

COMMENT LETTER

July 25, 2011

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c/o Larry Waite

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MUTUAL FUND DEALERS ASSOCIATION OF CANADA
PROPOSED AMENDMENTS TO MFDA RULE 2.2.1 (“KNOW-YOUR-CLIENT”)
AND
MFDA POLICY NO. 2 *MINIMUM STANDARDS FOR ACCOUNT SUPERVISION*
<http://www.mfda.ca/regulation/propAmend/Prop2-2-1.pdf>

Kenmar Associates are pleased to submit comments on the proposed Amendments regarding the use of leveraging. The proposed amendments seem to be effective in clarifying that the suitability obligations in Rule 2.2.1 with respect to investments apply equally to leverage strategies, and codify minimum standards for Members and Approved Persons in assessing the suitability of client leveraging.

We would however like to point out several issues we've encountered as a result of our involvement with investor complaints derived from a leveraging strategy :

1. The strategy was unsuitable because there was no economic need to take on debt based on the client's financial plan. In effect ,it was unsuitable because there was no need to take on borrowing risk
2. While the leveraging was not inconsistent with the client's risk tolerance , it was inconsistent, and therefore unsuitable with ,the client's loss capacity (sometimes referred to a loss tolerance).We recommend adding Loss tolerance to the Rule
3. The call features of the loan are not properly explained . Had they been explained ,the leveraging would not have been undertaken.
4. An argument is used that the extra income from the investment in mutual funds will cover the interest on the loan. In a number of cases the “income” was actually Return of Capital. The deception has proven costly , especially for seniors and pensioners.
5. Incorrect assertions are made about interest deduct ability for loans used in RRSP's
6. The KYC is not up-to-date or there are different versions available at the Branch vs. the version

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in the database. It should be made clear that the database version is the official version to be used in determining suitability.

7. The mutual funds purchased with the borrowed money are unduly risky and expensive. This causes an exponential increase in risk. Thus, although a fund may be risky but not necessarily unsuitable in itself, when used in combination with leveraging, the transaction becomes unsuitable.

The word MEDIUM as applied to risk occurs at several locations in the proposed amendments. As we've said before this is an imprecise term and have recommended that the MFDA clarify it on NAAF's. We take this opportunity to do so again.

But an even larger issue is now arising with the introduction of Fund Facts. MFDA MR-0069 *Suitability Guidelines* states that the risk ranking of a mutual fund should be determined with reference to the mutual fund's prospectus. We believe this is inappropriate and misapprehends the meaning of IFIC's Volatility Risk classification methodology and the meaning of the risk classification in the prospectus. Indeed, IFIC's document specifically says its document is intended only for Managers and is NOT to be used for suitability purposes. It too utilizes the word MEDIUM. This could lead to unsuitable investment recommendations because the risk scale used in the Prospectus by most firms is based solely on short term standard deviation. Additionally, since the CSA has permitted each fund company to choose its own risk rating methodology, the word MEDIUM may mean different things depending on the Company. A number of analysts and the media have already revealed gross discrepancies; one of the worst being a Silver fund classified as Low to Medium Risk. This conflict needs to be resolved by the MFDA without undue delay as Fund Facts is now being rolled out.

We add parenthetically, that although Fund Facts is designed for POS disclosure it is now being authorized for post sale delivery. Fund Facts is a highly abbreviated version of the prospectus and its disclosure of risk has been determined to be incomplete, deficient and misleading by SIPA, fund analysts, Morningstar, FAIR Canada, and ourselves. The Simplified Prospectus will no longer be delivered at all although it will be available upon request. In our view, this constitutes a systemic risk to the disclosure system. And a threat to investor protection.

Should you have any questions, do not hesitate to contact us.

Permission is given for public posting.

Sincerely,

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