

FAIR

Canadian Foundation *for*
Advancement *of* Investor Rights
Fondation canadienne *pour* l'avancement
des droits *des* investisseurs

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RE: CSA Notice and Request For Comment – Modernization of Scholarship Plan Regulation Phase 1 – A New Prospectus Form for Scholarship Plans – Proposed Amendments to National Instrument 41-101 *General Prospectus Requirements*, Form 41-101F2 and Related Amendments

We are pleased to offer our comments on the proposed amendments to National Instrument 41-101 (the “Proposed Rule”) and Form 41-101F2 (the “Form”, and together with the Proposed Rule, the “Instrument”), as set out in the “Request For Comments” section of (2010) 33 OSCB (Supp-1) (the “Supplement”). Thank you for the opportunity to provide these comments.

The Canadian Foundation for Advancement of Investor Rights (“FAIR Canada”) is an independent, non-profit organization dedicated to representing the interests of Canadian investors in securities regulation. The mission of FAIR Canada is to be a national voice for investors in securities regulation and a catalyst for enhancing the rights of Canadian shareholders and individual investors.

FAIR Canada would like to applaud the Canadian Securities Administrators (“CSA”) for undertaking this initiative in respect of Scholarship Plans (“Plans”). We believe that the initiative is an important one, that it is timely, and that it is an important step in responding to the *Review of Registered Education Savings Plan Industry Practices* report prepared for Human Resources and Social Development Canada (the “HRSDC Report”).

Our principal comments fall into four categories:

1. specific comments regarding the content of the proposed Plan Summary document,
2. specific comments regarding the content of the proposed Prospectus document,
3. comments regarding the format and delivery of the Plan Summary and the Scholarship Plan Prospectus, and
4. comments regarding the proposed second phase of the CSA's initiative, the reformulation of National Policy 15 *Conditions Precedent to Acceptance of Scholarship or Educational Plan Prospectuses*.

In addition, we provide responses to the CSA's three questions asked in the Supplement, following our principal comments.

Executive Summary of FAIR Canada Recommendations

1. Plan Summary

We recommend that:

- (a) a clearer discussion about fees, particularly upfront fees, be mandated;
- (b) certain specific comments within the Sample Plan Summary be changed in order to give Plans a clear indication that language **MUST** be unambiguous where it may negatively affect an investor's interest;
- (c) the Plan Summary mandate simple disclosure of the financial performance of the Plan; and
- (d) the Plan Summary and the Prospectus (and the advice provided by salespeople) recommend consultation with salespeople about alternative education savings plans.

2. Scholarship Plan Prospectus

- (a) The additional disclosure we recommend including in the Plan Summary, with respect to upfront disclosure of fees, sales charges, enrolment fees or other fees which may be refunded, should accompany the disclosure proposed in Item 15 of Part C of Form 41-101F3.
- (b) We recommend adding disclosure to the Prospectus regarding alternatives to scholarship plan investments.

3. Format and Delivery of Plan Summary and Scholarship Plan Prospectus

We recommend that the CSA require:

- (a) physical delivery of the Plan Summary and Prospectus, together with an explanation of what each document is, before the sale or investment; and
- (b) that all financial data contained in the Prospectus be made available for download via the World Wide Web in XBRL (eXtensible Business Reporting Language) format.

4. Comments regarding the Proposed Second and Third Phases of the CSA Initiative

(a) The reformulated version of National Policy 15 should require that all salespeople confirm that they have explained all of the information in the Plan Summary to the investor, including the availability of other types of education savings plans, and for the investor to confirm his/her understanding of that information.

(b) As part of the explanation described above, the CSA should require that salespeople make specific representations to investors about the potential unsuitability of scholarship plans for some investors.

(c) The suitability standard should be strengthened to meet the problems identified in the HRSDC Report, to require that salespeople act in their clients' best interests when offering scholarship plan products.

(d) We recommend that, in order to align the interests of investors and salespeople, the CSA consider substantively regulating fees. One option is to limit the extent to which contributions are used to pay enrolment fees in any one year.

(e) With respect to the proposed third phase of the initiative, we support requiring scholarship plan dealers and salespersons to become members of an SRO, as we believe that this could lead to increased oversight and supervisions.

1. Specific comments regarding the content of the proposed Plan Summary document

We would like to applaud the CSA for the proposed Plan Summary, which we think, in broad terms, helps to accomplish important goals identified in the HRSDC Report of improving the disclosure of the specific features of plans and the probabilities of various potential outcomes of Plans to consumers. We do think that there are specific aspects of the Instrument, and particularly the Plan Summary, that can be further improved to better meet these goals:

(a) a clearer discussion about fees, in particular upfront fees, should be mandated;

(b) certain specific comments within the Sample Plan Summary may be inaccurate or are potentially misleading, and should be changed in order to give Plans a clear indication that language **MUST** be unambiguous where it may negatively affect an investor's interest;

(c) the Plan Summary should mandate simple disclosure of the financial performance of the Plan; and

(d) the Plan Summary and the Prospectus (and the advice provided by dealers and salespeople, which we will review under point 3) should recommend consultation with salespeople about other types of education savings plans.

We consider the Plan Summary document to be the most important document from the investor's perspective. As its proposed form is short and plain, it will be the document most likely to be read by prospective investors before any investment decision is finalized.

(a) Clearer discussion about fees should be mandated

We consider the current discussion of fees within the Plan Summary to be an admirable first step, but still insufficient to protect investors in scholarship plans. The current Sample Plan Summary provides for a discussion of fees under the sub-heading “How much does it cost?” towards the end of the summary. We believe that this sub-heading should be much more prominent within the Plan Summary and should be discussed immediately after the section “Who is this plan for?” at the beginning of the document.

Furthermore, we consider the section “Fees deducted from your contribution” to be in need of more fulsome disclosure. In addition to the current discussion under “What you pay” in the table, the same language as in “Ongoing plan fees” should be employed, providing that “if you invested \$2,500 last year in monthly contributions, you would have paid \$■.xx in fees.”

In addition, both of these fees (ongoing fees and fees deducted from contributions) should be expressed as a percentage as well as a dollar figure.

Finally, any discussion of upfront fees or fees deducted from contributions to Plans should be accompanied by clear disclosure regarding circumstances where contributors withdraw from the Plan. This would apply to the Plan Summary, as well as, for example, to the discussion under Item 16 of Part B and Items 14 and 15 of Part C of the Prospectus (Form 41-101F3). In particular, a table should be presented showing the results of withdrawal at an early stage, a late stage and at maturity, which should include a figure that adjusts any refunded amounts for a reasonable base rate of inflation, and compares this result to the investment of such fee amounts for the same period at an appropriate benchmark rate.

Furthermore, if there is any discussion within the Plan Summary of refunded Sales Charges and other fees, then we recommend that the CSA mandate the presentation of a table as described above directly within the Plan Summary.

(b) Certain specific comments or statements within the Sample Plan Summary may be inaccurate or are potentially misleading, and should be changed in order to give Plans a clear indication that language MUST be unambiguous where it may negatively affect an investor's interest

We draw the attention of the CSA to certain aspects of the “Sample Plan Summary Document” at Appendix A to the Supplement and submit that certain aspects are unsatisfactory from an investor protection perspective:

- *Generally – binding of the Plan Summary:* We recommend that the Plan Summary be bound separately from the Prospectus itself, as a short document will be far more likely to be read by investors than the first section of a much larger document. The Plan Summary should not have a cover and the first page of the Plan Summary should feature the “If you change your mind” text in bold print on the front page, so that the language is visible to an investor without opening the document.
- *Generally – page numbering:* We recommend that all references to page numbers be specifically referred to as “page ■ of the Prospectus”.
- *Page 11 – “Who is this plan for?”:* We recommend that this section specify that investors should be **certain** that they can make contributions on time, stay in the plan until it matures, and have a child who will attend a qualifying school and program. Each bullet point should specify that investors should be certain of each of those specific points. Furthermore, the reference to qualifying schools and programs should be accompanied by a page reference to Item 7 of Part C, and the reference accompanied by a brief explanation of common post-secondary programs that are *not* qualifying.

- *Page 11 – “Who is this plan for?”*: We recommend plain language disclosure regarding the actual consequences of skipping a payment, in this section, headed by the phrase (in bold text) **“You cannot elect to skip a payment and maintain your rights in the Plan”** (if this is an accurate statement about the Plan).
- *Page 12 – “How do I make contributions?”*: We submit that the phrase “you sign up for one or more units of the plan” is not an accurate synopsis of the typical scholarship plan. Rather, “Your contributions to the plan purchase units that represent your share of the plan” should be the phrase used. Furthermore, any fees that apply to changing amounts of contributions should be specified here.
- *Page 12 – “How do the payments work?”*: We recommend deleting references to taxes here (that is, the last sentence of this section). We consider “little tax” to be a meaningless phrase. Many students will have sufficient income so that an EAP would represent taxable marginal income to them.
- *Page 12 – “What are the risks?”*: We recommend adding a sixth item stating that “Your investment in the plan is not guaranteed or insured by any government insurer, including the Canada Deposit Insurance Corporation.”
- *Page 12 – “Drop-out rate”*: While we consider this sidebar to be an excellent contribution to investor understanding, we would recommend that both figures be expressed as a ratio (“approximately 1 in 50” or “approximately 3 in 10”), as well as a percentage.
- *Page 13 – “Are there any guarantees?”*: We consider the statement “*There are no guarantees that your child will ever receive any payments from this plan, or the amount of any payment contributed.*” to be preferable here.

(c) The Plan Summary should require simple disclosure of the financial performance of the Plan

While the current Plan Summary provides an admirable *qualitative* summary of the most important aspects and risks of a scholarship plan, it does not adequately describe in a brief, clear manner the *quantitative* aspects of a plan. As such, we would recommend that the Plan Summary contain, following the current text but before the “For more information” tab, a single-page summary of the financial performance of the plan to date.

This summary, entitled “Financial performance of the Plan,” would be a summary of the Plan's most recent performance up to the most recent year or quarter. It should be made clear in the summary that the financial performance of the Plan will not necessarily mirror the financial performance of an individual investor of the investment, given: (a) the variability of the EAP take-up and (b) fees. This could take the form of a table describing investments by investors with 5-, 10- and 15-year windows to maturity. The table would be based on the plan's historical results (including investments and rates of EAP take-up), but would give the financial results (including the impact of all *current* fees including the *current* upfront commissions) for investors who:

- (a) withdraw early in the plan's lifecycle to maturity (at 20% of the time to maturity);
- (b) withdraw late (at 80% of the time to maturity);
- (c) stay to maturity, but whose child does not secure EAPs for not attending a qualifying program;
- (d) stay to maturity, but whose child drops out in or after the first year of a qualifying program; and
- (e) stay to maturity and whose child completes a four-year qualifying program.

The returns should be expressed as annualized percentages of return on total investment, as well as dollar amounts based on a hypothetical amount invested.

We consider the current Plan Summary to be an excellent foundation for understanding the plan for persons who are able to understand and process the descriptions provided. We consider the proposed “Financial performance of the Plan” section to be better able to put the qualitative warnings of the Plan Summary into real numerical terms.

(d) The Plan Summary should recommend consultation with salespeople about other types of education savings plans

We submit that there should be more specifics provided regarding alternatives to scholarship plans within the Plan Summary, since there are many investors for whom scholarship plans are not suited. We would therefore recommend a new section heading, entitled “Alternatives to a scholarship plan”, that specifically recommends that prospective investors discuss the plan with their banker, accountant, lawyer or other advisor. The section should specifically recommend discussing the alternative of “an individual registered education savings plan that can be opened with virtually any bank, broker or financial institution.”

If the CSA felt it appropriate, such a discussion could be moved to the “*Who is this plan for?*” section but we consider this point – the availability of alternative means of investment that would be objectively better suited (from a structural point of view) to large numbers of investors – to be particularly important and, therefore, should be given prominent display in the Plan Summary document.

2. Specific comments regarding the content of the proposed Prospectus document mandated by Proposed Form 41-101F3.

We would like to applaud the CSA for the proposed Prospectus, which we think, in broad terms, helps to accomplish important goals identified in the HRSDC Report of improving the disclosure of the specific features of plans and the probabilities of various potential outcomes of Plans to prospective investors. Certain aspects of the Prospectus might be better tailored to meet the needs of prospective investors.

We submit that the additional disclosure we recommend in section 1(a) above regarding upfront fees, sales charges, enrolment fees or other fees which may be refunded, should accompany the disclosure proposed in Item 15 of Part C. This would include a table showing the results for such “refunds of fees” where the investor withdraws at an early stage, withdraws at a late stage, or holds until maturity; the table should show total upfront fees paid out of contributions, should include a figure that adjusts any refunded amounts for a reasonable base rate of inflation, and compares this result to the investment of such fee amounts for the same period at an appropriate benchmark rate. We consider that this would clearly show the relative amount of fees that are refunded and how such a refund would compare with the investment of funds in an RESP that was not accompanied by such fees.

We further submit that there should be more specifics regarding alternatives to scholarship plans within the Prospectus, for the reasons outlined in section 1(d) of our response above. In addition to the discussion of alternatives within the Plan Summary, we would therefore recommend a new subsection of the Prospectus, within Item 6 “Eligibility and Suitability”, that specifically recommends that salespeople discuss alternative education savings plans with prospective investors. That section should specifically recommend discussing the alternative of “an individual registered education savings plan that can be opened with virtually any bank, broker or financial institution.”

3. Comments regarding the format and delivery of the Plan Summary and the Scholarship Plan Prospectus.

We submit that the Instrument's contemplation of delivery of a prospectus to an investor within two business days of an investment in a Scholarship Plan is insufficient to properly protect investors. It is not merely the unique features of scholarship plans and their complexity to the average investor that is a concern. It is also the need to engage investors' understanding of the other options that are available to them, and for salespeople to properly guide investors to the most suitable education savings plan. Scholarship plans are vastly different from typical securities since what is done, particularly regarding upfront fees, is not easily undone. Both reports in the media and the HRSDC Report itself have found that several investors have incurred large upfront fees for unsuitable scholarship plan products, due to a pre-purchase deficiency in information and/or understanding.

As such, we would recommend that the CSA require physical delivery of the Plan Summary and Prospectus, along with an explanation of what each document is, before the sale or investment.

We further submit that, as automated tools for investors grow more sophisticated, new possibilities open up that will allow more advanced manipulation of prospectus data than ever before. For this reason, we would recommend that the CSA mandate that all financial data contained in the Prospectus be made available for download via the World Wide Web in XBRL (eXtensible Business Reporting Language) format. This would allow prospective investors to use (and indeed would help encourage the market to develop) sophisticated tools to help them make decisions based on standardized reported information.

4. Comments regarding the proposed second and third phases of the CSA's initiative.

We have additional comments regarding the Plan Summary and Prospectus that would be more suited to the second phase of the initiative, but which we discuss here since they relate to the information passed on to prospective investors and to the Plan Summary and Prospectus.

It would be desirable for the reformulated version of National Policy 15 to require that all salespeople confirm that they have explained all of the information in the Plan Summary to the investor, and for the investor to confirm that the investor understands that information. This could be done by requiring the investor and salesperson to sign an acknowledgement to that effect at the end of the Plan Summary, one copy to be retained by the salesperson or distributor and one copy to be retained by the investor as part of the Plan Summary itself.

Furthermore, as part of such an explanation, the CSA should require that salespeople make specific representations to prospective investors about the potential unsuitability of scholarship plans for some investors, drawing specific attention to that point, including references to possible alternatives.

Finally, we recommend that the suitability standard be strengthened to meet the problems identified in the HRSDC Report of investors for whom scholarship plans are unsuitable. We would urge the CSA to adopt a strengthened suitability standard for Plan salespeople, which requires that such salespeople act in their clients' best interests when offering such products.

The HRSDC Report found that enrolment fees create incentives for sales representatives that are not aligned with those of the consumers. The report notes that "... there is a risk that sales representatives, in order to generate a higher amount of fees out of which they get paid, may attempt to make people commit to contributions they cannot maintain in the long run... If enrolment fees were structured different as a share of total contributions instead of being based on a per Unit basis, interests of sales representatives and consumers would be more aligned."

Given the finding in the HRSDC Report noted above, we recommend that, in order to align the interests of investors and salespeople, the CSA consider substantively regulating fees. One option is to limit the extent to which contributions are used to pay enrolment fees in any one year. Currently, up to 100% of contributions in the first year may go to pay enrolment fees. If payment of the enrolment fees were made over a number of years with a limit of 10% of the contributions in any one year, this could reduce financial incentives to sell scholarship plans to consumers who cannot maintain contributions in the long run, while increasing incentives to sell to consumers who have the ability to maintain contributions over the life of the plan.

With respect to the proposed third phase of the initiative, we support requiring scholarship plan dealers and salespersons to become members of an SRO, as we believe that this could lead to increased oversight and supervisions. In this regard, we note that the OSC recently required that registrants dealing in contracts for difference with retail investors become members of IIROC.

5. Responses to Specific CSA Questions

Finally, we would like to respond to the specific questions that the CSA has asked in the Supplement:

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. Do you agree with this approach? If not, how should these accounts be disclosed and why?*

We agree wholeheartedly with this approach on the basis that such an approach will better protect investors. To the extent that such accounts are not considered securities, the disclosure will be relatively anodyne (as the features will simply not apply to them), and compliance should therefore not be complex or difficult.

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. Do you agree or disagree with this approach? Why?*

We are not opposed to such an initiative, but do not consider it particularly helpful from an investor protection perspective. Rather than the legal recitals and complex relationships of Part D, it is the “nuts and bolts” of Part C that is most helpful for investors, in terms of understanding how the Plan works, what they pay for it, and how to protect themselves.

Investors will protect themselves better via a thorough understanding of Part C than of Part D; making Part D alone available separately would not necessarily assist.

We would also recommend that the Plan Summary, at least, be packaged along with any separate mailing or delivery of Part D. The Plan Summary document is intended to help investors understand the product; it can play that role here.

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. Do you agree or disagree with this approach? Why?*

We agree with this approach, but consider it to have a minimal effect on investor protection. The practical benefit would be of little use to the vulnerable investors that these reforms are, in our view, targeting.

We thank you again for the opportunity to provide our comments and views on the Instrument and welcome the public posting of this submission. We would be pleased to discuss our comments with you, at your convenience. We can be reached at 416-572-2282/ermanno.pascutto@faircanada.ca or 416-572-2215/ilana.singer@faircanada.ca.

Sincerely,

Canadian Foundation for Advancement of Investor Rights