Kenmar Associates

Dedicated to Investor Protection

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Comments on OSC Notice 11 -766 Priorities for fiscal year ending March 31, 2013
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Kenmar Associates welcomes the opportunity to comment on the PROPOSED Statement of Priorities (SOP) . Kenmar is an Ontario- based privately-funded, not for profit organization focused on investment fund investor education via on-line papers hosted at www.canadianfundwatch.com.
Kenmar also publishes ***the Fund OBSERVER*** on a bi-weekly basis discussing retail investor protection issues primarily for investment fund investors. An affiliate, Kenmar Portfolio Analytics, assists, on a no-charge basis, abused investors and/or their counsel in filing investor complaints and restitution claims.

In our view, the *primary* purpose of securities regulations and regulators is to protect retail investors. Specifically, we urge the OSC to tighten up the definition (s) of suitability (and unsuitability), definitize and increase the professional qualification requirements of persons permitted to provide investment advice and prohibit a controversial and risky scheme to permit adviser incorporation. Incorporation will add risks and costs for investors and should be outright banned Other items on our priority list include financial pornography (false and misleading marketing and sales materials (especially mutual fund ads) , excessive and inappropriate leveraging particularly in the mutual fund industry and repressive privacy terms and conditions in bank -owned mutual fund dealer Account Agreements.

Recent high profile scandals such as non-bank ABCP , and numerous Ponzi schemes, advisor fraud, online scams coupled with changing demographics (seniors, pensioners and retirees) suggest that investor protection demands HIGH priority attention . Surprisingly, there does not appear to be any statistics published by the OSC regarding estimated dollar losses incurred by Ontario retail investors . A November 2009 report by PricewaterhouseCoopers found that Canada was the fourth most fraudulent nation in the world -- behind Russia, South Africa and Kenya.
http://www.pwc.com/gx/en/economic-crime-survey/download-economic-crime-people-culture-controls.jhtml

With the evolution of the investment markets, a multitude of complex structured products and the volatility in today's markets, investor risks are much greater than ever before. The 2008 financial crisis is a powerful indicator that should be heeded. Investor losses

have reached epidemic proportions in the last 5 years with horrific consequences to individuals and the Canadian social system. Abuse of the elderly in particular continues to emerge as a serious issue- we did not see any specific initiatives in this area. We strongly recommend the establishment of a Branch dedicated to seniors issues such has been implemented at the SEC and elsewhere.

In this dangerous environment, the OSC should adapt its priorities to laser focus on specific retail investor issues. In general, it appears to have done so . In this Comment letter we hope to constructively comment and elaborate on these priorities based on our experiences.

For the 2012/2013 priorities, we note that the Commission has identified five strategic goals to achieve but no specific metrics or milestones are provided. It is definitive actions that will speak louder than words ["promote", "focus", "monitor" , "examine" should be replaced with action verbs] .We would like to see publicly disclosed specific action plans and metrics for each listed priority that will turn broad investor protection goals into measurable reality ["***What gets measured gets Done"***-Jack Welch, former GE CEO].

Our comments on the priorities are as follows:

Goal #1 -- Deliver Responsive Regulation

We are not sure of what to make of the OSC's intent to be proactive in pursuing regulatory standards that discourage or pre-empt regulatory arbitrage,.We hope it does not mean lowering investment industry standards to those found, say, in the insurance industry .

- We agree with facilitating shareholder empowerment in director elections by advocating for the elimination of slate voting, the adoption of majority voting policies for director elections and enhancing disclosure of voting results for shareholder meetings. We would like to see a rule requiring that management presentations and shareholder Q&A be considered a part of the formal AGM meeting and duly minuted.

- We concur with reviewing the reliability of the proxy voting system ; in particular the issues raised by securities lending by mutual funds and others ("empty voting") .

- We are glad to see the OSC is reviewing the logic behind the accredited investor and $150,000 exemption. Our recent Comment letter provided our views on this matter.

- We are supportive of a research project on the cost of ownership of mutual funds in Canada, identifying investor protection and public interest issues. We note however that much research already exists .It is not clear what will occur after the research is completed. Fund governance has been a critical

investor issue since at least 1995 with the issuance of the Stromberg reports. The Norshield, Portus and the Norbourg meltdowns highlighted once again the need for independent fund governance boards and the maintenance of robust regulatory provisions and prohibitions. We are also deeply concerned that National Instrument NI 81-107 Independent Review Committees effectively allows the elimination of long-standing prohibited practices if the IRC agrees. The Irc approach should be re-examined to assess whether it really has made a positive difference . (Canadians pay some of the highest mutual fund fees in the world, no doubt in part due to lack of fund governance and the commission-based model of "advisor" compensation).

- Kenmar agree that a re-evaluation of the regulatory and operational requirements associated with closed-end funds is worthwhile given their growth and reach.

- We encourage the Commission to research and analyze increasingly complex financial products such as Structured products, levered/reverse ETF's, CFD's and SPAC's. These need to be better regulated and their distribution channels better understood. More generally, we recommend the OSC heed the advice of investor advocates when permitting the unleashing of risky products onto the retail market and their suitability for Main Street investors. In this regard ,we add parenthetically that allowing shorting by mutual funds adds undue risk and complexity to a plain vanilla product. We opposed this rule change as not being in the Public Interest.

One chronic problem –non-standard, misleading NAAF forms within the industry . If the form and KYC process were re-engineered, a large number of investor complaints could be avoided. It is core to the client-dealer relationship. Our suggestion is to mandate the use of Investment Policy Statements in cases where professional advice (as opposed to sales) is being provided.. This would translate the KYC into a operational,auditable document. We recommend this to be a high 2012/2013 priority.

Goal #2 -- Deliver Effective Enforcement and Compliance

The OSC objective of pro-activity is welcomed. Timely and appropriate compliance oversight and enforcement actions are integral to preventing harm to investors and fostering investor confidence in the capital markets . We believe that developing and/or enhancing guidance and practices for boards, auditors and underwriters to address principal concerns will be cost-effective and prevent many problems. The TSX listing requirements applicable to Emerging Market issuers do need a thorough review. We would add that the use of reverse takeovers to obtain listings also needs a careful re-assessment.

- The plan to conduct compliance reviews of website and marketing disclosures should not be limited to smaller issuers. In particular we urge the OSC to review mutual fund print ads and websites.

- To achieve more timely (and hopefully more transparent) enforcement action by reducing timelines for completing investigations and initiating regulatory proceedings will require more than promotion. It will require process re-engineering. If done properly, vast improvements in cycle time can be achieved. We do not however concur with a " no contest" approach to speeding prosecutions as explained in our Comment letter on this subject.. A review of the OSC 2011 Enforcement Report suggests there are significant issues with illegal distributions and fine collection . Improving fine collection will improve deterrence/credibility and provide additional cash for investor protection initiatives .

- The plan to increase the use of stronger enforcement mechanisms and increase quasi-criminal prosecutions is in tune with Main Street expectations. We believe an enhanced whistleblower approach with financial reward will be of great assistance.

The penalties imposed on offenders are regarded as nothing more than wrist slaps. The penalties contained in settlement agreements often pale in significance to the gains made by those involved in wrongdoing. In fact, as recently reported by the OSC, many of the fines imposed on individuals are not paid since registrants leave the industry/country or declare personal bankruptcy. We strongly suggest that fines be increased and punitive damages be added to the tool kit. Moreover, dealers should be held accountable for any unpaid fines by their employees/agents – this rule change would result in an immediate change in dealer behaviour . The same dismal collection situation applies to the SRO's who collect somewhere between 20 and 30 % of fines levied and publicly announced.

Further, retail investors are more concerned about **investor restitution** than regulatory enforcement and compliance. The Commission should utilize its existing powers to order fines, disgorgement and compensation and apply them for the benefit of victims or if inadequate, pro-actively promote legislative changes. The status quo is just not working – we recommend investor compensation be a high priority .[FAIR Canada recently submitted comments on a consultation by the Autorité des marches financiers (AMF) regarding compensation for consumers of financial products and services. In its comments, FAIR Canada recommended that the compensation system be structured so as to cover losses due to firm fraud and/or insolvency, through fidelity insurance, and existing (or new) insolvency compensation funds along with fraud coverage being provided by the Financial Services Compensation Fund (the "Fund"). FAIR also recommended that all registrant firms be covered by a compensation fund . SIPA has taken this same position for over a decade.]

Goal #3 -- Deliver Strong Investor Protection

The Key initiatives the OSC plans to undertake to champion investor protection are welcomed as follows.

- The OSC Office of the Investor should help establish a stronger investor focus and understanding of Main Street. This Office will finally give retail investors a voice but it must be carefully harmonized with the IAP. We very

much like the idea of expanding communication with the Investor Education Fund We also highly recommend an Annual Town Hall meeting. We respectfully refer the OSC to ***Canada Steps Up***, a comprehensive research report by the *Task Force to Modernize Securities Legislation in Canada* http://www.tfmsl.ca/ Volume 6 contains an especially relevant paper by Prof. Julia Black**, *Involving Consumers in Securities legislation in Canada.***

- The plan to re-evaluate the adviser-client relationship to "consider whether an explicit statutory fiduciary duty or other standards should apply to all advisers and dealers in Ontario" is one of the highlights of the 2012-2013 priorities. As the CSA brochure " Working with a Financial Advisor " so aptly points out , *" Ultimately, you have to make the decisions and live with the results."*. In Feb. 2012, the UK Financial Services Consumer Panel published a briefing paper on consumer responsibility, which maintains that it's not reasonable to expect consumers to understand the detail of highly complex financial products and services, and the risks they create. We urge the OSC move away from the transaction model and pursue a fiduciary or "Best Interest" regime for advisors without undue delay. This is well underway in the UK, US , Australia and in other jurisdictions We do hope the investor advocacy community and OBSI will be consulted before any papers are released. Our view is it is unfair and unethical to deliberately mislead customers into a false sense of trust and confidence, using a false license (labeling oneself with a title such as "advisor" or "financial planner" for which no actual license exists) , and false pretenses of what the real business relationship truly is (salesperson) while purporting to deliver some kind of professional advice. Accordingly , we recommend that the OSC prohibit (and diligently enforce) the use of any title that misleads investors as to the intent, competency or qualifications of the dealer representative-only registered titles should be permitted.

- The OSC's initiative to help investors get the necessary information to enable them to make better investment decisions is good but the information must be provided at or before the point of sale.:

    - We are relieved to see that there will be a re-examining of the risk disclosure in the 'Fund Facts' (FF) as part of the Point of Sale initiative . We have conducted extensive research on FF and are of the firm conviction a lot more than risk disclosure needs rework. We are more than willing to meet Investment Branch staff to make the document better and safe for use. We rate this as a high priority given that Canadians have some $700 billion of their savings invested in mutual funds.

    - The initiative establishing rules that ensure investors receive from their dealers/advisers reports on the ongoing costs and personal performance reporting of their investment accounts should be put

very high on the priority list. Once fees , returns and a benchmark are presented, the investor will, for the first time, be better positioned to determine the health of his financial plan and assess the value of the advice provided. The fees , performance and benchmark should be integrated into monthly/quarterly client statements and not provided as stand-alone metrics.

- We applaud the intention to work with OBSI and the CSA to support a sustainable and robust system of complaint handling for investors. It is key however that their approach to loss calculation and systemic issues be maintained at world standards .We also feel strongly that OBSI decisions should be binding on dealers. The governing OBSI Framework should be re-assessed and the ToR reviewed for congruency and adequacy. It appears as if this Framework Agreement has no OSC or CSA ownership. We therefore recommend that a individual be assigned and named to provide this oversight and liaison. OBSI is a invaluable public service entity that merits regulatory oversight and support. The OSC should consider putting Seg funds and PPN's under the OBSI mandate.

- We recommend that the OSC's own complaint handling system be upgraded. As it stands now, the OSC does not undertake to provide a definitive response to a complainant. ISO 10003 should be used as a guide in redesigning the OSC's complaint handling process.

We concur with the need to assist and protect investors is critical given the availability of complex products, greater reliance on the exempt market for distribution, and potential intermediary conflicts-of -interest in the distribution of products (and the provision of "advice").

- A number of advocacy inputs have been made re the exempt market. It is a market that appears to be too loosely regulated. In any event ,consideration should be given to establishing an SRO and compelling OBSI participation by exempt market dealers (and we add parenthetically RESP Scholarship Plan Trust dealers).

- We certainly support re-consideration of the current regulatory requirements governing shareholders' rights plans in view of contemporary market and governance developments. Corporate democracy is a socio-economic issue of vital importance to all Ontarions

Although disclosure is stressed by the OSC as a potential solution to conflicts -of-interest, academic research on disclosure has found both positive and negative effects. In *The Burden of Disclosure* , the researchers present 3 experiments that reveal a previously unrecognized perverse effect of disclosure: Disclosure of an adviser's conflict-of-interest can decrease investors' trust in the advice while simultaneously increasing pressure to comply with that advice. This compliance pressure comes from two mechanisms: (1) recipients fear signalling distrust of the adviser, and (2) recipients feel an increased

pressure to help their adviser when the adviser's personal interests have been disclosed. Hence, disclosure can place a burden on those it was supposed to protect. Download paper at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1615025Additionally, advisers may feel morally licensed to offer biased advice once they've disclosed all the issues and conflicts-of-interest. Thus, disclosure can lead advisors to give even more biased advice to retail investors once they have disclosed their conflicts- of- interest!We believe fiduciary obligations, better enforcement, increased sanctions and meaningful fines (that are collected!) will be more effective in protecting small investors.

Goal #4 -- Run a Modern, Accountable and Efficient Organization

We are delighted to hear that the OSC will pursue its mandate and efforts to improve the efficiency and effectiveness of its operational and policy work. Our comments are:

- Prioritization and coordination will lead to better outcomes It is vital that the retail investor voice be heard as priorities are set.

- Establishing an Emerging Risk Committee that will develop a framework for the identification and analysis of risk is OK a long as it's role goes beyond framework development.

- The HR initiative will need a robust performance measurement and compensation system. It is important to provide a safe workplace where staff are empowered to demonstrate their skills. Kenmar believe that a comprehensive Human Resource review should be conducted to ensure that OSC resources are adequate and perhaps more importantly, that staffing competencies, experience and diligence are aligned with the articulated priorities. Without the right people, culture,allocation of resources and leadership the OSC will not achieve its objectives. We encourage the OSC to set investor protection goals for each staff person and provide meaningful recognition and reward incentives for accomplishment and disincentives for failure.

- We cannot comment on the pros/cons of improving the adjudicative process by moving to electronic hearings. As long as integrity is maintained, we are fine with this.

- Any productivity improvement plan will need a project manager and a key set of operational target metrics. This is what we recommend to ensure goals are achieved on time.

The enhanced use of TIP lines, financial incentives for truth tellers (whistleblowers), integrated information sharing (subject to the Privacy considerations) and scheduled, formal meetings with the FSCO/IIROC/MFDA/AG /RCMP IMET/OBSI et al could prove cost-effective tools for enhanced, timely investor protection and regulatory efficiency .

The OSC's priority list is ambitious and well correlated with identified retail investor needs. To maximize the use of Canada's other Securities Commissions, why not partition the load so more things get done faster? Such collaboration will optimize the use of resources and build stronger relationships between entities. We expect that the AMF would do a fine job on derivatives and investor restitution. Perhaps the NBSC could tackle leveraging issues. The BCSC would no doubt do exceptional work on the foreign listings problem. The ASC could easily handle the OBSI repair opportunity. On projects such as corporate democracy and fiduciary duty/advisor incorporation a team approach could be very effective. Such creative ways of working together will provide " more regulatory bang for the buck".

Goal #5 -- Support and Promote Financial Stability

The OSC's aim to build the capabilities required to play a more active role in assessing risks to its own objectives and to financial stability arising from the interaction between securities and other financial services activities is admirable. In particular we like the plan to increase cooperation by developing more formal and regular working relationships with the CSA and other financial service regulators in Canada and internationally

- In addition to working with IOSCO and the CSA Systemic Risk Committee to implement IOSCO Principle 6 regarding systemic risk, and Principle 7 regarding perimeter of regulation, we suggest adding investor advocacy entities, consumer groups and seniors associations.

As part of its liaison with other regulators we recommend that the OSC investigate the experiences of other jurisdictions with respect to the use of IFRS and the elimination of embedded sales commissions in products (the DSC sold mutual fund has caused retail investors much grief over the years).In the case of the advisor-client relationship challenge, the OSC need look no further than Quebec for a good benchmark.

In addition to the five listed priorities we suggest the following as well, all of which support the five primary goals:

1. **Restructure the Investor Advisory Panel** along the lines of the Australian Securities Commission and the U.K.'s FSA should be established. It should have a separate mandate, staff and adequate funding for research. It should not be restricted to commenting on OSC proposals. This revised IAP structure would assist investors in having a real voice at the OSC as regards regulation, issues, priorities, goals and operations. We urge the OSC to improve the current Panel's limited mandate without undue delay ensuring that adequate funds are provided for in operating budgets .Dr. P. Reeve has articulated the areas for improvement – these can be found at http://files.me.com/pjreeve/w55ab5

2. **Improve Enforcement focus and culture:**The unacceptably long time to bring firms and individuals to justice and the lack of results is well documented. Cases like Bre-X,

Hollinger, Nortel , Livent and SINO-Forest hardly give investors confidence in the regulatory enforcement process. The $32 billion non-bank ABCP debacle certainly shook investor confidence further with the modest fines imposed. Were it not for the courageous leadership of investor Brian Hunter aided by heroes, the investors would not have been compensated. Regulators stood on the sidelines as small investors fought pitched battles with the banks and securities dealers. This deficiency was identified by the Standing Committee on Government Agencies as a deficiency of the OSC .The Committee's Report noted *"In this respect, we have some concern that the Commission may have adopted a narrow interpretation of its public-interest jurisdiction in responding to the ABCP crisis. "*It is therefore essential that the OSC conduct a complete enforcement process re-engineering and staffing analysis to ensure that justice is effectively applied in a timely, effective and fair way.

3. Engage the Public: . We recommend that the OSC *pro-actively* seek out individual retail investors to participate in all OSC panels, studies and focus groups. Investors/ advocates should be given the same access as industry participants. The OSC's roles and responsibilities are not understood by the public and there is a strong belief that policies and regulations are unduly influenced by industry participants. The OSC Web-site should be overhauled to make it more investor- friendly and useful. More topics on education and awareness, investor research and Case studies should be added. The site design should be enhanced to provide better navigatability and search capability for the retail investor. An email ALERT system such as that employed by the Australian Securities Commission ["FIDO"] can be used to economically reach subscribing investors, consumer organizations and advocates regarding timely topics of import and concern to small investors. The OSC Stakeholder Survey should be reconstituted to provide a polling of retail investors on a broad range of topics. We believe the results will be illuminating and helpful.

4. Promote a change in the Ontario Limitations Act We urge the addition of a priority goal that the OSC convince the Ontario AG that the 2 year period in the Limitations Act is oppressive, unworkable, not in the public interest and re-baseline it at 6 years as before. <u>This is a MAJOR investor protection priority with small investors, seniors and retirees.</u>

5. Review the Regulatory exemptions process Regulatory exemptions cause considerable concern. These are generally not commented upon by the retail investor community, the very population that is most affected by the exemption. In most cases we find that the exemptions effectively nullify sound protective measures that investors wrongly believe are in place. <u>We recommend an overhaul of the approach so that original protective rules are not clandestinely removed via opaquely disclosed exemptions.</u>

6. Bring closure to MFDA Report on compensation fund for portfolio managers
Back in March 2011 ,the Mutual Fund Dealers Association of Canada released a report *Regulatory Gap in Canada – Fund Managers: The Need for a Compensation Fund* calling for the creation of an investor compensation fund covering fund managers and portfolio managers. There are already contingency funds that cover investment dealers and mutual fund dealers, and the MFDA report (which was written back in 2008)

recommends that there should be one for fund managers, too. The report points out that there is $225 billion of client assets, which have been purchased through MFDA dealers, but are held at the fund managers themselves, and so not covered by the dealer compensation fund. This number is significantly higher when all the assets held by all fund managers and portfolio managers is considered,As a result, it concludes, "Market confidence and efficiency, fairness, and, above all, suitable investor protection demands compensation fund coverage apply more broadly". The OSC should examine the issue and release a definitive report .Ref MFDA Bulletin 0469-P
http://www.mfda.ca/regulation/bulletins11/Bulletin0469-P.pdf

7. **Evaluate risks inherent in IFRS** It is a complete mystery to us how analysts, regulators and dozens of directors, the media, the so-called self-regulating organizations, etc.. WILL NOT ALLOW TO GET THROUGH THEIR HEADS that IFRS reporting is extensively DEFECTIVE because of all the freedom of choice to report practically any numbers that has been granted by IFRS to corporate management. A number of respected commentators including forensic accountant Al Rosen, have commented on the fact that directors and auditors have been permitted to cop out under Canadian laws and many court decisions. There are those who strongly believe that a major DE-REGULATION is contained in almost every page of IFRS. We implore the OSC to address these concerns by the publication of a Due Diligence review of these controversial standards and identifying the inherent risks.

8. Fix the bias in SEDAR Filings Access The System for Electronic Document Analysis and Retrieval (SEDAR) is a mandatory document filing and retrieval system for Canadian public companies that is operated under the auspices of the Canadian Securities Administrators. The idea is to ensure that all the documents are accessible to improve investor awareness and promote confidence in the transparent operation of the capital markets. But there are two SEDARs operating in Canada.:

- The first is available to fee-paying subscribers to SEDAR-SCRIBE where the information is virtually in real time. Typically Reuters or Bloomberg provide the information to its subscribers as part of a data feed;
- the second is available on SEDAR's web site- the next day.

As we have repeatedly noted , having two access levels to company filings on SEDAR is wholly inconsistent with the intent of securities regulations to foster fair and efficient capital markets and provide all investors with equally timely, accurate information on which to base investment decisions. The subscription system breaches the objective of " a level playing field".It's time this incongruity is fixed so that all Ontarions are treated fairly.

SUMMARY and CONCLUSION

By nearly any most measure, 2011 was not a good year for investor protection. Our 2011 Investor Protection Report highlighted numerous breakdowns , missed opportunities to protect retail investors and unfavourable trends.

There is overwhelming evidence that regulatory reforms are urgently needed .Investor protection is not sufficiently robust under the current regulatory regime. Workplace pensions are no longer the norm in the private sector as companies continue to scrap predictable Defined Benefit plans. Ottawa is essentially pushing an aging population into the arms of the financial services industry. RRSPs, TFSAs, RESPs and the newly created pooled registered pension plans (for employees of small businesses) all encourage private savings, typically managed by financial advisers. People are living longer. If the current egregious situation prevails , there will inevitably be a tremendous call on already burdened government social/pension programs and civil unrest (e.g. the OCCUPY Wall Street movement). .

We would like to take this opportunity to recognize www.Getsmarteraboutmoney.ca website initiative and the OSC Inquiries Service. These are functioning well and merit nurturing and increased stable funding.

Kenmar agree to public posting of this Comment Letter.

Kenmar would be pleased to discuss our comments and recommendations with you in more detail at your convenience.

Respectfully,

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