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and

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BMO Investments Inc., Response to CSA Mutual Fund Governance Concept Proposal 81-402

BMO Investments Inc. ("BMO Mutual Funds") appreciates the opportunity to continue to work with the Canadian Securities Administrators ("CSA") on the mutual fund governance Concept Proposal 81-402 "Striking a New Balance: A Framework for Regulating Mutual Funds and Their Managers" (the "Concept Proposal"). Two years ago BMO Mutual Funds participated in the initial fund governance survey, and since that time we have worked as part of the Investment Fund Institute of Canada ("IFIC") Governance Committee to help provide further suggestions and insights into the issues of fund governance during the preparation of the Concept Proposal. Since its release, we have also participated in IFIC's process of obtaining industry responses to the Concept Proposal and we have commented on IFIC's letter to the CSA as well as the individual questions raised in the Concept Proposal.

BMO Mutual Funds strongly supports the goal of enhanced investor protection and the efforts being made to improve mutual fund governance by attempting to ensure that all aspects of good governance are present in the mutual fund industry. As such we favour the establishment by the CSA of a mandatory requirement that all mutual fund managers be subject to the independent oversight and monitoring of an independent fund governance agency. Indeed, BMO Mutual Funds itself, for many years now, has had in place an independent governance agency which acts on behalf of our unitholders to provide independent monitoring and oversight of our management activities.

While we fundamentally agree with almost all of IFIC's detailed responses, we nevertheless would like to bring the following issues to your attention either because they are of particular concern to us or because in these particular matters our views differ from IFIC's:

Certain Regulatory Restrictions Should be Removed Before or at the Same Time as a Fund Governance Regime is Mandated

We believe that it is essential that the CSA revise and improve the existing regulatory framework governing mutual funds, at the same time (and in certain cases prior to the time) that it implements the new fund governance and manager registration rules. As a bank owned fund company related to an large underwriter, we in particular have an interest in eliminating the unduly onerous prohibitions which are currently used to deal with perceived governance and conflict of interest issues. We would like to strongly argue that, if additional regulatory requirements and burdens relating to governance and registration of mutual fund managers are to be imposed, along with their attendant costs, it is crucially important that any needlessly restrictive regulatory requirements be removed at the same time. In fact, we would not support the mandatory fund governance and manager registration rules without the concurrent elimination of now redundant restrictions.

Indeed, in considering changes to the existing rules, we submit that the CSA ought to rank the issues in terms of priority. First, we would suggest that some regulations such as those which relate to related party underwritings (s. 4.1 NI 81-102 Prohibited Investments - the "60 day rule") require urgent attention and that relief (interim or otherwise) should be considered as soon as possible and not be made dependent on the implementation of a new fund governance regime. We note that relief has been granted by securities commissions from time to time in respect of these provisions for certain specified offerings. We believe that the interests of investors in having the widest array of investments available to their portfolio advisers are being harmed by these restrictions and that such harm is not warranted in that appropriate safeguards already exist or can easily be introduced through the proposed governance model for the purpose of protecting investors against actual or perceived conflicts of interest. Second, there are several existing rules that may become redundant or unnecessary once a fund governance regime is implemented and which should therefore be eliminated or significantly revised. This category includes many of the investment restrictions (s. 2.1 NI-102 Concentration Restrictions; s. 2.4 Illiquid Securities; s. 2.5 Investments in other Mutual Funds).

We submit that the use of a governance agency to monitor manager compliance with policies on related party transactions can and should replace the current conflict of interest rules. The approach of allowing each fund complex, in conjunction with its governing agency, to develop its own tailor made rules – perhaps subject to general principles articulated in legislation or industry guidelines – should allow for a more finely developed regime that would protect the interests of investors without artificially restraining practices that are beneficial to investors. In fact, we submit that a governance agency may be better positioned than securities regulators to monitor and enforce such

policies because it will be closer to the mutual funds it governs, it will have a better idea how they operate, and it can act quickly to remedy any issues that may arise.

Fund governance must be mandatory and consistent for all Mutual fund industry participants large and small (including owner- managed mutual funds) and all similar investment products.

The purpose of the fund governance proposals is to enhance investor protection through improved oversight of mutual fund managers. For this reason, unlike IFIC's submission, we believe that an independent governance agency must be mandatory for all mutual fund managers large and small (including owner-managed mutual funds) and all similar investment products.

We believe that all investors in mutual funds and similar products should be afforded the same consumer protection, and that therefore whenever an investor buys a mutual fund in Canada, they should subject to the same equal regime of consumer protection.

Neither the Unitholder by vote, nor the members of the IGA should have the Power to Call for the Termination of the Manager

The Concept Proposal contemplates an independent governance agency that would have the ability to suggest a termination of the mutual fund manager by calling a unit-holder meeting. We believe that neither the unitholders by vote, nor the members of the IGA, should have the power to call for the termination of the manager.

A unitholder meeting is an expensive manner in which to resolve disputes between governance agency members and the mutual fund manager. This expense would be added to the already considerable costs that are borne by investors. We think, moreover, that an investor meeting to terminate the manager would be ineffectual. Consumers purchase mutual fund units because they wish to invest their money while being able to delegate the administrative and management aspect of their investment to professionals. Mutual fund investors, by conscious choice, pay to have management issues competently addressed on their behalf and thus be disinclined to become involved in precisely the types of matters that they have paid to have addressed and resolved for them.

In addition to considerations of cost and investors not being interested/motivated enough to participate, we wish to remind the CSA that it is the business of a mutual fund manager to make decisions on behalf of the fund's unitholders. The legitimacy to act in this manner is conferred by investors themselves who, at first instance and through an exercise of individual judgment, select a particular fund manager from among a host of market participants to whom they will entrust their funds and the fulfillment of their investment objectives. A mutual fund manager cannot coerce individuals into subscribing to units of its fund nor can it force them to refrain from redeeming them. Fund managers thus serve at the pleasure of investors and have no ability to ensure the security of their tenure through compulsion. The right and privilege to continue to act on behalf of unit-holders is thus earned and subject to reaffirmation on a continual basis, as nothing bars an investor from moving to a more appealing product/manager combination.

The Concept Proposal contemplates that independent governance agencies will serve in an oversight capacity. In delineating the scope of this oversight role, particularly with respect to the proposal to vest independent governance boards with the power to call for the termination of the fund manager, we urge the CSA to remain mindful of the fact that their roles are not equal or similar. The legitimacy of a fund manager to act on behalf of unitholders arises from the agreed assumption of continuous public accountability and the fulfillment of specific objectives. An independent governance board would not be charged with, or specifically chosen to, fulfill these responsibilities and thus cannot be vested with the same level of authority and legitimacy that comes only with their assumption. The CSA should thus take care so as not to empower a governance agency to an extent that it would have the ability to undermine or impair the conscious choices made by an investor.

Roles & Responsibilities of the Independent Governance Agency

In considering the appropriate roles and responsibilities of the IGA we examined the recently developed TSE Guidelines on Corporate Governance to determine whether or not they might be applicable in part to fund governance, afford the necessary flexibility, and yet satisfy the CSA's goals of consumer protection. Our discussion determined that a specific set of guidelines could be formulated that would apply to any business organizational structure (Corporate or Trust) which resulted in the issuance of a mutual fund. These guidelines include 1) the separation of manager and trustee/IGA 2) trustees could be individual or a trust company 3) trustees would have to have a majority of its members unrelated to the manager or its affiliates within the meaning of the TSE Guidelines; and 4) the fund managers should appoint the independent members. We feel that modeling fund governance after the TSE Guidelines, as applicable, may be a good starting point for the CSA's further consideration. We also believe that the Canadian Mutual Fund Industry is already highly regulated and that any additional regulation should not be undertaken without clear identification of the benefits to be achieved. We saw as one extremely important benefit, both by way of operating efficiency and cost/benefit, the ability of the IGA to deal with the numerous conflict of interest questions now regulated by the CSA.

Just as we see the IGA as a prudent check on the activity of the fund manager, in considering appropriate rules regarding the appointment and compensation of IGA members, we believe that the CSA must be careful to ensure prudent checks are also in place to guard against inappropriate actions by the IGA members. As stated above we believe the IGA members should be appointed by the Fund Manager. We believe that the costs and lack of investor motivation make the appoint/replacement of the IGA members by unitholder vote to be completely impractical. We also believe that the power to appoint in the hands of the Manager may act as an appropriate safeguard on the IGA. For example, we recognize that allowing the IGA members to set their own compensation creates an opportunity for abuse by the IGA members. We also however understand concerns that an appearance of bias may result if the Manager is allowed to set the salaries of those hired to supervise it. While not perfect, we believe that the ability of the Manager to appoint Trustees will provide some check or assurance that the majority of Trustees will be able to reasonably police the activities of any 'rogue' trustee. We also believe that appointment of IGA members by the fund manager would serve as a check to make it less likely that 'rogue' trustees could self perpetuate themselves or over time, form a majority.

We believe that all steps should be taken to ensure that the costs of implementing enhanced fund governance are kept reasonable. For this reason we favour a liability cap of $1,000,000 for the IGA members.

We believe that all steps should be taken to ensure that the costs of implementing enhanced fund governance are kept reasonable. We believe creating a liability cap of $1,000,000 for each IGA member may be one reasonable way to help control costs. In particular we are concerned that if there was no limitation of liability for IGA members then recruitment of agency members would become much more difficult and expensive, especially for the smaller members of our industry. We also are concerned that liability worries might also lead to micro-management by the IGA or to the IGA retaining various independent advisors (lawyers, accountants, etc.) all of which we believe would also tend to drive up costs.

In addition to capping the liability of the IGA, we would also suggest that an attempt be made to clearly define the duties and obligations of the IGA members and that the CSA ensure that the defenses available to members of corporate boards are also be available to members of an IGA.

Enhanced Fund Governance must be a Nationally Standardized Initiative

If a fund governance regime is ultimately brought into being, we believe that it must be implemented in a uniform manner across Canada. We fear that if one or more CSA member decides to move ahead with a fund governance initiative without the agreement of all members, that unitholders would be forced to bear all the additional regulatory requirements and costs of fund governance while not being able to enjoy many of the benefits. This is due to the fact that the elimination or reduction of the many prohibitions which are currently used to deal with perceived governance and conflict of interest issues can only be achieved with the cooperation and approval of all CSA members while any one CSA member alone can impose the increased costs and regulatory burden by mandating new fund governance rules.

We would be pleased to discuss any of our comments with you or to participate in any additional industry consultation that may be warranted following the CSA's receipt of the responses to the Concept Proposal. Please feel free to contact either myself at 416-867-7300 or Darcy M. Lake, our Director of Regulatory Affairs & Compliance at 416-867-5724.

Yours truly,

E. N. Legzdins
President & Chief Executive Officer