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September 23, 2011

John Stevenson, Secretary  
Ontario Securities Commission  
20 Queen Street West, Box 1903  
Toronto, ON M5H 3S8

Dear Mr. Stevenson,

**Re: Notice and Request for Comments re Proposed Amendments to National Instrument 31-103: Cost Disclosure and Performance Reporting**

As members of the Ontario Securities Commission's Investor Advisory Panel (IAP), we enclose in this letter our submission regarding Notice and Request for Comments re Proposed Amendments to National Instrument 31-103: Cost Disclosure and Performance Reporting (the "Proposed Instrument").<sup>1</sup>

The IAP is an independent body that was appointed by the Ontario Securities Commission in August, 2010. We are charged with representing the views of investors and providing input on the Commission's policy initiatives, including proposed rules and policies, the annual Statement of Priorities, concept papers and other issues.

**1. OVERVIEW**

The Investor Advisory Panel wholeheartedly endorses the steps proposed by the CSA regarding performance reporting and cost disclosure in the Proposed Instrument. While we have some

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<sup>1</sup> We extend deep appreciation to Christine Van Geyn and David Rotchtin, students-at-law, of Bennett Jones LLP for their excellent research assistance which has been provided on a pro bono basis to the Investor Advisory Panel.

concerns with the specifics of the Proposed Instrument, we here indicate our overall support for it. We are struck by the lack of transparency that exists in cost disclosure and performance reporting at the current time. Thus, the Proposed Instrument is long overdue; any delay in its implementation would undermine investors' interests.

Investors in Canada suffer from having much less information than their financial advisers. The Proposed Instrument will, if implemented, assist in providing investors with information that is easy to understand and will thereby facilitate intelligent decision-making for all investors. Especially in the absence of a fiduciary duty for Canadian financial advisers and salespeople to act in their clients' best interest – a duty that the Investor Advisory Panel strongly believes should be the law<sup>2</sup> – full disclosure of performance returns and costs, in easily understood formats, is necessary all the more.

**Cost disclosure – total costs, especially in dollar terms, will heighten investor sensitivity.**

The proposal that investors receive an annual statement with their total costs, in both dollar and percentage terms, is key. Additional disclosure about total compensation paid to their financial advisers with respect to their accounts, including trailer commissions and finders' fees, will further reduce information asymmetries between investors and their financial advisers.

**Performance reporting – mandate a clear, standard format.** We believe that clear performance reporting is a basic right of investors. We urge the CSA to mandate a standardized format (with improved graphic designs) to ease investors' learning curve and heighten comparisons between different funds and investments.

**Benchmarks are important but complicated; further study is needed.** The Investor Advisory Panel believes that benchmarks are important components of meaningful comparisons of investment returns, by providing the context to understand how comparable investments performed, and what risks were assumed in order to generate their investment returns. But the use of benchmarks can be hugely complicated and even misleading. We recommend that the CSA undertake a detailed study of the best way to use benchmarks to educate and empower retail investors.

**Transition – a sense of urgency!** The CSA's proposed two-year implementation period is long; we believe that a one-year timeframe would be sufficient. Regulators should maintain pressure on financial service providers to present original cost information. The Investor Advisory Panel urges regulators of the banking and insurance industries to follow the CSA's lead to ensure that investors in GICs, insurance funds and other products also benefit from the improved disclosure about returns and costs.

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<sup>2</sup> See Investor Advisory Panel submission on the OSC 2011-2012 Annual Statement of Priorities, online: <[http://www.osc.gov.on.ca/en/Investors\\_iap\\_submissions\\_index.htm](http://www.osc.gov.on.ca/en/Investors_iap_submissions_index.htm)>.

## 2. DETAILED SUBMISSIONS

### (a) Disclosure of Costs

One of the foremost purposes of the *Securities Act* is to “to provide protection to investors from unfair, improper or fraudulent practices”.<sup>3</sup> The Act states that one of the primary means to ensure this occurs is through “requirements for timely, accurate and efficient disclosure of information” and also through “requirements for the maintenance of high standards of fitness and business conduct to ensure honest and responsible conduct by market participants.”<sup>4</sup> We believe that while the information that is provided to investors from issuers themselves is relatively comprehensive, the information that is provided from financial advisers is not. We believe that greater disclosure is warranted in order to achieve responsible conduct by financial service providers. We therefore strongly endorse the proposal to provide much more detailed and inclusive cost information to clients. The suggestion to provide that information as a dollar amount as well as in percentage terms is crucial. The current arrangement of reporting performance net of fees effectively hides the amount that the client is paying.

**Disclosure of dollar amount of costs is crucial.** The annual disclosure of charges to the client, plus total compensation received by the financial services firm relating to the client’s account, are powerful steps towards empowering investors and redressing the current information imbalance between advisors and their clients. While some may protest that it is too much information and will confuse clients, we believe exactly the opposite. **Seeing that single number of total costs will be unquestionably educational to investors large and small.** It will no doubt enable a much more thorough and intelligent analysis about what value the financial advisor is adding to the client, and what risks are being taken to earn those returns.

**A single annual statement will have a greater impact.** We also feel strongly that collecting this information in a single annual cost statement is important. Although much of this information is available today in mutual funds’ annual information form, simplified prospectus or other documents, it largely goes unread and unnoticed. Collecting and concentrating the cost information in a single document will have a much greater impact and will make that document much more likely to be read by clients. We endorse the proposal to include information about which mutual funds are liable for deferred sales charges. Too often mutual fund investors only discover this information after the fact.

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<sup>3</sup> R.S.O. 1990, c. S.5, s. 1.1 (a).

<sup>4</sup> *Ibid.*, s. 2.1.

**Combine the annual performance and cost statement.** The OSC’s own research shows that clients want meaningful summary information, clearly and succinctly presented. The Investor Advisory Panel believes that combining the annual performance and cost disclosure statements would increase readership of both and serve to drive home the important investment lesson that costs greatly matter in investment decision-making.

**Requiring firms to reveal total compensation will identify potential conflicts of interest.**

Clients have a right to know how their advisors are being paid. Requiring firms to reveal third party commissions, finders’ fees, and other indirect compensation is important information for clients. Heightened international sensitivity to these conflicts has led the UK to ban completely third-party commissions to financial advisors. The UK is moving to force all financial advisers to shift from commissions to a fee-based model.<sup>5</sup>

**Principle of showing economic value should guide approach to technical issues.** There are a number of technical issues that have to be addressed. Determining the charges for fixed income investments, now typically embedded in the cost, will be a challenging but necessary exercise. Many structured products using derivatives include multiple levels of fees and charges. We believe that it is essential to ensure that investors are made aware of all costs, direct and indirect.

The same principle applies to initial public offerings. Investors should not proceed on the mistaken assumption that they are cost-free. Allocating charges between accounts can be somewhat problematic as well. For example, families with multiple registered and non-registered accounts will typically have the taxable accounts absorb all or most of the fees, to benefit from the tax deductibility of such fees. The guiding principle for regulators and financial services providers should be to disclose information as close to a true economic model as possible, without regard to the tax consequences.

**(b) Presentation of Data in Performance Reporting**

We support the simple and direct format tested by the Ontario Securities Commission that was included in the Proposed Instrument. Combining text with charts, tables and graphs conveys performance results in formats that have the best chance of being understood by the large majority of investors. Even those who have trouble understanding the performance returns should be able to use that information for (in the language of the Proposed Instrument) “more informed decisions about meeting their investment goals and objectives” through a more in-depth and relevant discussion with their advisors.

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<sup>5</sup> *Retail Distribution Review (Adviser Charging) Instrument 2010*, S.I. FSA 2010/12, online: <<http://fsahandbook.info/FSA/html/handbook/COBS/6/1A>>. The ban on commissions will be limited to financial advisers in relation to their provision of personal recommendations to clients.

**We recommend that the CSA recommend a standard format, to ensure comparability.** The Proposed Instrument states that the CSA does not intend to prescribe a format for presenting performance information. We respectfully disagree. There is a steep learning curve for investors associated with mastering this information, and the use of standardized terms and formats will greatly ease their mastery of that learning curve. The CSA must determine a standardized methodology for dealing with investment inflows and outflows, time-weighted rather than dollar-weighted results, and similar issues. **It is crucial that different investments can be easily compared.**

**Graphic design can enhance investor understanding.** We believe that use of intelligent graphic design could produce a standardized format similar to the nutrition information that appears on all food packaging. Investors will eventually get used to seeing certain information appear in a set order, and will find it easier to compare results between different products.

**Use original cost information, not tax (book) values.** Comparing original costs and additional (cash) investments is how most investors see their accounts. The fact that such reporting will not coincide with tax values is not particularly worrisome, in our view. Most Canadian taxpayers are used to tax reporting being quite different from the results that they see in their bank statements, personal cash flows, and investment results.

**Maintain pressure on financial services firms to find original cost information.** Most financial service providers should be able to attain the original cost information of all but the most illiquid or unusual investments. The internet and various service providers have greatly eased this search. In the absence of original cost information, the firm should be allowed to use intelligent estimates similar to those discussed for illiquid investments below. Such estimates should be clearly marked and subject to independent review. **Transferred-in prices distort the longer-term investment returns and should be used only in the absence of alternatives.**

**Use, highlight and review estimates of current value for illiquid investments.** Investments in private equities, structured products, seldom-traded bonds or other illiquid investments should contain the financial services firm's best current estimates of market value. Such estimates should be clearly highlighted and explained, and should be subject to independent review by the firm's auditors and regulators.

**Finding such information can be difficult.** We recognize the practical difficulties in finding information on illiquid investments. Such difficulties, however handled, should not slow down the important process of proceeding with performance reporting on the bulk of investor portfolios.

**Don't exempt scholarship funds.** Group scholarship funds are just one of a host of special cases that will arise that present particular challenges. All performance reporting is complex. Complexity should not be a reason for depriving investors of crucial information to aid in their decision-making.

**Time periods and frequency of reporting.** We endorse the use of periods covering 1, 3, 5 and 10 years, as well as from inception. Regulators should consider adding a semi-annual performance report once the current system is up and running, with the eventual goal of moving to a quarterly performance reporting system.<sup>6</sup>

**Highlight the annual year-end return for ease of comparison.** The revised form currently highlights the “from inception” number. We would prefer to see the annual return at year end highlighted, as such a number is more easily compared to other available investments and to benchmarks.

**Push to extend reporting requirements to similar investments.** We recognize that the Proposed Instrument does not cover investment products like GICs, other bank products, Canada Savings Bonds, and all insurance-related savings products. We propose that the CSA set the stage for full disclosure relating to all types of products.

**Transition – a sense of urgency is required!** The questions of cost disclosure and performance reporting have been tabled by many since well before the Fair Dealing Model of 2004. The Investor Advisory Panel believes that the proposed two-year transition period is too long. One year should be more than adequate for all financial services firms to implement these proposals on mainstream investment products. Exempt, illiquid or unusual investments might take a longer, but hopefully no more than the original proposal of two years. **Excessive delays in implementation will undermine investors' interests.**

**Enforcement is important.** Once the Proposed Instrument is enacted, the CSA must ensure timely compliance. We recommend that the CSA consider a significant penalty be imposed on firms which fail to comply on a timely basis with these changes.

### **(c) Benchmark Reporting**

The Proposed Instrument requires financial service providers to explain benchmarks, their uses and limitations. It permits the use of benchmarks without endorsing or requiring them.

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<sup>6</sup> The United Kingdom requires semi-annual performance reporting to retail investors. See *Conduct of Business Sourcebook Instrument 2007*, S.I. FSA 2007/33, s. 16.3.2, online: <<http://fsahandbook.info/FSA/html/handbook/COBS/16/3>>.

**Benchmarks are important.** The Investor Advisory Panel believes that benchmarks can allow meaningful comparisons of investment returns. Investors need to understand how comparable investments performed, and what risks were assumed in order to generate their investment returns.

The public policy objective should be: to enhance investors' understanding and encourage them to seek out additional information; and, to redress the information imbalance between financial services providers and their customers. Benchmarks have an important role to play in furthering that goal.

**Benchmarks are hugely complex.** Yet the proper use of benchmarks is a demanding and complex science. Should benchmarks be tailored to an individual's asset mix? How should foreign assets and foreign currencies be handled? An over-simplified benchmark can be mathematically incorrect and provide a distorted comparison. Timing differences in recording client purchases and sales can result in differences between the dollar-weighted and time-weighted holding period returns for a client relative to a simplified benchmark. The misapplication or misunderstanding of benchmarks could lead to an unintended lack of confidence in all provided figures.

**Benchmarks can educate – and confuse.** Given low levels of financial and particularly investor literacy, it should not be surprising that many investors find the entire question of benchmarks quite confusing. We understand that about half of the respondents to the OSC's Brondesbury survey of 2,000 investors misunderstood the simplified presentation of benchmarks in the two-page performance report. That two-page report included a laudable attempt to explain benchmarks in simple, direct language and to restrict their use to three simple measures for a risk-free rate, Canadian bonds and Canadian stocks.

We encourage regulators not to back away from the use of benchmarks altogether despite the confusion that they may cause. Intelligent use of even simplified benchmarks could lead to a richer discussion between investors and their advisors, or prompt the investors to learn more about benchmarks and about investing in general.

**Further study of benchmarks is urgently needed.** We call on the Canadian Securities Administrators to undertake additional research on the use of benchmarks to enhance and deepen the impact of performance reporting.

### 3. CONCLUSION

The Investor Advisory Panel endorses the steps proposed by the CSA regarding performance reporting and cost disclosure in the Proposed Instrument. While we have some concerns with the

specifics of the Proposed Instrument outlined above, we here indicate our overall support for it. The Proposed Instrument is long overdue; any delays in its implementation would undermine investors' interests.

Yours very truly,

The Investor Advisory Panel

Anita Anand, Nancy Averill, Paul Bates, Stan Buell, Lincoln Caylor, Steve Garmaise and Michael Wissell