they do not move far enough towards the necessary complete overhaul of the relationship between the client and the advisor. We call on the CSA, IIROC and the MFDA to undertake a review of regulatory initiatives around the globe to ensure that Canadian investor protection keeps up with international best practices.

A) Rule 2.2 (Client Accounts) & Policy No. 2 *Minimum Standards for Account Supervision*

Too many retail investors are confused and overwhelmed with the paperwork they receive when they first open an account with their financial services firm. Most have no idea how much they are paying for financial advice, what services their advisor offers, or other significant information.

The proposed amendments to Rule 2.2 intend to clarify the role and responsibilities of the MFDA members with respect to their clients. The goal of the new Rule is laudable: to make clear that mutual fund dealers have the duty to access the suitability of investments when certain "triggering events"

occur (Rule 2.2.1.), and to provide all mutual fund purchasers with fundamental information about their investments (Rule 2.2.5).

In particular, the Relationship Disclosure document will provide critical information about the nature of the relationship between the client and her advisor, details of the products offered, how often the client will receive reports for the account and the compensation paid to the advisor.

FAIR Canada calls on the MFDA to clarify that all information pertaining to fees, charges and other advisor compensation should appear in a single document written in plain language. We believe that allowing other documents to be incorporated by reference diminishes the benefit of simplified relationship disclosure. In a world where too few investors actually read or review opening documents because of their length and complexity, we should be doing everything possible to make this information easily accessible to investors. At the very least, the main disclosure document should include a brief summary in plain language of any incorporated documents.

The MFDA proposes to review the suitability of trades accepted and recommendations made on retail accounts upon occurrence of the "triggering events". The suitability review must be made within a reasonable time and before the next trade. Events such as major transfers/deposits into accounts, material changes in client circumstances, or a change in the account representative will "trigger" a full-scale suitability review (Rule 2.2.1(e)). Dealers should conduct such reviews at least annually and after major market moves.

A frequent source of investor complaints, particularly after market crashes, is inappropriate asset mixes. Both dealers and investors have a duty to monitor these matters closely and ensure that actual portfolios do not deviate from the client's stated asset mix and risk tolerance objectives. FAIR Canada endorses these new rules as important steps to monitor clients' accounts.

The MFDA plans to issue a Member Regulation Notice on what details MFDA members should include in their Relationship Disclosure document. The document should provide sufficient detail for explicit and comprehensive disclosure without reducing the simplicity and clarity of the document. The proposed MFDA amendments are an important step in disclosing information that an informed client needs to know.

Recommendation: FAIR Canada supports the proposed disclosure rules pertaining to client accounts, role of financial advisors with respect to their clients, and duties of mutual fund dealers to conduct suitability assessments. Much more is needed however, particularly regarding the question of fiduciary responsibility and the conflict of interest between the client, the advisor and the firm.

B) Rule 5.3 (Client Reporting) and Rule 2.8 (Client Communications)

A very basic right of investors is to know clearly how their investments are performing. Most want the simplest number available – what has been my total return over the past year? How does it compare to the most relevant benchmark?

The amendments to Rule 5.3 include a new requirement to provide the gain and loss in the account as at the end of the period covered by the report. The information will be provided on the investor's account statement as total of amounts already required under the Rule. FAIR Canada supports this change and considers the new requirement to be a logical step forward in order to facilitate investors' access to the key information relating to their investments.

Rule 2.8.3 addresses the MFDA members' practices on disclosure of rates of return in communications with clients. The current practices do not require dealers to provide personalized rate of return. However, where dealers choose to provide such information, the rules require that a client be advised as to the methodology used in calculating the rate. There is presently no guidance as to what standard practices mutual fund dealers must use in calculating rates of return; instead dealers are given flexibility in deciding to which standards to adhere. Retail investors are in need of clear and practical information about their investments' performance. If the information on rates of return is to be presented to investors, the reporting should be based on uniform and consistent standards commonly accepted across the industry and familiar to investors.

The MFDA indicated that it will be issuing a Member Regulation Notice to provide guidance with respect to standard industry practices in calculating rates of return.

FAIR Canada believes that the MFDA proposal about performance reporting should go further. Clients need to see a personalized rate of return on their statements. And they need to see it in relation to the performance of the relevant benchmarks, in order to truly assess how their investments are faring. Note that the new regulations in the U.K. require both the calculation of annual returns and the inclusion of the benchmark returns.

Several financial service companies have complained about the difficulties of providing such calculations. It is true that sometimes it is hard to get historical cost information. And there are occasionally illiquid assets that are hard to value.

But for the vast majority of retail accounts these calculations are not that difficult. There is an entire industry devoted to performance measurement in the institutional world. Numerous systems are available to slice and dice investment performance by category, style, and a host of other factors. It is hard to accept that providing such a service is too big an obstacle for MFDA members.

We suspect that a certain element in the financial services industry does not particularly want its customers to have clear, easily comparable information that truly helps them understand how their investments have performed.

Recommendation: FAIR Canada calls on the MFDA and the CSA to require calculating and reporting client portfolio returns at least annually, if not more frequently. The regulators should also mandate the inclusion of the returns of the relevant benchmarks.

CONCLUSION

The new CSA rules and the IROC/MFDA proposals are incremental improvements in the longer process towards addressing conflicts of interest, lack of information and other problems in the client/advisor relationships. But they do not move far enough towards the necessary complete overhaul of the relationship between the client and the advisor. While some issues (registration and customer complaints) are being addressed, others are not even on the radar screen. There has been very little public discussion in Canada about the international initiatives to reduce or eliminate broker/advisor conflicts.

Canadians investors deserve a further-reaching shift in how financial services are sold and delivered in this country. FAIR Canada calls on the regulatory authorities to study international best practices regarding advisor compensation and fiduciary obligations to ensure that Canadian investors have the same protection as investors in the U.S., the U.K. and other leading financial markets, and that the interests of investors, advisors and financial services providers are better aligned.

We would be pleased to discuss our comments with you in more detail at any time.

Sincerely,

Canadian Foundation for Advancement of Investor Rights (FAIR Canada)

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