Kenmar Associates
Investor Education and Protection

John Stevenson, Secretary
Ontario Securities Commission
20 Queen Street West, Suite 1903, Box 55
Toronto, ON M5H 3S8
Fax: 416-593-2318
E-mail: jstevenson@osc.gov.on.ca

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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
Fax : 514-864-6381
E-mail: consultation-en-cours@lautorite.qc.ca

CSA NOTICE AND REQUEST FOR COMMENT

IMPLEMENTATION OF STAGE 2 OF

POINT OF SALE DISCLOSURE FOR MUTUAL FUNDS

PROPOSED AMENDMENTS TO

NATIONAL INSTRUMENT 81-101 *MUTUAL FUND PROSPECTUS DISCLOSURE*,

FORM 81-101F3 AND

COMPANION POLICY 81-101CP *MUTUAL FUND PROSPECTUS DISCLOSURE*

AND CONSEQUENTIAL AMENDMENTS

http://www.osc.gov.on.ca/en/SecuritiesLaw_rule_20110812_81-101_stage2-pos.htm

We are pleased to respond to the Request for Comment.

By way of introduction, Kenmar Associates is an Ontario- based organization focused on investor education and protection via on-line research papers hosted at www.canadianfundwatch.com.Kenmar also publishes ***the Fund OBSERVER*** on a bi-monthly basis discussing investor protection issues primarily for retail investors. Kenmar routinely submit comments and ALERTS on proposed regulatory changes that could impact Main Street.

The stated intent of the proposals is to replace the Simplified Prospectus (SP) with the Fund Facts document. It would be delivered within 2 business days of having been sold to a mutual fund investor. Delivery of the simplified prospectus will no longer be required, ;it will continue to be available to investors but only upon request.

The Canadian Securities Administrators (CSA) have set a noble goal of providing a plain language document, Fund Facts (FF), originally intended for disclosure at the point-of-sale so investors can assess mutual funds being sold to them before they buy . Short, summarized disclosures of Key information such as the Fund Facts document are not necessarily a bad idea. However, this greatly reduced disclosure should not eliminate the obligation of dealer representatives to recommend suitable investments. They should be able to rely upon it to make an informed purchase decision.

While the document contains some useful information, there's a number of improvements that need to be made before the form can be considered for use by retail investors:. These are.

1. There should be a more emphatic statement at the beginning of the document WARNING that it is a greatly abbreviated version of a simplified Prospectus and emphasizing that if additional details on costs and risks are required the SP should be consulted. The Introductory text is too bland in our view . Adding the fund's symbol and CIFSC Fund Category would also provides valuable information .The SEC requires its "Summary Prospectus." to include an introductory legend as follows:
   Before you invest, you may want to review the fund's prospectus, which contains more information about the fund and its risks. You can find the fund's prospectus and other information about the fund online at _________. You can also get this information at no cost by calling _________ or by sending an e-mail request to _________. We add parenthetically that the FF uses the term "adviser" - the terminology of NI31-103 should be used --viz registered representative. The previous descriptor was " salesperson" .

2. The section at the bottom right of the first page , "Who is this fund for?", is important and should be moved up right under the "Quick facts" section. The fund Objectives need finer delineation given the importance of investors choosing funds with objectives and strategies that are consistent with their own objectives and risk/loss tolerances. A survey of American investors found that most are unaware of the objectives and strategies of the

funds in which they invest .The list of the top holdings should include the percentage of each holding would give some idea of concentration risk.

3. The "What does the fund invest in?" needs more than a tweak. In the FF sample it says "The fund invests in Canadian companies." Instead, for clarity, it should say "The fund invests in the stock of Canadian companies."Surveys have found that most retail investors were unaware even if their funds invest in stocks or bonds. CSA research determined that a grade 6 literacy level is the target audience for FF.

4. Because retail investors are known to chase returns , cost and risk information should precede performance data. This is consistent with behavioural finance research. Given the potential long term impact of fees on an investor's total returns, the section entitled 'How much does it cost?' should precede the section entitled 'How has the fund performed. " Relocation of the fee table will place fee information in a more prominent location and encourage investors to give greater attention to costs and cost comparisons.

5. The "How has the fund performed?" section should contain a strong warning about choosing funds based on past performance. Thus, it would be helpful if past performance were de-emphasized by putting it lower down in the document . A strong warning can be effective "Do not expect the fund's quoted past performance to continue in the future. Studies show that mutual funds that have outperformed their peers in the past generally do not outperform them in the future. Strong past performance is often a matter of chance."

6. The cost information should clearly indicate whether or not the salesperson will earn a commission from selling the fund. .This will alert the retail investor there is a conflict-of-interest present and therefor adviser risk. The statement " *Investment firms* ***may*** *pay part of the trailing commission to their representatives."* does not provide this visibility. in our opinion The SEC Fund Summary Prospectus disclosure is a good example of a Best practice*.

   * "Payments to Broker-Dealers and Other Financial Intermediaries If you purchase the Fund through a broker-dealer or other financial intermediary (such as a bank), the Fund and its related companies may pay the intermediary for the sale of Fund shares and related services. These payments may create a conflict of interest by influencing the broker-dealer or other intermediary and your salesperson to recommend the Fund over another investment. Ask your salesperson or visit your financial intermediary's Web site for more information."

For a comprehensive review of the comparable SEC Summary Prospectus see http://www.sec.gov/rules/final/2009/33-8998.pdf It includes details on portfolio turnover, manager tenure, principal investment strategies and other useful information. A sample

Summary Prospectus can be found at http://www.edgarfilepoint.com/XyZ%20Growth%20Fund.pdf

7. Fund Facts provides historical return information but it lacks context. Without a benchmark ,investors cannot gauge for themselves how the fund has performed relative to a passive index . Such a comparison could assist investors in assessing relative fund riskiness and the value of active management. The OSC's Investor Advisory Panel , in its Comment Letter on 2011-2012 OSC Priorities,stated: "*Investors cannot judge rates of return without the appropriate context"*. Common sense and best practices dictate that a benchmark must be provided .

8. The FF risk measure is completely inadequate and misleading.. In most cases it is merely volatility risk (3-year standard deviation of returns) using a methodology prepared by fund industry lobbyist IFIC. In others it can apparently mean anything. SIPA, FAIR, Morningstar , PIAC , the Common Front for Retirement Security (CFRS) and even the OSC's own Investor Advisory Panel have cautioned about using this type of defective disclosure. Most investors are not going to understand what standard deviation means. Most investors will view risk as the likelihood that the investment will decline in value over a long- term investment horizon. Several media articles have also been highly critical of the FF risk disclosure. At least two industry studies have demonstrated how unreliable and inconsistent the IFIC methodology can be. In one example a Silver fund was rated as Low to Medium. In another example, an identical fund was rated differently by 2 fund companies. These studies have been communicated to the OSC and CSA.One classic media example is the Mackenzie Growth Fund Series A. The FF assigns it a a Medium risk . Yet this fund fell 60 % in 2008 while the S&P//TSX index fell 35 %.. This kind of miscategorization can leave unsuspecting investors with huge losses. For seniors ,such losses could be life altering.

9. Risk scales have significant limitations. Nevertheless,a risk scale could be more helpful to the typical investor than traditional measures of risk that investors might not understand, such as Beta or Maximum Drawdown. But there are issues, however, in determining which of the defined five risk buckets a fund should be put in. For example, in the CSA sample, the XYZ Canadian Equity Fund is listed by its fund company as having "medium" risk. However, one doesn't think of equity funds as having "Medium" risk; for a broad-based equity fund, "medium to high" seems more appropriate. It's absolutely necessary to ensure that fund companies are all using the same methodology in determining risk categories, and that investors have an understanding of what they mean (e.g., "Low" means returns are generally not volatile over time, and you are unlikely to lose money on this investment). Lack of a standard risk assessment methodology between firms prevents investors from robustly comparing funds between

fund manufacturers and goes against the goal of allowing comparability Another alternative as suggested by the Small Investor Protection Association (SIPA) , would be to let actual numbers do the talking. Accordingly, they have proposed presenting the worst month , quarter and 12 months based on rolling averages vs. the benchmark. This would respond to the most obvious question, " How much can I lose?" . We endorse this approach while noting that the US SEC requirement is to reveal the best and worst quarterly performance and the time that occurred.. Additionally, we strongly believe the principal qualitative risks of the fund should be enumerated and not let FF rely solely on a single word to define overall fund risk. This is consistent with IOSCO standards which we believe the CSA should adhere to. The US SEC also requires a delineation of the principal risks. Ironically, it is only by reading the Simplified Prospectus [See APPENDIX I] that an investor discovers just how flimsy the FF risk disclosure is.

10. Because Fund Facts is a greatly condensed prospectus there needs to be a bridge built to the Simplified prospectus and some tools for using Fund Facts in building a portfolio. A CSA Companion Guide that would be made available to small investors really is needed . It was a requirement of an earlier draft but dropped despite endorsement by SIPA , Kenmar Associates and others. It would show how to interpret each block of information in Fund Facts , include some educational material and links to websites for further information .

Most retail investor complaints stem from unsuitable investments being sold to them. The biggest cause of unsuitable investments is associated with risk . Therefore, any document that has so incomplete, defective and misleading risk disclosure as Fund Facts cannot be endorsed by us and should not be enacted by provincial legislative amendments. It would in fact be a form of regulatory negligence to do so.

Related to unsuitable investments of course is the NAAF/KYC regime. The words in Fund Facts describing risk are virtually identical to those on NAAF's. Any attempt by the investor or his/her salesperson to connect the two could be disastrous. It could lead to substantial investor losses that may be difficult to file a unsuitable investment redress claim for. This is because fund dealers could argue that the risk disclosure was as prescribed by regulators. It is not hard to envision the kinds of dispute this could lead to. This is further supported by the fact that FF will only be delivered **AFTER** the sale to the investor .

The IIAC has stated in their Comment Letter http://www.obsi.ca/images/document/IIAC___July_25_2011.pdf] to the OBSI consultation process : " *We also seek clarification on the stated principle in the Consultation Paper that disclosure does not validate an unsuitable recommendation. It should be clear that,although such disclosure may not make the investment suitable, if full disclosure is followed by informed client consent and direction to make the investment, the client must bear responsibility for losses relating to that investment."* .Thus, defective disclosure can lead to a lot of trouble for Main Street.

The CSA designed the Fund Facts to make it easier for investors to find and use key information at the point-of-sale . Because the CSA agrees that further review and consideration of issues related to point- of- sale delivery for mutual fund documents is necessary, we believe that it would be safer for investors that Fund Facts **not** to be made available to investors at this time By describing the scale as "medium", "high" etc. the disclosure minimizes the perceived risk and makes consumers more comfortable than they should be.

We are of the conviction that the Proposed Amendments and consequential amendments will reduce investor protection by providing investors with defective after-the-fact disclosure thus preventing informed investment decisions at a time that is most relevant to their acceptance of salesperson investment recommendations (at the POS).

We're sure that allowing delivery of the Fund Facts instead of the Simplified prospectus to satisfy the current prospectus delivery requirements under securities legislation would benefit capital markets by reducing printing, distribution and mailing costs but it will do less than nothing to help address the "information asymmetry" that exists between fund salespersons and retail investors. **It is therefore not in the public interest to proceed with these amendments.**

We applaud all efforts to provide investors with succinct, understandable, unbiased information so that they can make truly informed mutual fund investment decisions. That is why we strongly urge the CSA to consider these points and revise Fund Facts to better protect retail investors., a stated priority in the 2011-2012 OSC Statement of Priorities

We have a huge quantity of information and analysis to support our recommendation for a cautious approach. Millions of individual Canadians invest in open-end mutual funds relying on mutual funds for their retirement, their children's education, and their other basic financial needs In fact , some 10 million Canadians have about $700 billion of their nesteggs invested in mutual funds.

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

We agree with the public posting of this Comment letter.

Sincerely,

Ken Kivenko P.Eng.
President
Kenmar Associates
(416)-244-5803
kenkiv@sympatico.ca

APPENDIX I – Typical FF Prospectus risk disclosure and commentary

Here's a typical SP disclosure:

" We assign fund risk ratings to each fund as an additional guide to help you decide whether a fund is right for you. Our determination of the risk rating for each fund is guided by the methodology recommended by the Fund Risk Classification Task Force of The Investment Funds Institute of Canada (Task Force). The Task Force concluded that the most comprehensive, easily understood form of risk is the historical volatility of a fund as measured by the standard deviation of its performance. However, you should be aware that other types of risk, both measurable and non-measurable, also exist. Additionally, just as historical performance may not be indicative of future returns, a fund's historical volatility may not be indicative of its future volatility. The Task Force guidelines suggest that managers refer to standard deviation bands associated with fund categories as a point of reference where historical performance does not exist. Consistent with the Task Force guidelines, qualitative factors are also considered before making a final determination of the appropriate risk ratings.

Using this methodology, we assign a risk rating to each fund as either low, low to medium, medium, medium to high, or high risk. In certain instances, we may classify a fund either higher or lower than the risk rating indicated by the Task Force's methodology. We may do so where qualitative factors, such as style and sector concentration, may contribute to the fund's overall volatility and therefore the risk rating of the fund. We review the risk rating for each fund on an annual basis."

NOTE: The actual name of the Task Force report is the IFIC Volatility Risk Classification report. By incorporating it by reference in the prospectus , this voluntary industry Code should be publicly available. It is not. Only after we filed a formal complaint with the OSC would a bank-owned fund manufacturer provide us a copy. Additionally, note that fund firms that voluntarily accept the Code in the Task Force Report should consider the Guidelines provided by the Office of Consumer Affairs http://www.ic.gc.ca/eic/site/oca-bc.nsf/eng/ca00963.html One key item on their list for a "good" voluntary Code is stated as follows:

" **Open, transparent development and implementation** — Codes are more likely to reflect broader socio-economic concerns and be better received if they are developed and implemented openly and with the participation of the larger community (that is, workers, suppliers, competitors, consumers, public-interest groups, governments and neighbours). This enhances the credibility and effectiveness of the code and its proponents and participants. " As far as we are aware no investor advocates or consumer groups were part of the Task Force. [Perhaps even regulators were not engaged in the development process.] If there were ,that fact is not disclosed. Certainly , neither Kenmar Associates nor SIPA was never contacted. We note also that when the objective of the Code is to maintain or improve market position, parties must keep in mind that the methods employed must comply with the *Competition Act* and other legislation. Prospectuses do not refer to a specific revision level or date ,so configuration control cannot be maintained. The IFIC document can be changed without prior notice or approval , leaving investors unduly exposed to disclosure risk (actually, we are not aware that IFIC has taken on the obligation to keep the report up to date , retain records of changes or even if IFIC's Board of Directors has endorsed use of the document) .

Perhaps as importantly , it seems wholly unreasonable for the CSA to accept this Code under the administrative control of a trade Association that has often been at loggerheads with the investor advocacy community and whose primary purpose is to represent the interests of the investment fund industry. In June 2010, IFIC even complained to Morningstar's Chicago head office about Morningstar Canada s use of Stewardship Grades, an important investor protection tool.. Here's another problem- IFIC is leaving risk disclosure to the SP (and the fund manager) in order to comply with regulatory obligations and the fund managers are relying on the IFIC document

We also note that in order to understand the risk of investing in the mutual fund, investors will have to first (a) look at the risk scale category on the Fund Facts document which is not helpful or meaningful and may be misleading to an investor and then (b) ask for or go onto SEDAR to find a copy of the Simplified Prospectus (SP). The SP will not properly disclose the risk of investing in the fund as it will simply provide the boilerplate language suggested in IFIC's document which states that "the most comprehensive, easily understood form of risk in this context is historical volatility risk as measured by the standard deviation of fund performance." It may or may not also state as suggested by IFIC's document: "However, the Task Force recognizes that other types of risk, both measurable and non-measurable, may exist and reminds that historical performance may not be indicative of future returns and a fund's historical volatility may not be indicative of its future volatility." Most SP's will likely also say that the methodology used by the manager to identify the investment risk is available upon request. The investor may then request the manager's methodology. Even if, as a result of requesting it, the IFIC document were disclosed, it would tell the investor that there are other forms of risk that are not dealt with by the IFIC document and that the IFIC document only covers volatility risk. In other words, the level of disclosure of risk to the investor is inadequate and takes a ridiculous amount of work to figure out!

A recent research report by Fundata's Manager of Analytics, Brian Bridger concluded :" ***This analysis should highlight the fact that investors cannot assume to expect a certain level of volatility simply by choosing a fund within a particular risk category.*** " Ref: http://www.fundlibrary.com/features/columns/page.asp?id=13753

We have analyzed the IFIC Task Force report and provided the CSA a copy. We have demonstrated that the IFIC document in a couple of places points out that volatility risk does not equal risk as risk includes other qualitative factors. However, IFIC then discounts the qualitative facts as unimportant (and contradict themselves) by stating that a description of risk as required in a SP can be addressed by describing volatility risk. IFIC adds language to cover themselves from liability "Fund managers are reminded to seek their own legal counsel when determining their obligations of disclosure under NI 81-101F1. An explanation of risk should not be limited to volatility risk and they agree with this but that is what IFIC (and its member firms) has done – equated volatility risk with risk. All in all, this type of disclosure amounts to a shell game where the only vulnerable player is the retail investor.