

December 19, 2008

John Stevenson, Secretary
Ontario Securities Commission
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Ontario Securities Commission
SECRETARY'S OFFICE

**CSA Notice 81-318 Request for Comment Framework 81-406
Point of Sale Disclosure for Mutual Funds and Segregated Funds**

Disclaimer: *The comments that follow are my own as a financial advisor and private citizen. In no way have I consulted with my employer, Burgeonvest Securities Limited, on this matter. I have no idea what their views are on this subject and in writing to you, I am strictly expressing my own views.*

While I applaud that an attempt is being made to improve disclosure, I fear that this is more of a step back than a step forward. As such, I cannot support the initiative as it is presently constituted. More to the point, I would like to add that I have been an active participant in this process, having served as a member of one of the working groups for the former Fair Dealing Model ((FDM). To my mind, the elements of what is being proposed now are materially worse than what was proposed then. In short, I believe we are moving backwards.

The most obvious deficiency here is the lack of universality. Any proposal for greater transparency that applies to some products, but not others merely institutionalizes an uneven playing field. In essence, if the mutual funds and segregated funds are required to utilize the proposed Point of Sale (POS) disclosure document, while Exchange Traded Funds, Hedge Funds, Principal Protected Notes and other competing products are not required to use comparable POS documentation, it sets up an environment where people who want to avoid making disclosure can do so in a compliant manner by simply changing their product recommendations.

Any rule, if it is to have meaning and applicability, must apply to all related products and services. Otherwise, there are three obvious abuses that come quickly to mind:

1. Clients might invest in unsuitable products without ever receiving documentation that would provide the requisite transparency that they would otherwise expect.
2. Advisors might deliberately (yet legally) skirt their moral obligation of disclosure by substituting comparable products under the pretense of suitability/ appropriateness when their real motive is to avoid making certain disclosures.

3. Those products, product suppliers and financial intermediaries (i.e. registrants) that do make disclosures could inadvertently be punished for their decency, given that some disclosures might make products look worse in the eyes of consumers who might be fooled into thinking a product without a disclosure/ disclaimer is somehow "better" since the risks and limitations are not being expressly enunciated and itemized. In other words, if they are not referenced, investors could be duped that risks do not exist. The logic being that they would trust (i.e. rely on) regulators to insist on appropriate disclosure being made if risks did exist.

To my mind, the first thing that needs to be done is that the elements of POS (which are fine in principle) need to be applied to all financial products, not just some.

The second thing that needs to happen is that the disclosure needs to incorporate not only facts, but also consequences. Most people cannot determine the impact of an additional 100 basis points of product cost on their portfolio's performance over a lifetime. As the accompanying article demonstrates, the impact can be truly massive. It is my considered opinion that costs must be disclosed in a way that conveys their long term impact rather than merely their present day quantification. This principle is in place today with regard to appliances and energy efficiency. Consumers are not generally able to discern high efficiency from low efficiency and to compare products meaningfully on that basis. The Energuide stickers on appliances force consumers to consider the long term "operating costs" of running that appliance. Similarly, investment products have long term "operating costs" that are commonly known as Management Expense Ratios (MERs). Some consumers know what their products' MERs are. Very few, in my estimation, can reliably quantify the *impact* of costs on their marginal performance over long time horizons.

To offer further detail regarding the previous paragraph, I would invite you to consider the three articles I have included in this package ("Whither Materiality", "Disclose Material Facts" and "Price Chopper"). I believe they are self-explanatory and that the issues addressed constitute a conspicuous gap in contemporary disclosure.

Finally, I would invite you to review the printout of the powerpoint presentation entitled "You Get what You Don't Pay For". I will be making a presentation using these slides at the Financial Forum at the Toronto Convention centre in mid January. In it, I will be asking (relatively more informed than most) members of the public whether or not they are aware of certain elements of cost, market efficiency and the impact on long-term performance. Rather than surmise what the response might be or to characterize that response in accurately, I think it would be best if a representative from the OSC came to hear the talk (and more importantly gauge the reaction) for themselves.

To my mind, the financial services industry does such a poor job of making tangible, actionable disclosures that are meaningful and applicable to most consumers that the industry might as well not making any disclosure at all. In short, my view is that what is being done now (more accurately, that as a result of what is *not being done now*) that most investors might actually be better off with no disclosure as compared to the

misleading non-disclosure they are presently subjected to. Meaningful disclosure of all material information (including not only product costs but also the *impact* of those costs) ought to be mandatory for all products. Not optional. Not applying to some products, but not others.

For years, I have been saying that the solution to this problem can be captured in the simple acronym STANDUP- Scientific Testing And *Necessary* Disclosure Underpin Professionalism. It would be impossible for me to understate the importance of the word 'necessary'. The current POS proposal makes disclosure necessary for some products and unnecessary for others. Since the use of these competing products is optional (i.e. up to the discretion of the advisor making the recommendation), disclosure is effectively optional. For instance, an advisor could simply elect to recommend principle-protected notes to his or her clientele and no meaningful disclosure would be required at all. Imagine if the government required some cigarette companies to disclose that their products were carcinogenic while others were relieved of this obligation!

The current proposal, as it is presently constituted, is madness. I urge you to go back to the drawing board and to come back with requirements that apply equally and without exception to all financial products, so that unscrupulous stakeholders cannot manipulate outcomes by simply electing to use products where meaningful disclosure is not required.

If there is anything in this correspondence that is unclear, I would be happy to expand upon it further.

You have my permission to post the contents of this correspondence in any suitable public forum.

Sincerely,


John J. De Goey, CFP

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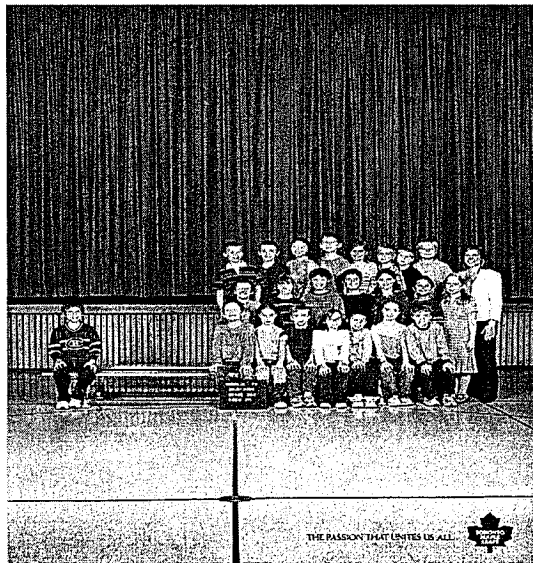
You Get What You Don't Pay For

The ABCs of Investment Management

John J. De Goey, CFP
Vice President
Burgeonvest Securities Limited

Financial Forum, Toronto, Ont.
January, 2009

STANDUP for Professionalism



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There's a lot that is communicated through implication/inference by advisors, advisory firms and product suppliers...

The great enemy of the truth is not the lie - deliberate, contrived and dishonest - but the myth - persistent, persuasive and unrealistic.

-John Fitzgerald Kennedy



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Speaking of Truth...

- The subtitle of my book is "How the Financial Services Industry Hides the Ugly Truth". 'Hiding the truth' and 'allowing myths to persist' are effectively synonymous
- I believe there are parallels to Al Gore's book and movie "An Inconvenient Truth"
- Evidence and (lack of) disclosure go hand in hand - global warming, cigarettes, active management...



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Embedded Compensation Can Cause Bias

It is difficult to get a man to understand something when his salary depends on his not understanding it.

- Upton Sinclair



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Do you know your ABCs?

- Has your advisor told you about Alpha, Beta and Costs?
- Alpha is about (potential) rewards, Beta is about risk levels and Costs are manageable, yet can impact performance significantly.



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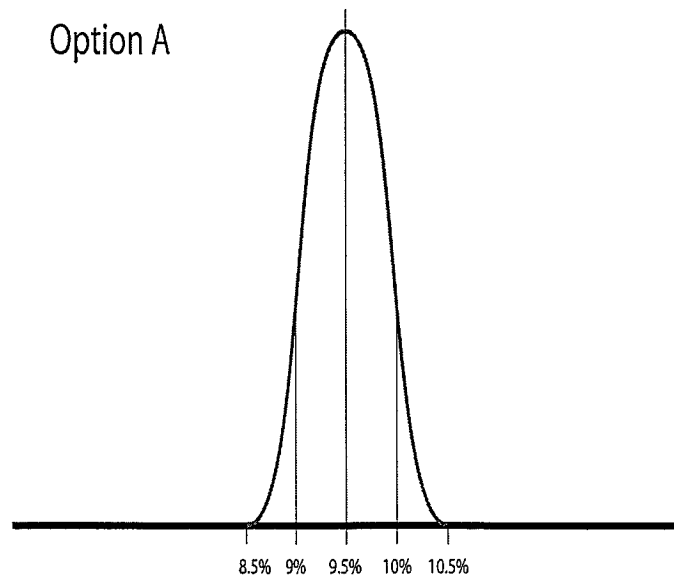
The ABCs of Investing

- A is for “Alpha” – the amount of ‘outperformance’ that is attributable to security selection, market timing, etc.
- B is for “Beta” – the risk and return level of the market in general
- C is for “Costs” – all investment products have them and they impact performance numbers

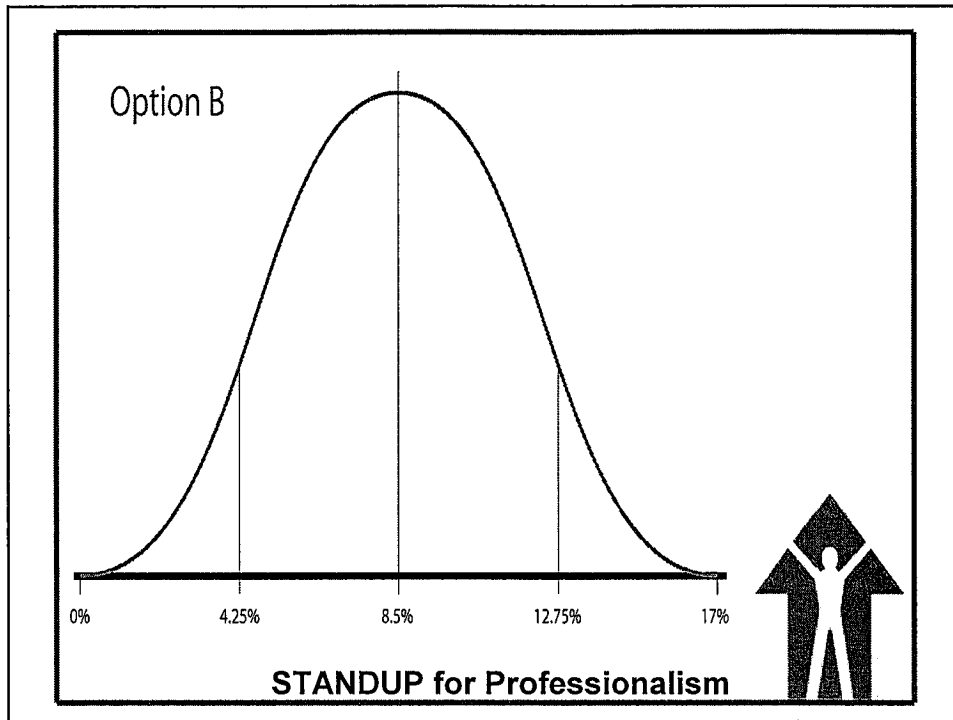


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Option A



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Pros and Cons

Option A:
Statistically stronger probability of return

Option B:
Pursuit of the positive outlier

What's your preference?

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What does William F. Sharpe say?

“Properly measured, the average actively managed dollar *must* under perform the average passively managed dollar, net of costs. Empirical analyses that appear to refute this principle are guilty of improper measurement.”

Sharpe won the Nobel Prize in Economics in 1990



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Scientific Testing

- Many studies on the subject have shown that cost and performance are negatively correlated and that the impact is often 'material'.
- Do advisors disclose that today? Will they in the future?
- How professional is it to willfully *not disclose* material facts that will assist clients in making an informed decision?



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A Little Test about Overconfidence

- Are you an above-average driver?
- Are you an above-average lover?
- Are you an above-average money manager?
- In over 15 years in the business, I have yet to meet a mutual fund manager who admits to being “below average”



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We can't all be above average

- Only a small fraction (10% to 20%?) of all actively-managed funds have a long term (10+ years) track record that beats the benchmark.
- Those that end up in that minority group are virtually impossible to reliably identify in advance.



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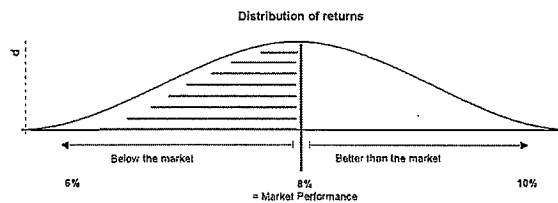
What does "Top Quartile" mean to you?

- If only about one manager in seven has a long-term track record that beats a benchmark, that means the odds are nearly 50/50 that a "Top Quartile" performer is actually *lagging* a benchmark.
- Has anyone ever told you that before?

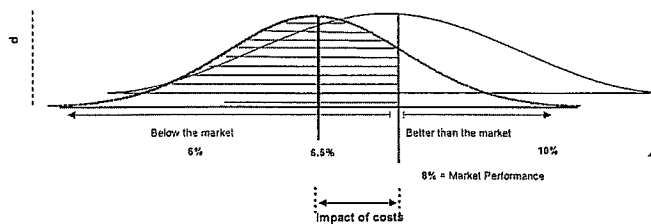


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Investing is a Zero-Sum Game before costs;
a Negative-Sum Game after costs



After Costs, Index Managers Will Outperform Most Active Managers



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And now for the 'D'... Disclose

- Were you aware of the things mentioned in the previous slides?
- Does the industry go out of its way to tell you about the ABCs of investing?
- Not suggesting anyone is lying, they're simply failing to actively tell you the truth (and the truth is ugly).



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Disclaimer

The views expressed are those of John J. De Goey and are not necessarily shared by Burgeonvest Securities Limited (BSL). Debate regarding market efficiency, the usefulness of fundamental and technical analysis, active vs. passive management and the efficiency of fee payments is ongoing. To date, neither side of these debates has been able to claim unchallenged victory. BSL as a policy, supports both active and passive as well as fee based and commission based platforms.



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Other Potential Disclaimers and Disclosures:

- Mutual Funds are not Free. Their cost (MER) is applied against your returns.
- Most actively managed funds lag their benchmark over long timeframes and those that do outperform cannot be reliably identified in advance.
- Many mutual funds charge trailing commissions for advice even if they are purchased through a discount broker.
- Cost can be a major determinant of performance. Research shows that expensive funds underperform cheap funds, on average.



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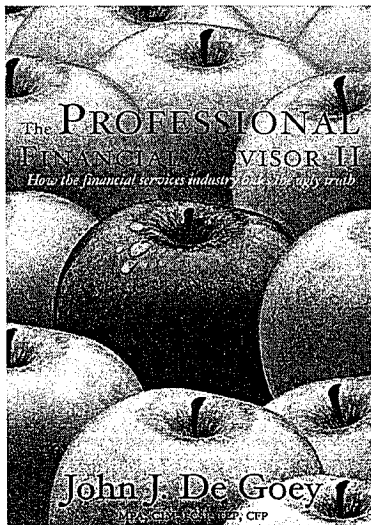
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S.T.A.N.D.U.P.

Scientific Testing And
Necessary Disclosure
Underpin Professionalism



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ADVISORPRACTICE

Whither Materiality?

Impact disclosure can help consumers make informed decisions

STANDUP ADVISOR BY JOHN DE GOEY



The question of meaningful, professional disclosure can be addressed in a number of ways. The most obvious way is to comply with the letter of the regulation. As such, product manufacturers need to make clear

disclosures in their prospectuses and offering memoranda, including what their products cost and any associated permutations, such as taxes, performance bonuses and additional service fees.

Another way that one might look at disclosure is to apply the Golden Rule as it relates to the financial services industry. Essentially, that means advisors should disclose unto others as they would

like others to disclose unto them. That might well mean that their disclosure involves not only (for instance) what a product costs, but also what the impact of that cost would be on a portfolio of a certain size over a certain time frame, *ceteris paribus*.

At issue here might be the notion of materiality. The directive from IIROC (Rule 29.7) says that industry participants are to dis-

close all material facts pertaining to products and services. When I asked an IIROC manager of Business Conduct Compliance to define the standard more precisely, she said: "Materiality is well defined in several places. We expect members to be professionals, able to apply rules reasonably."

Given this response – every answer is a response, but not every response is an answer – it seems our esteemed securities SRO is quite happy to offer general guidance regarding where the line might be drawn on industry matters without ever specifically drawing a line at all. Different firms, in turn, take it upon themselves

to draw different lines regarding disclosures, disclaimers and such. The perspective they bring to the table will inform their individual corporate policies and procedures regarding product disclosures and practice disclaimers, among other things. In short, the same marketing piece might involve different disclosures at different firms governed by the same regulatory framework.

Perhaps that's no big deal in your eyes. What if the same firm required different disclosures for different advisors using the same material? After all, if there's no uniformity between firms (a macro question) is it a big deal if there's no uniformity within firms (a micro question), either? Now, the question of materiality morphs into a question of consistency and fairness.

If you're buying an appliance, you'll see it comes with a sticker that shows not only how much energy it consumes, but also how much it consumes *relative to other appliances one might purchase*. As such, government bodies have decided that it is important that consumers can determine not only the absolute quantum of usage, but also the comparative quantum of usage. It seems giving consumers only absolute (but not comparative) information might inhibit them from making a responsible self-interested choice. To date, disclosure has revolved around what costs *are* rather than what they *mean* for investors.

I think it would be constructive to have the industry include comparative data – how much does this Canadian equity mutual fund cost compared to the universe of Canadian equity mutual funds? I also think an impact disclosure is clearly material, even if IIROC (or the MFDA for that matter) doesn't force the industry to connect the dots. For instance, \$10,000 invested at 10% over 10 years yields a total value of \$25,937.43. That same product would generate a final value of \$20,610.32 after accounting for a 2.5% MER (assuming no difference in pre-cost performance). In my view, that kind of "impact disclosure" of fact is material. It's also something that professionals can easily apply in a reasonable manner that would help consumers make a truly informed decision.

AER

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ADVISORPRACTICE

Price Chopper

Percentage saved, percentage earned

GUEST COLUMN

BY JOHN DE GOEY



There's an intriguing attribute about the financial services industry that is seldom discussed. Unlike other businesses that provide either goods or services, the business of providing financial services seems somewhat immune to price competition. This seems to be the case for both

products (those manufactured in Canada are consistently among the most expensive in the world) and services. There's a real benefit to people if they make a concerted effort to lower their costs – a tactic that is self-evident in most circles.

Your grandmother was right when she offered her homespun wisdom "a penny saved is a penny earned." It never ceases to amaze me how so many people miss something so basic. An investment that earns 9% before fees with fees

at 2.5% leaves the investor with 6.5% in his pocket. An investment that earns only 8% but costs only 0.5% leaves the investor with 7.5% in his pocket. Anyone who thinks a fraction of a percent isn't worth considering should take a look at the chart below. I estimate that I save my clients somewhere between 0.5% and 1.0% in annual fees as compared to what they were invested in before they met me.

Let's start with \$10,000 and consider the power of compounding by assuming a saving of 1% on a fairly aggressive portfolio – one that converts an 8.5% annual return into a 9.5% return.

Looking at the chart, we see

FEES, LIKE RETURNS, COMPOUND

Years Return	10	20	30	40
6.0%	17,908	32,071	57,435	102,857
6.5%	18,771	35,236	66,144	124,161
7.0%	19,672	38,697	76,123	149,745
7.5%	20,610	42,479	87,550	180,442
8.0%	21,589	46,610	100,525	217,245
8.5%	22,610	51,120	115,583	261,330
9.0%	23,674	56,044	132,677	310,994
9.5%	24,782	61,416	152,203	377,194
10.0%	25,937	67,275	174,494	452,593

that after 20 years, the two bolded numbers are about \$10,000 apart (\$61,416 - \$51,120 = \$10,296). So what? That's a saving of more than \$10,000 on an investment that

was only \$10,000 to begin with!

Now, let's put this in the context of a client's entire portfolio. Let's assume that a client and spouse are both 50 years old and have a combined RRSP portfolio of \$400,000. Setting aside the fact that they'll likely be adding to their portfolio(s) for the 20 years immediately prior to converting their RRSPs to RRIFs, let's just look at the last twenty years of compounding for the money that was already in their accounts.

Because the actual dollar amount of the clients' portfolio was actually 40 times the hypothetical \$10,000 amount, the actual savings would also be 40 times that amount: $\$10,296 \times 40 = \$411,840$.

Here's a question that I like to ask prospective clients: "If I could show you a way to save over \$400,000 in the course of your working life alone (the savings will continue after you retire) and all you had to do was use cheaper, purer, more tax-efficient investment products than you are currently using (same expected risk; same expected pre-cost return), is that something that would interest you?" Just think how the cost savings could be used to add to your clients' net worth!

The savings would be far greater still when you consider that most clients add considerably to their portfolios while they are working. A simple \$19,000 annual RRSP contribution added to the original portfolio would make for an astronomical amount of additional savings. Bear in mind that even that severely underestimates the total cost savings when you consider the fact that savings may well continue for 10, 20 or more years in retirement, too. Cost matters. It is a compelling value proposition that too few advisors are prepared to acknowledge. AER

John J. De Goey is a Senior Financial Advisor with Burgeonvest Securities Limited (BSL) and author of *The Professional Financial Advisor II*. The views expressed are not necessarily shared by BSL.
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ADVISORPRACTICE

Disclose Material Facts

Even contradictory information is material; clients have a right to know the facts and decide for themselves

STANDUP ADVISOR BY JOHN DE GOEY



How exactly might a person define the word "material" — as in: "Professional Advisors must always disclose all material facts when making product and strategy recommendations to clients?" The dictionary suggests

synonyms like relevant, substantial and pertinent could all be used in place of the word "material."

To my mind, any piece of information that causes a person to change their opinion or behaviour is material. For example, if you were a smoker and I were the first to inform you that cigarettes cause cancer, I would say that the information was material if it caused you to change your habits.

Obviously, one could quite properly add that the information could be relevant, substantial and pertinent whether one gives up smoking or not. At that point, materiality is debatable. However, once the end-user's behaviour changes, genuine materiality can safely be assumed to be the cause.

For some time now, I've been making written disclosure to my

clients that most actively managed mutual funds lag their benchmarks and that the few that seem to outperform cannot be reliably identified in advance. Not surprisingly, most of my clients resist using actively managed funds once they've been presented with this information. There is nothing in the industry that requires that this disclosure be made.

As a result of this, it has become clear to me that disclosure is a significant contributor to consumer decision-making and can be used to manipulate choices. Similarly, non-disclosure can be used to direct and impact on decisions, too. What a financial intermedi-

ary (be it an advisor or product manufacturer or advisory firm) discloses often has an impact on what a consumer chooses. This then begs the question: where does one draw the line on what does and does not need to be disclosed?

Disclosure is a significant contributor to consumer decision-making and can be used to manipulate choices.

Most advisors don't make disclosures about the relative merits of active and passive management approaches. Similarly, most clients don't change the way they invest or their belief systems about the subject after meeting an advisor. Ask me no questions and I'll tell you no lies.

I can't help but notice that disclosure often has a direct impact on the selection of products and strategies. After all, how can anyone be concerned about something that they are unaware of?

In the financial services industry, the sales culture holds sway over the professional culture largely because material disclosure, which is a primary attribute of professionalism, is bad for business. If advisors and the firms they work for were genuinely concerned about their clients' welfare, they would not only give good and comprehensive advice, but full disclosures would be commonplace. As it now stands, only a small number of STANDUP (Scientific Testing And Necessary Disclosure Underpin Professionalism) advisors ever bother to explain this to their clients.

Advisors ought to be able to think for themselves and to recommend whatever products and strategies they feel are best for their clients. However, I don't believe that exonerates them from the willful concealment of material facts.

If nothing else, advisors shouldn't deny their clients of a right to be wrong. Advocate whatever you feel is best, but tell clients the other side of the story. Get them to sign off on your disclosure and then let them decide for themselves. Collectively, we have been too paternalistic for far too long.

AER

*John J. De Goey, CFP is a Senior Financial Advisor with Burgeonvest Securities Limited (BSL) and author of The Professional Financial Advisor II. The views expressed are not necessarily shared by BSL. www.johndegeoy.com
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