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Investor Education and Protection

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CSA and CCIR Joint Notice and Request for Comment – Proposed Amendments to National Instrument 31-103 Registration Requirements, Exemptions and Ongoing Registrant Obligations and to Companion Policy 31-103CP Registration Requirements, Exemptions and Ongoing Registrant Obligations and Proposed CCIR Individual Variable Insurance Contract Ongoing Disclosure Guidance Total Cost Reporting for Investment Funds and Segregated Funds
CSA and CCIR Joint Notice and Request for Comment – Proposed Amendments to National Instrument 31-103 Registration Requirements, Exemptions and Ongoing Registrant Obligations and to Companion Policy 31-103CP Registration Requirements, Exemptions and Ongoi | OSC

Kenmar appreciate the opportunity to comment on the proposals to enhance total investment cost reporting. We are delighted to see that regulators are turning their attention to this critical issue and are determined to make it happen. The MFDA has been the pioneer on total cost reporting since at least 2015 and it is wonderful to see their vision now being realized.

It is encouraging to see securities and insurance regulators coordinating on this initiative to avoid big gaps in standards across segments that look/sound the same to end consumers (i.e., regulatory arbitrage). We welcome the proposals that would provide periodic reporting to clients showing the ongoing costs of owning segregated funds and investment funds. For retail investors, account statements would be expanded to include the fund expense ratio for each of the investment funds that the client owns, expressed as a percentage.

Our comments will focus on investment side reporting but most are relevant to segregated funds as well.

Kenmar Associates is an Ontario-based privately-funded volunteer organization focused on investor advocacy (www.canadianfundwatch.com).Kenmar also publishes ***the Fund OBSERVER*** on a monthly basis discussing investor protection issues primarily for retail investors. An affiliate, Kenmar Portfolio Analytics, assists, on a no-charge basis, investors and/or their counsel in filing investor complaints and restitution claims.

Introduction

Mutual funds are the foundation of Canadian investors' saving and retirement plans. Their dependency on these products gives rise to concerns about retail investor vulnerability. There is an asymmetry in knowledge, information and experience between retail investors and their financial advisor; in fact, many investors do not know how their advisors are paid. In some cases, investors have been told advice is "free"! Moreover, there is a loose correlation between the fees charged and the advice or services provided. Mutual funds are Canadians' most commonly held investment product with their investment portfolios totalling about $2 trillion. Mutual funds are thus particularly important to Canadians for their retirement income security.

Canadian mutual funds are among the most expensive in the world according to Morningstar research. On March 30, Morningstar published its Global Investor Experience report around fees and expenses. In that report, Canada received an overall grade of **Below Average** when compared with 26 other jurisdictions. Source: ***Canadian Fund Fee Trends and the Cost of Advice in Canada***
https://www.morningstar.ca/ca/news/220120/canadian-fund-fee-trends-and-the-cost-of-advice-in-canada.aspx

In July 2019, the OSC IAP disclosed investor survey results that raised significant questions about whether most small and mass-market investors actually have access to advice that is comprehensive and timely enough to effectively meet their needs, even though they pay for it (especially those with actively-managed mutual funds with conflict creating embedded trailer commissions). In some cases, it is unclear if any advice was provided at all. Such research supports the argument that total cost reporting is a high priority investor protection imperative. Source: OSC's ***Investor Advisory Panel Releases Survey Findings on How Much Advice Investors Receive***
https://www.osc.ca/en/news-events/news/oscs-investor-advisory-panel-releases-survey-findings-how-much-advice-investors-receive

One failing of CRM2 is that the presentations appear to be intended to fulfill a regulatory requirement – not to leave clients more informed. With CRM3, there needs to be a focus on making people more aware of what they are actually paying for the advice/services they receive and nudge them into action. Separating costs is a particularly important in the context of an embedded commission product like a mutual fund where service /advice and product costs are bundled together.

In Canada, the mutual fund industry is heavily vertically integrated with many of the largest Firms also restricting the product shelf to proprietary products. This situation makes the value of total cost reporting especially important for Main Street. It should also be noted that one key finding of the CSA sponsored Cumming Report on embedded fund commissions was that affiliated dealer flows showed no flow-performance sensitivity at all, which was found to be relatively more detrimental to investors relative to all trailing commission paying purchase options for non-affiliated dealer flows See ***A Dissection of Mutual Fund Fees, Flows and Performance*** https://www.osc.ca/en/securities-law/instruments-rules-policies/8/81-407/dissection-mutual-fund-fees-flows-and-performance .

It seems particularly appropriate to cite the words of former OSC Commissioner Glorianne Stromberg who has been a trailblazer over the past two decades in identifying the need for reform of Canadian mutual funds. In her classic 1998 report she stated, *"Permitting these capital-eroding fees will impact the need for social support systems that we simply don't have and probably won't be able to afford given the erosion of the tax base as the population ages".* With the decline of DB pension plans, more Canadians than ever now depend on their own investments for their retirement .Increased longevity makes retirement income security especially important.

Because investing costs reduce client returns, Total cost reporting is therefore a socio-economic issue. This regulatory initiative should help reduce the chances of retirement portfolio erosion due to excessive investing costs.

The importance of total costs

The MFDA has been the driving force behind total cost reporting. We respectfully acknowledge their major contribution to this initiative.

Morningstar's Director of Mutual Fund Research has observed, *"If there's anything in the whole world of mutual funds that you can take to the bank, it's that expense ratios help you make a better decision."* In order to make a truly informed investment decision, investors need another piece of information – details of the services and investment advice that they will be provided for the fees paid. The product may be fine but the advice provided may not be. That discussion will have to wait for another day.

Total cost reporting provides a good basis for investors to compare costs. Together with the performance report, the investor would be empowered to start asking informed questions. With a better informed client population, the industry will have to take actions to remain competitive. Total cost reporting is a WIN-Win for all stakeholders.

It should be noted that CRM2, while imperfect, is credited by some with causing IIROC dealers to come clean on double billing and overcharging for a decade or more. Similarly, it is quite possible that expanded cost reporting, and the visibility it provides clients, will inspire Dealers and fund salespersons to recommend lower cost funds and products and account types for their clients.

One of the challenges in evaluating investor responses to cost/fee information is to understand why investors so frequently overlook fee information, and what kinds of interventions might make fees more salient. In our experience we have found that retail investors downplay the importance of investing costs because (a) they do not know them because some costs are embedded in the product cost (b) fees in percentage terms appear to be inconsequential; (c) they assume their "advisor" is a fiduciary; (d) they lack the financial literacy and numeracy to assess the impact of fees on annual and especially long-term returns and (e) they are not aware of competitive products or account types.

Hopefully, enhanced cost/performance reporting, the CFR regime (which now makes costs a suitability determination parameter), coupled with enhanced CSA investor education, will lead to better financial outcomes for Main Street Canadians.

Commentary

Our main comments are:

Transition period: The consultation document is proposing that both sectors move forward in lockstep, with final amendments coming into effect at the same time in September 2024. That is about 2 years away. This transition period is extraordinarily long given the length of time the industry has spent studying the issue. We can trace the timeline back to the FDM proposals of 2004.

It is our understanding that a number of forward looking Dealers already provide fulsome cost reporting to their clients.

Given the strategic importance of this initiative, we urge the industry and the CSA to go into a room to identify the impediments to meeting the proposed timelines and not exit until the barriers are resolved.

While we agree in principle that the insurance and securities sector should work in lockstep, we are concerned that if a delay occurs in one sector, it would slow down implementation in the other sector. We are willing to experience a short period of potential regulatory arbitrage in order to meet the greater objective. We already have significant arbitrage in that the insurance industry has not banned DSC funds while the securities sector has.

Regulatory exemptions, burden reduction initiatives and the millions of dollars in savings expected with New SRO should provide the wealth management industry plenty of cash to expedite the transition to investor-centric cost reporting.

Closed-shelf Firms should have no difficulty implementing the proposals, so the transition time is likely measured in months not years.

Investment fund scope: For the purposes of the Discussion Paper, "Investment Funds" would include mutual funds, exchange traded funds, labour-sponsored funds and commodity pools.

"Cost": Total cost reporting would capture all direct and indirect costs incurred by a client in their account. This includes, but is not limited to, product costs, advice and service fees, account fees, fund trading costs, DSC early redemption penalty fees, NSF charges, switch fees , transaction commissions, RRSP account fees, front loads, embedded trailing commissions , short term trading fees , cost of borrowing , sales commissions embedded in IPO offerings and the like.

Inclusion of TER: The TER is a cost of product manufacturing and should be considered in total cost disclosure. In some cases the TER can actually exceed the MER depending on the trading strategy of the portfolio manager. The more active, the higher the trading costs. **For funds with less than one year of operation no TER (or MER) will be available so the CSA should prescribe the process to be followed in such a case.**

GST/ HST breakout: Many professional advisors quote fees pre-tax. We note that in other industries these goods and services taxes are explicitly revealed on transaction slips. Not so in the case of mutual funds. These taxes are not immaterial and nearly always exceed the TER impact on returns.

Consumer/investor testing Report:The consultation does not reveal the investor testing that led to the cost table formats being proposed. The test results report should be provided to commenters. In the case of Fund Facts, extensive investor testing was carried out and the report publicly disclosed. https://www.osc.ca/sites/default/files/2021-05/pos_201209_fund-facts-doc-testing.pdf The testing proved to be invaluable, resulting in numerous changes to the proposed presentation format and content. The OSC asserts that it is an evidence based regulator. It should therefore not disrespect investors by refusing to reveal the research underlying the proposed presentation formats. **It is unreasonable, unfair and improper that the OSC is relying upon research to formulate laws but will not share it with the Public and commenters.**

Calculation oddities: There are no doubt a few issues such as *management fee rebates* and the like that impact reporting. **We urge stakeholders to identify them quickly and agree how their impact will be factored into the calculations and reporting. The CSA should prescribe the calculation methodology to ensure that cost disclosures are comparable between Firms.**

Product range: Must also include GIC's, PPN's, U.S. ETF's and other investments held in the account.

Attention getting: **The report should be prefaced with a short intro and key numbers of most interest to clients.** A short preamble to the report(s) could help draw attention to the importance of costs viz

These documents provide more information about your account holdings, performance, and costs. You can use this information to take actions that will help you achieve your objectives. Consider setting up a meeting with your

advisor to discuss your account type, investments and related account costs and whether or not they are still right for you especially if your personal circumstances or financial goals have changed or you are dissatisfied with results.

Using simple language and eliminating industry jargon would improve clients' comprehension.

Personalized Context: We recommend that the following text be added to the Annual fee report to provide context:

"Based on the current value of your account ($47K) your total investment costs are approximately $815 per year – equal to about 1.73% per year .Lowering investment costs for comparable performance would yield higher long-term returns for you. Talk to your advisor about alternatives" [We appreciate that proprietary only fund Dealers will not be able to offer suitable alternatives.]

We believe this language will encourage clients to put the cost of investing in perspective. That in turn should help in getting investors more engaged with value-for-money considerations.

If a client has opened an account after having been given clear disclosure that a dealer or advisor will be using proprietary products exclusively, the CSA believe it is reasonable to assume that the client has agreed to a client-registrant relationship on that basis. The CSA thus implicitly assume that the average retail mutual fund investor understands the potential long-term impact on returns related to a restricted product shelf. We question this assumption. **Accordingly, Kenmar recommend that the CSA test that assumption and if it is not confirmed, amend CFR accordingly so as to better support the regulatory intent of Total cost reporting. Relationship disclosures should inform clients of the limitations of a prop –only Dealer and the potential adverse impact on fund/account performance]**

Account type: The type of account can be a big factor in long term returns. Regulators should provide more guidance and enhance enforcement to prevent consumer harm. Although a fee-based account may have benefits in select cases, such accounts are not appropriate for all clients. See **The trouble with fee-based accounts** http://www.canadianfundwatch.com/2014/12/alert-trouble-with-fee-based-accounts.html

Foreign exchange: The cost of currency conversion from/to Canadian dollars is a cost incurred by investors whose portfolio holdings are denominated in non-Canadian currency. Its disclosure is opaque in the sense that the conversion is subsumed in the exchange rate charged.

"Intelligent" reports: Regulators should encourage Firms to use more advanced disclosure documents. For example, hyperlinks could be used to expand reporting detail, define terminology or link to tools/calculators .A layered approach to disclosure is the modern way to provide disclosure.

Delivery of Annual report on costs: Consumers should have the option of electronic delivery. This could reduce printing and postage costs while satisfying certain clients delivery preferences. The savings can be passed on to clients in the form of lower fees and/or better reporting systems. There should be no charge for those clients requesting paper delivery.

Performance Fees: **The Report should also include performance fees related to investment funds that pay such fees**.

Bonds: Until there is more transparency, the true costs of transacting in bonds will be unknown to consumers.

Nomenclature : The table heading on fees should be Shares/units as mutual funds owned are quantified by units rather than shares owned.

Standardization of terminology: To reduce investor confusion, the CSA should provide a glossary of commonly used terms to be utilized by all Firms. This glossary should be available online for consumer lookup. [When assessing CRM2 disclosure, the MFDA Bulletin 0740-C http://mfda.ca/bulletin/bulletin0740-c/ found some Firms used different terms for trailer commissions, which impedes clients' ability to make comparisons between firms]. The legal definition of Trailing Commission should be used albeit expressed in plain language.

DSC sold funds: We note that DSC early redemption penalty fees are to be included in investor costs which is a great reminder to investors of the toxic nature of such funds. **While new sales of such mutual funds are banned in the securities sector, insurance regulators need to take similar action on segregated funds - the faster the better.**

Borrowing cost: Interest costs should be included if an investor uses leveraging or has borrowed stock on margin.If the figure is not known ,the report should state that the investor should add the interest expense to his/her total investing cost. If regulators decide not to include interest charges, the report should explicitly state that any costs incurred for leveraging are not included in the report.

Font: Printed material should have a defined font style and minimum size to ensure client readability.

Educational materials: Financial confidence plays a greater role than financial knowledge when it comes to developing healthy financial behaviour, according to a Financial Consumer Agency of Canada (FCAC) report .FCAC's *Progress Report on Canada's National Research Plan on Financial Literacy 2016-2018* was developed to share important findings with financial literacy practitioners and researchers in order to improve the financial well-being of Canadians.https://www.canada.ca/en/financial-consumer-agency/programs/research/progress-report-national-research-plan-2016-2018.html The CSA can play a key role in building financial confidence among Canadians. **Kenmar**

recommend that the CSA partner with the FCAC on such investor education programs and their promotion.

Quality control: We recommend adding this provision "To ensure the accuracy and integrity of the reported costs, Firms should have policies and procedures in place to ensure that (a) the reported costs are accurate; (b) the reported costs are appropriate for the client. "

We are suggesting this because we have found that Firms do not have adequate supervisory controls to prevent mischarges such as (a) double billing, (b) using the wrong fund series/class for the type of account: (c) charging trading commissions in fee-based accounts or (d) charging for the wrong series/class of fund applicable to the client (not credited with price breakpoints).

Referral fees: We do not have adequate information on referral fees received by dealers. We leave it to regulators to decide whether such fees should appear on annual client cost reports.

Enforcement: Robust Regulatory enforcement of Firm cost disclosure and application will reinforce the regulatory emphasis on costs and their impact on consumer savings. The $350 million double billing fiasco could have been prevented if regulators had taken timely action. Similarly, the discount broker overcharging scandal caused investor harm in excess of $1 billion over the period securities regulators allowed it to prevail. The sanctions and fines imposed should be impactful for industry participants. **Enhanced cost-related enforcement could inspire Firms to move more swiftly with CRM3.**

Better cost/ fee disclosure: The CSA should consider an audit of Canadian industry practices relevant to cost disclosure. See UK FCA Report MiFID II costs and charges disclosures review findings - https://www.fca.org.uk/publications/multi-firm-reviews/mifid-ii-costs-and-charges-disclosures-review-findings . If disclosure is not confusing, misleading or missing, the benefits of better cost reporting will be increased. The consultation did not address any initiatives with respect to the improving the robustness of cost/ fee disclosure.

Back-up plan. If the industry is unwilling or unable to step up to the challenge, the CSA should consider extreme measures to protect Canadians from high costs. One possibility is for the CSA to permit Canadians to purchase competitive U.S mutual funds.

Summary and Conclusion

Kenmar strongly recommend that industry and the CSA (with investor input) step on the accelerator and work together to find ways to meet or exceed the planned timelines. Based on what we see, the wealth management industry is dragging its heels. The CSA will therefore need to assertively nudge industry to match their stated good intentions with actions. While there some issues that need to be worked, the project is not leading edge software development. The key to success is for industry leadership to invest the resources necessary and demonstrate a real sense of urgency. This project has gone on for far too long with the retail investor paying the price.

The CSA should prescribe the reporting format and cost calculation methodology to ensure consistency across the industry.

We urge regulators to provide a summary page highlighting some key numbers with similar text to Fund Facts that will motivate investors to take action. In our experience, most retail investors are not aware that fees can be negotiated and that equivalent lower cost products and service arrangements are available.

One of the hoped for benefits of the New SRO, CFR and Total cost reporting initiatives is greater investor access to low cost , high quality products such as ETF's and Index funds . Therefore, one indicator of total cost reporting success will be a material rise in the percentage of lower -cost products held in retail investor accounts.

We fully expect that after implementation of these proposals, the reduced performance drag of excessive fees will result in better financial outcomes for Canadians and a more competitive financial services industry. The investing cost to earn 1% of return will be lower, all else being equal.

Overall, the proposed reporting format appears to provide a good plain language explanation of the total investing costs incurred. We have made a number of suggested improvements/changes .As we were not provided a copy of the investor testing/ research we cannot be confident the format has been adequately validated from a behavioural finance perspective. Kenmar believe the key question to ask is: **Will the enhanced reporting prompt the average retail investor to ask questions and take actions such that the investing costs (advice, product and transactional) incurred will result in better value for money?**

We have identified a number of issues but we clearly support the initiative of more fulsome disclosure of total investing costs on monthly (or quarterly) client statements and particularly annual cost reports . The ability to match total investing costs to account performance empowers the investor to ask why they have been sold a DSC fund, why the fees they pay approximate their returns or why lower cost alternatives, such as Index funds or ETF's , are not being recommended. **We strongly recommend that the reports include a short summary paragraph containing language nudging investors to ask questions and take action.**

A plain language Guide should be produced providing consumers information on how to use the cost information for better decision making. The Guide should contain links to applicable online cost impact calculators. Some cost benchmarking would not be inappropriate. The long term impact of fees on portfolio performance appears to be a blind spot for many Consumers.

We also recommend that the CSA provide a tool or link to a tool(s) that would help retail investors better understand the long term impact of fees. The one provided here allows for adding periodic payments rather than just a lump sum at the beginning. See http://saviifinancial.com/seg-funds/m-e-r-fee-calculator/ Also, ***How Fees and Expenses Affect Your Investment Portfolio*** https://www.sec.gov/investor/alerts/ib_fees_expenses.pdf There is also the OSC cost impact calculator.

While the design of Fund Facts (FF) is not part of this consultation, we feel obligated to once again articulate that the trailing commission should be an isolable cost in the FF fund fee table. The increased cost spotlight could cause investors to be more aware and sensitive to these embedded sales commissions at the outset. The SEC requires the Fund Summary document to break out the 12(b) 1 fee in the fee table – they refer to it as a distribution fee, not as a fee for advice and services. See SEC Bulletin *Mutual fund fees and expenses* https://www.sec.gov/oiea/investor-alerts-bulletins/ib_mutualfundfees.html

Based on the experience of CRM2, we recommend that regulators err on the side of more prescriptive language/format standards, than less.

Kenmar hope this feedback is useful to you.

Kenmar Associates agree to public posting of this Comment Letter.

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

Respectfully,

Ken Kivenko P.Eng.
President, Kenmar Associates

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We like the Desjardins brochure on mutual fund investing. It uses charts and plain language to good effect. With minor modifications it could be an excellent educational tool.
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Why Does the Law of One Price Fail? An Experiment on Index Mutual Funds
http://www.ncbi.nlm.nih.gov/pmc/articles/PMC2872995 ABSTRACT: We conduct an experiment to evaluate why individuals invest in high-fee index funds. In our experiments, subjects allocate $10,000 across four S&P 500 index funds and are rewarded for their portfolio's subsequent return. Subjects overwhelmingly fail to minimize fees. Search costs for fees matter, but even when we eliminate these costs, fees are not minimized. Instead, subjects place high weight on annualized returns since inception. Fees paid decrease with financial literacy. Interestingly, subjects who choose high-fee funds sense they are making a mistake.[The composition of their subject pool , college staff/MBA students made it more likely that they would find support for rational theories; given the dismal results it is thus no surprise that ordinary Canadians have trouble figuring out fund fees]

EXHIBITS

EXHIBIT 1 Why investing costs are not top of mind for retail investors
Notwithstanding any regulator mandated disclosure there are other powerful influencers on investor decision making. These include trust-inducing "advisor" titles , creative , glitzy brochures with images of a happy retirement, attention grabbing websites, biased investment calculators," free lunch " seminars , controversial industry financed investor polls , mind -capturing celebrity speakers , portfolio manager's appearances on television expounding their smarts (but not the fees) and of course an advice-skewing distribution system addicted to opaquely disclosed (and poorly understood by retail investors) sales incentives and trailers. These have the undesirable effect of diverting investor attention from the regulated disclosures and incentivizing advisers more toward sales volume, than the investors' best interests.

We add parenthetically, that most Canadian mutual fund advisers do not have a fiduciary duty to clients, yet trust in the advice provided by advisors is generally very high especially among the elderly .Even when a disclosure is available, regulator finds significant deficiencies and non-compliance yet does nothing more than issue a Staff Notice detailing the shortcomings and suggesting how improvements can be made. This cycle goes on, year after year, with little sign of progress. One need only look at the double dipping scandal involving all of Canada's leading investment dealers as evidence. Better regulatory enforcement is required to support an expanded cost reporting initiative.

Exhibit 2 The BCSC study
https://bcsc.bc.ca/News/News_Releases/2017/76_Significant_improvements_in_investor_knowledge_following_new_fee_disclosure_documents__BCSC_study_finds/
The British Columbia Securities Commission (BCSC) published a report that outlined the results of an survey that examined the impact of the new annual investment reports had on those individuals working with a salesperson In addition, the BCSC rolled out an educational online tool to help investors navigate and understand the new reports, including a short video and an improved fee calculator. In the report, it stated that 52 % of investors who had expressed less confidence and investment knowledge at the outset of the study increased their general understanding of fees after receiving CRM2 reports.

Other findings included:

- Half of all respondents always read statements
- Nearly all respondents confident in their understanding of their statements and bills
- Slight majority feel they know how to compare investment advisors, products
- 57% are familiar with the two types of fee they pay.

The report also showed that while there was an overall increase in fee knowledge among less-confident investors, that knowledge was short-lived. The report states that while "many" of those investors surveyed in March and then again in June saw their knowledge level increase upon receiving their CRM2 reports, that knowledge later declined during a follow up study several months later. "Clearly, knowledge fades," the BCSC says in the note.

Of 400 respondents who answered questions on specific fees, such as the total amount of fees paid, investor knowledge improved among 34 % of survey participants, but 35 % saw no change. Curiously, 31 % said it actually worsened.

The research shows that there is an overall positive effect on investor knowledge and behaviour; but what we would also want to see is whether the fee reports will cause investors to have a conversation with their Reps about the fees they pay, is there a different mix of products that could work for them, or would they consider changing their Firm or advisor. . And while that 52 % learned more – which is great – they didn't do anything with that knowledge. The CSA initiative should aim to greatly improve on that.

Exhibit 3 OSC behavioural insights study

A 2019 the OSC Investor Officer released **OSC Staff Notice 11-787, *Improving fee disclosure through behavioural insights*, i**dentified behaviourally-informed tactics for designing more effective investment fee disclosures. The research report focused on the annual reports on charges and other compensation investors receive from their registered dealer or advisor, and identified 24 concrete tactics for making these reports more engaging and easier to understand and act on. This behavioural insights research study demonstrated how plain language and attention to disclosure design can place retail investors in a better position to make informed decisions about their Advisory relationship and portfolio construction.

Tactics identified in the research included using electronic alerts or notifications that attract investors' attention or, if the report is being provided by mail, including attention-grabbing language or visuals on the envelope; testing and employing simpler terms to describe key concepts and different types of fees; and listing actions investors can take to reduce their investment fees or increase the quality of service they receive for those fees.
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