Small Investor Protection Association

Ken Kivenko P.Eng.
Chairman, Advisory Committee

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Ontario Securities Commission
Rebecca Cowdery
Manager, Investment Funds Regulatory Reform

Rebecca,

I've gone through the 45 pages of NI81-106 (Investment fund continuous Disclosure) and generally find it is a step in the right direction. I think the fund industry will have difficulty with it since they are not used to such a level of disclosure. In the long run it is of course in their best interests to change. Based on several years of investor complaints with mutual fund reporting I thought I'd summarize some of our biggest concerns below:

1. **independence of fund auditors from parent firm if applicable-this is important as the fund investors are quite distinct from the parent Corporation (e.g. a bank)**
2. **the lack of specificity of commentary on results-what went right, what went wrong, what's being done <u>directly</u> related to the fund. Too often general comments about the economy are made or some philosophy is presented with no real value to the reader. What unitholders deserve and are often denied is an honest discussion of results of whether the fund kept up with the market and peers.**
3. **Annual report comparison tables should mandatorily compare pre-tax returns to the applicable Total Return benchmark index and category quartile ratings over the performance measurement periods required by regulation**
4. **the role of a governance agency to approve financial statements prior to release does not appear to be covered**
5. **the unduly long delay in reporting results to unitholders has always been upsetting-given the volatility of markets and the vast improvement in information technology quarterly reporting seems well overdue**
6. **the need to clearly and plainly disclosed brokerage commissions, current and <u>historical</u> (5 years)-ideally these would be part of MER calculation and cited in tabular form along with other financial metrics**
7. **the confusion caused by fund names that do not closely match holdings and the designated benchmark index-we suggest a minimum of 80 percent of assets be of the character suggested by the fund name**
8. **News releases, email alerts or special mailings regarding fund mergers, acquisitions, name changes in fee structure, auditor changes and manager changes to be advised within forty-eight hours**
9. **delineation of the health of the governance and ethics programs-quantitative metrics at possible**
10. **formal explanation of any litigation or material conflict of interest breaches**
11. **disclosure upon request of ethics policy, governance policy and share voting policies**
12. **disclosure via the Internet of share voting/non-voting and rationale**

13.

mandatory mailing of Annual reports is a fundamental obligation of fund factories to already information- disadvantaged investors/unitholders. If this cannot be imposed, than as a minimum, any NO RESPONSE should automatically require a mailing. (A controversial Dec.2002 OSC precedent- setting ruling will allow mutual funds to stop automatic mailing of Annual Reports to already under-informed investors. The attitude of industry participants towards unitholders/Annual Reports is evident from the following: "Bates, a former chief executive in the fund industry agrees that much of the costs associated with the Annual reports were a waste in the first place because so few investors take the time to read through the document. "There's no question that for many recipients it tends to end up in the category of bulk mail. In many cases, it's superfluous. For people that want it, they make a choice or you can get it tangibly online," Source :Investment Executive Jan. 2003.)

14. availability upon request of key fund metrics-standard deviation, Beta and Sharpe ratio
15. breakout of dividend and interest income-important for tax purposes and planning
16. Calculation of *after-tax* fund returns based on median Canadian tax rate or maximum Ontario marginal tax rate. This is especially important for highly taxed Canadian investors.
17. NOTES to annual statements to include dollar amount and percentage of total brokerage commissions paid to related parties and affiliates
18. identification of portfolio manager name(s) and professional credentials and tenure with the fund
19. flagging of conflicted portfolio holdings-conflict can arise because of work performed, such as corporate financing, by parent or affiliated companies over the previous two years. They should be identified by an asterisk. We would of my automatically include any holdings of the publicly traded stock of apparent and/ or affiliated company or subsidiary.
20. the names and contact coordinates (address, telephone number, fax number, email address) of the compliance officer, governance committee members and the lead external auditor should be provided.
21 Despite numerous requests from unitholders, mutual fund companies do not disclose what actions, *if any*, they are taking on behalf of unitholders via moral suasion, share voting, class actions or otherwise, to recover losses due to fraud that hurts unitholders returns. Specifically, massive losses were incurred by holdings of YBM Magnex Inc., Bre-X, and Nortel. In the case of Nortel for instance a bank owned fund may also provide banking, advisory and financing/IPO services for Nortel so it's easy to see conflict- of -interest here. Canadian mutual funds have been extremely reluctant to step up to their fiduciary duties as shareholders. Canadians have lost billions of dollars via their mutual fund investments. This is an area where better Annual reports could provide useful information.
22. Use of Canadian GAAP is understandable but controversial-the many deficiencies of Canadian GAAP vs. U.S. GAAP are like a toxic waste to Canadian investors. Many

reports and studies have highlighted the problems. See the latest article from Canadian Business attached.

23. **more detailed, visible and highlighted disclosure of trailers paid would be an assist to investors who still don't see the potential for conflicted (" linked ") advice and the impact of trailers on the MER of Canadian mutual funds. This has been substantiated by numerous investor surveys. Linked advice can result in the following adverse consequences for the unsuspecting unitholder:**

1. **an unhealthy high proportion of your portfolio in mutual funds**
2. **the wrong mix of funds as between growth and income**
3. **an unduly low level of cash**
4. **low performing and/ or unnecessarily high MER funds**
5. **potentially higher overall fees (and lower returns) over time when a back- end load fund is chosen over a front or no load fund**
6. **reduced returns due to excessively high MER and other fees because of biased fund selection**
7. **a higher tax liability due to purchase of a high turnover fund or excessive fund switching**
8. **excessive risk for the given return**
9. **lack of *dollars and cents* clarity of the fees paid**
10. **inability to exit the fund without penalty**

I hope this gives you a flavor of the issues as seen by information users. If you can feed this into the system, despite it being late, it would be great. I'd be glad to discuss this further with any OSC representatives.

Sincerely,

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Attachment- Canadian GAAP issues

Same old song and dance

Accountants did some fancy footwork in 2002. Can you follow the lead this year?

BY AL ROSEN

Year-end is the time to look back at what we have (or is that *haven't*?) accomplished in terms of improving Canadian corporate accountability, and also to look at what could be ahead for 2003.

Company financial results for 2002 are likely to be overly optimistic and inflated because of several recent accounting rule changes. Investors have to realize that reported profit improvements in 2002 may have little to do with corporate efficiency and lots to do with questionable changes to the accounting rules. For proof, just look at some of the financial reporting choices that are allowed in Canada, but not in the US. Companies that suffered certain intangible asset impairments during 2002 were allowed to recognize the loss by retroactively reducing shareholders' equity as of the end of 2001. Thus, not only did the losses avoid the income statement altogether (both in the past and present), but they weren't even recognized in the year in which the impairment occurred. In addition, Canadian GAAP is still seriously weak in the areas of capitalized development or start-up costs, and the favorable recognition of quasi-equity instruments. Both can lead to a perpetual overstatement of income and equity. However, despite strong evidence to the contrary, our accounting rule-setters continue to argue that Canadian GAAP is not weaker than its US counterpart.

Tightening Canadian accounting doesn't seem to be on the radar screen for 2003, mainly because of the self-interest that exists in the standard-setting community. The Accounting Standards Board (AcSB) claims to have no connections to the audit practitioners, but who's kidding whom? budget dollars with the Canadian Institute of Chartered Accountants, or CICA (which includes the auditors who sell their services to the companies that benefit from the rules). As well, some AcSB members are seconded from auditing firms and eventually have to return to face the heat for their questionable independence. Worst of all, the appointment of AcSB members is the purview of the Accounting Standards Oversight Council, which is directly accountable to CICA. In comparison to the US, which separates the standard-setters (the Securities and Exchange Commission and the Financial Accounting Standards Board) from the auditors (the American Institute of Certified Public Accountants), and intends to take further steps to improve corporate accountability, Canada seems to be standing still.

Some Canadian investors got a wake-up call in 2002. Unfortunately, other important groups (including our governments are pretending that no serious change i necessary. Some claim that regulation wil become too costly. Many of these arguments are the product of a short time horizon and a narrow, self-interested view of th situation. We need to consider the long term costs that under-regulation can hav on the quality of the Canadian market The idea of a second-tier (under-regulated market is practically an invitation to opportunistic promoters. We can understan that some company executives, with thei short-term outlooks, care little about th long-term quality of the Canadian capita markets. But why are some stock exchang executives and lawyers willing to compromise Canada's future? Perhaps the fee associated with "second-tier" listings ar just too attractive to turn away.

The year 2003 is likely to see the sam unsatisfactory state continue for investor Canada didn't have the highly publicize collapses that the US suffered last yea However, we certainly have had more tha our share over the past 20 years. The bottom line is that current proposals to fi corporate accountability in Canada seen grossly deficient. And make no mistak history will repeat itself. More Canadia investors will surely lose their savings, an more foreign investors will lose patienc with Canada.

For Canada to keep in step with th world, auditor influence of accountin rule changes must be greatly reduced, not eliminated altogether. But currentl input from investors is minimal, and ou governments are largely standing on th sidelines. Both these groups need to ste up and realize their duty. Investors cann be left in a state of bewilderment.

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