Kenmar
Investor protection & education

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Commentary on Consultation Paper NI 31-103

Kenmar appreciates the opportunity to comment on the CSA proposal National Instrument 31-103 Registration Requirements. We are clearly disappointed not to see so many of the wonderful ideas of the FAIR Dealing Model in this Document. We believe this undesirable situation is due to the fact that investors were largely absent from the rule- making process. Nevertheless, this proposal takes a number of modest steps towards protecting retail investors and we provide our commentary. Kenmar is dedicated to investor protection. We maintain a website www.canadianfundwatch.com and publish a bi-weekly publication the Fund OBSERVER. Kenmar is active with Investor/Consumer protection Groups, regulators, politicians and the media in trying to represent the interests of Main Street.

Based on our observations, various studies and media reports there is clearly a crying need for improved investor protection and regulatory enforcement in Canada. The losses absorbed by retail clients run in the billions of dollars annually. The most vulnerable, seniors and retirees, are often unable to recover emotionally or financially from the effects of the abuses.

COMMENTS

STANDARDIZED NAAF FORM

We recommend the financial services industry standardize the NAAF form and the terminology embedded in it. This would include all industry participants not just those who are MFDA /IDA members. This would cut down on misunderstandings that result in unsuitable investments, undue capital losses and prolonged & costly disputes. One other issue that is partly addressed by the proposed rule is improving disclosure to clients. The plan imposes a requirement that registrants provide a new “relationship disclosure

document" [Division 2] when a client opens an account. Depending on what the SRO's come up with this could be a positive. However, absent any information, we choose to be constructively critical. We would prefer NI31-103 develop a pretty specific model of such a document.

REGISTRATION OF INVESTMENT FUND MANAGERS

A fundamental change proposed by the CSA is the requirement that managers of investment funds (domestic, foreign, reporting and non-reporting issuers) other than private investment clubs be registered. This will allow direct regulation of such managers, provide a framework to deal with conflicts- of- interest between a manager and the funds managed and impose requirements to ensure managers have resources to either directly carry out their management functions or properly supervise any outsourced functions. This is a positive action. We have serious reservations about the limitations of NI81-107 and welcome any regulatory improvements in fund governance.

We are all familiar with the horrendous Norbourg fiasco and the more general mutual fund market timing scandal. As a result of being a registrant, the proposed Rule will require investment fund managers to meet certain requirements. These include having a chief compliance officer who meets certain minimum proficiency requirements, maintaining minimum excess working capital and maintaining a prescribed amount and type of insurance by way of a financial institution bond. They will also be required to provide and deliver financial information to regulators. All of these actions add to the robustness of investor protection and are to be encouraged as long as there is the will and resources to enforce.

RETAINING AN ADVISER ACROSS PROVINCIAL BORDERS

Another issue for investors is the ability to continue being served by an adviser they are comfortable with when they move from one jurisdiction to another. The proposed rule provides a very limited "mobility exemption," which allows individual brokers to serve up to 5 clients, and firms to serve up to 10 clients, who move to a different province without obtaining registration in the new province. We are disappointed that the CSA isn't taking a more progressive approach to allowing brokers to serve clients in multiple provinces. We believe that the exemption should be unlimited. If the practice of allowing clients to be served by advisers across provincial borders makes sense in principle, then it shouldn't matter how many clients are involved. The regulator in the province in which the clients live would still provide oversight, and there would be an exemption they could take away from the dealer/broker if required.

TRADING VS. ADVISING

A big issue with investors is the subject of "advice". Most mutual funds for instance embed the fee for advice in the MER .The presumption is that a buyer of a mutual fund is implicitly paying for professional advice. In many disputes the question arises whether the adviser was merely making suggestions or was acting as a fiduciary. Industry

participants typically assign the responsibility to the investor because he/she took the advice and thereby are liable for the consequences. There is an opportunity here for the Instrument to add clarity to the investor-adviser relationship .The FDM provided a framework that appears to be missing in this proposal .We add parenthetically that insurance industry personnel and bank branch staff sell products that do not fall under the CSA the IDA or the MFDA umbrella(s). Chiefly among these are Index-linked Notes, PPN's and Segregated Funds. This gap in regulatory oversight needs to be closed as it can cause much harm in the form of unsuitable investments, high fees reduced liquidity and unclear remediation processes.

Again, we add as an endnote the fact that adviser designations/titles and industry advertisements are confusing and often not meaningful. The use of such a general term as adviser or consultant misleads investors into thinking their adviser can advise on portfolio construction, risk analysis taxes and estate planning when in fact the registration is nothing more than a sales license and the service provided is less than professional. The best adviser relations are based on an agreed-upon plan, based on the client's objectives, and an open, ongoing dialogue between the adviser and the client. Key documents are an IPS and an Engagement Agreement defining the services to be provided. Too many investors are given the false impression they can expect broad financial planning advice.

KNOW YOUR BROKER

In any transaction, retail investors are at a tremendous disadvantage - the imbalance of information is heavily in favour of the broker and the firm. Regulators should be on the side of investors by ensuring they have as much information as possible. Moreover, the regulatory enforcement process, and the courts, are so incredibly slow that waiting to disclose judgments also effectively leaves investors perilously uninformed. It's time clients are truly given the opportunity to know their broker.

Often, brokers sanctioned in one province skip to another. A national database of complaints against brokers would be a wonderful tool for retail investors. We recommend the CSA require SRO's to publicly web-publish complaints about brokers and firms similar to the practice of NASD's BrokerCheck. NASD BrokerCheck reports on firms will include: administrative information including address, legal status, types of business engaged in and direct and indirect owner/officer information; a 10-year history of all felony charges and convictions, as well as investment-related misdemeanor charges and convictions; disciplinary actions and proceedings initiated by regulators; a 10-year history of investment-related civil judicial actions and proceedings; bankruptcy proceedings; unsatisfied judgments or liens; summary information on arbitration awards; and, for former NASD firms-registered firms, the date that the firm ceased doing business and, when appropriate, details regarding funds owed customers or other firms. This would alert investors to potential dangers. Sunshine is the best disinfectant in protecting investors.

CONFLICTS-OF-INTEREST

The proposed Rule consolidates and modernizes the conflict- of- interest provisions currently contained in various legislation, rules and policies. The Rule requires registrants to identify potential and actual conflicts and provides prescriptions for dealing with such conflicts, which, depending upon the circumstances of the conflict, may be handled by disclosing the conflict to clients, controlling the conflict or completely avoiding the conflict. Obviously, we would prefer the avoidance of conflicts-of-interest since such conflicts more often than not are harmful to retail investors. Our view is that advisers must at all times act in the best interests of clients and that disclosure of a potential conflict does not mitigate this obligation. The disclosure of compensation methodology however would assist somewhat in reducing the risks for small investors especially in conflict-of –interest scenarios. Kenmar maintains that those who hold themselves out as advisers have a fiduciary duty to clients. We are shocked that financial planners and advisers are still arguing over whether the interest of their customers comes first.

Indeed, the Financial Planners Standards Council already has a clear fiduciary obligation for CFP professionals in Canada, and the CFP Board is changing its proposed standards to re-impose a fiduciary duty of care on CFP professionals in the U.S. as well. We understand that FPSC is working to ensure that it has the greatest opportunity to enforce that fiduciary obligation on CFP professionals within the Canadian legal and regulatory framework; we would-support the strengthening of FPSC's ability to enforce by having a requirement that financial planners must hold CFP certification passed directly in law. These are important actions moving the advisory business from a sales orientation to professionalism.

REFERRAL ARRANGEMENTS

The Portus fiasco pointed to the dangers of referral arrangements and the dire consequences to investors (especially retirees and seniors). We support the imposition of restrictions on the referral arrangements into which a registrant may enter. Under the Instrument, any arrangement in which a registrant agrees to pay or receive a fee or other compensation for the referral of a client to or from the registrant must be evidenced in writing by an agreement between the registrant and the person making or receiving the referral. The requirement that the arrangements must be disclosed to the investor with considerable detail, including the method of calculating the fee and, to the extent possible, the amount of the fee is a positive step forward. We feel full disclosure of the amount of the fee should be mandated, not optional.

STATEMENTS OF ACCOUNT

One of the most serious issues for retail investors are Statements of Account. We feel that investors should receive at least quarterly a statement that identifies type of account, holdings (with symbols), dollar value of account, transaction details, changes in value from prior period, the fees charged during the period and YTD and as a minimum a personal rate of return for the account. The statement should answer the questions 1.what exactly do I own and what's its value? 2. what transactions have occurred? and 3. how am I doing? *Personalized* rates of return using modified Dietz have proven to be effective

well- read document quality enhancers and this is in fact the IFIC standard. The FDM Client Reporting committee recommended that personal rates of return be provided to clients.

COMPLAINTS

Section 5.29 requiring a registered firm to document, and effectively and fairly deal with, each complaint made to the registered firm about one of its products or services is basic. The complaint system should provide the protocols, records and analyses to ensure the system is working and the recurrence of systemic complaints is minimized. Merely requiring fairness is inadequate. There is no attempt in the proposed Instrument to address the problems relating to conflict- of- interest and lack of transparency in communications in the internal complaint process. An excellent and detailed discussion of this important dispute resolution issue by Dr. P.J. Reeve can be found at http://www.osc.gov.on.ca/Regulation/Rulemaking/Current/Part3/Comments/33-901/com_20040809_33-901_pjreeve.pdf There ought to be an obligation or requirement on the part of the firm in a complaint investigation to disclose to the client any aspect of the decision-making process that could lead to self-serving outcomes.

The system should also be swift. We recommend that the firms complaint system be modeled after ISO 10002. All provinces now have oppressive Limitation periods, some as short as 2 years. We feel that the Instrument should provide language that firms act without undue delay and in any event allow clients to bring their cases to OBSI if there is no resolution within 90 days. OBSI, an industry-sponsored agency, requires that clients spend inordinate amounts of time dealing with firms before they will take on a complaint case. This time could lose them their right to a civil action.

The main goal of complaints is to obtain restitution for undue losses. The CSA has an opportunity now to ensure investors are treated fairly in this regard. SRO's limit their sanctions to fines for non-compliance with their rules. The fines are not used to make investors whole. And even with this limited action, too often the SRO's sanction an adviser only to discover he/she has left the industry and not subject to SRO rules. Fines are not paid and restitution is left in limbo. We strongly suggest that this Instrument make it clear that restitution be an obligation of the firm and not the individual adviser employed by the firm

It is also appropriate for the CSA to adopt a rule relating to sanctions. If a broker is sanctioned in one province, the sanction should apply to all provinces and territories. As it stands now a provincial regulator can prevent a broker from working in the province but by a simple relocation, he/she can restart their abusive ways in another jurisdiction.

OBSI

We highly recommend the CSA undertake a full review of OBSI, an industry-funded and sponsored dispute resolution service, as regards to its ability to provide timely, fair and unbiased reviews of investor / client complaints as well as the impact of its restrictive policies on retail investors. One typical issue that bears examination is the case where an

adviser is dual registered and sells an investor a Segregated fund-a insurance product, not a security per se. When a complaint is filed, OBSI take the position that the insurance industry is not part of their mandate and thus they have no role to play. Perhaps the Joint Forum should resolve this. A review of the 2006 Annual Report shows just how shallow the OBSI operation is due its restrictions. Organizations like SIPA, CARP, The National Pensioners & Senior Citizens Federation, United Senior Citizens of Ontario among many others are hollering for action. The New Democratic Party is calling for a Canadian Securities Commission with clout to replace the toothless network of provincial securities commissions that now 'protects' retail investors in Canada - including worker pension funds. The CSA's new proposals [the NRP project NI 31-103] also acknowledge that serious shortcomings in complaint handling must be dealt with.

ACCESS TO U.S. MUTUAL FUNDS

If this proposed registration system is adopted, the CSA should take steps to permit Canadians to buy lower-cost U.S. based mutual funds. This is not inconsistent with NAFTA. We can buy U.S. stocks, why not U.S. mutual funds to broaden the competitive choices for retail investors as long as we accept their regulatory regime? A Quebec group has in fact made precisely this recommendation. A 2006 U.S. study on mutual fund fees found that Canada has the highest fees among 18 countries studied.

INVESTOR INPUT

The method of posting the Instrument on regulator websites for comment is bound to attract many more industry participants than actual investors. This could result in unbalanced feedback and conclusions. We encourage the CSA to establish more pro-active mechanisms to engage retail investors in the assessment of the proposal. A number of these mechanisms are contained in the **Canada Steps up** Research Study by Julia Black *Involving Consumers in Securities Regulation*
http://www.tfmsl.ca/docs/Volume6_en.pdf pg 554

SUMMATION

The Instrument appears to be more about harmonization and streamlining than ensuring that investors are treated honestly and fairly. When small investors approach industry or the regulators to have their complaints addressed, it is often disillusioning when they encounter an attitude which suggests they should have been more responsible and looked after themselves. Were they wrong to expect professional help from an industry that is supposed to have a fiduciary responsibility? We are cautiously optimistic that N 31-103 will be phase 1 of what we had originally hoped would be a process entirely completed by now that would help provide the necessary degree of investor protection.

Like so many other regulations, the key to success or failure will be enforcement. Any revisions to regulations should be accompanied by concurrent implementation of robust and uniform cross-Canada regulatory processes and adequate resources that would ensure that industry participants are monitored. This will help ensure that rules and regulations are enforced, that offending participants are appropriately penalized and held accountable

for restitution to investors who suffers loss due to industry wrongdoing (and not just to those who are able to pursue a complaint through a complex, bureaucratic, time-consuming complaint process).

Should you require any additional information, do not hesitate to contact us.

Sincerely,

Ken Kivenko P.Eng.
President and CEO, Kenmar