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Comments on Proposed Amendments to NI 31-103

Thank you to the CSA for allowing me to comment on the above initiative. I would like to begin by clarifying that the comments that follow are my own and are therefore not necessarily shared by my employer, Burgeonvest Bick Securities Limited (BBSL). Account performance and cost reporting are two issues where I have offered my input in the past and I am happy to do so again.

By way of background, I was a member of one of the advisor transition working group that offered input as part of the OSC's Fair Dealing Model – the precursor to this initiative. The primary objectives there were: improving cost, conflict and compensation transparency, achieving clarity when opening accounts and standardizing meaningful performance reporting.

While I applaud that industry is moving forward on some of these important matters, I cannot help but lament that it is taking so long and that the reforms being proposed are so modest. Some time ago, I came across a quote from Tommy Douglas that I believe is appropriate: "Canada's governing parties almost never undertake real reform, reform that is likely to upset their private enterprise financial backers, until and unless they believe that they will be hurt more for not doing the right thing than for doing it. I cannot help but think that the same goes for Canada's Securities Regulators and SROs.

I have coined an acronym for what I believe needs to be done to truly "professionalize" the financial services industry. That acronym is STANDUP- Scientific Testing And *Necessary* Disclosure Underpin Professionalism. In essence, it means that true professionals disclose all material facts in order to help retail consumers come to a self-interested decision based on their consideration of the material elements of the best evidence available. It should be obvious, therefore, that I support the general thrust of this initiative.

While the proposed reforms regarding point of sale disclosure are worthwhile, they simultaneously miss a number of opportunities to genuinely inform end-users. I would depict the concepts as being "baby steps" when far more radical moves would be preferred. One need only look at the reforms being implemented in the UK and Australia to get a feel for the order of magnitude I'm talking about.

Performance Reporting

The issue for comment regarding cost information in performance reporting is, ironically, something that I have no truly strong (operational) opinion about. I do, however, have some strong opinions about costs and cost disclosures in general.

To begin, it has been my experience that when a client switches firms, old ACBs might not reliably follow (if at all). Has proper consideration been given to how this might be addressed going forward? Once the above issue is addressed, I believe percentage returns over 1, 3, 5 and 10 years - and since inception (with inception date noted) would be appropriate benchmark timeframes. I might add that my perception is that no firms want to meaningfully disclose either client rates of return or client returns relative to appropriate benchmarks because the industry is presumptively predicated on “adding alpha” (i.e. outperforming the market) as a means of justifying it’s collective fees. Once the tyranny of a normal distribution in a negative sum environment is quantified for all participants to see, there are a number of advisors and firms who will be “outed” regarding their inability to deliver on their implied (but not definitively demonstrated) value propositions. The important thing here is that there is one single, simple, consistent rule be enacted that applies to all participants.

I find it both ironic and instructive that discount brokerages like RBC Direct Investing already provide tools much like what is being contemplated here. If poor performance relative to a benchmark can get Do-It-Yourself investors to feel inferior (and possibly move to higher margin full service offerings), that fine... but if those same deep pocketed and vertically-integrated firms (like RBC) were to offer similar reporting to their full services clients, well... that would likely be *awful* in their eyes. Demonstrated underperformance might cause clients to move from full service back to a discount model. Full, true and plain disclosure is all fine and well in principle, if it cannibalizes a higher-margin silo and smashes a value proposition in the process, that is quite another matter! At any rate, as soon as one firm does it, it explodes the myth that technology limitations preclude it from being done (by anyone – at all). What is more, evidence continues to mount that most managers are not, in fact, “adding alpha” as they implicitly claim to: <http://www.spindices.com/assets/files/solutions/SPIVA-Canada-Year-End-2010-FINAL.pdf>

General Comments About Cost

I recently completed the CSI’s course: “Ethics, Regulation and the Professionalization of the Advisor”. As such, I note that NI 31-103 will require registered firms to “identify each potential and actual conflict of interest to a client while dealing with such conflicts in a fair, equitable and transparent manner”. To my mind, nothing fits that description more obviously than product cost.

It has long seemed to me that there are double standards regarding proper disclosure as they pertain to different stakeholders and that the industry. One thing that I believe would go a long way in eliminating confusion would be consistent nomenclature. The most obvious example in this regard is trailers. I’ve seen many people refer to them as “fees”. I’ve seen many others refer to them as “commissions”. Whichever it is, surely to goodness, they cannot be both and they cannot morph from one to another and back again depending on who the speaker is or who the audience is. Would the CSA kindly step in and mandate that all trailers be referred to consistently (i.e. as commissions) going forward? I believe a study of the subject will demonstrate that legally (i.e. in the wording used by CSA-mandated disclaimers) and fiscally (i.e. as depicted by CRA), trailers are indeed commissions. If the CSA genuinely wants to protect consumers and avoid confusion, then it should prohibit the sales element of our industry from deliberately mischaracterizing commissions as fees.

There are myriad disclosures that one could make more plainly at the point of sale. The single, simple “Fund Facts” document at point of sale is a start, but more direct messaging provided on packaging should further augment this. Two examples include:

- Micro vs. macro level considerations

The micro vs. macro consideration could disclose that there are actively-managed and passively-managed products available for the same asset class, that cost correlates negatively to performance and that outperformers cannot be reliably identified in advance.

- Embedded compensation and the possibility of bias

That embedded compensation is not homogeneous and has been shown (See the study done by Ron Sandler for the FSA in the UK in 2001) that about 75% of all advisors admit that compensation considerations impact product recommendations.

In essence, the primary concern I have is one of reasonable perspective. Many relatively unsophisticated investors have no way on sifting through current information in order to come to a truly informed decision regarding the long-term impacts that product cost or the cost of advice (or both) might have on their overall investing experience.

Consider what the government has done to help consumers make informed decisions regarding energy consumption (something most consumers are similarly unfamiliar with). New appliances (dishwashers, microwaves, etc.) that use energy have stickers on them that show not only how much energy they use as discreet appliances, but also *how that consumption level compares to other appliances on the market*. It is this kind of information that provides meaningful context that allows for more informed decision-making at the point of sale. Similarly, if mutual funds and segregated funds had their MERs posted boldly on their front package along with a continuum showing how much comparable funds charge (i.e. where they rate within that continuum), consumers would be able to choose more effectively based on price.

The financial services industry is, to my mind at least, in a state of collective denial about the plethora of evidence-based research that shows the negative correlation between product cost and investor performance. Most people I know in the business continue to deny such a correlation exists. It is as if I work with (and among) a small army of flat earth society members. Opinions are fine and well (and I certainly support peoples’ right to think for themselves), this, to me, is the professional equivalent of having virtually all physicians *actively encourage their clients to take up smoking*.... while being paid largely by commissions from tobacco companies.

This consideration for meaningful cost disclosure (one ought to depict not only what the cost of a product *is*, but also what the *impact* of that cost is on an investor’s end value) is explained in the articles I am forwarding with this submission.

I note that there is currently a discussion going on in Canada (beyond the purview of NI 31-103, but related nonetheless) about whether or not Canadian advisors ought to be held to a Fiduciary Standard. I have recently moved to this standard voluntarily by adding the Associate Portfolio Manager registration to my advisory arsenal. Therefore, when I say that I believe it would be a good thing for all registrants to move to this standard, I am “eating my own cooking”, so to speak. In those jurisdictions (and circumstances) where a Fiduciary Standard of Care exists, it is my understanding that it is mandatory to disclose cost considerations when making recommendations to retail clients. In short, if the Fiduciary Standard comes to Canada, more meaningful cost disclosure will inexorably follow.

Interplay of Fee Collection and Performance Reporting

The request for comment did not make specific mention of advisory fees charged by advisors. This concerns me, as I am therefore unclear about whether or not proper consideration has been given to this matter. For instance, I might have a client family with \$500,000 assets being charged 1% (\$5,000) + HST. This family might have two RRSPs, one or two TFSAs a family RESP and a small (perhaps \$100,000) investment account. It is standard practice within my business to charge clients from a non-registered account (let's assume that the \$100,000 in non-registered asset belongs to the man of the family in the example above). That account (20% of total invested assets) will be charged \$5,000 + HST – while all other accounts will not be debited at all. How will this standard industry practice of fee collection impact the proposed performance reporting requirements for each of the constituent accounts within the household? Without reading anything in the discussion paper, one might be led to fear (as I do) that the account being debited might be made to look artificially poor, while those not debited could be made to look artificially good. Neither outcome is desirable.

General Comments, Materials and Recommendations

I might also add that there are a number of disclosures that could be posted online that would allow consumers to look more deeply into matters of importance to them if they are so inclined. For instance, prominent positioning for those who would like to learn more could direct consumers to the OSC's Investor Education web site or www.sedar.com. Over time, a significant percentage of people will indeed visit the site (or sites) to learn more if they are so inclined. One thing is nearly certain- a lot more people will ultimately go to these sorts of sites if they were more prominently posted on product packaging than if they were not. As samples of the sorts of things I have been driving at, I am enclosing my personal Compensation Disclosure Form (a one page document signed by every new client) and a couple of articles written by me about the critical importance of cost.

Conclusion

I sincerely hope that the suggestions I've shared with you are given serious consideration. It is my hope that tangible steps will be taken to effect meaningful cost disclosures going forward. To date, in spite of a number of consultations, papers, focus groups and the like, there has been precious little done by way of real disclosure and consumer protection. Should anything in this correspondence prove to be unclear or incomplete, please do not hesitate to contact me, as I would be delighted to explain my positions further or expand upon them if need be. I'd like to wish you success in bringing together what must surely be an enormous and challenging task.

Sincerely,

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Encl.