THE INVESTMENT FUNDS INSTITUTE OF CANADA
L'INSTITUT DES FONDS D'INVESTISSEMENT DU CANADA

IFIC.CA

VIA ELECTRONIC MAIL: comments@osc.qov.on.ca, consultation-en-cours@lautorite.qc.ca

August 29, 2012

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: Proposed Amendments to National Instrument 31-103: Cost Disclosure and Performance Reporting

We are writing to provide the comments of the Members of The Investment Funds Institute of Canada to the second publication of proposed amendments to *National Instrument* 37-703 *Registration Requirements, Exemptions and Ongoing Registrant Obligations:* Cast *Disclosure, Performance Reporting and Client* Statements (the "Proposais"), published on June 14, 2012.

Our Members support the general principles of the Proposais to provide clients with clear and

transparent reporting on performance and costs, and welcome the opportunity to respond. In this letter we re-state the concerns raised in our response to the previous draft- that the Proposais are:

- unfair in their treatment of mutualfunds relative to other investment products,
- are costly to implement, and
- fail to provide any evidence of a proportionate benefit accruing to investors from their application.

The CSA's failure to respond to these concerns in the current draft suggests that our position that the rules are inconsistent with securities commission mandates to foster fair and efficient capital markets may not have been fully understood. We spell that out in greater detail in the **General Comments** below. Each of the following tapies is discussed under **Specifie Comments** below:

- Time-weighted vs. Dollar-weighted Performance Reporting;
- Account Reporting;
- Client Statement Format;
- Original Cast vs. Book Cast;
- Inappropriate switches; and
- Duplication with existing ReferralFee Rules

GeneralComments

Unfair Treatment of Mutual Funds in Traiter Commission Reporting:

The CSA acknowledges that the Proposais regarding disclosure of trailing commissions are unfair ta mutualfunds relative to disclosures required for other products.

The Notice states:

> ***"We acknowledge that investment products sold by financial services firms that* are not *under* CSA or *CSA and SRO oversight would* not *have the* same *requirement to disclose their compensation. White we* are *sympathetic, we note that we* can *only* make *rules within* our *jurisdiction. The fact that other segments, including banks and insurance companies, would not be required to comply with corresponding requirements for* non-*securities investments is not* a *reason to reduce the levet of disclosure that we believe is necessary for securities investors."***

We respectfully disagree with the above statement. Investors utilize a broad range of financial products. That broad usage is demonstrated in the following table, taken from ***Investor Economies - Household Balance Sheet- Breakdown of Financial Wealth.*** Mutualfunds occupy 25.5% of the

household balance sheet. This leaves 74.5% of the household balance sheet in ether types of investments.

Household Balance Sheet – Breakdown of Financial Wealth		
	Assets ($bn)	As a% of Financial Wealth
Deposits and Cash Equivalents	1217	40.73%
Equities and Fixed Income	885	29.62%
Mutualfunds	**762**	**25.50%**
Seg Funds	120	4.02%
Other financialassets	4	0.13%
Financial Wealth	2,988	lOO%

Source: Investor Economies, December 2011

These Proposais would mislead investors to believe that there are costs of distribution for mutual funds, roughly a quarter of their portfolio, that are not present for the financial products that make up the remaining three quarters of their portfolio. The unfairness of this is amplified by the tact that distribution costs for mutual funds are already disclosed in ether prescribed disclosure documents provided to the client whereas the distribution costs for many of the ether financial products, including deposit products, are not disclosed at all.

We believe this will result in investors being misinformed and misled with regard to the cost of their investments, with potential inappropriate impacts on their investment choices.

No Evidence that Benefits Outweigh Costs:

White the June 14, 2012 ***Notice and* Request *for* Comments *(the "Notice")*** acknowledges the concerns we have raised in a number of areas, the CSA has chosen not to change the proposais materially. With respect to provisions which the CSA acknowledges will raise costs to industry, and thereby to investors, there is no evidence provided, or attempt to establish, that the benefits of the proposed regulations would outweigh these costs. We do not believe therefore that these Proposais are consistent with the purpose and principle of securities regulation as laid out in securities law.

Section 1.1 of the Ontario Securities Act (the "Act") states that:

> *"1.1 The purposes of this Act are, ... (b) to* foster *fair and efficient capital markets and confidence in capital markets."*

The Act goes on to say in Section 2.1 that:

> *"2.1 In pursuing the purposes of this Act, the Commission* shall *have regard to the following fundamental princip/es:* ..... 6. Business *and regulatory* costs *and other restrictions on the business and investment activities of market participants should be proportionate* to *the significance of the regulatory objectives sought* to *be realized."*

We respectfully note that no quantitative cost-benefit analysis has been disclosed which demonstrates that the business and regulatory costs of the Proposais would be proportionate to the significance of the regulatory objectives sought.

The lack of attention to the matter of costs and benefits is evident in the following CSA response to the issue concerning the disclosure of trailing commissions:

> ***"Most industry comments suggested that requiring registrants to disclose the dollar amount of trailing commissions was* unnecessary, *would be confusing to investors and would result in* a *sizable cast to industry without providing* an *overall benefit. We do not agree. We acknowledge the potential costs to industry, but believe that informing the investing public is worth this cast."***

The above statement regarding costs and benefits is an opinion. There is no consideration of monetized costs or benefits as required by law.

In our response to the first publication of these Proposais, we commented specifically on the significant costs and complex technology requirements for implementation. The CSA- s response has been to provide additional transition time to complete the required changes. This however does not mitigate the acknowledged potential costs to the industry and investors, or illustrate why it believes the provision of the required information, in the form and format prescribed, is worth the cost.

Overlap with Point of Sale Nl81-101 Changes:

As noted above, and in our previous submissions on this Proposai, there is significant overlap with the Point of Sale (POS) disclosure requirements. Disclosure of mutual fund costs, charges and commissions is now required to be made in the Fund Facts document. Components of the Management Expense Ratio, trailing commissions and other fees and expenses related to the product and its distribution are fully disclosed in Fund Facts which will be provided to investors with the implementation of Point of Sale Phase 2.

These changes ta NI 81-101 will ensure that the costs of investing in mutualfunds are fully disclosed ta investors. lt is our view that disclosure of mutual fund fees and commissions should continue ta be mandated through NI 81-101.

We support the clear and simple disclosure of costs and commissions that is in the Fund Facts document. We do not believe it is necessary ta provide the additional disclosure related ta trailing commissions, especially when, for reasons stated above, it will mislead investors, put the mutual fund industry at an unfair disadvantage, and raise costs for the industry and investors for a benefit that is asserted, but not demonstrated, ta be "worth the cast".

S ecific Comments

Performance Reporting must include Approximation Methods:

The CSA has proposed a single method for performance reporting ta promote consistency across registrants. We note, however, that the SROs, who are mandated ta regulate the activities of dealers, have not favoured prescribing a single method of calculation for performance reporting. They have acknowledged the need for flexibility in recognition of different investor needs. A competitive marketplace is sufficient ta ensure that registrants will choose the best method of performance reporting for their clients.

The CSA has not taken this view. lt has proposed the dollar-weighted methodology, believing it ta most accuratety reflect the actualreturn of a client's investments after accounting for deposits and withdrawals over the performance period. However this choice does not take into account the fact that not all investors are identical. Sorne investors may be more concerned with the actual performance of the underlying investments sa they can decide how ta allocate future investments. Others may be more interested in annualgain/loss information.

Although performance reporting has not been mandated ta date for mutual fund dealers, many dealer registrants have already imptemented performance reporting measures using methodologies best suited ta their clients' needs. These include time-weighted and dollar-weighted methods, as well as a common methodology known as Modified Deitz, which approximates the more computationally intensive internat rate of return dollar-weighted methodology. Sorne of these registrants have gone beyond regulatory requirements ta provide the reporting method that best suits the needs of their clients. lt would be unfortunate ta bring additionalcosts ta these registrants by imposing a standard not wanted or confusing ta their clients.

Offering the option for registrants ta provide more than one performance measure is not a viable option due ta operational challenges. Registrants will have ta duplicate their statement production processes which will impact the timeliness of information, increase costs that will ultimately be borne by investors, and increase opportunities for error and confusion. Mandating a single performance measure for registrants not currently using that method will have the same

operational challenges and cost implications without necessarily providing a corresponding benefit to investors.

We recommend that the CSA provide registrants with the option of choosing a recognized time-weighted or dollar-weighted performance reporting methodology as long as the dealer clearly discloses to the client the reporting method and explains what the reporting method represents. If the CSA chooses to mandate a dollar-weighted methodology we would like confirmation that commonly used dollar-weighted methods, such as Modified Deitz, would comply with that requirement and that approximation methods in calculations are permitted.

Account Reporting:

The Proposais as drafted do not give a clear definition of account. A dealer may define an account according to the number of KYC forms they have for the client. In client name a mutual fund company will have an account for each client that holds funds with them. Under these two definitions the number of accounts in the industry will differ. If dealers are required to aggregate across client name accounts there will be enormous operational challenges to aggregate the quantity of information as well as maintain data integrity. Clarification on the definition of account is required for the industry to assess the operational challenges and cost implications of cost disclosure and performance on a per account basis.

Client Statement Format:

We note the importance of providing investors with clear and meaningful client statements. Within the proposais contemplated in paragraph 14.14 the CSA has suggested that these statements maintain distinct sections for transactions, client name accounts, and nominee held accounts. We do not see any value in providing investors with transaction information that is separated from their related accounts. For many registrants this requirement may add additional costs for statement reprogramming, without any apparent investor benefit, and may lead to actual confusion for the clients.

Original Cost vs**. Book Cost:**

We recognize the importance of g1v1ng investors accurate cost disclosure. We believe that prescribing one method in preference to the other, however, does not accomplish that goaland may invariably lead to client confusion. Our members have different approaches to the use of original cost or book cost.

Sorne members have concerns with mandating original cost for the account statement as they do not believe original cost represents an accurate cost method as it does not include such items as return on capital, distributions or dividends, and is not the most favourable way of reporting on tax-advantaged items such as mortgage-type securities.

Other members faveur original cast as it gives their clients information about how their investment has performed over time or recognizes that calculating tax is the responsibility of the client's tax advisor. On the issue of reporting cast after a transfer there is the potential for confusion and errors in calculating tax payable for investors if market value at the time of the transfer is used as book value. Original cast addresses the issue of dealers not having accurate book costs on transfers. 'Amount invested' or 'transfer in cast' are better terms than 'book cast' for transfers. Registrants should have flexibility on how ta manage the issue as their clients have different reporting needs.

We recommend that the CSA provide dealers with the option of choosing between original cast and book cast as long as the dealer discloses clearly ta the client the reporting method and explains what the reporting method represents.

Inappropriate Switches:

The section on inappropriate switches in the Companion Policy is another example of duplication and bias towards the fund industry. The issue of inappropriate switches is already dealt with in SRO rules and there is regulatory guidance on the issue. The Companion Policy is a frequently consulted document and applies to all registrants sa it is inappropriate to single out mutual fund dealers and to comment on a single transaction. The description of switches is incomplete and potentially misleading as it only highlights a few forms of switches. We recommend that this section of the Companion Policy be removed.

Duplication with existing Referral Fee Rules:

The requirement to report noted in CP 31-103 on paragraph 14.15(1)(g) on referral fees is problematic as referral fees are not always associated with a specifie client account, which will make it difficult to disclose on an annual basis on account statements. The requirement ta disclose referral arrangement fees is already covered in Division 3 of NI 31-103. Prior ta paying any referral fee, written disclosure of the method of calculating the referral fee and, to the extent possible, the amount of the fee is already required disclosure under 13.10 of NI 31-103. For example, a dealer may not have a client account but receive a fee from an IC/PM to whom the client has been referred. There is also a potential privacy issue as referral fees may be calculated on a percentage of a client's assets held in the account of the firm ta which the client was referred. Clients may not want the mutual fund dealer ta know or report on how much is held in the client's assets at the other firm. MFDA rule 2.4.2 also requires disclosure to the client of the referral fee and an example or explanation to the client asto how the fee is calculated. lt is our submission that the requirement to report on referral fees on an annual basis creates complications for registered firms with no apparent additional benefit ta a client, given that disclosure of referral fees is already required under NI 31-103 and the MFDA rules.

We also note that it will be difficult to report on all amounts contemplated by the proposed paragraph 14.15(1)(g) which are not specifically associated with an account. We ask that these amounts be specifically excluded from 14.15(1)(g).

Conclusion:

We urge the CSA ta reflect on its recognition of the unfairness issues towards mutual funds and work towards a common performance reporting and cost disclosure practice across financial products that do not disadvantage individual industry sectors.

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1 would be pleased to discuss our comments in greater detailplease contact me directly by phone at 416-309-2300 or by emailat jdelaurentiis@ific.ca.

Yours truly,

The Investment Funds Institute of Canada

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