PMAC
PORTFOLIO MANAGEMENT ASSOCIATION OF CANADA
Advancing Standards™

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Dear Sirs and Mesdames:

Re: Discussion paper on Expanding Cost Reporting

OVERVIEW

The Portfolio Management Association of Canada (**PMAC**), through its Industry, Regulation & Tax Committee, is pleased to have the opportunity to provide the Mutual Fund Dealers Association of Canada (**MFDA**) with comments on the Discussion Paper on Expanding Cost Reporting (the **Consultation**). Capitalized terms used in this letter but not defined have the same meaning given to such terms in the Consultation.

As background, PMAC represents over 250 investment management firms registered with one or more members of the Canadian Securities Administrators (**CSA**) to do business in Canada as portfolio managers. In addition to this primary registration, the majority of members are dually registered as investment fund managers and/or exempt market dealers. PMAC members encompass both large and small firms managing total assets in excess of $1.8 trillion for institutional and private client portfolios.

PMAC advocates for the highest standard of unbiased portfolio management in the interest of the investors served by our members. In fact, that is PMAC's mission statement: advancing standards. For this reason, we are consistently supportive of measures that elevate standards in the industry, improve investor protection, and promote transparency. PMAC applauds the MFDA's leadership in proposing this Consultation on expanding cost reporting (**Expanded Cost Reporting**), as well as in devising examples of potential disclosure on this point. We believe that the Consultation formally launches an important discussion and is an acknowledgement of the gaps in cost disclosure that remain, even as a result of the implementation of CRM2.

Expanded cost reporting must extend to all investment products and services to be consistent and comparable – this disclosure is fundamental information for investors to enable a cost/benefit analysis. However, this information should bolster – and not detract from - clearly communicating to investors how and whether their portfolios are meeting their goals in alignment with their risk tolerances. Any proposed amendments that introduce only piecemeal or partial cost disclosure will be a disservice to all stakeholders, especially to Canadian investors.

GENERAL COMMENTS

As referenced in the Consultation, proposals to expand cost reporting for Investment Funds, would necessitate amendments proposed by the CSA to National Instrument 31-103 – *Registration Requirements, Exemptions and Ongoing Registrant Obligations* (**NI 31-103**). PMAC has copied the CSA on this submission as we believe that current CSA consultations and research, including the recently proposed amendments to NI 31-103 – the Client Focused Reforms, soon to be released proposals on certain types of embedded compensation, and the project to measure the impact of Point of Sale disclosure (**POS**) and Phase 2 of the Client Relationship Model (**CRM2**), form critical components of the assessment of the proposals contained in the Consultation. The determinations the CSA will make with respect to which Client Focused Reforms to implement and the impact of POS and CRM2 will be important in shaping the specifics of the next round of cost disclosure reporting.

Further, we recognize that many of the comments in PMAC's submission are outside the scope of the MFDA's jurisdiction and require coordinated regulatory efforts from the CSA and other self-regulatory organizations (**SROs** and, together, the **Securities Regulators**). Ultimately, we would expect that any mandated Expanded Cost Reporting provides investors with the information they need to understand the costs of all of the securities they invest in and that this be clearly communicated in a manner that investors easily understand.

PMAC'S KEY RECOMMENDATIONS ON THE CONSULTATION

PMAC is cognizant that the Consultation is being undertaken in the context of the MFDA's membership, hence the focus on cost transparency for retail mutual fund investors. PMAC is concerned that, as proposed, Expanded Cost Reporting does not go far enough to improve transparency or sufficiently increase investor awareness of the costs of owning securities because the Consultation, (in part by nature of being an MFDA-only proposal), does not propose sufficiently comprehensive disclosure. Specifically, PMAC does not believe that the current proposal with respect to Expanded Cost Reporting would result in full cost transparency for investors for the following reasons:

1. Investors deserve transparent, comparable, easy to understand, cost reporting for all securities they hold

The Securities Regulators should ensure that any proposed amendments to cost reporting result in fully transparent, comparable, and easily intelligible disclosure for investors to allow them to understand the cost of all of their investments, not just of some securities, and the impact of costs on their personal rate of return. This is material information for investors to have and to understand and we believe the current proposal falls short on this.

We believe that it is essential for all products with fees and embedded expenses to have such costs reported transparently to investors – not just for Investment Funds. Investors holding pooled funds, separately managed accounts, exchange-traded funds (**ETFs**), or segregated life insurance policies, for instance, should also receive transparent cost reporting[1]. PMAC is also concerned that the disclosure of fees for some products and not others could result in product arbitrage to the potential detriment of investors. The focus on retail mutual funds may give rise to an unintended consequence of investors being unable to fully compare the costs of owning Investment Funds with the costs of owning other types of securities. We note in the Consultation that the MFDA is encouraging members to disclose total costs to provide clients with more accurate information and a better understanding of costs associated with their

[1] We are cognizant that segregated funds are not within the jurisdiction of the Securities Regulators and we strongly encourage coordination with other regulators to minimize product and regulatory arbitrage.

investments[2]. PMAC believes that this is a laudable goal, but one that will not be fully achieved with Expanded Cost Reporting, as currently proposed.

PMAC believes that investors should receive statements that easily enable them to understand what their investment performance is, net of all fees paid (regardless of the type of securities they hold) and help investors understand how the costs of their investments impact their personal rate of return. There should be an emphasis on how their performance relates to their personal goals and risk tolerance.

We caution against any expanded reporting that detracts from communicating the progress of an investment portfolio in alignment with the client's goals and reflective of the client's risk tolerance. We believe that the full and transparent disclosure of costs is one essential part, but not the only important aspect, of effective communication with investors. Expanded Cost Reporting should be made in plain language so that investors can understand and evaluate these costs, as well as the type of advice they are getting, and how those two factors impact the investor's ability to achieve his or her desired rate of return.

The Securities Regulators should be careful that the focus on costs does not blur the important end goal of reporting on whether the investment manager / firm are meeting the client's objectives. If the client and adviser have conducted an appropriate know-your-client and suitability analysis and concluded with specific portfolio construction and rate of return goals, the reporting and communication of performance against those goals should not be lost in a myriad of data that does not help the investor understand return on investments.

2. Action on improved cost reporting is beneficial to investors, but only if it enables an "apples to apples" comparison of the costs of owning different securities

We believe that action on improved cost reporting is beneficial to investors. That having been said, new and additional disclosure that serves to obfuscate or mislead investors as to the true costs of owning securities across the board is worse than the status quo. To properly achieve this objective, more information about what cost information is most useful and understandable to investors – and which information will assist investors in understanding the impact of the cost of securities on their investment returns – is required.

PMAC believes that any regulatory amendments with respect to cost disclosure should ultimately enable investors to compare "apples to apples" to assist them in evaluating and understanding the cost of owning different securities. We feel it would be a disservice to investors and to the Canadian capital markets as a whole, if extensive reporting and systems work were to be required as a result of Expanded Cost Reporting amendments that result in less-than-fully-transparent reports or if that cost disclosure is not intelligible to retail investors.

In developing a new set of Expanded Cost Reporting proposals, the Securities Regulators should be mindful of the tension between the variety of ways in which the calculation of various costs can be done and in how costs can be allocated over different time periods against the risk of having overly prescriptive rules which may be at cross-purposes. In addition, any sample or form of reporting must be simple, digestible and easy-to-understand for retail investors.

[2] Consultation, Section A.

3. Expanded Cost Reporting should exempt non-individual Permitted Clients

It is crucial to ensure that the exemption available under CRM2 for permitted clients that are not individuals also be included in any Expanded Cost Reporting requirements. We do not see provisions currently made for this in the Consultation. Permitted clients have unique and often highly specialized reporting needs and are typically managed and served on a client-specific basis to respond to those particular needs. To impose Expanded Cost Reporting for such permitted clients would only increase regulatory burden in a way that does not benefit these types of sophisticated investors and ignores their unique needs.

4. The policy objectives of implementing Expanded Cost Reporting should be clearly articulated to align outcomes with intention

We strongly encourage the Securities Regulators to collaboratively assess and more clearly articulate the policy and investor protection goals that Expanded Cost Reporting is meant to address. A question that has not been fully answered at this stage is whether the ultimate goal of the Securities Regulators in requiring Expanded Cost Reporting is to simply provide more information around the cost of holding investment funds, or, if it is to provide investors with gross and/or net comparisons of the costs of holding the different securities in their portfolios. If the former, PMAC has concerns about the limited scope and potentially misleading effect of that policy intent on investors and, if the Securities Regulators aim to achieve the latter (or some form of the latter), PMAC believes the proposals fall short and require additional work.

It is unclear from the Consultation whether the goal of Expanded Cost Reporting is to provide information to investors *ex ante* or *ex post*. If the goal is to provide disclosure based on results instead of on forecasts, PMAC believes that this goal can only be achieved if investors are provided with cost reporting that demonstrates: 1) total cost (in dollars and in percentages); and 2) the net return, on a time-weighted basis, of the product after all such costs. Only the use of time-weighted returns properly permits the comparison of different managers, time periods, and products in this way. The dollar-weighted returns under CRM2 are only one part of this disclosure and insufficient to provide investors with a full understanding of the impact of costs on their investments.

Based on the Consultation and the proposed illustrative reporting examples, it is unclear that a method for allocating between accounts and time period costs (i.e.: trading commissions and certain expenses that are not or that cannot be accrued). The importance of such allocation arises in scenarios where there has been extensive trading conducted during Q1 and, as a result, substantial trading commissions are incurred. Would registrants be required to allocate such clustered trading commissions differently between unitholders who disposed of their units early in Q2 and unitholders who only acquired units in Q3? If that is the case, how would the calculation be done?

5. Expanded Cost Reporting must be launched in conjunction with investor education and outreach on these changes, as well as on the value of advice

The Securities Regulators should ensure that extensive and accessible investor education is a core strategy in the implementation of Expanded Cost Reporting so as to maximize investor benefit and understanding of these amendments. As discussed further below, we believe that clear and meaningful disclosure of costs, accompanied by investor education, can serve to mitigate several investor protection and market efficiency concerns identified by the CSA.

PMAC believes that a critical component of expanding cost reporting is increased investor education and outreach to improve investor knowledge about the importance of investing, the benefits of advice, the nature of the various investor-registrant relationships, and products available to help Canadian households meet their savings and retirement goals. We believe that regulatory change is most impactful when accompanied by a corresponding public awareness campaign which can educate investors as to their options, negotiating power and the value of advice. It is also important to note that the advice PMAC members provide clients extends beyond helping clients invest for retirement and understanding different types of accounts. A focus solely on costs, without a wider focus on whether the investor's investment objectives and goals are being met, does a disservice to Canadian investors.

It is important to ensure that the value of advice is not obscured through a focus on costs. Different registrants offer differing advice and service offerings and investors should be educated about which best suits their investment objectives. We believe that investors should be made aware of the differences in services and offerings, as well as the differences in proficiency requirements and the duty of care owed to them by different registrants. PMAC believes that one effective way to educate investors on these meaningful differences is through the approach being proposed by the United States Securities and Exchange Commission which highlights the differences between the business model and duty of care owed to retail investors by broker-dealers and the fiduciary duty of care owed to investors by investment advisers (the U.S. equivalent of portfolio managers).

6. The impact of recent and on-going regulatory changes must be assessed holistically when devising improved Expanded Cost Reporting

We urge the Securities Regulators to explore the gaps in CRM2 reporting while assessing the impact of CRM2 and POS and the impact of the Client Focused Reforms to ensure that no duplicative or counterproductive requirements are proposed. This will avoid implementing another set of cost disclosure reporting requirements that do not result in full transparency and comparability of products.

To do so would be a disservice to investors in two ways: the costs to industry to implement such changes without a corresponding investor benefit would be burdensome, and it would compound confusion and obfuscate true costs for investors. PMAC also believes that the Securities Regulators must undertake a cost/benefit assessment in conjunction with their assessment of the final, likely material, costs and impacts of implementing the Client Focused Reforms.

PMAC continues to support and champion the regulatory endeavours being undertaken by Securities Regulators, including the MFDA, to enhance the quality of the registrant-investor relationship, especially with respect to client disclosure, know-your-client (**KYC**), know-your-product (**KYP**), suitability, and conflict of interest requirements through the Client Focused Reforms. We believe that the impact of certain of the proposed Client Focused Reforms may increase investor awareness and understanding of the costs associated with their investments and believe that a gap analysis should be undertaken to determine where investor understanding and comparability would require additional cost disclosure. We believe that this exercise needs to be undertaken when the Securities Regulators are poised to implement the final Client Focused Reforms so as to ensure that duplicative efforts are not being undertaken as well as to ensure that investor reporting does not generate confusion. While not in one place and not in a manner that PMAC believes to be user-friendly, we note that the costs outlined in the Consultation are currently provided to investors in different fashions. Management expense ratios (MERs) are in the MRFP, while and the other costs are found in trade confirmations.

The costs of implementing any expanded cost reporting will be material for many firms and, it is important that the Securities Regulators assess the impact of such costs – which will ultimately be borne by clients themselves – against the utility and outcome for investors of mandating a particular model of Expanded Cost Reporting.

7. **Expanded Cost Reporting will require material changes impacting all stakeholders, the details of many such changes still require articulation and consideration to enable a more fulsome assessment**

Amendments to cost reporting and the necessary technology and systems updates will be resource intensive for firms, especially so soon after the implementation of a number of regulatory and reporting amendments in recent years. This cost can be justified, but only if end investors benefit from full and transparent cost disclosure and if they are able to understand, evaluate, and make subsequent decisions based on a complete understanding of these costs and their impact on their investment returns.

The investment management industry is one of layered service and product offerings and, as drafted, we do not believe the Consultation provides sufficient detail regarding which parties will bear responsibility to report to the end unitholder. We also believe that additional details are required to evaluate the mechanism for such responsible parties to obtain the data they require from third parties that are more remote from the end unitholder. It is currently unclear which stakeholders will be required to implement and fund the infrastructure required in order to allow for expanded cost reporting for securities such as ETFs, segregated funds and pooled funds.

PMAC notes that a lack of existing infrastructure could impede the ability for industry to move towards fully transparent and comparable Expanded Cost Reporting. For instance, ETFs calculate MER at the fund or series level and, in order to provide personalized account or individual amounts, there will need to be one standardized method to calculate and report MER in a comparable way. Devising such a calculation will require the engagement and input of various stakeholders, such as those that have access to data that will be needed to perform the necessary calculations.

Following a revised consultation on Expanded Cost Reporting from the Securities Regulators, we believe that a transition period of 3 years from implementation should provide stakeholders with relevant time to create and operationalize processes, as well as to generate and deliver the necessary investor education materials.

8. **Done properly, Expanded Cost Reporting will be in the best interest of investors and may address several material investor protection concerns articulated by Securities Regulators**

Clarity, transparency and simplicity of cost reporting will be in investors' ultimate best interest, though we appreciate that devising proposals in this respect is not a simple task.

We believe that a more fulsome Expanded Cost Reporting proposal could address a number of material investor protection concerns articulated by the CSA in the following ways. Expanded Cost Reporting and accompanying investor education could help mitigate the information and financial literacy asymmetry between clients and registrants. More transparent and fulsome cost information (accompanied by a deeper understanding of the value and types of advice available) will provide investors with additional information to assist them in engaging with their advisors to help them achieve the value or returns investors can reasonably expect from investing. We believe that additional information through expanded and easily-intelligible cost reporting will strengthen the registrant-client relationship.

PMAC believes that, while a revised consultation on Expanded Cost Reporting is being devised, Securities Regulators should encourage the voluntary disclosure of all costs that are currently within firms' reporting capabilities to promote the business case and consumer demand for transparency. Ultimately, however, this expanded information must not detract from the overall picture of clearly communicating whether an investment portfolio is meeting a client's goals, in alignment with their risk tolerance.

CONCLUSION

Thank you for the opportunity to participate in this consultation as well as for the very proactive industry outreach that the MFDA undertook to ensure that various stakeholders – even those outside of MFDA membership – were aware of and engaged in the comment process. We would be pleased to continue the dialogue on this important issue and discuss the recommendations included in this submission in more detail.

PMAC believes that expanded cost reporting that results in full transparency of the costs of owning securities, as well as an understanding of the impact of costs and the value of advice on helping investors achieve their targeted rate of return, is essential.

If you have any questions regarding this submission, please do not hesitate to contact Katie Walmsley (kwalmsley@portfoliomanagement.org) at (416) 504-7018.

Yours truly;
PORTFOLIO MANAGEMENT ASSOCIATION OF CANADA

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British Columbia Securities Commission

Alberta Securities Commission

Financial and Consumer Affairs Authority of Saskatchewan

The Manitoba Securities Commission

Ontario Securities Commission

Autorité des marchés financiers

Financial and Consumer Services Commission, New Brunswick

Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island

Nova Scotia Securities Commission

Securities Commission of Newfoundland and Labrador

Superintendent of Securities, Northwest Territories

Superintendent of Securities, Yukon

Superintendent of Securities, Nunavut