

Kenmar Associates
The voice of the retail investor

John Stevenson, Secretary

Ontario Securities Commission
20 Queen Street West, Suite 1903, Box 55
Toronto, ON M5H 3S8
Fax: 416-593-2318
E-mail: jstevenson@osc.gov.on.ca

Me Anne-Marie Beaudoin
Corporate Secretary
Autorité des marchés financiers
800, square Victoria, 22e étage
C.P. 246, tour de la Bourse
Montréal (Québec) H4Z 1G3
Fax : 514-864-6381
E-mail: consultation-en-cours@lautorite.qc.ca

Kenmar Associates Comment Letter

**RE: NOTICE AND REQUEST FOR COMMENT ON PROPOSED
AMENDMENTS TO NATIONAL INSTRUMENT 31-103
REGISTRATION REQUIREMENTS AND EXEMPTIONS AND TO
COMPANION POLICY 31-103CP REGISTRATION
REQUIREMENTS AND EXEMPTIONS
COST DISCLOSURE AND PERFORMANCE REPORTING**

http://www.bcsc.bc.ca/uploadedFiles/securitieslaw/policyBCN/CSA_Notice_RFC31-103.pdf

Kenmar Associates welcomes the opportunity to comment on the proposed amendments. We are glad to finally see progress on individual account performance and cost reporting. We are delighted to see actual dollar and cents cost amounts disclosed .The sheer number of fees investors pay, which will be inventoried on the annual cost reports will open investor eyes and ultimately lead to a better financial services industry . Except perhaps for the largest investors, prevailing statements are usually incomplete, confusing and near useless.

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In fact, seven in 10 respondents to an InvestorEd survey found their investment statements incomplete or hard to understand –Source: <http://www.getsmarteraboutmoney.ca/tools-and-calculators/understanding-your-account-statement/default.aspx> See also this research [paper](#) concluding that investor's perception of their own performance has a small correlation to their actual results.

A 2010 DALBAR study *Trends and Best Practices in Mutual Fund Statements* report. Observed :” ... A telling sign that mutual fund statements are not meeting basic client expectations can be found in the area of performance reporting. According to a consumer preference study that DALBAR conducted, the most important statement feature valued by investors is overall rate of return information on their portfolio. A disappointing 68% of mutual fund providers are omitting this crucial piece of information on their statements.” The majority of firms in the study did not earn a DALBAR Designation because its mutual fund statement scored less than 60 points out of a possible 100 points.
<http://www.dalbarcanada.com/content/view/114/66/>

The Brondesbury Group *Report: Performance Reporting and Cost Disclosure*
http://www.osc.gov.on.ca/en/SecuritiesLaw_rpt_20110622_31-103_perfomance-rpt-cost-disclosure.htm ,confirms these findings as well - most retail investors do not have the information they need to make informed decisions.

The CSA's decision to mandate better cost and performance reporting will allow investors to use their account statements to check the accuracy of the recorded transactions, the fees associated with the portfolio/advice and to monitor whether their portfolio returns are appropriate to their financial goals and the risk they are accepting to achieve these results. In our experience ,good reporting on Client Statements also can prevent/reduce complaints, disputes and litigation by highlighting issues quickly before major losses are incurred. Several provinces have reduced the period of time you have to file a civil claim. Most of these Limitations Acts now have periods as low as 2 years. It's more important than ever to stay on top of things before they get out of hand. We therefore agree with Section 14.14 requiring

registered dealers to deliver statements to clients at least once every three months. The CSA should clarify if electronic access is or is not acceptable delivery.

Without knowing personalized rates of return, it is not possible for a client or the Rep to determine whether the recommendations being made are actually working towards achieving the investor's objectives. It is inconsistent to be in the advisory business and not be able to tell investors how their accounts are performing. It is not an add-on service as some have suggested ; it is integral to the advice business. We applaud the CSA for mandating this long needed core piece of account information.

A number of firms already have the capability. RBC Direct Investing makes it available online. For those who don't currently provide personalized rates of return, a short transition time should be permitted since this is not rocket science or an unexpected requirement. At least since 2003 , the OSC's Fair Dealing Model made it clear this was a necessary component of a relationship. SIPA www.sipa.ca has been asking for this since 2001. Articles, surveys and research have been published pointing out this reporting gap since at least 1995. Thus, two years (up to 10) for implementation is far too long for such a basic capability. Given all this history we are extremely disappointed that information will only be required to be reported on a go-forward basis - dealers will not be required to retrieve data for any past periods, even one year, unless it is already available.

Technology now allows mass customization of the necessary information at a very reasonable cost. Low cost Internet- based statements in fact allow them to be *intelligent* in the sense that investors can use hyperlinks to drill down to the level of detail they desire.

It is our understanding that a rate of return methodology that takes into account the client's cash flow into and out of a portfolio should be the standard. [Re Paragraph 14.16(1)(f)] . A time -weighted return measure accounts for the precise amount and timing of the intermediate cash flows, whereas the dollar- weighted return measure is based on assumptions regarding amount and timing. A dollar-

weighted Rate of Return measures how much an investor's investment dollars returned on average . A rate of return will allow an investor to see if his/her personal rate of return is above or below the returns anticipated in his/her long term return objective/IPS . Per the MFDA website www.mfda.ca ,the MFDA considers the Modified Dietz , a time-weighted return methodology http://en.wikipedia.org/wiki/Modified_Dietz_Method , as their standard for performance reporting. The CSA should define the acceptable method of calculation and not leave it to each dealer to determine return calculation methodology. Dealers should describe the methodology used in detail on their websites and/or in print . The explanation should include a worked example and avoid reference to non-public documents (see http://www.russell.com/ca/investor_services/personal_rate_of_return.asp as a good example). As we understand the proposals, the return calculations are to be provided on a pre-tax basis only.

Meaningful account statements are an essential component of increasing the awareness and knowledge of investors and their ability to make informed personal financial and economic decisions and detect abusive practices such as account churning. Some firms include Messages with the statement that aid in understanding the information and/or important changes to the fund(s) such as a change in fees or price breakpoints. Also, we are aware that portfolio evaluation software may produce errors that in some cases result in substantially misleading performance differing substantially from the statement data

Issue for comment: Base Cost figure

We have considered the option of permitting the use of tax cost (book value) as an alternative to original cost. We invite comments on the benefits and constraints of each approach to cost reporting, in particular as they relate to providing meaningful information to investors and their usefulness as a comparator to market value for assessing performance.

Response : We believe costs should be the actual cost incurred. Any other cost will be confusing for most retail investors. The costs incurred should be in the currency of the account. The costs should be labeled by category, not consolidated as a single lump sum dollar

figure. Interest expenses on investment loans should be included in the cost base. Perhaps there should be more guidance on how ROC is to be disclosed and used in cost disclosure/performance calculations. Fees received, such as referral fees from third parties, that are not related to the account portfolio should be flagged but not included in the performance calculation.

Issue for comment: Valuation

Is the guidance provided on determining the market value of securities in section 14.14 [*client statements*] of the Companion Policy useful and sufficient? Please indicate if there is additional or different guidance needed. We are particularly interested in your comments on the guidance related to the valuation of exempt or illiquid securities where there are no quoted values available.

Response: The guidance appears adequate. We would add however that foreign currency conversion exchange rates should be consistently applied in security valuations.

Issue for comment: Group plans

We acknowledge that there are unique features to group plans offered by scholarship plan dealers (group scholarship plans). We invite comments on whether the proposed account performance reporting requirements should apply to accounts invested in group scholarship plans or what other types of performance reporting would be useful to clients of group scholarship plans in lieu of the proposals outlined in the Rule.

Response: We see no reason why group plans should be treated differently.

Benchmark information reporting

The Brondesbury finding that only 4 out of 10 understood the notion of a 'benchmark of comparable funds' or the 'S&P/TSX composite index' suggesting that people are better at understanding the simpler forms of performance reporting rather than those relying on a comparison to some mix of investments implies that regulators and dealers have an important educational opportunity. Including a benchmark will prompt investors to ask questions and over a relatively short time, the concept of benchmarking will be understood by a

majority of retail investors. We concur with the Brondesbury finding on benchmarking that a simple understandable but imperfect benchmark will help investors more than a complex perfect benchmark that they don't understand. In the extreme, just including the CPI or a 5-year GIC rate would be better than no benchmark at all.

Unfortunately, the use of benchmarks for account performance tracking is not being prescribed. Without a benchmark an investor has no context in evaluating performance. We urge the CSA to require benchmarks. Ideally, the expectation should be that dealers would provide their clients with a meaningful and relevant benchmark against which the performance of the client's account can be compared. While benchmark returns closely matching the nature of the portfolio and/or the client's stated investment objectives is ideal, even a simple benchmark will provide some context. It would at least make it possible for the investor to determine whether the fees paid are worth it for the risks being taken. Thus, we believe that requiring investment dealers to provide each client with a general description of benchmarks, the factors that should be considered when using them and whether the firm offers any options for benchmark reporting to clients is an inadequate response to the information needs of investors in a non-fiduciary relationship.

Original cost of securities in account statements

Subsection 14.14(5.2) requires the account statement to include the original cost of each security position. This is taken as the total amount paid for a security, including any commissions or related fees and currency conversion. We see no problem with permitting dealers to choose whether to disclose original cost on an aggregate basis for each security position or on an average per security basis. The cost should be total cost not cost per share/unit as we see on some prevailing statements. We concur that original cost information will allow investors to readily compare the market value of security positions to the original cost on their statement .

We are concerned that where the original cost information is unavailable, registrants may elect to substitute market value

information as at a certain point in time as the cost going forward. The proposal postulates that where the account was transferred in to the registrant firm, the market value assigned to the securities could be that as at the date the account was received in by way of transfer, and this could be used instead of original cost. In this case , the client statement should asterisk/footnote this so that the client is not misled or confused. A longer term solution would be a rule requiring transferring dealers to provide original cost information .

For an existing account where security cost records are incomplete or known to be inaccurate, the market value as at the [implementation] date or an earlier date may be used, provided that the date and value selected for the security is applied consistently to all client accounts for which cost information is incomplete or inaccurate. If the market value cannot be reliably measured for a security position, the cost information should , per the proposals, be reported as indeterminate. We assume this means it will be treated as ZERO in the return calculation.

General Comments

Some general comments on reporting/account statements

- There should be no discrete new charge or fee for cost/performance reporting .
- All performance reports should be generated by the firm, and not by the dealer Rep in order to ensure adequate management controls, accuracy and consistency.
- We assume these provisions will apply to discount brokers as well as traditional investment dealers.
- Client statements should avoid industry jargon and acronyms.
- The appearance of account statements should be uncluttered, with ample separation between different sections.
- Provide foreign exchange rate used to convert to C\$'s if applicable
- We agree with Subsection 14.16(3) minimum reporting periods of 1, 3, 5 and 10 years and the period since the inception of the account. We also agree that allowing Registered firms to opt to provide more frequent performance reporting is a good feature.

- a risk measure for the portfolio keyed to the client's New Account Application Form / KYC is desirable. Knowing returns without knowing the risks taken to obtain the returns is a major deficiency of most performance reporting regimes. We recommend a simple measure:- the worst 12 month performance for the account.
- a delineation of the actions/transactions during the reporting period (including cash contributions, automatic withdrawals and early DSC redemption charges) is useful so a comparison to transaction slips and prior statements can be made
- Annual charge and compensation disclosure [14.2(4.1)(a)]: All fees and expenses in dollars and cents paid directly or indirectly by the client should be included. We understand reportable costs to include but not be limited to : sales loads, management fees, interest expenses, sales commissions, trailing commissions , switch fees , RRSP/RRIF fees, and other charges (including fees, charges and expenses for transactions, foreign exchange conversion fees , wrap accounts, insurance fees, registered plans, pooling arrangements and asset-allocation services).
[Question: Are embedded commissions in IPO offerings a cost captured by these proposals?] Any fee or expense disclosure subject to GST/HST should include the applicable taxes.
[Question : In what manner are Registrants to identify a client's investment fund holdings that may be subject to a deferred sales charge ?] [Question : In what form is this aggregated cost disclosure to take place – year end client statement? Attachment ? Separate transmission? Paper / electronic?]

We like the sample performance presentation format in Appendix D but are unsure whether time-weighted returns are the best approach. We will leave this to the experts. Also , the word "Adviser" should be replaced by the words " Dealing Representative" per NI31-103 . We believe the CSA should clarify " *We do not expect registered firms to provide clients with information on product-related charges since the range of products offered by a registrant may be quite broad and the types of products in a client's account may change over time.*" - what exactly is meant here?

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As an aside ,the CSA should consider the situation where an investor is disturbed by the annual charge and compensation figures. Will the firm be expected to provide a itemized breakdown of each cost category upon request ?

Overall, we feel these proposals are very positive and strongly support their implementation without undue delay.

Permission is granted for public posting of this Comment letter.

Should you have any questions, do not hesitate to contact us.

Ken Kivenko P.Eng.
President, Kenmar Associates
June 31 , 2011
kenkiv@sympatico.ca
(416)-244-5803