

# FAIR

Canadian Foundation *for*  
Advancement *of* Investor Rights

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September 23, 2011

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***

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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 22, 2011.

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.

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

1. FAIR Canada supports the proposed cost disclosure and performance reporting requirements. FAIR Canada welcomes the Proposed Amendments which intend to provide consumers with crucial information about their account and product-related charges and the compensation received by registrants, as well as clear and meaningful account performance reporting. The Proposed Amendments will better enable consumers to evaluate the performance of their investments and make informed financial decisions.
2. FAIR Canada recommends that the CSA mandate performance reporting on the basis of liquidation value of a security position in addition to performance reporting on the basis of market value of that security position. FAIR Canada also recommends that the CSA require performance reporting for each security position in the account.
3. FAIR Canada believes that low levels of financial literacy among Canadian investors should prompt regulators and industry to provide more detailed financial information to investors through cost disclosure and performance reporting. Providing more detailed information in clear, plain language will assist in improving the financial literacy of investors, so they can make informed financial decisions and improve their financial outcomes.
4. FAIR Canada recommends that the CSA include appropriate benchmarking (particularly benchmarks that are specifically chosen to appropriately match the client’s portfolio and investment objectives) as a mandatory element of the performance reporting requirements contained in the Proposed Amendments in order to help investors understand the relative performance of their investments.
5. FAIR Canada urges the CSA to implement the Proposed Amendments in a timely manner and views the proposed two year phased introduction period to be unduly long and unnecessary.
6. FAIR Canada has specific recommendations regarding the Proposed Amendments relating to:
  - a) the frequency of performance reports,
  - b) the form of performance reports,
  - c) reporting of trailing commissions,
  - d) statements of charges generally, and
  - e) extensible mark-up language for delivery of accounts and reports.
7. FAIR Canada supports more transparent and detailed disclosure about the charges, commissions or fees associated with the purchase and sale of fixed income securities than is currently proposed in paragraph 14.2 (4.1) (d). Investors should know the amount of any commission or charges that they incur either directly or indirectly when they, for example, purchase a five-year GIC or corporate bond.
8. FAIR Canada responds to the specific “Issues for Comments” listed in the Notice: (a) tax cost reporting; (b) guidance on determining market value; and (c) group scholarship plans.
9. FAIR Canada comments on other submissions received by the CSA.

**1. FAIR Canada supports the proposed cost disclosure and performance reporting requirements.**

- 1.1. FAIR Canada welcomes the Proposed Amendments which intend to provide consumers with crucial information about their account and product-related charges and the compensation received by registrants, as well as clear and meaningful account performance reporting. The Proposed Amendments will better enable consumers to evaluate the performance of their investments and make informed financial decisions.
- 1.2. FAIR Canada views the Proposed Amendments to be an essential step in fulfilling the obligation that financial intermediaries should be under to provide their clients with clear and unbiased information to increase their clients' awareness and understanding of the implications of their investment decisions. Financial intermediaries should be required to provide information in a transparent manner using plain language regarding the charges associated with their products and services, and the compensation registrants would receive (directly or indirectly). The investor must be provided with the necessary information and tools to be able to assess the products and services offered and the performance of their investments.
- 1.3. FAIR Canada welcomes the Proposed Amendments as a key step to making such performance information available to investors, as well as to making the charges applicable to their investment accounts clear and easy to understand. FAIR Canada views this to be important to improving the transparency of the relationship between the registrant and the investor. It is also an element of the Organisation for Economic Co-operation and Development's ("OECD") Principles and Good Practices for Financial Education and Awareness.

1.4. Principle 6 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 clients, especially for long-term commitments and commitments which represent a substantial proportion of current and future income.<sup>1</sup>*

**1.5. Providing complete cost disclosure and clear and meaningful account performance reporting is essential to promoting clients' financial awareness.**

- 1.6. FAIR Canada also strongly supports the CSA's intention to conduct further research with investors on their understanding and expectations about reporting on their security holdings. Such research is fundamental to ensuring that investors receive useful and meaningful reporting.

**2. Liquidation value of a security position should be provided and performance reporting should be provided on the basis of each securities position in the client's account.**

- 2.1. FAIR Canada recommends that the CSA mandate performance reporting on the basis of the liquidation value of a security position in addition to performance reporting on the basis of market value of that security position.

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<sup>1</sup> Organisation for Economic Co-operation and Development (OECD), "Principles and Good Practices for Financial Education and Awareness" (July 2005), online: <<http://www.oecd.org/dataoecd/7/17/35108560.pdf>> [emphasis added].

- 2.2. Retail investors often face a barrier to successful investing: they are unable to assess their current financial position and cannot, in many circumstances, accurately determine what their investments are worth or how they have performed.
- 2.3. As discussed above in section 1, FAIR Canada considers the Proposed Amendments to be important in assisting retail investors in understanding basic facts about the value and performance of their investments.
- 2.4. FAIR Canada is concerned that both investment reporting in general, and performance reporting in particular, will not help investors understand their financial picture or provide an accurate assessment of performance if investors are not apprised of situations where the liquidation value of an investment position – the cash return to be expected on an investment position where the position is sold, wound up or converted to a different position – is different from the quoted market value of the position within an investment report.
- 2.5. The reporting of market values of a position is not necessarily a reporting of the practical value of that position to a particular investor. For example, charges for the liquidation of a position (which can include anything from brokerage fees, to unexpunged deferred sales charges, to penalties within financial contracts for early withdrawal) can create a major drag for any investor seeking to sell or transfer the position.
- 2.6. FAIR Canada therefore considers it crucial for the CSA to adopt reporting requirements for account statements and performance statements that clearly identify situations where an investor's expected liquidation value (net of all unpaid charges, penalties and other fees, but not income taxes) is less than the quoted market value of the position at the date of the statement. Investors deserve to receive full and complete information about their financial position and only by disclosing the cash value of an investment position is an advisor able to help an investor assess its value.
- 2.7. It may be, in many circumstances, 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. An account statement should give an accurate picture of value to the investor of each position 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.
- 2.8. As such, and in order to allow investors to make meaningful comparisons to benchmarks and other investments that they hold or are considering for purchase, FAIR Canada recommends that performance reporting under the Proposed Amendments be made on the basis of the liquidation value of each investment position, including all charges that would be assessable if the client were to liquidate their investment position as of the date of the performance report or account statement, in addition to performance reporting on the basis of market value.
- 2.9. For example, FAIR Canada believes that “fees” in proposed paragraph 14.16 (1) (f) of the Proposed Amendments should include all fees which would be assessable on the liquidation of all positions.
- 2.10. Furthermore, FAIR Canada strongly encourages the CSA to make performance reporting mandatory in respect of each and every securities position in a client's account. FAIR Canada considers account-wide reporting to be of little value for investors in the absence of a careful further breakdown of performance of each of the client's security positions. 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.

### 3. Financial intermediaries should have a responsibility to increase financial awareness.

- 3.1. FAIR Canada believes that low levels of financial literacy among Canadian investors should prompt regulators and industry to provide more detailed financial information to investors through cost disclosure and performance reporting. Providing more detailed information in clear, plain language will assist in improving the financial literacy of investors, so they can make informed financial decisions and improve their financial outcomes.
- 3.2. The investor research survey report<sup>2</sup> prepared for the CSA by the Brondesbury Group (the “Report”) repeatedly notes the low level of financial literacy among Canadian investors. Basic terms such as “management expense ratio” and “market indexes”, including the S&P/TSX index, were understood by only a small minority of the investors surveyed. An understanding of these terms is essential in understanding charges incurred, investment performance and an overall financial picture.
- 3.3. Furthermore, the Report indicates that many investors are not able to analyze the performance of their own investment holdings, and simply rely on measures such as loss or gain in the last reported period. Additionally, it suggests that many investors are uncertain as to whether the cost of investments or the rate of return shown on existing account statements are before or after the deduction of commissions and fees.
- 3.4. This inability to assess the performance of account statements means that many investors do not have sufficient financial awareness to make informed financial decisions, which likely results in poor financial outcomes for many investors.
- 3.5. The provision of clear and accurate information by financial institutions should also improve the competitive marketplace by enabling market participants, including retail investors, to know 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 investment performance causes harm to investors as a whole. An example comes from the Canadian mutual fund industry, which charges fees that are among the highest, if not the highest, in the world.<sup>4</sup>
- 3.6. Research and modelling by economists has laid the blame for higher fees partially on poor financial knowledge on the part of investors.<sup>5</sup> This occurs because high-fee mutual funds (which tend to be poor performers) tend to be held by investors who are “performance-insensitive”. Poor financial knowledge can arise from poor financial literacy, but it can also arise from (or be compounded by) inadequate or confusing information provided about investment performance. 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.
- 3.7. A pool of performance-sensitive investors will force a marketplace to compete more strenuously (since investors will be more likely to switch 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

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<sup>2</sup> Dr. Edwin L. Weinstein, *Report: Performance Reporting And Cost Disclosure*, Prepared for: Canadian Securities Administrators (Sept. 2010), online: <[http://www.osc.gov.on.ca/documents/en/Securities-Category3/rpt\\_20110622\\_31-103\\_performance-rpt-cost-disclosure.pdf](http://www.osc.gov.on.ca/documents/en/Securities-Category3/rpt_20110622_31-103_performance-rpt-cost-disclosure.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> Khorana et. al. "Mutual Fund Fees Around the World" in *Review of Financial Studies*. Electronic copy available at: <<http://ssrn.com/abstract=901023>>.

<sup>5</sup> See especially Javier Gil-Bazo and Pablo Ruiz-Verdú, “The Relation between Price and Performance in the Mutual Fund Industry”, to appear in the *Journal of Finance*. Preprint available at <<http://www.afajof.org/afa/forthcoming/4611.pdf>>.

standards that allow for direct comparison, then investors will be less sensitive to quality (that is, performance) or price (that is, fees). This reduces the incentive for the industry to compete via performance and price, harming all investors.

- 3.8. A central goal of securities regulation in the modern context needs to be to increase financial literacy among retail investors and consequently to give those investors the tools necessary to increase their ability to evaluate investment performance. Providing costs, charges and performance reporting in clear, plain language statements will further this goal.
- 3.9. The Report makes it clear that many investors would prefer more detailed reporting than they currently receive. The CSA should ensure that the Proposed Amendments require more detailed information in cost disclosure and performance reporting. It is clear from the Report that investors would, as a rule, prefer the reports to contain more detailed information and would like to receive information presented in more ways that investors find useful (text and graph for example).
- 3.10. Another CSA research report (the “Allen Report”) 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>6</sup> Regulators and financial intermediaries therefore have a responsibility to ensure that vital and relevant information is provided, rather than placing the onus on the investor to request such additional disclosure.

#### **4. Benchmarking is essential to performance reporting.**

- 4.1. FAIR Canada recommends that the CSA include appropriate benchmarking (particularly benchmarks that are specifically chosen to appropriately match the client’s portfolio and investment objectives) as a mandatory element of the performance reporting requirements contained in the Proposed Amendments in order to help investors understand the relative performance of their investments.
- 4.2. In FAIR Canada’s view, the registered firm should be required to provide benchmarks and should, at account opening, provide each client with a general description of benchmarks and the factors to be considered when using them. FAIR Canada therefore does not agree with the proposed amendment to subsection 14.2 (2) that would add paragraph (m) to allow the registered firm, upon opening the account, to notify the client of whether the firm offers any options for benchmark reporting to clients. Requiring the registered firm to provide benchmark information upon account opening will provide the intermediary with an opportunity to discuss the appropriate level of risk for the particular client and their financial goals and to educate the client about benchmarking.
- 4.3. FAIR Canada also recommends the mandatory use of benchmarks as part of performance reporting within the Proposed Amendments. The use of benchmarks will allow retail investors to have a context within which they will be able to assess performance of their account. Many types of investments are subject to material variation in returns, particularly equities, and this necessitates benchmark comparisons to make sense of performance.
- 4.4. Where appropriate benchmarks do not exist, the CSA should give consideration to prescribing a formula for creating them and mandating their widespread use in performance reporting. We agree with the Report’s conclusion that a simple, understandable (albeit imperfect) benchmark will help investors more than a complex perfect benchmark that they do not understand. Simply mandating the use of a five year

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<sup>6</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 page 25.

GIC or average savings deposit rate and the S&P/TSX Composite Index would be better than no benchmark information at all.

- 4.5. The Allen Report indicates that many investors surveyed did not associate different levels of risk with each benchmark or stop to think about the asset mix of their own accounts or their own risk level. The provision of benchmark information to retail investors provides a financial education opportunity for financial intermediaries. Including benchmarking information in performance reporting documents sent to retail investors is an opportunity for financial intermediaries to engage in a teachable moment, in line with the Task Force on Financial Literacy's Recommendation 7.<sup>7</sup> Financial intermediaries should assist their clients in understanding the benchmark information so that their clients can assess the performance of investment decisions they have made in the past. A brief description of each benchmark should be provided on the report and could provide an indication of the level of risk associated with the benchmark (for example, a five year GIC rate could be described as "low" risk with an explanation of why this is the case, as illustrated in the sample performance report appended to the Allen Report).
- 4.6. FAIR Canada notes that the Allen Research Corporation Research found that very few registrants provide benchmarks; where they are provided it is usually only to high net worth clients, upon request. Many registrants indicated that they did not want to provide the benchmark information because the sample performance report did not discuss the client's goals, asset mix or risk level or because the benchmark does not match the client's asset mix and risk level. Such reservations or concerns could easily be overcome by providing information about the client's asset mix or risk level in the document.
- 4.7. While many clients may not understand the benchmark information at the present time, providing this information will give the client a point (or points) of comparison which could prompt clients to ask questions, consider the asset mix and risk level of their investments and/or account, and thereby provide an opportunity for investor education. This should increase the investor's financial awareness and assist the investor to make more informed financial decisions. The fact that many investors do not presently understand the benchmark information should not suggest that it is not crucial information for the investor or that the investor should not be provided with it.

## **5. Two year phased introduction period unduly long and unnecessary.**

- 5.1. FAIR Canada urges the CSA to implement the Proposed Amendments in a timely manner and views the proposed two year phased introduction period to be unduly long and unnecessary.
- 5.2. Various forms of performance reporting already are in existence in the marketplace. A short transition period should be provided to allow firms to develop processes and systems to comply with the requirements. Performance reporting has been acknowledged to be necessary information for investors for a considerable period of time. A six month transition period from the time the Proposed Amendments are approved should be more than adequate.
- 5.3. The cost to investors of making financial decisions based on inadequate information is of great public interest since it directly impacts on Canadians' ability to save for their retirement or other financial goals. It is imperative that this information gets into the hands of investors in a timely manner.

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<sup>7</sup> Task Force on Financial Literacy, *Canadians and Their Money: Building a brighter financial future*, (December 2010), online: <<http://www.litteratiefinanciereaucanada.com/pdf/canadians-and-their-money-1-report-eng.pdf>> at page 42.

**6. FAIR Canada has additional comments regarding specific aspects of the Proposed Amendments.**

***Frequency of Performance Reports***

- 6.1. Under the Proposed Amendments, performance reports are to be provided once every twelve months. In the Report, over 90% of those investors who expressed a preference stated that they would like to receive performance reporting at least every six months.
- 6.2. FAIR Canada recommends, in the light of a clear expressed investor preference for frequent performance reporting, and in light of the clear need of Canadian retail investors to become more performance-sensitive, that the CSA require performance reporting semi-annually.

***Form of Performance Reports***

- 6.3. FAIR Canada recommends that the CSA prescribe the format of the additional reporting investors will receive from their registrant under the Proposed Amendments. 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.
- 6.4. FAIR Canada urges the CSA to undertake further retail investor consultation as to the most clear, comprehensive, and meaningful format through which to present this information to investors.

***Reporting of Trailing Commissions***

- 6.5. FAIR Canada particularly approves of the requirement within the Proposed Amendments for registered firms to report trailing commissions received over a twelve-month period. FAIR Canada approves strongly of the proposed language clarifying how trailing commissions affect investor returns. FAIR Canada would suggest, rather than leaving the placement of such a notice up to the registered firm, that the notice of trailing commissions received should be required to be placed prominently among other cost information in the account statement.
- 6.6. While fund managers may not generate trailing commission information on a per client basis, dealers and advisors do know what amount of trailing commission they will receive in respect of the sale of a particular mutual fund to a given investor. The advisor knows what percentage of the trailing commission he or she will receive versus the amount that will go to the dealer. Investors deserve this information as well.
- 6.7. Investors may not currently understand what trailing commissions are and how they will impact on the performance of the mutual fund they have been sold. This lack of financial literacy is not a justification for not providing them with the information in a clear and plain language manner so that they make an informed assessment. In fact, this is all the more reason to present such information clearly to investors.

***Statement of Charges, Generally***

- 6.8. FAIR Canada would suggest placing the rest of the statements relating to account charges (that form proposed subsection 14 (4.1) of NI 31-103) as the first several paragraphs of the account statement in which they are included. Furthermore, FAIR Canada would suggest that, rather than being included in a statement of account once every twelve months, such statements of charges be included in every statement of account or account report that is sent to a client, regardless of the frequency of such reports, and that where investors have the ability to access account statements online, the page on which such statements are presented should always include, as part of its display, the relevant list of charges for the same period as the account statement.



***Extensible mark-up language for delivery of accounts and reports***

- 6.9. FAIR Canada encourages the CSA to develop an extensible mark-up language based on the XBRL standard for registered dealers to use in providing account statements to clients. This would be a standard that all registrants could use to deliver account statements, performance reports and the detailed information we are suggesting be included in these statements and reports. A standardized mark-up language in XBRL format would allow investors to download their account statements and performance reports from their dealer/advisor and have them be easily read either by existing financial software (which could be updated to read such XBRL formats, potentially via a software plug-in) or by specialized tools developed by the financial community or the open-source software community.
- 6.10. FAIR Canada also advocates for the adoption of a single data standard for electronic versions of cost and performance reporting. Detailed cost and performance reporting that adheres to a single model of reporting will allow third-party developers to develop financial and investment tools such as web and software platforms that will help investors gain better control over and understanding of their investments. The growth of applications that allow for fine-grained control of personal finance has been extremely successful and has given many more people more power and control of their personal finances. The adoption of a single, open standard for cost and performance reporting would allow, over time, for the successful development of such applications for investors that would be much easier to use and less time-consuming for the investor (since data could be added to the application automatically).

**7. Fixed income securities require more transparency and detailed information.**

- 7.1. FAIR Canada supports more transparent and detailed disclosure about the charges, commissions and fees associated with the purchase and sale of fixed income securities than is currently proposed in paragraph 14.2 (4.1) (d). Investors should know the amount of any commission or charge that they incur either directly or indirectly when they, for example, purchase a five-year GIC or corporate bond.

**8. FAIR Canada responds to specific “Issues for Comments” within the Notice.***Tax Cost Reporting*

**Issue For Comment** - *We have considered the option of permitting the use of tax cost (book value) as an alternative to original cost. We invite comments on the benefits and constraints of each approach to cost reporting, in particular as they relate to providing meaningful information to investors and their usefulness as a comparator to market value for assessing performance.*

- 8.1. FAIR Canada considers the provision of tax cost information to investors to be a very important aspect of cost and performance reporting by registrants. Many investors, particularly retail investors, find themselves unable to accurately estimate the adjusted cost base for tax purposes when they dispose of securities, a situation which can lead to unfavourable tax consequences. However, at the same time, we consider it unfavourable to calculate performance measures using tax cost instead of original cost.
- 8.2. FAIR Canada, therefore, would encourage the CSA to adopt the reporting of both cost measures as part of its cost reporting requirements. Reporting both tax cost and original cost is far more useful for the typical investor than any other method of reporting provided that the cost reporting is designed to minimize confusion. Reporting both tax cost and original cost does not need to be confusing to investors providing that all performance reporting is done on the basis of original cost, while a separate report (at the back of the main cost and performance report) presents a clearly labelled and clearly explained summary of the

tax cost of each security position, including an explanation (in general terms and plain English) of why the values may differ from the cost values in the performance report, and to what use the tax cost figures should be put. Such a breakdown of cost values would be of the most benefit to investors.

- 8.3. Performance reporting can and should be measured relative to original cost, with a note that for tax purposes, reference should be made to the tax cost report. Performance reports would not need to discuss, mention or include tax cost, since such measures are not strictly relevant in comparing investment performance.

#### *Guidance on Determining Market Value*

**Issue For Comment** - *Is the guidance provided on determining the market value of securities in section 14.14 [client statements] of the Companion Policy useful and sufficient? Please indicate if there is additional or different guidance needed. We are particularly interested in your comments on the guidance related to the valuation of exempt or illiquid securities where there are no quoted values available.*

- 8.4. FAIR Canada considers the guidance provided to be useful. The valuation of securities where there is no market made in the security is difficult and there is no set method of valuation that can be universally applied. The provision of general guidance, including care taken to exclude non-valued positions from calculations, is the best practice. This is what the CSA has provided.
- 8.5. FAIR Canada does consider it important that, where values have been calculated or computed by means other than a quotation on a public market, investors should be informed of this directly within their reports, on the same page as the values presented (that is, not within notes buried in some other part of the report). Investors require clarity as to the source of valuations from registrants, since they rely on such valuations to form an accurate picture of their investments. This is especially important in circumstances where valuation data is less reliable, such as using valuation at cost.
- 8.6. FAIR Canada would encourage the CSA, going forward, to collect data on what non-market methods of valuation of securities registrants are employing in their reports to investors. Such data could then be studied (by regulators as well as others) with an eye to improving and standardizing valuation methods and providing registrants with further guidance as to best practices.

#### *Group Scholarship Plans*

**Issue for Comment** - *We acknowledge that there are unique features to group plans offered by scholarship plan dealers (group scholarship plans). We invite comments on whether the proposed account performance reporting requirements should apply to accounts invested in group scholarship plans or what other types of performance reporting would be useful to clients of group scholarship plans in lieu of the proposals outlined in the Rule.*

- 8.7. FAIR Canada does not consider there to be any substantive reason to exempt group scholarship plans from any of the account performance reporting requirements. Based on our discussion above, at section 2, group scholarship plans should also be required to report to accountholders based on the liquidation value of their portfolio. There is no unfairness in requiring group scholarship plans to report on the same basis as other securities positions (i.e. on a market value and a liquidation basis). What would be unfair would be to permit such funds to report performance and cost on the basis of some uncertain future event. This would be a fundamental abuse of the principle of cost and performance reporting, which is intended only to provide an accurate picture of an investor's current situation and not to provide projections of an uncertain future event.

- 8.8. Although group scholarship plans may have unique features, they are ultimately still investment contracts like any other, and their investors are should be afforded the same degree of clear and accurate information as any other investor in any other type of investment contract. In fact it is this uniqueness that makes group scholarship plans particularly difficult to understand and places their investors in a more difficult position to properly understand the true nature of their investments and their financial position.
- 8.9. Therefore, the reporting of the value of client accounts invested in group scholarship plans should take the same format as reporting in other kinds of accounts. In particular, FAIR Canada encourages the adoption of our recommendations in section 2 of this letter, to report the value of security positions in terms of their liquidation value to the investor as of the particular date of the report (based on market valuations of security positions where relevant).
- 8.10. FAIR Canada believes it should remain open to sponsors of group scholarship plans to make additional information available to investors that will enable or assist an accurate understanding of the investor's financial position should certain future events come to pass. In the case of group scholarship plans, making such additional reports available to address future possible events relating to investment contracts (including the reporting of potential upside and downside results of future uncertain events) should be permitted so long as nothing is done to change the substance of the mandated cost and performance reporting, and so long as such additional reports are clearly marked as subsidiary to the main cost and performance reports required by the Proposed Amendments.
- 8.11. FAIR Canada noted with some dismay the comments of scholarship plan dealers contained in the Allen Report.<sup>8</sup> It seemed clear that scholarship plan administrators were “concerned” that an accurate picture of the quantum of fees charged to scholarship plan accounts would “misrepresent” the value of the clients’ accounts. In our view this is a fundamental misunderstanding of the notion of value and is entirely at odds with what we have outlined in section 2 as an accurate portrayal of the value of a security position, that a report of value should never make assumptions about what an investor or any other person may, or may not, do, particularly at some future date.

## 9. Comments on other submissions.

- 9.1. FAIR Canada would like to offer some additional comments in support of issues raised by other persons who have offered comments on the Proposed Amendments.
- 9.2. In the comment letter provided by Kenmar Associates, FAIR Canada agrees particularly with the comments that:
- 1) performance reports should be generated in all instances by dealer firms and not individual representatives;
  - 2) the CSA (and not individual dealers or industry lobby groups) should establish clear guidelines and rules for setting the methodology for calculating returns;
  - 3) the two years to implement the requirements is far too long;
  - 4) there should be a rule requiring transferring dealer registrants to provide original cost information to the new dealer registrant; and
  - 5) exchange rates to arrive at Canadian dollar amounts should be included within the report.

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<sup>8</sup> *Supra* note 6, at page 67.

- 9.3. FAIR Canada agrees with Mr. John J. De Goey's call for the CSA to consistently refer to trailer fees as "trailing commissions" and for the CSA to require dealer/advisors to refer to such charges as "trailing commissions". FAIR Canada also echoes Mr. De Goey's call for a standardized method of advertising the management expense ratio of mutual funds in order that they can be compared to an overall average of similar funds.
- 9.4. FAIR Canada disagrees with many submissions made by the industry lobby group, the Investment Funds Institute of Canada (IFIC).
- 9.5. In particular, FAIR Canada urges the CSA not to succumb to IFIC's request to exempt self regulatory organization ("SRO") members from compliance with the requirements under the Proposed Amendments. It is essential that all registrants, whether or not they are a member of IIROC or the MFDA, be required to provide the same information regarding costs and performance reporting to investors. All investors, regardless of who regulates the intermediary, should receive the same cost and performance reporting information.
- 9.6. FAIR Canada views IFIC's argument that SRO members should be exempted from compliance with the Proposed amendments because the MFDA has developed related rules to be weak at best. We view the CSA's Proposed Amendments to propose more fulsome information than some of the SRO rules and we stress above the importance of uniform cost disclosure and performance reporting requirements among registrants. The MFDA performance reporting rule (Rule 5.3.5) only requires reports to show the changes in value in the previous year, for example. All investors should be entitled to receive the same amount of information regardless of whether the registrant they are associated with is regulated by a member of the CSA or an SRO. Those investors whose intermediary is regulated by an SRO should not receive less information than the investors whose intermediary is regulated by a member of the CSA.
- 9.7. Additionally, FAIR Canada feels strongly that the lack of transparency in the insurance or banking industries should not obviate the need for such disclosure for registrants in the securities industry. The CSA should reject an argument which results in a "race to the bottom" and which disregards the interests of investors.
- 9.8. We disagree that disclosure of mutual fund costs, charges and commissions is dealt with adequately in the Fund Facts documents or in other documents provided to clients and should not be mandated in cost and performance reporting requirements. Investors deserve to know what they have actually paid in costs, fees and charges in addition to the general information that is provided in Fund Facts. The fact that there may have been historical disclosure is not a justification to not provide present information as to the account, since the investor cannot form an accurate picture of their investments without taking into account the quantum of costs and fees. Furthermore, investors should not be expected to always have all of the information previously disclosed at their fingertips when making comparisons or assessing performance. This is unfair, unrealistic, and investor-unfriendly.
- 9.9. FAIR Canada disagrees that the provision of complete information on all fees, charges and costs will result in investors double counting costs. If the information is provided clearly and in plain language, investors will be better able to understand the costs associated with any given investment. Providing the information that makes up the MER will not be misleading but will be informative and will likely lead to improved price competition. It should be, and will be, open to dealers and advisors to explain clearly to their customers the nature of such fees and when they have been charged.

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

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Sincerely,

A handwritten signature in blue ink, appearing to read "Ermanno Pascutto".

Canadian Foundation for Advancement of Investor Rights