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

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RE: Request for Comment on Proposed Amendments to MFDA Rules 2.8.3 (Rates of Return), 5.3 (Client Reporting) and 5.4 (Trade Confirmations)

FAIR Canada is pleased to offer comments on the Mutual Fund Dealers Association of Canada ("MFDA") Request for Comments regarding the MFDA's proposed amendments to MFDA Rules 2.8.3, 5.3 and 5.4 (collectively the "MFDA CRM2 Amendments") which are intended to implement MFDA rule requirements that are substantially the same as amendments to National Instrument 31-103 announced by the Canadian Securities Administrators ("CSA") on March 28, 2013 relating to annual account performance reporting, pre-trade and trade confirmation disclosures and annual account fee/charge reporting (collectively, the "CSA CRM2 Amendments") (together, the "CRM2 Proposals").

FAIR Canada is a national, charitable organization dedicated to putting investors first. As a voice for Canadian investors, FAIR Canada is committed to advocating for stronger investor protections in securities regulation. Visit www.faircanada.ca for more information.

1. FAIR Canada Supports Cost Disclosure and Performance Reporting

1.1. FAIR Canada supports the proposed cost disclosure and performance requirements contained in the CRM2 Proposals and the commitment that regulators have made to the provision of this crucial financial information to financial consumers. Canada's self-regulatory organizations, namely the MFDA in this instance, are proposing rule requirements that are substantively and substantially the same as the CSA CRM2 Amendments so that the MFDA's dealer members will be subject to a single set of client reporting and disclosure requirements,. FAIR Canada is supportive of this so long as all firms, regardless of whether they are a member of the Investment Industry Regulatory Organization of Canada ("IIROC"), the MFDA or are directly supervised by a CSA member, are subject to the same minimum requirements, without any material differences. It is important that

consumers can meaningfully compare the reports they receive from various firms, no matter which regulator directly oversees each firm.

1.2. FAIR Canada supports the requirement that all financial intermediaries, including MFDA dealer members, provide essential financial information to consumers so that consumers are able to answer two basic questions about their investments: (1) How much did I pay? and (2) How did my investments perform? Research has shown that investors often do not know the answers to these two fundamental questions.[1]

1.3. Canadians have become increasingly responsible for ensuring their own financial security in retirement and are required out of necessity to enter into the financial marketplace to invest their life savings. When doing so, they face huge asymmetries in the amount of information and resources they possess as compared to financial intermediaries. It is rightly the responsibility of financial intermediaries to provide (and be required to provide) clear, complete, standardized and meaningful information about the costs the consumer has incurred and how the investment(s) has performed. We note that the transition period proposed in the CRM2 Proposals would mean that this crucial information will not actually get into the hands of Canadian consumers until sometime after July 15, 2016 when the rules come into effect.

2. FAIR Canada's Comments on the MFDA CRM2 Amendments

2.1. FAIR Canada sets out below its specific comments on the MFDA CRM2 Amendments.

a) Pre-Trade Disclosure of Charges

2.2. FAIR Canada supports a formal requirement that a retail customer be informed of all fees/charges associated with a client's decision to purchase or sell a security in an account before the purchase or sale takes place. While this may currently be an industry best practice, it is necessary that it become a required practice by making it a rule. Such a requirement is in compliance with section 14.2.1 of the CSA CRM2 Amendments.

2.3. FAIR Canada recommends that such disclosure, which includes "whether the firm will receive trailing commissions in respect of the security", should include the dollar amount of such trailing commissions. Consumers understand dollar amounts better than amounts expressed in percentage terms. For example, if the trailing commission is 1%, then the disclosure should be that for every $1,000 the trailing commission will be $10.

2.4. FAIR Canada does not understand why the proposed changes to Rule 2.4.4 contemplate narrowing the scope of the section so that it only applies to *securities* in the account rather than any investments in the account (as it presently does). While the MFDA must have rules which are substantially similar to those of the CSA in order to be exempted from the requirements of the CSA CRM2 Amendments, this does not mean that the MFDA should lessen the disclosure that is already occurring on those investments that are not securities. Arguably such narrowing of the scope of Rule 2.4.4 goes against the spirit of the CRM2 initiative. If the proposed amendment is made, an MFDA Approved Person could sell a segregated fund or other investment product on a

[1] See CSA Notice (2012) 35 OSCB 5430.

deferred sales charge basis, for example, without having to disclose this fact to the client prior to the sale. Currently, they must do so. Reducing the amount of such important disclosure should not be sanctioned by the MFDA. FAIR Canada recommends that the changes to Rule 2.4.4 apply to all investments, not just securities.

2.5. FAIR Canada further recommends that the wording conform to the wording of the IIROC CRM2 Amendments and the CSA CRM2 Amendments with respect to Rule 2.4.4(a) and read "the charges the client will be required to pay, directly or indirectly, in respect of the purchase or sale..." rather than "any charges to be deducted in respect of the transaction".

b) Client Relationship Disclosure

2.6. FAIR Canada recommends that the key requirements for client relationship disclosure upon opening an account with the Member be contained in one rule, namely Rule 2.2.5 as it is with the CSA CRM2 Amendments. This will allow Members and clients to refer to a single rule to determine the obligations and responsibilities of the Member. In addition, we make recommendations to make this disclosure more meaningful to the investor. Accordingly the follow amendments are recommended:

i. In Rule 2.2.5(a), Instead of "describing the nature of the advisory relationship", the Member should describe the nature or type of the account offered by the Member and the types of accounts it does not offer (such as fee-based accounts, fee for service accounts and do-it-yourself accounts, as applicable). This would allow the client to make a more informed decision.

ii. In Rule 2.2.5(b), the Member should be required to describe "the products and services offered by the Member" and in addition, "describe the products and services not offered by the Member", as applicable, such as ETFs, individual securities and/or segregated funds (with respect to products). A reasonable investor would consider the types of products and services that are not offered to be important to their decision and should be informed of the limitations of what the salesperson can offer to them.

iii. Rule 2.2.5 should include, in conformity with Section 14.2(2) of the CSA CRM2 Amendments, the following:

- A general description of the types of risks that a client should consider when making an investment decision (Section 14.2(2)(c))
- A description of the risk to a client of using borrowed money to finance a purchase of a security (Section 14.2(2)(d));
- A description of the conflicts of interest that the Member is required to disclose to a client under securities legislation (Section 14.2(2)(e)
- Disclosure of the operating charges the client might be required to pay related to the client's account (Section 14.2(2)(f)) by moving Rule 2.4.3(a)(i) to form part of Rule 2.2.5;

- A description of the content and frequency of reporting for each account or portfolio of a client (Section 14.2(2)(i);
- Disclosure about scholarship plan terms as set out in Section 14.2(2)(n) if the MFDA Member is also a scholarship plan dealer; and
- Disclosure that all MFDA Members are required to be members of OBSI in order to resolve any dispute that may arise between the client and the Member about any trading or advising activity of the Member or one of its Approved Persons.

iv. Rule 2.2.5(g) should be amended to read "describing the nature of any compensation that may be paid to the Member *by any other party in relation to the different types of products that a client may purchase through the registered firm*" rather than "describing the nature of the compensation that may be paid to the Member and referring the client to other sources for more specific information". Clients should not be made to go to various other sources to obtain important disclosure which will inform the client about the existence of potential and/or actual conflicts of interest between that of the client and the Member and its Approved Persons.

c) Client Account Statements

2.7. FAIR Canada supports the proposed amendments which would require reporting in respect of all securities and other investment products transacted through, or transferred into, the Member. Clients will want information provided about all of their investments and their performance and costs.

2.8. FAIR Canada supports having the same requirements for both client name and nominee name accounts as clients think of an account statement from a Member as "a statement of my investments with my dealer". The CSA has indicated that many retail investors do not understand the ways in which their investments may be held and are entitled to receive the same level of reporting regardless of whether held in client name or nominee name.

2.9. FAIR Canada agrees that it needs to be made clear to investors which securities are held by a custodian, and thereby protected by IPC coverage, and which are not. The investor must know whether or not they will have recourse in respect of a given investment in the event of a Member's insolvency. MFDA Rule 5.3.1(e) should require this level of disclosure.

d) Performance Reporting

2.10. FAIR Canada recommends that Members be required to provide annualized percentage return information for the most recent 1-, 3-, 5- and 10-year periods from account inception, unless the Member reasonably believes that the annualized total percentage return for the period before July 15, 2015 is not available. For consistency with the CSA CRM2 Amendments, Members seeking to be excused from providing this information should be required to demonstrate that it is not reasonably available.

2.11. FAIR Canada is of the view that the performance reporting requirements should be in the MFDA's Rules rather than made Policy "X" in order to have *rules* substantially similar to those of the CSA CRM2 Amendments. It is not clear that the MFDA's Policies are regarded by its Members as being binding rules, since the MFDA's website states: "MFDA Policies set minimum industry standards that expand on prescriptive requirements that Members are required to comply with."

e) Fee/Charge Reporting Including Compensation Received from Third Parties

2.12. FAIR Canada urges the MFDA to require that Members not only provide information about performance for all investments (not just securities) transacted or transferred into the Member but also provide charge/fee reporting on those investments. In order for the client to know the answer to the question "how much did I pay?" and compare the costs to the performance of the account, and thereby come to an assessment of value, the client needs to know about all charges/fees.

2.13. FAIR Canada does not accept the proposition that reliable data cannot be obtained on the fees/charges (including commissions, referral fees etc) that are paid to Members in respect of the investments they sell. It should not be left up to the Member to "elect to provide charges and compensation information" on investments they sell that are not securities. They should be required to do so. Members who sell investments are sophisticated parties operating for a profit and are aware of the payments that the sale of the investments they offer trigger. The amount of compensation received is a known amount. We expect that financial intermediaries would have internal processes for allocating such compensation (where it is not directly tied to a particular sales transaction) as a result, and could determine the compensation earned from the investments sold. In addition, FAIR Canada expects that regulators who have jurisdiction over these other products would be amenable to such information being provided to clients. For example, insurance regulators would be amendable to such information being provided to clients of segregated funds.

2.14. FAIR Canada recommends that the fee/charge report have a heading for "Compensation we received through third parties" as set out in Appendix D of National Instrument 31-103, in accordance with the CSA CRM2 Amendments.

2.15. FAIR Canada refers the MFDA to its previous comments made to IIROC on the definition of trailing commission and disclosure regarding trailing commissions which are equally valid here.[2] The definition of trailing commission in the MFDA CRM2 Amendments at Rule 5.3(1)(f) is inaccurate and meaningless and needs to be reworked as does the disclosure regarding the payment of trailing commissions to the Member at MFDA's Rule 5.3.3(1)(g).

f) Members Who Are Exempt Market Dealers

2.16. As indicated in the MFDA's consultation document, the MFDA CRM2 Amendments will require performance reporting and fee/charge reporting in respect of all securities including exempt

[2] Letter dated April 10, 2014 to IIROC from FAIR Canada re IIROC Request for Comments re Client Relationship Model – Phase 2, Performance Reporting and Fee/Charge Disclosure, at page 3-5, available online at http://faircanada.ca/wp-content/uploads/2011/01/FAIR-Canada-comments-re-IIROC-CRM2-Proposals.pdf.

market securities. FAIR Canada agrees that this should be required.[3] We believe that all registrants should be required to provide these reports. MFDA Rule 5.3.6 should therefore be clarified so it is clear that, in addition to Rule 5.3.1, 5.3.2, 5.3.3 and 5.3.4, where a Member is also an exempt market dealer it will also (in addition to Rule 5.3) have to comply with any additional client reporting requirements that are imposed on exempt market dealers and scholarship plan dealers, as set out under securities legislation (such as monthly account statements if there is a transaction involving an exempt market product in the account).

3. Further Reforms Beyond CRM2 Needed to Adequately Protect Consumers

3.1. FAIR Canada commends securities regulators for moving forward with initiatives such as CRM2 and Point of Sale disclosure for mutual funds (which will be extended to other products such as ETFs). These initiatives have faced opposition by many in the industry and, as a result, have taken a considerable amount of time to come to fruition. Such opponents are now resigned to publicly supporting the benefits of these initiatives while, at the same time, pointing to them as a reason not to proceed with other much-needed initiatives. We do not agree with the argument made that additional regulatory measures under consideration (such as the mutual fund risk rating methodology and mutual fund fee reforms) could jeopardize smooth implementation of other regulatory changes such as CRM2. FAIR Canada disagrees that other needed reforms should be placed on hold pending implementation of CRM2.

3.2. FAIR Canada cautions that the CRM2 Proposals do not address the serious conflicts of interest that impede the development of a healthy, competitive marketplace. The CRM2 Proposals also do not impose a high enough standard to fit (a) the relationship that consumers expect (the full trust and reliance consumers place in their advisors, and the resulting expectation that their advisors will provide advice in the consumer's best interests); or (b) the relationship that the industry professes in much of its marketing and advertising materials. Disclosure alone will not address the serious, systemic issues that have been identified (that is, high costs to investors (in particular, high mutual fund fees), poor product recommendations and lack of effective price competition). Accordingly, waiting for the CRM2 Proposals to be implemented and further waiting to monitor and assess the effects of the CRM2 Proposals before moving on with other needed reforms would be unjustified and will impose real costs on Canadian consumers.

3.3. These costs are important to all Canadians. Ensuring that Canadians have adequate savings for their retirements is an important public policy goal shared by provincial and federal governments and society in general. Securities regulators are mandated to foster fair and efficient capital markets and protect investors and action is required now to meet these objectives. FAIR Canada notes that other jurisdictions have moved beyond improved disclosure to ban embedded commissions or otherwise impose substantive changes that remove and/or minimize conflicts of interest and misalignment of incentives for financial firms and their intermediaries vis a vis their clients. Australia and the United Kingdom have implemented reforms in the consumer interest; the Council of the European Union has approved new rules; and the U.S. is considering doing so. We urge regulators in Canada to move forward with these needed reforms to address the issues that

[3] See our comments to IIROC, supra, at paragraph 3.1 and 3.2, at page 5.

are cited in the consultations and that we have outlined in our recent submissions[4]. FAIR Canada therefore views the CRM2 Proposals as a necessary and important but insufficient step to ensure adequate consumer protection.

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 Neil Gross at 416-214-3408 (neil.gross@faircanada.ca) or Marian Passmore at 416-214-3441 (marian.passmore@faircanada.ca).

Sincerely,

Canadian Foundation for Advancement of Investor Rights

[4] See FAIR Canada's submission on reform of mutual fund fees at http://faircanada.ca/wp-content/uploads/2011/01/FAIR-Canada-comments-re-Mutual-Fund-Fees.pdf and our submission on implemented a statutory best interest standard on dealers and advisers at: http://faircanada.ca/wp-content/uploads/2011/01/FAIR-Canada-Submission-re-CP33-403-Statutory-Best-Interest-Duty.pdf.