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November 20, 2002

BY ELECTRONIC MAIL

Ms. Denise Brousseau
Commission des valeurs mobilieres de Quebec
800 Victoria Square, Stock Exchange Tower
P.O. Box 246, 22nd Floor
Montreal, Quebec
H4Z 1G3

Dear Ms. Brousseau:

Re: Response of Borden Ladner Gervais LLP to the Notice of Proposed Amendments to National Instrument 81-102 and Companion Policy 81-102CP Mutual Funds and to National Instrument 81-101 Mutual Fund Prospectus Disclosure and Form 81-101F1 Contents of Simplified Prospectus and Form 81-101F2 Contents of Annual Information Form

Thank you for the opportunity to comment on the proposed amendments to National Instrument 81-102 ("NI 81-102") and Companion Policy 81-102CP Mutual Funds ("NI 81-102CP") and to National Instrument 81-101 Mutual Fund Prospectus Disclosure ("NI 81-101") and Form 81-101F1 Contents of Simplified Prospectus ("NI 81-101F1") and Form 81-101F2 Contents of Annual Information Form (NI 81-101F1") (collectively, the "Amendments").

Background To Our Response

Our comments represent views of the Investment Management Group of Borden Ladner Gervais LLP on the Amendments. These comments do not necessarily reflect the opinions or feedback of all of our mutual fund clients.

The Amendments

The Amendments cover several issues but focus primarily on fund on fund investment structures. We would like to address this portion of the Amendments and the issues regarding "standing" and performance data. We wish to endorse and support the comments made by the Investment Funds Institute of Canada ("IFIC") and, as stated by IFIC, believe that while the Amendments as proposed are a good step in the right direction, the restrictions and conditions placed on fund on fund investments makes it problematic for mutual funds to achieve a result which implements the stated principle of the Amendment that "a mutual fund is one of many potential investments that a portfolio adviser may make with the assets of a top fund". We believe that the Amendments currently make it very difficult for portfolio advisers to select mutual funds for the top funds they manage.

As a starting point in assessing the Amendments, we were mindful of the fact that the conflict of interest issues that arise when a mutual fund invests in another mutual fund are not insignificant and we appreciate the great strides that have been made toward establishing a uniform baseline policy towards managing these issues from a regulatory perspective. We believe that any such policy must still, at best, reflect the traditional "Fund on Fund" structure and that flexibility in the form of exemptive relief from these restrictions must still be considered and if the circumstances merit, granted in order to support innovation in the industry. Although the Amendments may represent liberalization of the active management restriction which, without the Amendments, restrict fund on fund investments to less than 10% of the net assets of the top fund, the conditions and restrictions in the Amendments do not, for some mutual fund complexes, represent an expansion of their investment management powers. Accordingly, we believe that some latitude must be given to fund on fund structures that currently exist but which do not conform to the Amendments in order to preserve the investment products which investors selected based on the features disclosed to them. Failure to grandfather this relief unnecessarily prejudices these investors and the money managers who established their business model for the delivery of investment management services to these investors. Existing fund on fund structures that do not comply with the Amendments do not present fresh, unique or previously unaddressed conflicts of interest and should be grandfathered rather than eliminated.

1. Fund on Fund Issues

(a) Investment Restrictions on Pooled Funds

We agree with IFIC's comment that the investment restriction in the Amendment that prohibits a mutual fund from investing in any mutual funds that are not reporting issuers in every jurisdiction that the top fund is a reporting issuer is unduly restrictive.

(i) Pooled Funds should be treated like any other non-reporting issuer investment

Mutual funds that are reporting issuers ("Public Funds") differ from non-reporting issuer mutual funds ("Pooled Funds") in two material respects: continuous disclosure and mandatory NI 81-102 compliance. Public Funds routinely invest in non-reporting issuers whenever they invest in foreign markets or in illiquid securities. A Public Fund must file with each securities regulatory authority and deliver to its security holders, its annual audited and semi-annual un-audited financial statements and must update its prospectus to ensure that the document does not contain any material misrepresentations. While Pooled Funds do not have an obligation to file annual audited and semi-annual un-audited financial statements[1] with each securities regulatory authority and do not have an

[1] Many jurisdictions such as Ontario require that "mutual funds in Ontario", as that term is defined in the Securities Act (Ontario) must file its financial statement with the applicable securities regulatory authority and must distribute those documents to its security holders. This security holder distribution

obligation to deliver these documents to security holders, non-mutual fund issuers that distribute securities outside of Canada are also not obliged to make these filings or deliveries.

Generally, if an offering memorandum contains a material misrepresentation about a non-reporting issuer, investors have statutory or contractual rights of action for rescission or damages. Similar rights exist for Public Funds in respect of misrepresentations in their prospectus. As a result, Pooled Funds, and any other non-reporting issuers, that use an offering memorandum must ensure that, when delivered, the document is as up to date as a prospectus for a Public Fund.

In all cases, portfolio managers are expected to review non-reporting issuers to satisfy themselves that the issuer is an appropriate investment. We understand that a primary reason why currently portfolio managers are permitted to invest portfolios they manage in non-reporting issuers is because portfolio managers are deemed to have a level of proficiency that permits them to research and evaluate investments independently. The distinction between investments in non-reporting issuers that are mutual funds and those that are not, does not effect the fundamental duty of a portfolio manager or any person who manages a Public Fund to "exercise the powers and discharge the duties of its office honestly, in good faith and in the best interests of the mutual fund, and in connection therewith . . . exercise the degree of care, diligence and skill that a reasonably prudent person would exercise in the circumstances"[2].

Portfolio managers of mutual funds have an obligation to review and select investments that they believe satisfy the investment objectives and conform to the investment strategies of the portfolio they manage. Investors who invest in mutual funds select mutual funds and pay an investment management fee because they want a professional investment manager to indirectly provide them with investment advice. We believe that subject to reasonable conditions such as restricting investments in Pooled Funds to those which comply with NI 81-102, portfolio managers should be free to invest the assets of Public Funds in Pooled Funds that they have determined are appropriate.

(ii) Pooled Funds Can Adopt NI 81-102

Essentially, NI 81-102 is a set of investment rules and restrictions as well as regulations governing the conduct of a mutual fund and its manager's business. As such, it may be a concern that by permitting a Public Fund to invest some or all of its assets in a Pooled Fund, the investment rules and restrictions of NI 81-102 may be circumvented. We agree with IFIC's position that this issue can be addressed by only permitting investment in Pooled Funds that, in their offering documents or constating documents, adopt NI 81-102. In certain circumstances, there may be valid reasons for having as a bottom fund, a pooled fund that does not comply with all of NI 81-102. In those circumstances, we believe that securities regulatory authorities should remain open to granting discretionary relief that imposes appropriate conditions on the structure.

requirement is in addition to any requirements that corporate law or the constating documents of the mutual fund, may impose.

2 Section 116(1) of the Securities Act (Ontario).

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(iii) Fully Managed Accounts

Several mutual fund managers manage Public Funds as part of the fully managed account services they provide their clients and do not sell any mutual funds to the general public. Registered as advisers in the categories equivalent to investment counsel and portfolio manager, these advisers manage personal and institutional assets pursuant to investment management agreements.

For these managers, mutual funds represent a cost effective way for managing asset allocation programs or industrial and geographic sector investment mandates. Fund on fund structures represent another layer of flexibility by providing these managers with a method of grouping investment mandates. While establishing Public Funds represents a cost effective structure, establishing Pooled Funds within this context is even more cost effective. In the fully managed context, members of the CSA have approved fund on fund structures where the top fund is a Public Fund and the bottom fund is a Pooled Fund, both mutual funds are under common management, and both mutual funds comply with NI 81-102. We believe that these structures continue to provide clients with adequate protection and should be included in the Amendments for the following reasons:

(A) Clients of portfolio managers have privity of contract with, have direct rights against, and are owed direct duties of care from, their portfolio managers, and

(B) Where an investor has appointed a portfolio manager to manage its investment portfolio on a full discretionary basis, that investor has placed his or her trust in the portfolio manager's investment selection skills. That trust remains the same regardless of whether the investment is a Pooled Fund, a Public Fund or several levels of mutual funds all under common management.

Where a client's investments, including investments in Public Funds and Pooled Funds, are managed under the client's investment management agreement and all the mutual funds in which the client invests, are under common management, the fund on fund structure achieves the same result as one investment management account holding several securities directly. When compared with direct investments for individual accounts, fund on fund structures cost significantly less. We are of the view that the increase in cost to investors that direct investments present and the marginal increase in investor protection that the prohibition on Public Fund on Pooled Fund structures provides are disproportionate. Accordingly, we are of the view that portfolio managers should be able to establish Public Fund on Pooled Fund structures for their managed accounts, and that for reasons of efficiency and cost, direct investment structures should not be the only permissible structure for managed accounts.

(b) The Requirement That Fund on Fund Investments Be Disclosed In The Investment Objectives of The Top Fund is Too Restrictive

The investment objectives of a Public Fund are intended to be a general description of the investment mandate of a mutual fund. Essentially, investment objectives describe the ambitions or the results a mutual fund seeks to achieve. The investment strategies of a

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Public Fund, in contrast, describe how the investment fund expects to achieve its investment objective. Essentially, investment strategies describe the methods the mutual fund will employ to achieve the sought after result. If the portfolio of bottom fund complies with the investment objectives of a top fund, that, in our view, should be sufficient. As currently drafted, the Amendment will require the amendment of the investment objectives of many mutual funds, some of which currently employ a fund on fund investment strategy to the extent permitted by section 2.5 of NI 81-102. Security holder meetings would have to be called by these Public Funds in order to obtain approval for a revised investment objective that incorporates an existing investment strategy. We believe that this imposes unnecessary expenses on mutual funds and their security holders.

The securities regulatory authorities have in the past held that some fund on fund structures must disclose the name of the bottom fund in its investment objectives section. The Amendment would not permit these top funds to change their investment in the bottom fund without calling security holder meetings to approve a change of investment objectives. We believe this is also imposes an unnecessary expense on mutual funds and their security holders in circumstances where the top fund wishes to change the bottom fund but not the essential features of the investment objective. In both instances, we believe that guidance must be provided where a bottom fund’s portfolio is compatible with a top fund’s investment objective. It would be preferable if an investment objective “looked through” to the bottom fund’s portfolio, rather than focus on the structural device used to gain exposure to the portfolio.

2. Application of NI 81-102

The Amendments do not address the issue of “standing” under NI 81-102. At present, despite the language in section 1.2(b), mutual fund service providers cannot apply for relief from certain sections, which may apply to them generally rather than in the context of services provided to a particular mutual fund. For example, a custodian cannot presently apply for relief from Part 6 of NI 81-102, which applies to mutual fund custodians. Such relief would have to be applied for on a one off basis by each mutual fund wishing to use such custodian and wishing to rely on the relief sought.

In discussions with staff of various securities regulators last year, it was evident that this is an issue that had been previously brought to the attention of the securities regulators. However, we note that no proposed amendment to NI 81-102 has been made to remedy this issue and furthermore it has not been addressed in the new Commodity Pool rule NI 81-104 or the proposed Continuous Disclosure rule NI 81-106. We suggest that this issue be addressed in all of these new and proposed rules and that the “Application” section be amended to permit service providers independent ‘standing’ under these rules.

3. Changes Affecting Performance Data

The proposed amendments do not address any changes or clarification to section 15.9(1) of NI 81-102. Section 15.9(1) of NI 81-102 requires certain disclosure to be made in sales communications if there have been events which may have effected the performance of a mutual fund in a certain time frame. Section 15.9(2) of NI 81-102 addresses how performance data must be presented in a sales communication if a mutual fund has

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undergone a merger or reorganization. It is clear in section 15.9(2) of NI 81-102 that the securities regulators view a continuing fund after a merger similar to a "young fund" or a new fund which cannot show performance data for 12 months following the merger (subject to certain exceptions) and in addition this section prohibits showing performance for a period which reflects performance prior to and subsequent to the merger.

It would follow from the approach taken in section 15.9(2) of NI 81-102 that a Public Fund, which changed its fundamental investment objectives and therefore changed its portfolio of investments, should be treated like a "young fund" or new mutual fund and should not show performance data in sales communications for 12 months following such change. This was the approach that the securities regulators took in discussions with them in April 2001 with respect to one mutual fund, which had changed its objectives from fixed income to high yield bond. We agree with this approach. However, in spring 2002 upon the filing of a prospectus of a mutual fund which had changed its objectives from fixed income to equity, the securities regulators insisted on the inclusion of performance data to December 31, 2001, which was reflective of its performance as a fixed income fund and which was completely irrelevant to new investors in the fund and, in our opinion, very confusing for prospective purchasers.

We would request that the securities regulators address this issue and provide guidance either by an amendment to NI 81-102 or could be addressed by providing clarification and guidance in the companion policy NI 81-102CP.

Yours very truly,

BORDEN LADNER GERVAIS LLP

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