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September 14, 2012

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Saskatchewan Financial Services Commission
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
New Brunswick Securities Commission
Superintendent of Securities, Prince Edward Island
Nova Scotia Securities Commission
Superintendent of Securities, Newfoundland and Labrador
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Yukon Territory
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Dear Sirs / Mesdames,

Re: Notice And Request For Comment On Proposed Amendments To National Instrument 31-103 *Registration Requirements And Exemptions* And To Companion Policy 31-103CP *Registration Requirements and Exemptions – Cost Disclosure And Performance Reporting*

We are writing in response to the Canadian Securities Administrators' (CSA's) Request for Comment on Proposed Amendments to National Instrument 31-103 *Registration Requirements And Exemptions* and to Companion Policy 31-103CP *Registration Requirements and Exemptions – Cost Disclosure and Performance Reporting* (the "2012 Proposals").

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EXECUTIVE SUMMARY

PART ONE: GENERAL COMMENTS ON CHANGES SINCE THE 2011 PROPOSALS

Advocis has concerns about the policy development process employed by the CSA in general and the specific failure to conduct a formally empirical, industry-reviewed and evidence-based cost-benefit analysis. We believe such a review to be fundamental to all policy development in the financial sector. Failure to attempt to quantify the potential economic impact of the sweeping changes necessitated by the 2012 Proposals is troublesome. Given the state of the Canadian economy and the current savings rates and retirement planning readiness of many Canadians, to create confusion among consumers about the costs of their various investments strikes us as highly problematic. Further, to exclude stakeholders such as Advocis from the early stages of the process is a fundamental flaw in the initial stage of the policy development process. As financial advisors, Advocis' members are better positioned than any other stakeholder group to understand the advisory and informational needs of the typical Canadian investor – on whose behalf the CSA has promulgated these draft rules and amendments. Finally, the currently unfolding Fund Facts disclosure requirements will not receive, as a result of the scheduling of the roll-out of the 2012 Proposals under review here, an adequate opportunity for careful stakeholder assessment and further refinement.

PART TWO: REVIEW OF KEY ISSUES

1. Key issues and decisions since the 2011 Proposals

(i) Disclosure of trailing commissions.

Advocis urges the CSA to revise its draft text to include reference to the usefulness of consulting a professional financial advisor. Given the vast number of Canadians approaching retirement, a brief statement suggesting that the investor consult a financial advisor would be a highly effective, low cost way to remove confusion on the part of the typical individual retail investor and help the CSA achieve its policy objective of providing clarity in this area for members of the investing public. In addition, the idea of complete disclosure that the CSA is attempting to realize in practice is effectively prejudicing the attractiveness to the typical retail investor of securities investments, relative to non-securities investments. The result is consumer-driven product arbitrage, a phenomenon which can result in Canadians engaging in sub-optimal investment product selection based on the mistaken belief that, by avoiding certain costs such as trailing commissions, they are making better investment decisions.

(ii) Disclosure of fixed-income commissions / *Issue for comment*: Fixed-income transactions compensation disclosure

Advocis believes that making fixed-income transactions more transparent, including desk spreads and commissions, is at present overambitious: the Fund Facts process is still being rolled out, and the complexities of certain fixed income transactions may well be beyond the ken of the average Canadian investor. Mandating disclosure of all compensation earned by registered firms from fixed-income transactions seems at this point in time more likely to add to confusion, rather than remove it.

(iii) Expanded client statement / *Issue for comment*: Reporting of transactions in securities listed in s. 14.14(5.1)

The CSA states that "We believe our proposals with respect to client statement reporting will provide clients with more comprehensive information about the securities in their portfolio with a dealer or adviser, regardless of whether they are held in an account at the registrant or otherwise." Advocis would point out that historically in Canada it is generally only high net worth investors who receive such complete individual account performance and cost reporting. It must be borne in mind that these high net worth individuals have the acumen and experience, and/or access to the relevant advice and assistance needed to understand such statements. Indeed, in Canada the typical retail investor currently receives an account statement which is too often incomplete or confusing. The problem is especially compounded when the individual is retired or nearing retirement and, in some instances, his or her level of financial acumen has regrettably not kept pace with the times. In this area, experience has shown Advocis that professional advice proves to be more dispositive toward beneficial investment

outcomes than any amount of statement information.

With regard to the reporting of transactions in securities listed in s. 14.14(5.1), Advocis understands the need of the client to see all of his or her securities listed in the client statement. Clients are not interested in the back office categorization of securities and accounts. In the interests of simplicity, we would relegate the specifics of the section 14.14(5.1) to a legal footnote and preserve the simplifying spirit of the proposal by treating – for *reporting* purposes only – these securities as part of a single client "account." This is, Advocis submits, the only information a client is looking for at this stage from this document. Finally, for exempt market products, we strongly urge the CSA to require that client statements which list exempt market securities clearly state that, given the nature of the exempt market, an investor owning exempt market securities may often receive from advisors or dealers a minimal amount of transactional information about their securities.

(iv) Common baseline requirements for registrants

Advocis is concerned by the CSA's statement that "We anticipate exempting the SROs and their members from some or all of the proposed amendments if the SROs adopt materially harmonized requirements." Given one of the main purposes of CRM-2 is to ensure enhanced disclosure of information to investors, Advocis would suggest that all retail clients should have the same information, so *full* harmonization is a critical objective. In the interests of fairness and clarity for all stakeholders, Advocis would ask that the CSA identify and publish those areas of substantive difference between the CSA's 2012 Proposals and the rules of IIROC and the MFDA. It is expected that assorted SRO rules will need further refinement – particularly the rules which are currently suspended pending the implementation of the CSA's final version of the 2012 Proposals. In the interest of getting the perspective of those who advise ordinary Canadians in such matters, Advocis would urge the CSA to include financial advisors in any future consultations in this area.

(v) Percentage return calculation method comparing the CSA & IIROC rules / *Issue for comment*: Use of dollar-weighted method

Advocis supports the CSA's proposal to mandate that registrants use the dollar-weighted method in calculating the percentage return on a client's account or portfolio. Advocis further supports the CSA's position that registrants may provide percentage returns calculated using a time-weighted method in addition to the mandated dollar-weighted calculation. Advocis would encourage the CSA to require that registrants who provide both calculations avoid client confusion over the two methods by explaining the differing purposes behind them, and stating that the two methods can produce significantly different results. Advocis further submits that the CSA require a specific method of calculating the money-weighted rate of return to ensure a uniformity of

application so that, regardless of the particular advisor/dealer, investors are seeing results generated from an identical methodology.

(vi) Market valuation methodology

Advocis agrees with the CSA that more specific requirements and guidance for determining market value will be helpful to consumers. Registrants will benefit from greater certainty as to regulator's expectations and consumers can expect consistency in reporting. Advocis would add the proviso that professional advice from a registrant will likely be necessary in helping clients understand the information provided. Advocis submits that the CSA should provide some guidance on what is meant by "reasonable belief" in the context of the application of an approved market value methodology.

(vii) Issues related to reporting (*viz.*, the annual client report on charges and compensation report, client statements, and investment performance reporting)

With regard to disclosure, reporting and account statements in general, Advocis, like all stakeholders, supports in principle enhanced transparency and disclosure. Much of the suggested disclosure regime will not achieve the desired policy outcome of greater consumer understanding of the costs of products and services. Ironically, the likely outcome will be further confusion on the part of retail investors with regard to commissions and other charges. Indeed, given the current draft text of the 2012 Proposals, the typical consumer will need a financial advisor to help him or her attain a realistic understanding of the elements now proposed for disclosure; consequently, Advocis feels that the need for professional consultation with an advisor on the part of the average retail investor should be recognized and clearly addressed by the CSA by way of explicit reference in the model client forms now proposed. With regard to the proposal that registrants must explain how charges "may affect the investment," Advocis is concerned about the inherent ambiguity in this phrase and its impact on successful implementation of this requirement.

(viii) Scholarship plans

Advocis supports the CSA's proposed performance reporting and tougher disclosure requirements for scholarship plans.

(ix) Disclosure of new or increased operating charges

Advocis supports the requirement that firms provide their clients with 60-day written notice of any new or increased operating charges.

2. Industry consultation

We would urge the CSA to take formal notice during the consultative process of Canada's financial advisors and Advocis, their membership association. It is largely advisors who will be the industry's face and voice when explaining the complexities of

CRM-2 when it is finalized to individual Canadians.

Advocis: Who We Are

Advocis, The Financial Advisors Association of Canada, is the oldest and largest voluntary professional membership association of financial advisors in Canada. Through its predecessor associations, Advocis proudly continues a century of uninterrupted history of serving Canadian financial advisors, their clients, and the nation. With over 11,000 members organized in 40 chapters across Canada, Advocis serves the financial interests of millions of Canadians.

As a voluntary organization, Advocis is committed to professionalism among financial advisors. Advocis members adhere to an established professional *Code of Conduct*, uphold standards of best practice, participate in ongoing continuing education programs, maintain appropriate levels of professional liability insurance, and put their clients' interests first.

Across Canada, no organization's members spend more time working one-on-one on financial matters with individual Canadians than us. Advocis advisors are committed to educating clients about financial issues that are directly relevant to them, their families and their future. Almost all Advocis members are regulated under provincial securities commissions.

Since the CSA's members constitute a key regulatory body for securities intermediaries and dealers, and since in many provinces they oversee various powers delegated to recognized self-regulatory organizations, the CSA's priorities and activities directly affect a significant number of Advocis members. Our following comments on the CSA's proposals reflect the priorities of Advocis' members and their clients.

PART ONE: GENERAL COMMENTS ON CHANGES SINCE THE 2011 PROPOSALS

New draft amendments to National Instrument 31-103 propose far-reaching changes on issues directly relevant to the currently unfolding Fund Facts regime. Since in its *Request for Comment* the CSA did not discuss in great detail several of the new features of the 2012 Proposals, as well as the consultative and analytical processes upon which it relied, Advocis would like to offer the following comments on process issues, the relationship between Fund Facts and the 2012 Proposals, and certain key pre-trade recommendation disclosure requirements, before moving in Part Two to the specific issues designated by the CSA for stakeholder comment.

Advocis supports the CSA's focus on the retail investor

Truly professional financial advisors believe that all investors, regardless of sophistication, should have at a minimum the option of receiving proper disclosure. Advocis is pleased to note that the CSA's focus is not on the nut-and-bolts of competing compensation models, but on the ongoing effort to provide Canadians with enhanced disclosure – in other words, on the very necessary task of providing investors with the information they need. Indeed, Advocis knows that in general Canadians understand the value of the services they receive from their advisors, even if they do not fully understand the minutia of details and policies surrounding commissions and fees.

The process of policy development

Advocis wishes to raise several concerns with the policy development process which has been adopted by the CSA. Advocis has long supported policy development that is targeted at correcting identified market failures that are significant and require regulatory intervention. Unfortunately, we see no evidence that the proposals pursuant to National Instrument 31-103 are meant to address such market failure.

With regard to the policy development process, the CSA has not conducted a formal, publicly shared and widely reviewed cost/benefit analysis based on empirical evidence. We believe that such an analysis should be considered as a necessary prologue to all far-reaching or radical policy development in the financial services arena. Indeed, we are very concerned that the CSA has not waited to determine what will be the short- to mid-term impact of Point of Sale disclosure with regard to mutual funds *prior* to putting forward the 2012 Proposals which are aimed, in part, at addressing the same set of policy issues. We remain convinced that the best regulatory approach would have been to first gather the information and evidence which tend to demonstrate both the strengths and weaknesses of the Fund Facts regime before proceeding with any scheduling of the implementation of the 2012 Proposals. Only after such review of the efficacy of the Fund Facts proposals would the CSA's members be in a position to properly determine what next steps should be taken.

In short, the process adopted by the CSA in limiting the initial consultations to four specific stakeholders, while excluding Advocis and other groups who deal one-on-one with the consumer, represents an error in the initial stage of policy formulation. Good policy development necessitates working with those stakeholders who meet regularly with retail investors and then informing the regulatory approach to be deployed with their experience and insights. To exclude stakeholders such as Advocis from the early stages of policy development is a fundamental and perhaps irremediable flaw in the process.

Fund Facts **and disclosure requirements**

Moving on from general policy development issues, Advocis would point out that certain elements of stage two of the Client Relationship Model (CRM-2) which are required for disclosure have previously being identified as subjects suitable for mandatory disclosure – and in a prescribed format – under other disclosure initiatives. In fact, the 2012 Proposals follow the 2011 Proposals by ignoring, in the main, the current and proposed Fund Facts disclosure requirements and similar disclosure requirements related to mutual funds and other investment products. This is confusing for stakeholders, particularly retail investors. Accordingly, Advocis would request that the CSA make every effort to ensure each disclosure initiative which is submitted for stakeholder comment be vetted with regard to its consistency with its sister initiatives.

The Fund Facts document provides clear information with regard to costs and charges for the consumer. We believe that the Fund Facts initiative, supplemented when necessary by a financial advisor providing informed comment and advice to the retail investor, will be more than adequate in addressing substantive concerns with respect to consumer understanding of investment product costs. We accept that for the "do-it-yourself" investor there may be some need for additional disclosure, but even on this point we have yet to see if the Fund Facts initiative can achieve its desired regulatory outcome. While transparency with respect to product cost and consumer comprehension are critical, we would urge that Fund Facts be brought to execution and then subject to proper scrutiny before engaging in the expensive, intrusive and costly measures contained in the 2012 Proposals.

Based on the CSA's summary of its research, most of the proposed disclosure requirements have been drafted in response to the fact that many Canadian investors remain unclear on costs and charges in the investment field in general and in regard to mutual funds in particular; indeed, many Canadians do not fully understand the mechanics of how their advisors are paid – specifically, trailing commissions and some other models of compensation. Given the level of public uncertainty on these issues, Advocis would submit that the Fund Facts regime be finalized and thoroughly studied before the implementation of the proposed changes under National Instrument 31-103.

Failure to demonstrate that the costs are worth it

Advocis has concerns with respect to the costs of implementing the proposed changes versus the utility accruing to individual investors from the information delivered. We would note that securities dealers will have to re-engineer their databases and various proprietary systems simply to meet the 2012 Proposal's requirements for quarterly client statements, and will have to do so again for the

implementation of the annual statement. All of this is in addition to the Fund Facts requirements. Continual increases in the costs of doing business on the securities side is making it more difficult for dealers and advisors to take on those clients who are most in need of financial advice. One result of this will be an ongoing "product arbitrage" as advisors and their clients move away from mutual funds to other products which present fewer transactions costs for advisors and dealers and a comparatively reduced regulatory burden, the cost of which is typically passed on to the consumer. To simply suggest, as the CSA has done, that the "added cost is justified," absent the undertaking of a full cost-benefit analysis, is very troubling. A recently released research paper, "Economic Models on the Value of Advice of a Financial Advisor," demonstrates clearly that consumers of financial products will achieve better long-term returns with the assistance of a financial advisor, as opposed to consumers who proceed without such assistance.[1] Therefore, if the CSA continues to implement policy that increases the costs of providing financial advice and restricts the ability of consumers to afford access to a financial advisor, then the broader policy objective of greater financial independence and less reliance on government cannot be achieved and the retirement future of many Canadians will be made poorer.

The peril of too much information for investors

Finally, we would like to emphasize that, in terms of consumer comprehension, more disclosure may ultimately hinder the successful achievement of the CSA's identified policy objective. Care must be taken when developing policy to first use existing tools before creating additional regulatory requirements that will, of necessity, add to stakeholder costs. As all costs are ultimately borne by the consumer, great care must be exercised by regulators. Rather than waiting to see if the Fund Facts regime, in conjunction with the role to be played by the financial advisor, will achieve the desired outcome, the CSA is moving to add additional regulation to address, in large part, the same issues. We feel that the regulators should wait for the results of Fund Facts prior to developing additional regulation. After assessing the impact of Fund Facts, regulators could have tailored any additional regulation to produce a more precise outcome. Further, in reviewing the impact of regulation, the regulators will not be able to determine if any positive or negative outcome is the result of Fund Facts or changes to National Instrument 31-103.

Pre-trade / recommendation disclosure

Under the 2012 Proposals, the required "pre-trade" disclosure can be provided verbally. However, the required written disclosure is considered to be supplemental to the Fund Facts documents and other disclosure documents; therefore, the

[1] The complete CIRANO study is available at www.cirano.qc.ca.

requirement to provide it cannot be satisfied by delivery of these documents. Registered firms will be required to provide clients (other than "permitted clients" who are not individuals, or clients with managed accounts), with information about the charges in connection with each investment to be made for the account on a pre-trade/pre-recommendation basis.

In specific, the firm must also inform the client that a deferred sales charge (DSC) may be payable by the client on a future redemption of that security and provide the fee schedule that will apply if the firm will receive trailing commissions in respect of that security. The CSA explains in the *Companion Policy* that this disclosure is not required to be provided in writing; verbal explanations are sufficient and certain aspects of this disclosure can be satisfied, as applicable, by directing the client to the disclosure provided for in the *Fund Facts* document or prospectus. Advocis agrees that a verbal conversation in which a recommendation is proposed – but then a decision is reached to not act on it – should not require written disclosure.

PART TWO: REVIEW OF KEY ISSUES

1. Key issues and decisions since the 2011 Proposal

This submission now moves on to consideration of the specifics on which the CSA requested comment. For ease of reference, the analysis and comment which follows replicates in sequence the CSA's enumerated headings and reproduces *verbatim* its "Issue for Comment" text boxes. Advocis has commented on issues 1 (i) to (ix) and issue 2 of the total issues listed in the *Request for Comment*.

(i) Disclosure of trailing commissions

The CSA continues to propose that registered firms be required to disclose the dollar amount of trailing commissions. By way of justification, the CSA has adduced research which shows that most investors are not aware of this type of compensation. It should also be noted that although trailing commissions are typically associated with mutual fund products, but the CSA proposal is not limited to mutual funds; the proposed disclosure would in fact apply to *all* investment products that pay commissions which are similar in substance to trailing commissions.

Broadly put, the purpose of trailing commissions is to compensate financial advisors for the service and advice they provide to their clients. Research strongly supports the proposition that there is value in that advice. Advocis believes that, if implemented correctly, this proposal will help investors understand and assess the costs and benefits of the advice they receive and, in so doing, become more informed consumers of that advice.

To begin, Advocis is pleased to see that the CSA understands the need to make clear to investors that trailing commissions do not represent an additional client cost. However, the current proposal's draft text contained in the model form does not accomplish this. Advocis believes it is necessary to clearly state on the relevant reports and statements themselves that commissions, including trailing commissions, represent the advice and other services provided by financial advisors.

Advocis agrees that the CSA's research suggests most investors do not understand trailing commissions and other similar compensation. The management expense ratio or MER represents the combined costs of the investment management services provided to the fund and its investors by the fund company and the financial advice and planning services provided by the advisor. One can therefore predict with reasonably certainty that consumers will assume that the trailing commission component will be in addition to the fund costs that are contained in the MER. In effect, the CSA's attempt at transparency and greater understanding on the part of the consumer will not be achieved. Rather, attainment of the desired policy outcome will be rendered impossible and individual retail consumers will receive a disservice.

The model *Annual Charges and Compensation Report*

As set out in Companion Policy Appendix D of the *Request for Comment*, the proposed *Annual Charges and Compensation Report*, under the heading "Compensation we received through third parties", the following three items appear:

- Commissions from mutual fund managers on purchases of mutual funds (see note 1)
- Trailing commissions from mutual fund managers (see note 2)
- Total compensation we received through third parties.[2]

Note 2 deals with trailing commissions and, states, in its entirety, that

> During the year, we received $[000] in trailing commissions on mutual funds you held in your account.

[2] Canadian Securities Administrators, Notice and Request For Comment on Proposed Amendments to National Instrument 31-103, *Registration Requirements, Exemptions and Ongoing Registrant Obligations*, And To Companion Policy 31-103 CP*, Registration Requirements, Exemptions and Ongoing Registrant Obligations* – Cost Disclosure, Performance Reporting and Client Statements (June 14, 2012; 2nd Publication). Accessible at www.osc.gov.on.ca/en/SecuritiesLaw_rule_20120614_31-103_proposed-amendments .htm.

> Investment funds pay investment fund managers a fee for managing their funds. The managers pay us ongoing trailing commissions from that management fee for the service and advice we provide you. The amount of the trailing commissions depends on the sales charge option you chose when you purchased the fund. You are not charged the trailing commission or the management fee. But, as is the case with any investment fund expense, trailing commissions are likely to affect you because, in most cases, they reduce the amount of the fund's return to you. Information about management fees and other charges to your investment funds is included in the prospectus or Fund Facts document for each fund.[3]

While the CSA's proposed text notes that "You are not charged the trailing commission," it then states that such commissions "are likely to affect you because, in most cases, they reduce the amount of the fund's return to you." The words "are likely" and "most cases" will indicate to the "lay reader" (the typical retail investor) that in more than *half* of the funds he or she is invested in, the trailing commissions *will reduce* his or her investment return. As written, the proposed text provides to the average investor a false picture of the impact of these charges on their investment returns.

We see no value in stripping trailer fees out of commissions to become a stand-alone item. Doing so will only further confuse consumers. We propose that the term "commissions" be used in a manner inclusive of trailers and that an additional note be inserted to the text of the model *Annual Charges and Compensation Report*. This note, which would be similar to Note 2 of the annual form, would indicate that consumers may wish to make inquiry of their financial advisors to explain how commissions work and, specifically, what a trailing commission is. The consumer who is a "do-it-yourselfer" can be directed to the prospectus for an explanation of what a trailing commission is and how it works.

Simply put, Advocis does not believe that the CSA's proposed treatment of trailing commissions, as manifested in the model Annual Charges and Compensation Report, provide the clarity the CSA is seeking in this regard. Advocis urges the CSA to revise its draft text to include reference to the usefulness in consulting a professional financial advisor. Given the vast number of Canadians approaching retirement, a brief statement suggesting that the investor consult a financial advisor would be a highly effective, low cost way to remove confusion on the part of the

[3] *Ibid*.

typical retail investor and help the CSA achieve its policy objective of providing clarity in this area to members of the investing public.

Disembedding does not reveal or guarantee an advisor's motivations

Much recent argument in Canada on improved cost disclosure has relied explicitly or implicitly on the assumption that without the unbundling of advisor compensation from investment products, the consumer cannot be expected to feel assured that the advisor's motivation is primarily in the client's interest. In this view, advisor compensation simply should not be tied to an investment product, and that unbundling or disembedding is absolutely necessary to ensure that the advisor acts ethically.

Advocis takes issue with this assumption. Most Canadians do not have the time or inclination to second-guess their advisor's motivation. Further, this argument cannot be safely relied upon in the Canadian context. First, in Canada, advisors are under a common law fiduciary duty which prevents them from recommending a product simply because it will pay them more than other competing products. Many advisors in Canada also adhere to a code of professional conduct which requires them to act in their client's best interest. Second, virtually all mutual fund companies have released F Class mutual funds, which "strip out" an advisor's compensation, effectively offering the same investment products at a reduced cost. The cost is reduced by the exact amount of embedded compensation, allowing interested consumers to make a clear distinction between mutual fund management fees and expenses and the advisor's compensation.

Continued privileging of the position of non-securities investments

Finally, Advocis would note that the idea of complete disclosure that the CSA is attempting to realize in practice is effectively prejudicing the attractiveness to the typical retail investor of securities investments relative to non-securities investments which are not distributed under this type of disclosure regime. Advocis believes that Canadians should be made aware of this regulatory discrepancy to prevent further consumer-driven product arbitrage, a phenomenon which results in more and more Canadians engaging in sub-optimal investment product selection based on the mistaken assumption that, by avoiding certain costs such as trailing commissions, they are making better investment decisions.

(ii) Disclosure of fixed-income commissions

Fixed-income securities – preliminary observations

Before proceeding to the specific fixed-income issue on which the CSA asked for comment, Advocis has some preliminary comments on fixed-income disclosure. We

are concerned that what the CSA proposes for disclosure with regard to fixed-income securities is not complete, upfront and intelligible for the typical Canadian investor. Indeed, the 2012 Proposals represent a substantial modification of the previous fixed income disclosure proposals. The client is now mandated to receive in respect of all fixed income securities purchased or sold during the last 12 months:

- specified disclosure regarding compensation paid to financial advisors of the firm,
- disclosure stating that dealer firm compensation may have been added to, or deducted from, the price of the securities, and
- that this amount is in addition to any commission shown as paid to financial advisors.

As well, there is now a one-year transition period, down from the previous two-year transition.

The average consumer is already being asked to digest a massive amount of information regarding standard securities in the revised client account statement. It is hard to see how he or she will be able to come to terms with this information in addition to expanded disclosure on fixed-income investments. In particular, expecting consumers to be able to make sense of data on the spreads taken by bond desks is to demand a level of discernment that the majority of statement recipients simply do not have. Nor should they be expected to. For the average investor to be able to first compare the "apples" of securities fees to the "oranges" of the costs associated with fixed-income investments, and then, secondly, properly understand the importance of those costs through a nuanced interpretation and evaluation of them in terms of the individual's own risk tolerances and investment horizon, seems almost impossible. Once again, Advocis would remind the CSA it is overlooking the fact that much of this information requires a level of personal knowledge or access third party knowledge which is at the level of professionalized financial advice.

Advocis also notes that the 2012 Proposals state, quite sensibly, that the annual yield of any fixed income security purchased should be provided, but Advocis notes that "annual yield" is not defined. Although the CSA provides additional guidance on what it considers to be appropriate disclosure in this regard in the *Companion Policy*, Advocis would prefer that a standardized definition be provided to ensure uniformity of calculation for all clients, regardless of their advisor/dealer.

In short, both pricing and compensation in the fixed-income world are difficult to understand, particularly because the compensation paid to the financial advisor on fixed-income transactions does not represent the *entirety* of fixed-income

compensation. With respect to the disclosure of other compensation embedded in the price of a fixed-income security, information on desk spreads, and so on, the CSA's requirement that a prescribed notification (similar to that in the annual report on charges and other compensation) be included in the trade confirmation does not strike Advocis as a necessary improvement in transparency for the consumer.

Issue for comment

Fixed-income transactions compensation disclosure

CSA's comment: In the interest of making fixed-income transactions more transparent, we invite comments on whether it is feasible and appropriate to mandate the disclosure of all of the compensation and/or income earned by registered firms from fixed-income transactions. This would include disclosure of commissions earned by dealing representatives as well as profits earned by dealers on the desk spread and through any other means.

Advocis' response: Making fixed-income transactions more transparent, including desk spreads and commissions, strikes Advocis as overambitious at this point in time, since the Fund Facts process is still being rolled out, and the complexities of certain fixed income transactions may well be beyond the ken of the average Canadian investor. To mandate the disclosure of all compensation earned by registered firms from fixed-income transactions seems at this stage more likely to add to confusion, rather than remove it.

Many advisors already have access to market transparency tools, including price improvement logic and proprietary systems which give them the ability to select the best bonds at the best prices for their clients. Interested clients should be encouraged to ask their advisors for this information. Mandating this disclosure when all stakeholders have so much re-adjusting to do strikes Advocis as excessively costly, with the value of any resulting benefits to consumers uncertain at best.

Potential risk of reduction in liquidity and efficiency of the fixed-income market
While improved transparency will help savvy, self-directed investors, a much larger group of investors is now at risk of being confused by this information; such cost disclosure may only serve to increase the "amount of noise" in terms fixed income trading.

Moreover, this disclosure requirement may prove problematic at the macro level for the fixed income market. It should be born in mind that Canada has a small pool of

domestic fixed-income securities: the 2012 Proposals pose a real risk that consumers will misunderstand the costs and charges slated to be disembedded, and the result of this misunderstanding, on an aggregate level, could hurt the liquidity of that small pool: unlike a single class of shares, each fixed-income security is dissimilar in terms of maturity, coupon, interest rate, liquidity and rating. This creates imbalances in the number of buy and sell orders placed by investors for a bond at any one time. Such unmatched flows cause two problems: one is that an instrument's price may change abruptly, even if there has been no shift in either supply or demand for the bond. The second is that either buyers have to pay more, or sellers have to accept lower prices, if they want to make their trade immediately.

Advocis wonders if the CSA has considered the possibility of its proposal negatively impacting current fixed-income market efficiency and liquidity, especially in a period where the existing market making model is already under stress because of current economic conditions. If market makers are facing a restricted client base due to individuals "misreading" the compensation revealed by enhanced disclosure of the costs of fixed income transactions, then one will see a negative impact on trading activity and overall market liquidity. Such adverse effects on illiquid debt will detrimentally impact investors and retirees, but also small and medium issuers, who will find it harder to access capital.

(iii) Expanded client statement

The revised proposals expand the information required to be provided in the account statement, which is now renamed the "client statement." This new client statement, along with the revised performance report, form the centerpiece of CRM-2. Registrants will be required to provide client statements on a monthly basis at the request of a client or where there has been activity in the account over the past month. Otherwise, quarterly statements will be required. This is a minimum requirement, as the CSA has now clarified that registrants cannot have clients agree to receive client statements less frequently than quarterly, and Advocis supports these delivery requirements.

The information to be provided depends on whether the securities are held in:

- nominee name, or in
- certificated form, or in
- "client name."

The client statement must include the "book cost" of each security. "Book cost" is defined as the total amount paid for a security, including any transaction charges related to its purchase, adjusted for reinvested distributions, returns of capital and

corporate reorganizations. The CSA expects and Advocis agrees that this information is generally available, but where the information is unavailable, incomplete or inaccurate, registrants may use, as prescribed, market value information as at a certain point, an earlier date or at the date of implementation of the proposed amendments.

Also of significance is that the CSA now proposes to expand the current account statement into a multi-section client statement that will consist of three principal sections:

- the first section will continue to include a list of transactions made for the client during the reporting period,
- the second section will include reporting on securities held by a dealer or adviser in a client account in nominee name or certificate form, and
- the third section will include reporting on any securities of a client that are not held in an account of the dealer or adviser where:
    - the registrant has trading authority over the security,
    - the registrant receives continuing payments related to the client's ownership of the security from the issuer of the security, the investment fund manager of the security or any other party, and
    - the security is a mutual fund or labour-sponsored fund.

In addition, a client statement will only include the sections that are relevant to the client; to avoid confusion, blank sections would not need to be included. Also included would be any investor protection fund coverage that applies to the accounts.

The need for professional financial advice to interpret the statement
The CSA states that:

> We believe our proposals with respect to client statement reporting will provide clients with more comprehensive information about the securities in their portfolio with a dealer or adviser, regardless of whether they are held in an account at the registrant or otherwise.[4]

In response, Advocis would point out that historically in Canada it is generally only high net worth investors who receive such complete individual account performance and cost reporting. It must be borne in mind that these high net worth individuals have the acumen and experience, and/or access to the relevant advice and

[4] *Ibid*.

assistance needed to understand such statements – while, in contrast, typical individual retail investors do not enjoy access to such resources.

Indeed, in Canada the typical retail investor currently receives an account statement which is too often incomplete or confusing. The problem is especially compounded when the individual is retired or nearing retirement and, in some instances, his or her level of financial acumen has regrettably not kept pace industry developments. In this area, experience has shown Advocis that professional advice proves to be more dispositive of a beneficial investment outcome than any amount of statement information.

Certainly sections two and three of the proposed client statement will reflect a set of legal relationships and investment arrangements between the investor and the dealer or advisor which extend far beyond the average Canadian's level of financial knowledge. In fact, by the CSA's own admission, research into retail investors shows that they generally do not understand the ways in which their investments are held (i.e., in nominee name or client name) and that they do not think this should affect the reporting they receive. Accordingly, Advocis would once again ask the CSA to emphasize the need for professional financial advice in the text of the proposed model form of the new client statement.

Book cost as comparator to market value

The CSA's selection of book cost is based on the reasoning that it is a more widely used measure than original cost and is already familiar to "some investors." However, Advocis would submit that the substitution of book cost for original cost does not solve the problems identified by the CSA as arising from the use of original cost – in fact, it only exacerbates them: book cost is not a term familiar to *most* investors and, as such, it will be at best potentially confusing for them.

Further, while the CSA is very likely correct in noting that book costs will be readily available for most investments in a client's portfolio, Advocis must once again emphasize the need for most retail investors to seek professional financial advice. There can be differences between the tax cost and the book cost of a security the impact of which a retail investor may not discern, and using one cost as a substitute for the other may prove problematic; using book cost as a proxy for the market value of a security can be risky, as the spread between the two may change significantly in an extremely short period of time.

Again, we must re-emphasize that most Canadian retail investors will be best served by securing the services of a professional financial advisor, rather than relying on their own interpretations of the significance of this information. Indeed, the type of

disclosure being proposed by the CSA in this area will, absent a financial advisor, serve only to further confuse the typical Canadian investor. Consumers who are not sophisticated investors will benefit from the disclosure of this information only with the assistance of a financial advisor. It is incumbent on the CSA to make this clear to the consumer in the test of the client statement.

Issue for comment

Reporting of transactions in securities listed in section 14.14(5.1)

CSA's comment: We understand that all securities transactions are carried out through an account, even when the securities are not held in that account. We have drafted the Rule on this understanding and invite comments on the practicality of this or other approaches to including the securities listed in section 14.14(5.1) in client statements and performance reports.

Advocis' response: Advocis understands the need of the client to see all of his or her securities listed in the client statement. Typical retail investors are not interested in the "back office" categorization of securities and accounts. In the interests of simplicity, we would relegate the specifics of the section 14.14(5.1) to a legal footnote and preserve the simplifying spirit of the proposal by treating – for *reporting* purposes only – these securities as part of a single client "account." A comprehensive listing is, Advocis submits, the only information a client is looking for from this particular document.

Exempt-market securities

Advocis is pleased with the CSA's recognition of two major characteristics of the exempt market which tend to make compliance with the thrust of CRM-2 difficult, if not impossible. First, often a market value for an exempt market security cannot be reliably determined; second, it is not always possible for a registrant in the exempt market to reliably determine whether a client still owns a security that was issued in client name.

Advocis believes that it is not in the best interests of exempt market investors, regardless of their investment sophistication, to receive unreliable information. Accordingly, we strongly urge the CSA to require that client statements which list exempt market securities clearly state that, given the nature of the exempt market, an investor owning exempt market securities may often receive from advisors or dealers a minimal amount of transactional information about their securities.

Advocis believes that while many ongoing retail investors in the exempt market do not expect the level of information in their client statements to be the same as that provided for publicly traded securities, there is a valid concern over the investment experience and sophistication levels of "one-off" or neophyte exempt market investors. These investors lack the comfort and trust that comes with an ongoing relationship with an exempt market registrant, and their account statements should contain text alerting them to the paucity of price information that often comes with exempt market securities.

The use of plain language

Advocis vigorously supports the idea that client statements should avoid industry jargon and be drafted in plain language, so, in regard to National Instrument 31-103, we urge the CSA to recommend that all client communications, including account statements, use the word "advisor," not "dealing representative."

(iv) Common baseline requirements for registrants

The CSA seeks to implement a set of proposals with regard to reporting on charges and other forms of advisor compensation and investment performance. To do this, a common baseline needs to be established across registration categories. However, by 2011 both the Investment Industry Regulatory Organization of Canada (IIROC) and the Mutual Fund Dealers Association of Canada (MFDA) had developed performance-reporting proposals which differed from one another's and from the CSA's. Fortunately, both of these self regulatory organizations (SROs) currently have representatives on the CSA's project committee, and both have agreed to suspend implementation of their performance-reporting requirement, pending finalization of the CSA's proposals.

The CSA notes that it received substantial comment concerning harmonization of its proposed reporting requirements with those of IIROC and the MFDA. In brief, the CSA's position is that advisor/dealers who are members of the MFDA and IIROC will be exempted from most of the proposed requirements. Exemptions will be based on the determination that the SRO in question has substantially similar requirements to the CSA's.

Advocis is concerned by the CSA's statement that "We anticipate exempting the SROs and their members from some or all of the proposed amendments if the SROs adopt materially harmonized requirements." Given one of the main purposes of CRM-2 is to ensure enhanced disclosure of information to investors, Advocis would suggest that all retail clients should have the same information, so full harmonization is a critical objective.

An illustration of SRO / CSA (dis)-harmonization: the example of position cost

On the issue of position cost, the IIROC and the CSA proposals are largely identical. Both have the requirement to disclose position cost information; indeed, such information must be provided for all positions held or controlled by the advisor/dealer member for the client, including nominee name positions and client name positions held in physical form that are held or controlled by the dealer for the client. The position cost information to be reported is original cost, not tax cost.

However, the CSA's point of difference with the IIROC rules is that the CSA proposes that position cost information be provided within the client account statement. IIROC members will be allowed to provide the information within a separate report, provided that there is a side-by-side comparison to position market value. This difference takes us to the heart of Advocis' concern – why should IIROC members be exempted from this format of disclosure? Surely the need for consistency across all categories dictates that IIROC conform to this CSA rule.

Advocis' second caveat on this issue is that the CSA has not yet demonstrated that in practical terms there will be one standardized industry-wide definition to be interpretively applied and then provided to investors in a uniform manner. Currently, it appears that the CSA and IIROC will let position cost information be provided on a per share basis, as long as the side-by-side comparison to market value is provided on the same basis. To this, Advocis asks: why not require the total cost in dollar terms as well, to provide more consistency with other forms of cost disclosure being proposed under National Instrument 31-03?

Varying disclosure requirements and the potential for client confusion

As many commentators have noted in response to the earlier iteration of the proposals now under review, certain financial products which compete with the products offered by registrants will not be subject to the CSA cost disclosure and performance reporting requirements. The result is that cost disclosure provided by registrants will without a doubt confuse or mislead some clients when they compare products offered by their financial advisor with some competing products. For example, clients who receive mandated disclosure on their mutual funds will not receive the same disclosure regarding their GICs.

However, it is not just products which are at risk of client misunderstanding. The distribution channel also determines the mode of compensation for an investment product, which may end up not being disclosed. The client may be misled as to how and where he or she pays the compensation associated with a product. For example, a mutual fund distributor will have to provide extensive disclosure on compensation

paid to advisors, but a bank will not be required to disclose that a bank employee's compensation is related to mutual fund sales.

Accordingly, Advocis recommends that registrants, when providing the compensation disclosure, should be at liberty to explain how some competing financial products are not subject to the same disclosure requirements, and that the costs associated with those products are not directly comparable to the costs associated with the products offered by the dealer. Advocis would also recommend that the CSA work with IIROC and the MFDA to explore the possibility of inserting on model forms and statements a non-exhaustive but representative list of products and distribution methods (i.e., banks and mutual funds) not covered by the enhanced disclosure proposals.

Toward SRO-CSA harmonization

In the interests of fairness and clarity for all stakeholders, Advocis would ask that the CSA identify and publish those areas of substantive difference between the CSA's 2012 Proposals and the rules of IIROC and the MFDA. It is expected that assorted SRO rules will need further refinement – particularly the rules which are currently suspended pending the implementation of the CSA's final rules. Accordingly, the CSA suggests the following:

1. Identifying, publishing, requesting stakeholder comments and establishing a timetable for the finalization of the SROs' rules and the CSA's corresponding rules, along with a request for comment. This will help ensure better harmonization with the CSA's final proposals.

2. Ensuring that the same requirements are applied to all registrants across all categories. Accordingly, Advocis would recommend the institution of a single implementation period across registration categories. Such coordination will benefit both the Canadian consumer and advisor/dealers and their firms that are registered in multiple categories.

3. Finally, it is to be expected that mutual fund dealers registered in Quebec will be subject to local rules promulgated by the Autorité des marchés financiers (AMF). Advocis would request that the CSA work with the AMF to ensure a general harmonization between the disclosure regimes of the IIROC, the MFDA and the AMF.

(v) *Percentage* return calculation method comparing the CSA and IIROC rules

Both the CSA and IIROC have requirements to provide net account percentage return information to clients for the most recent one-, three-, five- and 10-year periods and from the account's inception (if the account has been in existence for

more than one year). It is Advocis' understanding that both organizations' proposed rules require that:

- the calculation of percentage return information must consider returns for all positions held or controlled by the dealer member for the client, and all other positions on which the dealer member continues to any form of ongoing compensation,
- percentage return information can either be provided within the client account statement or in a separate report, and
- percentage return information can be calculated using either a time-weighted or dollar-weighted methodology.

However, unlike IIROC, the CSA requires that a standard reporting format be used – the format requires the inclusion of specific explanatory language as well as the mandatory use of tables and charts. Advocis notes that the rules and *Companion Policy* do not specify the investment product positions that must be covered by the report. Advocis would submit that the CSA decide which investment product positions would be considered to be "in the account" for the purposes of client statement and performance reporting. Finally, Advocis would submit that the CSA work with SROs such as IIROC to agree upon a standardized definition of "net amount invested."

Issue for comment

Use of the dollar-weighted method in providing meaningful investor information

CSA's comment: We invite comments on the benefits and constraints of the proposal to mandate the use of the dollar-weighted method, in particular as they relate to providing meaningful information to investors. We are not prohibiting the use of the time-weighted method, but if a registered firm uses such a method, it must be in addition to the dollar-weighted calculation.

Advocis' response:
The CSA's 2011 Proposal would have permitted registrants to choose between a time-weighted or dollar-weighted performance method for calculating annualized total percentage returns. The CSA now proposes mandating that registrants use the dollar-weighted method in calculating the percentage return on a client's account or portfolio.

A dollar-weighted method most accurately reflects the actual return of the client's investments and therefore reflects a major goal of CRM-2, enhanced disclosure to enable investors to measure how their investments have performed. It generates the average amount a client's investment dollars returned, enabling him or her to more simply and effectively evaluate than with a time-weighted method whether his or her rate of return is consistent with the pre-established investment goals. Advocis therefore supports the CSA's proposal to mandate that registrants use the dollar-weighted method in calculating the percentage return on a client's account or portfolio.

Advocis also supports the CSA's position that registrants may provide percentage returns calculated using a time-weighted method in addition to the mandated dollar-weighted calculation. Advocis would encourage the CSA to require that actors who provide both calculations avoid client confusion over the two methods by explaining the differing purposes behind them, and that the two methods can produce significantly different results. In specific, any statement or report using both methods should state that the dollar-weighted method most accurately reflects the actual return of the client's account, while the time-weighted method shows how much value a registrant has added to the performance of the investor's account. Time-weighted methods are generally used to evaluate the registrant's performance in managing an account.

Finally, Advocis further submits that the CSA require a specific method of calculating the money-weighted rate of return to ensure uniformity of application so that, regardless of the particular advisor/dealer, investors are seeing results generated from an identical methodology.

(vi) Market valuation methodology

Proposed section 14.11.1 of the 2012 Proposal sets out a methodology for registrants to use in determining the market value of securities in client reports. The CSA's goal is to provide "consistent and reliable standards" by using, wherever possible, the following: (1) data from a marketplace, and, for securities not traded in a marketplace, (2) other market reports, such as inter-broker quotes.

The reliability of inter-broker quotes is itself open to question in terms of reliability and consistency from broker to broker, and, whether justified or not, the ongoing LIBOR scandal suggests that such quotes may be subject to suspicion from stakeholders that they are fairly and transparently generated.

The CSA further states that where neither of methods (1) and (2) are available, then (3) the registrant firm shall use observable market data or inputs, or, in the event observable information is not at hand, then (4) unobservable inputs and assumptions, as consistent with International Financial Reporting Standards. Finally, in the event (4) is not available – that is, "if no price for a security can be reliably determined using these methods", then (5) obtains: the firm must report that its market value is not determinable and exclude it from calculations of change in value and performance returns.

The need for clarity regarding the meaning of "reasonable belief"

Advocis submits that the CSA should provide some guidance on what is meant by "reasonable belief" in the context of determining market value. While the proposal requires that the registrant firm "reasonably believe the market value they are presenting is reliable," and that the "dealer or advisor [will have] to exercise some professional judgment," the notions of reasonable belief and professional judgment strike Advocis as so open-ended conceptually as to be vague enough to raise the possibility of excessive deference by regulators to registrant firms disingenuously claiming on an *ex post* basis that they held a reasonable belief at the time of valuation – thereby hiding behind the cloak of professional judgment. It is hard to see how a regulator could have the resources to mount a challenge to "pierce the veil" in such cases to determine the reliability and reasonableness of the information used to generate these proxies for market valuation.

Accordingly, Advocis would submit that method (5) be eliminated and replaced with a statement that the proxy is simply a "good faith determination that market value cannot be reliably determined." Advocis believes that investors – particularly in the absence of a professional advisor – may not fully understand the hazards of being misled by an accounting assessment of value which has been constructed in the absence of a market for that security. Indeed, for methods (1) to (4) the client statement contain a section detailing the inherent lack of reliability and severe temporal limitations such proxies for market value contain by their very nature.

Determining market value and the need for professional advice

Advocis agrees with the CSA that more specific requirements and guidance for determining market value will be helpful to consumers. Advocis would add the proviso that professional advice from a registrant will likely be necessary in helping clients understand the information provided. Registrants will benefit from greater certainty as to regulator's expectations and consumers can expect consistency in reporting.

The CSA's proposals purport to be based on "a hierarchy of methodologies reflecting available information… [including] concepts from International Financial Reporting Standards (IFRS) in the valuation of securities for which there is no public market or substitute for a public market such as brokers' quotes." Advocis would like stakeholders to have the opportunity to review this hierarchy of methodologies.

Therefore, in the event that an investor receives an accounting valuation where no market exists for a security, Advocis would ask the CSA to require that the statement clearly indicate, for the benefit of less sophisticated investors, or those without professional advice, that the accounting estimate may not be an accurate reflection of what they would receive if they sold the security.

The CSA also notes that its prescribed methodology will still permit in certain cases a registered firm to report that a value cannot be determined, and is allowing for a registrant, in the case of illiquid private issuer securities, to arrive at a good faith determination on the facts that market value cannot reasonably be determined. As long as this determination is clearly indicated to the client on the client statement in plain language, Advocis would support this allowance.

(vii) Issues related to reporting

The CSA's *Request for Comment* identifies this section as containing information on various changes included in the 2012 Proposal that relate to client reporting.

Timely reporting

Advocis supports the CSA's efforts to ensure retail investors receive timely reporting. Such reporting, in the form of easy-to-understand client statements, can prevent complaints – as well as eventual litigation – by keeping the investor informed in a timely manner, especially with regard to investment losses. Advocis agrees with Section 14.4 (1), which requires that registered dealers to deliver statements to clients at least once every three months. Provided client approval has been given, electronic access is acceptable delivery.

The client's *Annual Charges and Compensation Report*

It is clear that significant costs to the dealers will be associated with the proposed changes. Advocis questions if the least intrusive and costly approach has been selected. By way of introduction, we note that the revised 2012 proposals modify the existing rules requiring disclosure information to be provided to clients of registered firms.

In specific, all registered firms, including in certain circumstances a registered investment fund manager, will be required to comply with the proposed new

disclosure requirements. Significantly, the CSA acknowledges that some of the proposed disclosure need not be provided to "permitted clients" who are not individuals (typically, institutional investors). As well, if a client has set up a "managed account", certain of the information need not be provided to that client in respect of that account.

To assist clients in understanding the costs that are associated with their account with a registered firm, as well as the compensation received by the firm, the CSA proposes that firms report annually on certain mandated matters, in a written statement to each client which must be provided with or in the formal client statement. Registrants need not provide this information to permitted clients who are not individuals. However, investment fund managers will be required to send an annual statement to securityholders in their funds, if there is no dealer or adviser of record associated with those securityholders.

Also new are the defined terms "operating charges" and "transaction charges." The annual report on charges and compensation must include:

- the firm's operating charges: the firm's current "operating charges" that may apply to the account;

- the total charges paid by the client: the total amount of each type of operating charge and transaction charge paid by the client during the previous 12 months, along with the total aggregate operating charges and the total aggregate transaction charges. Third-party charges, such as custodian fees that are not paid to the registered firm, are not to be included in operating charges or transaction charges.; and

- total third party fees: the total amount of fees paid to the registered firm by any third party in relation to the client during the past 12 months. The CSA clarifies in the *Companion Policy* that it intends for this provision to capture referral fees, success fees on the completion of a transaction or finder's fees that are paid by a third party to a registered firm or any of its registered individuals in relation to a client of the firm. This disclosure must be accompanied by an explanation of each type of payment.

As well, firms will be allowed to consolidate information in certain circumstances:

- consolidation of reports: firms will be permitted to consolidate the required information in one report that covers more than one account for a client if the client has consented to it (in writing) and if the consolidated report specifies

which accounts it consolidates. Advocis is curious if the CSA has a position on whether on such consolidated reports registered accounts and nonregistered accounts should be reported separately.

Registrants must explain how charges "may affect the investment"

The proposed *Companion Policy* amendments explain that the required cost and charges disclosure by a firm must include an explanation of the specified costs and fees paid by mutual funds if the client would likely be invested in mutual funds, in addition to the charges that will be levied against the account by the firm. So not only must disclosure about the charges associated with a mutual fund investment be provided to the investor, but the registrant must also explain how these charges "may affect the investment."

Advocis is concerned about the ambiguity contained in the phrase "may affect the investment." It seems clear that this disclosure may be in the form of generic investor education "boilerplate" about investing in mutual funds – that is, it need not be tailored to the specifics of the individual client's situation. Advocis worries that this boilerplate may prove misleading to an investor, or provide an unfounded sense of comfort. Accordingly, Advocis would suggest that the registrant be required to include a statement following the generic text about the impact on the mutual fund investment with the value of consulting with a financial advisor.

Implementing the changes

Obviously, a major obstacle to effective implementation of these cost and charge proposals lies in the realm of client education. Advocis would urge members of the CSA to ensure all communications made to retail investors by fund companies contain text explaining to the client how to properly interpret information in the account charge report. A brief note on the value of consulting a financial advisor who can assist in understanding the cost and charge information and its impact on one's individual long-term financial planning – particularly if there is a pre-existing relationship with an advisor (i.e., when the investor has already set financial goals through ongoing consultation with an advisor) – should help the CSA realize its policy objectives in this area.

Quarterly client statements

As noted earlier, the CSA now calls for quarterly "client" statements (monthly in certain prescribed circumstances) with enhancements to existing requirements, which include reporting the following:

- the "book cost" for each security held (as well as the market value) – the definition of "book cost" must also be included in the statements,

- the identification of which securities are subject to deferred sales charges,
- the name of applicable investor protection fund, and
- specified disclosure depending on whether the securities are held in "client" name or "nominee" name.

Advocis' other comments on the client statement appear above, in the sections dealing with costs and charges in general and trailing commissions in particular.

Investment performance reporting

The 2012 Proposals continue to require firms to provide clients with account performance reporting on an annual basis, as part of, or together with, the client statement. These performance reports are to be account-based, although the 2012 Proposals specifically permit the consolidation of performance reports for more than one account for a client in limited circumstances. The annual investment performance report now mandates enhanced disclosure to retail investors. This report must be delivered with client statements that accompany or include the annual charges and compensation report, and it is required to include the following:

- specified information, including market value at the beginning and end of the period, annual change in value, the cumulative change in value, annualized total percentage return – all as at one year, three years, five years and 10 year periods,
- specified disclosure in respect of scholarship plan investments, and
- a Sample Report on Investment Performance, as provided as part of the *Companion Policy* – but, as noted at the end of this section, unfortunately no specific format mandated.

There is no requirement to provide this report to institutional "permitted clients" who are not individuals.

Although Advocis would prefer a longer transition period for the production of the first set of 12-month reports, Advocis supports the three-year transition to provide three year annualized returns, the five-year transition to provide five year annualized total returns and the 10-year transition to provide 10 year annualized total returns. This revised transition period is a change from the 2011 Proposals, which envisioned two-year transition (with longer transition periods for certain content).

Where more than one registered firm provides services pertaining to a client's account, the responsibility for performance reporting rests with the firm with the client-facing relationship. This means that a portfolio manager with discretionary

authority must provide the performance report, not the dealer who only executes adviser-directed trades or provides custodial services.

Advocis noted that the annualized total percentage returns are to be calculated using a dollar-weighted method for the specified time periods of one, three, five, and ten years and since inception periods. Advocis agrees with these reporting periods of one-, three-, five- and 10-years, as well as the period accruing since the account's inception. Advocis would encourage the CSA to work with IIROC and the MFDA to ensure that they use essentially the same definition of "total percentage return," and that they also note in their reports that total percentage return was calculated net of charges, using a dollar-weighted method.

Finally, the introduction of a risk measure for a client's portfolio in connection with "Know Your Client" requirements is on the face of it an attractive idea, but one that requires more study: Advocis believes that such a measure should be presented along with the client's pre-tax rate of return, since clients need to be provided with both the return and the risk information.

Opening market value, and changes in value due to deposits and withdrawals

The 2012 Proposal removes net amount invested in performance reports as the starting point for calculating the change in value of a portfolio of securities over time; instead, the CSA is now requiring reporting of the constituent elements of deposits and withdrawals. Advocis supports this change, as it should provide investors with a clearer picture of their investment's performance.

The 2012 Proposal provides formulae for registered firms to employ for the calculation of changes in market value of clients' accounts. This is to ensure that in their reports clients are shown the opening market value of the account and the market value of deposits and transfers of cash and securities into the account, the total of which will then be compared to the closing market value of the account. The resulting numbers represents the change in value of the account over the past 12-month period and since the inception of the account. The client can therefore easily discover how much money he or she has actually made or lost in dollar terms.

Advocis supports the idea which underlies this reporting initiative – that is, the disclosure of information intended to help the investor better understand his or her investments' costs and performances, but must urge the CSA to recognize that such disclosure will have the opposite of the intended effect on the average Canadian retail investor, for whose benefit the CSA is apparently acting. Without the intermediation of a professional financial advisor, the disclosure of such information related to changes in investment value will serve only to confuse and mislead the

vast majority of individual investors. The policy objective of the CSA, while wholly laudable, cannot be achieved through the means envisioned. It is to be hoped that the CSA will encourage registered firms – as described in the *Companion Policy* – to provide more detail about the activity in the client's account that has caused the change in value figure, and to properly emphasize the critical role of needed interpretive information and advice to be dispensed, as necessary, by professional financial advisors to individual investors.

Sample reports

The CSA notes that it is not prescribing the format for the new client reports required in the amended Rule. The CSA goes on to state that:

> we expect dealers and advisers to present this information in a clear and meaningful manner. They will be required to use a combination of written information with text and tables, and graphical presentation using charts. We encourage registrants that are already providing such information to continue to do so.[5]

Advocis would strongly encourage the CSA to work SROs and their members and other registrants to arrive at a higher degree of uniformity than this statement seems to envision. By way of analogy, Advocis notes that all bank account statements read in the same general fashion and are all equally intelligible; without a similar level of uniformity in client reports, CRM-2 runs the risk of failing to achieve its original policy objective of enhanced investor understanding.

(viii) Scholarship plans

Advocis agrees with the CSA that there is no compelling reason to exempt scholarship plan dealers from the proposed requirements for the disclosure of charges. However, in a scholarship plan, the account and the product are essentially the same, and they have unique risks and conditions that do not exist for other investment products or portfolios of investments. Accordingly, Advocis supports the CSA's proposed performance reporting for scholarship plans:

- how much has been invested,
- how much would be returned if the investor stopped paying into the plan, and
- a reasonable projection of how much the beneficiary might receive if the investor stays in the plan to maturity and if the beneficiary attends a designated educational institution.

[5] *Ibid*.

Overall, Advocis approves of the rules setting more rigorous disclosure requirements for scholarship plans, including the specific requirement for the disclosure of unpaid enrolment fees or other installment fees, as these are a unique feature of scholarship plans. Advocis agrees that group plans offered by scholarship plan dealers (group scholarship plans), should be required to detail in an upfront discussion the added risks inherent in these products, such as the consequences of failing to maintain one's payments, or failing to choose a qualified course of study. Improved annual cost and performance reporting will also result in better consumer protection.

Advocis commends the CSA for its pragmatic approach to regulating this area of financial services, and hopes that the CSA will soon be able to shift more resources once devoted to scholarship plans to the task of refining and implementing other proposals which impact many more Canadians – in particular, those concerning mutual funds.

(ix) Disclosure of new or increased operating charges

Advocis supports the requirement that firms provide their clients with 60-day written notice of any new or increased operating charge.

2. Industry consultation

The CSA states that it held consultation sessions with four industry associations: the Investment Funds Institute of Canada, the Investment Industry Association of Canada, the Portfolio Management Association of Canada and the RESP Dealers Association of Canada. While no doubt these organizations provided input of value to their own members, Advocis would suggest that the CSA would do well to include advisor and investor organizations when proposing reforms as broad as those under National instrument 31-103.

As financial advisors, Advocis' members are better positioned than any other stakeholder group to understand the advisory and informational needs of the typical Canadian investor – on whose behalf the CSA has promulgated these draft rules and amendments. Canada's financial advisors are a vast pool of individual intermediaries between dealers and individual retail investors who are too often ignored or overlooked in the public policy creation process. Moving forward, we would urge the CSA to take more formal notice of Canada's financial advisors, many of whom will be the industry's face and voice when explaining the complexities of CRM-2 when it is finalized to individual Canadians.

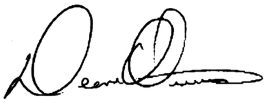
Final comments

Advocis looks forward to the CSA's release of the next stage of the CRM project, and to working with the CSA and its constitutive member organizations in helping them

achieve our common objectives. We would be pleased to meet with you to further discuss our issues and concerns.

Should you have any comments or questions you wish answered before any such meeting, please do not hesitate to contact the undersigned, or email Ed Skwarek at eskwarek@advocis.ca.

Sincerely,



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