November 19, 2008

Mr. John Stevenson, Secretary
Ontario Securities Commission
20 Queen Street West, Suite 1903, Box 55
Toronto, ON M5H 3S8
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
e-mail: consultation-en-cours@lautorite.qc.ca

CSA NOTICE 81-318 - REQUEST FOR COMMENT
FRAMEWORK 81-406 POINT OF SALE DISCLOSURE FOR MUTUAL FUNDS AND SEGREGATED FUNDS

The Small Investor Protection Association is pleased to respond to the CSA's request for comments. Members of our Advisory Committee, in particular Ken Kivenko, chair, and Dr. Pamela Reeve have expended considerable effort towards developing our comments. They have previously participated on committees and submitted comments on various proposals and regulations, but it has been disappointing that little attention seems to be paid to those who wish to contribute to improving the investment environment for investors.

Too often we have seen initiatives that at first blush appear promising for investors, only to see these initiatives sidetracked or diluted to such an extent to have very little, if any, benefit for investors. It seems that industry/regulators appear intent to create perceptions that betray reality. Nevertheless once again we are optimistically submitting our comments.

We are limiting our discussion here to mutual funds. However, regulators should consider expanding the Fund Facts concept to cover higher-risk products like hedge funds, limited partnerships, universal life insurance policies and ABCP. [principal-protected notes disclosure is covered by Federal rules based on principles–based regulations].

Introduction

People wouldn't risk their physical health without all the facts - they should want the same for their financial health. But, retail investors don't have all the facts, because fund

prospectuses are too bulky and not written in plain language. Mutual funds are the investment of choice for small investors with over $600 billion invested. Investments could be unsuitable and they wouldn't even know it. Financial consumers must have access to this critical information on what they purchase or their investments, nest eggs and retirement could be at risk. Professional advisers should in principle welcome the opportunity to educate and inform. Regrettably, what we see is fund industry resistance to meaningful, timely disclosure. It was this inability to change and focus on customers that led to the decline of former giants Polaroid, Nortel and GM.

Effective POS disclosure is all the more important given some recent research reports. The “Tufano” report concluded that Canada had the highest mutual fund fees in the world suggesting that Canadians should expect truly superior performance for the outsized fees. Or, it could suggest an uninformed investor base getting gouged. Approximately 85 % of funds are purchased through an “advisory” (sales) channel so this is an important issue. Other research has concluded that Do-It–Yourselfers outperform adviser-based accounts with embedded commissions. Again, all the more reason for transparency in POS disclosure where opaque trailer commissions lurk. The reality is that most investors simply follow their advisor's advice, and the depth of explanation they get depends on the advisor.

Commentary

We have expended tremendous energy in responding to multiple Joint Forum and CSA requests for retail investor feedback on the issue of disclosure at the point-of sale. We’ve been at it for 10 years and feel that progress has been minimal, perhaps regressive. SIPA retains its belief in simplified, meaningful disclosure at the point –of-sale. However, the latest proposals in SN81-318 [JF Framework NI81-406] are so far off what was originally contemplated, we feel we are back at point zero.

The Fund Facts concept was developed by the Joint Forum of Financial Market Regulators http://www.jointforum.ca/JF-WWWSite/attachment/final%20docs/Final-Framework-for-Publication-22Oct2008.pdf, to enhance POS disclosure for retail fund investors. After consultations with industry participants, regulators are now drafting the rules and regulations. The regulators' stated priority in Fund Facts was to keep things basic and in plain language. Despite our representations, there are still no performance comparisons to index benchmarks, a key assessment statistic to validate if the active fund manager adds value relative to a passive investment product. We had also recommended that after-tax returns be provided as is required in the United States. With about 50% of fund assets in open accounts, this was to us a critical and material disclosure especially since fund turnover and TER information will not be provided. None of this information is in the new proposed FF’s.

As to fees disclosure, we still feel a simple metric like the dollars and cents fees for a fund if held for 10 years would get the message across. (A 6 % pre-tax return could be assumed to standardize the calculation) .The sheer size of this number would stimulate constructive dialogue which is the root purpose of disclosure. This would be a win-win for clients and salespersons.

Also, the fund companies are still allowed to rate the relative riskiness of its fund on a sliding scale that will leave investors in the dark about the fund's true risks. Would a fund company consider a loss of 25% since the beginning of 2008 low to moderate, moderate, or moderate to high? As we understand it, this measure, essentially a volatility metric, was a creation of fund industry lobbyist, IFIC. As a result, the investor is not provided the information he/she needs to make an informed decision. We had recommended, and still recommend, using the worst 12-month return if the fund has been around for at least 10 years. If not, we continue to suggest using the return of the fund category realizing that a number of risks such as political risk, securities lending risk or currency risk are not captured in a simple statistic. That is why there should be a clear message that only the prospectus provides full and complete disclosure of investment risks. We add parenthetically that prospectus disclosure should consider including Beta as a risk measure and Fund Governance should be a listed risk, given NI81-107 deficiencies and a history of breakdowns. We would also like to see the *Statement of Portfolio Transactions* reinstated as it provided tremendous insight into the portfolio managers' behaviour.

We had recommended that the FF's be delivered for all categories of funds including money market funds (money market funds have had some of the biggest problems due to the credit crisis – the ABCP fiasco). Instead, the Joint Forum has modified the delivery requirements so that investors can waive their right to receive the document when buying money market funds or in cases in which they initiate the purchase. We agree with the decision not to require FF delivery if purchase is made through discount brokers or for subsequent purchases of the same fund (if no material changes). The one situation in which the new document must actually be provided at the point of sale is for new fund purchases recommended (however defined) by an advisor. But the electronic delivery option has been craftily revised so that it can be met by merely providing an e-mail link to the document as well as by e-mailing the document itself. No documentation regarding proof of delivery is required to be maintained by the firm. To us this is such in-your-face mechanization of a critically important disclosure that seriously negates its value. It effectively amounts to "access equals disclosure". There is no requirement for client–adviser discussion on costs, risks or suitability, just the mechanical transmission of an important document. This is useless for protecting retail fund investors.

Another controversial aspect of Fund Facts has to do with the different delivery rules for so-called salesperson-initiated orders and those initiated by investors.

For salesperson-recommended initial purchases of funds, other than money market funds, Fund Facts will need to be delivered before or at the point of sale [an IFIC Investor survey revealed that 85% of mutual fund purchases are based on the recommendation of an adviser]. Under the proposed new rules, fund dealers won't be allowed to send the document with an order confirmation, as is done now with prospectuses. However, for "investor-initiated orders", investors can choose to wait to receive Fund Facts until the mailed confirmation is received. In the case where an adviser asserts the sale is "investor-initiated", clients should, in principle, be sold low-cost F–class funds due to adviser disengagement – but will they? Can you imagine the issues that will arise in the event of a dispute? *He said*, *she said.* Retail investors will inevitably be exposed to abuse, as under the FF regime they won't see the prospectus

unless they formally request it. [Investors in mutual funds and segregated funds will have a cooling-off right that allows them to cancel their purchase - they will have 2 business days from receipt of trade confirmation to exercise this right. Based on experience, we regard this of minimal protection value] The delivery of the FF, depending on whether the salesperson recommended the fund or the investor initiated the purchase, raises some significant legal, compliance and operational issues for dealers as well. Given the well-documented inadequacies in prevailing complaint systems, this constitutes a major new risk for investors and the industry.

On the administrative side, we would suggest that the CSA rule be clear that when an investor requests a prospectus he need not repeat the request each year. Negative option delivery doesn't work. As regards font size, we would suggest that a minimum of 10 be specified to satisfy the reading requirements of seniors. Further, when a print document is converted to pdf, care should be taken to ensure that it is still reader-friendly. In *the For More Information* block we recommend the wording be changed to: "This document is an abbreviated summary of important information. You can ask for a copy of the fund's simplified prospectus which provides more details on risks, sales commissions and other factors" .The current text is disingenuous in that implies that the FF ***may*** not be adequate when in fact it leaves out significant details found only in the prospectus.

Bottom line

Mutual fund investors are regarded as among the most vulnerable. Regulators have concluded that Grade 6 language is required to deal with literacy inadequacies. Further, it's generally accepted that financial literacy is also seriously wanting among this investor group. With so many disclosures not provided and some disclosures like risk, actually misleading, we're uncomfortable with the new disclosure regime. The requirement to reveal performance, including the impact of fees/penalties and taxes is fundamental to safeguarding retail investors. Without this compass they do not know what they are buying or how it fits into their portfolio .The FF regime is more an illusion of investor protection than a reality. In our view, any advisory firm that is unable or unwilling to provide fundamental fund information at the time of sale should be excluded from providing advice to trusting retail fund investors. If the CSA or SRO's allow this new proposal to pass as written, yet another opportunity to protect small investors will have been missed. If POS disclosure is important, it's worth doing right or not at all.

If the FF regime is going to proceed despite our input, why not at least allow augmentation of the mandatory two-page FF template and give fund companies some leeway in what they include in the document. They can include the defined information that the Joint Forum proposes [but hopefully not with the current IFIC risk measure] but they should also be able to include additional <u>factual</u> information that they consider relevant, such as risk factors that can affect performance, benchmarks, worst 12 months performance, management style, and anything else that would allow investors to make informed analysis.

In any event, we recommend that a Companion User document be prepared by regulators that would add context and meaning for each element of FF information. The document could also explain the pros and cons of a deferred sales charge over an initial sales charge, and in the case of an initial sales charge, whether such charges can be negotiated at less than the "up to" amount stated in a prospectus. The FF should make reference to the document and be available free in hard copy and on-line upon request. Simultaneously, regulator educational materials should be beefed up so as to enable investors to better understand this complex product and confusing distribution system.

As always, we point out that this system will only be effective if there is constant regulatory monitoring and enforcement.

After lengthy deliberation and trade-off analysis, unless substantive investor-protecting changes are made, SIPA believes continuation of the existing imperfect prospectus system and abandonment of the FF approach would be a better alternative for investors. Continued investor education/experience, actual returns, the media, investor advocate websites, objective free third-party information sources like Morningstar, increased regulatory enforcement and improved complaint processes will, in our view, offer better protection than a flawed FF regime. Additionally, the recent market tsunami has already raised retail investor attention to risks, fees and taxes. Mutual fund salespersons are being exposed to a torrent of questions and redemptions. This is proving to be a valuable learning experience, albeit an expensive one.

The only redeeming feature of the POS proposal is the principle of disclosure at the point of sale. This is something that has been proposed by investor advocate Joe Killoran for a decade. However, the current proposal lacks in substance and simply attempts to create the perception that something has been done.

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

Permission is granted for public posting.

Yours truly

Stan I. Buell, P. Eng.
President