December 23, 2002

British Columbia Securities Commission
Alberta Securities Commission
Saskatchewan Securities Commission
Manitoba Securities Commission
Ontario Securities Commission
Securities Administration Branch, New Brunswick
Office of the Attorney General, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
Registrar of Securities, Department of Justice, Government of the Northwest Territories
Registrar of Securities, Government of Yukon
Registrar of Securities, Legal Registries Division, Department of Justice, Government of Nunavut

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- and -

Denise Brosseau, Secretary
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Re: Proposed National Instrument 81-106 – Investment Funds Continuous Disclosure

General

The Investment Funds Institute of Canada ("IFIC") appreciates the opportunity to offer comments on behalf of its members with respect to the Canadian Securities

Administrators ("CSA") proposed National Instrument 81-106 Investment Fund Continuous Disclosure ("NI 81-106").

IFIC is the member association of the investment funds industry in Canada and its membership includes 73 fund management companies sponsoring 1,963 mutual funds, 98 dealer firms selling mutual funds, and 58 affiliates representing law, accounting and other professional firms.

IFIC members currently manage assets representing almost 100% of all open-end mutual funds in the country. IFIC member funds manage $397.46 billion in assets (representing nearly 95 per cent of the industry) in over 52 million unit-holder accounts.[1]

Organization

Our comments have been divided into two parts. This letter sets out our general thoughts on NI 81-106 and raises for consideration some of the more significant areas of industry concern that we think merit particular attention by the CSA.

Appendix "A" is a section-specific comment. Appendix "B", "C" and "D" have been provided as supplementary information.

Overview

As a preliminary matter we think that the CSA, in considering disclosure obligations for our industry, should remain aware of the fundamental dissimilarity between corporate issuers and investment funds that renders quarterly reporting inherently useful and meaningful to investors of corporate issuers while providing little value to mutual fund unit-holders.

A determination of the current value of the securities of corporate issuers is based upon expectations of future performance and the relative confidence that investors place in the ability of management to map and strategically execute a forward looking strategy while prudently leveraging existing assets. The quarterly report is thus useful to investors of corporate issuers as it provides these investors with a timely statement by management of its future plans and outlook that allows investors to engage in an assessment of the corporation's future prospects and thereby determine the current value of its securities.

Investment funds are look-through vehicles and the value of mutual fund assets, in contrast to those of corporate securities, is simply a determination of the assets held by the fund on any given day and a calculation of their value at that time. Quarterly reports would thus not be useful in determining value in the

[1] Note: figures representing membership and assets under management by IFIC members are current as at November 30, 2002.

mutual fund context as the value of mutual fund assets is determined on the basis of an exclusively mathematical calculation that is not dependant upon an assessment of management's plans or outlook for the future.

We understand that the general objectives of NI 81-106 are to establish consistent, comparable and timely continuous disclosure by investment funds. We recognize that, from an implementation perspective, these are challenging and ambitious goals. We believe that NI 81-106 articulates sound concepts and welcome the CSA's initiative in seeking to address continuous disclosure issues for the investment funds industry in Canada.

NI 81-106 proposes the removal of items 8, 11 and 13.1 of Part B of Form 81-101F1 Contents of Simplified Prospectus ("Form 81-101F1") of National Instrument 81-101 Mutual Fund Prospectus Disclosure ("NI 81-101"). With this proposed amendment, the CSA have clearly indicated that they recognize the need to eliminate redundancies and thereby provide information in a readable and focussed document that is more in accordance with what investors are likely to want and use. We encourage the CSA to continue to consider the prospectus with a view to its utility and meaningfulness to investors.

We are hopeful that the CSA will build upon the proposed amendments by ultimately moving to eliminate prospectus delivery requirements and allowing the provision of prospectus information predominantly on an access basis.[2]

We think that NI 81-106 will potentially allow for cost savings to accrue to Canadian investment funds as a result of generally reduced fulfillment and delivery costs. However, we are concerned that these cost savings will be significantly reduced by the higher direct costs associated with quarterly reporting and indirect costs that will result from an increase in abusive/opportunistic practices such as front-running/free-riding by sophisticated fund outsiders.

We wish to emphasize that we support both meaningful transparency of process and the CSA's efforts to facilitate reasoned and timely investor decisions. However more frequent disclosure of portfolio holdings, instead of achieving

[2] With respect to the current prospectus delivery obligations, we are of the view that mutual fund securities should be treated like all other securities in continuous distribution and that the requirement to deliver a prospectus should, consequently, be removed. As an alternative, we propose that the CSA consider developing rules that would:

1. provide for electronic access to semi-annual and annual financial statements, management reports of fund performance, simplified prospectus etc. through publicly accessible web-sites and SEDAR; and
2. require fund complexes to notify investors, annually, that the information in 1. exists, in addition to when and how this information could be accessed.

Investors and advisors would, in this way, have the ability to download (or view online) the information that they were interested in reviewing.

these aims will, in our view, actually subject investors to a greater potential for abuse.

The strategies developed and implemented by actively-managed funds to select individual portfolio holdings are proprietary and are meant to be used for the exclusive benefit of the unit-holders that pay to acquire precisely this manner of expertise.

The CSA's proposal with respect to the frequency and disclosure of portfolio holdings will, in our view, significantly compromise the economic value of these services by compelling fund managers to give sophisticated third parties free access to proprietary information and management expertise that unit-holders have already paid for.

NI 81-106 Carries Over Unresolved Issues from National Instrument 81-102 ("NI 81-102")

IFIC commented on specific industry concerns in 2000/2001 in the context of the amendments to NI 81-101 and NI 81-102.[3] In our view, the issues raised in these submissions, specifically with reference to repurchase/reverse-repurchase agreements and the calculation and presentation of Management Expense Ratios ("MERs"), represent significant and legitimate concerns. These issues were not, from the perspective of the industry, given sufficient consideration by the CSA and as a consequence, remain as outstanding matters.

We urge the CSA to revisit and give serious consideration to the concerns of our members with respect to unresolved NI 81-102 issues. It is, in our opinion, inappropriate to import into NI 81-106 provisions that continue to be contentious and that were, from the industry's perspective, inappropriate for inclusion in NI 81-102.

<u>Responses to Specific Questions Raised by the CSA</u>

<u>Management Reports of Fund Performance</u>

<u>***CSA Question 1****: The CSA invite comments as to whether the quarterly management reports of fund performance will achieve the goals that they are intended to achieve. Should there be more or less frequent disclosure of fund performance information and why? Should there be quarterly reporting for all investment funds? Does the proposed type of information allow an investor or an adviser to make informed investment decisions?*</u>

We agree that summary information should be available to investors who expressly request to receive it. However, we do not believe that quarterly

[3] Copies of our letters are attached for your reference – please see Appendix "B".

reporting would provide investors with information that would be meaningful or of greater use to them and are of the view that it would be appropriate to limit the frequency of this disclosure to annual and semi-annual reporting.

The Need to Appropriately Assess Investor Demand for More Information

We think that it would be appropriate for the CSA to undertake a survey to determine the amount and level of detail used by average Canadian investors. We note also the need for questions to be placed in a context that discusses the costs of providing more information and also assesses the utility of information on the basis of the extent to which it would be used by an investor in making informed investment decisions.

Efforts to enhance the readability and utility of the prospectus have clearly demonstrated that more is not necessarily better. We emphasize that this concept extends to both the variety of information provided as well as the frequency of disclosure as not all information and levels of detail will be meaningful to the average Canadian investor. It is, in our view, more important to improve the quality of information that is currently disclosed rather than increase the frequency of what might, at best, be only marginally useful data. We think that some of the more relevant items of information for investors to consider, from the perspective of assisting them in evaluating their investments and making informed and timely decisions, are a statement of major holdings, rate of return, management expense ratio and a brief commentary. Most investment funds are valued on a daily basis and the net asset value per security is readily available to interested security-holders. Moreover, with respect to investor responsiveness to existing levels of disclosure, our members have indicated that only a very small percentage of their investors express any interest in receiving semi-annual reports.

Quarterly reporting obligations would be particularly onerous for fund of fund arrangements as top and underlying funds would be individually subject to quarterly reporting while each fund would likely have a different year-end. Having to provide quarterly disclosure for essentially identical funds with different year-ends would require disclosure more often than quarterly. Similarly, funds managed on a sub-advisory basis that had mandates similar to other funds would render the reporting process even more cumbersome as the sub-advised funds would also have different year-ends and thereby necessitate the overall production of monthly disclosures to meet the quarterly reporting obligations of multiple year-ends. The increased frequency of disclosure would give rise to significant additional costs and place oppressive reporting requirements upon fund of fund structures while exposing unit-holders to an increased risk of abusive/opportunistic practices by sophisticated fund outsiders.

From our perspective, significant disinterest with respect to existing and available information, coupled with the current availability of relevant information to interested investors, does not demonstrate a need for additional disclosure.

We continue to believe that the current frequency of disclosure provides interested investors with ample access to information. The current regulatory framework, in our view, provides sufficient and appropriate flexibility to allow funds to tailor and adopt disclosure regimes that best serve the needs of their unit-holders.

Direct Costs Associated with Quarterly Management Reporting of Fund Performance

The CSA have proposed the introduction of a quarterly management report of fund performance in an effort to enhance the timeliness and relevance of financial information currently provided by investment funds.

In assessing the overall utility of instituting a quarterly reporting requirement, we remind the CSA to remain cognizant of the fact that such a requirement should be assessed in terms of its net benefits to investors. As a consequence, the costs and non-monetary implications of the proposal must be weighed against the actual or perceived benefits that might obtain from its implementation.

Cost consequences in our industry are always a significant consideration as mounting cost burdens are invariably borne by the investor in the form of increased expenses charged to the funds themselves. The CSA have clearly acknowledged and indicated their awareness of the reality of the costs involved in the preparation and delivery of financial statements by proposing to allow investors to opt in for the receipt of any or all of a fund's financial statements and management reports of fund performance.

However, we anticipate that there will be significant increases to costs including additional preparation, accounting review, editing, project management, design, copy proofing, translation, paper and printing, binding, and fulfillment as well as delivery expenses associated with quarterly management reporting of fund performance. Moreover, the drafting and inclusion of a meaningful but not misleading quarterly statement of forward-looking commentary will require that the articulation of the future impact of current issues be given added consideration from a legal perspective and this, in our view, will give rise to significant additional legal review costs.

These new costs are not insignificant. We are concerned that they will, in aggregate, reduce the potential cost savings that will accrue from allowing investor opt in for the receipt of a fund's financial statements/management reports and thereby significantly diminish the cost savings that the CSA hope to confer. These added costs would be borne by all mutual fund investors despite the fact that only a small subset of investors are likely to request the additional information. As a consequence, we strongly recommend that required disclosure be limited to annually and semi-annually.

Increasing the Frequency of Disclosure Inappropriately Lends Itself to a Short-term Focus on Performance

Disclosure provided by investment funds by necessity represents a "snapshot" of information that is current as at a particular point in time. Increasing the frequency of these "snapshots" could, in our view, focus disproportionate attention on individual portfolio holdings and thereby inappropriately encourage a short-term investment perspective.

Investors in actively-managed mutual funds are distinct from purchasers of individual stocks. The purchaser of mutual fund units does not want a pre-selected basket of securities but rather seeks to acquire, over a longer term, the services of a professional manager and access to a professionally managed investment pool.

The industry and regulatory authorities have often reminded Canadian investors that investment in mutual funds should be based upon a properly diversified investment portfolio that is designed to meet their investment objectives and based upon their risk tolerance. In addition, it has long been the goal of both regulators and the industry to emphasize to investors that mutual funds should not be regarded as short-term investments. We are of the view that these continue to be prudent and timely messages that should be strongly articulated and reinforced jointly by both the industry and regulators, particularly in the current market environment. We are concerned that increased frequency of disclosure, particularly portfolio holdings, might undermine these messages and alter investor perception and behaviour in a manner that is wholly inconsistent with sound investment practices and the basic nature and general investment philosophy of the majority of mutual funds.

More Frequent Disclosure that Includes Portfolio Holdings Increases the Risk of Abusive/Opportunistic Practices

We are concerned that requiring more frequent disclosure of fund portfolio holdings would facilitate practices that could potentially harm unit-holders. More frequent disclosure will encourage "front-running"/"free-riding" by sophisticated fund outsiders. Front-running has the potential to be a dual abuse to the unit-holders of a fund as this practice would result in higher prices for purchases of fund securities and lower prices for fund sales. Moreover, we are disinclined to believe that making the disclosure of portfolio holdings subject to a mandatory delay period would remedy or ameliorate this problem in the case of either larger trades or trades in less liquid securities that take longer to complete. More frequent disclosure of portfolio holdings could also facilitate the ability of outside investors to "free ride" and thereby obtain for free the benefits of proprietary fund research and investment strategies that fund shareholders pay for.

The relationship between disclosure of portfolio holdings and the occurrence of front-running/free-riding has been the subject of much investigation in the United States where such opportunistic/abusive practices are prevalent.[4] We note that financial web-sites on the internet currently offer a number of services that claim to allow clients to "piggyback" off of mutual fund research and investment strategies.[5]

The gains made by individuals who might use more frequent disclosure of fund holdings in an abusive/opportunistic manner will come at the direct expense of fund unit-holders. This, in our view, would build into our regulatory framework an opportunity to expose Canadian mutual fund investors to an increased risk of exploitation and thereby clearly contravene the CSA's investor protection mandate.[6]

We urge the Commission to recognize front-running/free-riding as extremely deleterious practices that expropriate economic value from mutual fund investors. Engaging in this conduct should not be actively facilitated and we reiterate our strong belief in the need to preserve the confidentiality and value of the proprietary fund information that investors pay for when they purchase the services of professional fund managers.

Expanded Disclosure Requirements for Portfolio Holdings May Cause Non-Resident Advisors to Withdraw from Canadian Markets

We are concerned that the proposed disclosure of portfolio holdings may also adversely impact advisors of Canadian funds whose home jurisdiction does not require them to disclose portfolio holdings to the extent contemplated by NI 81-106.

Foreign/international advisors with mandates in Canada might withdraw from the Canadian market so as to avoid disclosure obligations that could result in

[4] The Investment Company Institute ("ICI") in its July 17, 2001 submissions to the Securities and Exchange Commission ("SEC") indicated that requiring mutual funds to disclose portfolio holdings more than twice per year would subject the average mutual fund investor to serious potential for harm as a result of an increase in abusive/opportunistic trading practices by fund outsiders. The ICI made reference to a research study that it commissioned ("The Potential Effects of More Frequent Portfolio Disclosure on Mutual Fund Performance"). The study is attached for your reference as Appendix "C" to this letter.

[5] Please see attached advertisements in Appendix "D"

[6] In seeking alternatives to the proposed disclosure of portfolio holdings, the CSA might consider requiring graphic presentations of portfolio information, such as pie charts showing different categories of securities held in a fund's portfolio (e.g., broken down by industry sector, credit quality, or other specified characteristic).

sophisticated traders in their home markets having access to information publicly available in Canada that these advisors would not have otherwise disclosed (or have been required to disclose) in their home jurisdiction.

Proxy Voting

The issue of proxy voting disclosure has recently been the subject of renewed media attention with the apparent focus being on the collective power of institutional investors and the influence that funds have through the voting decisions of fund managers, over companies in their portfolios.

We are concerned by the manner that has generally been adopted in addressing this issue. We find it disconcerting to note that a desire to have proposed disclosure first evaluated as to its materiality and utility to the buy, hold and sell decisions of the average Canadian mutual fund investor is, in some quarters, being equated with having something to hide.

The concerns of our industry do not stem from a desire for secrecy. The industry and Canadian mutual fund investors have had years of experience with disclosure documents such as the prospectus that have, in our estimation, clearly shown how an effort to convey too much can distract and discourage investors from a careful review of key information.

The mutual funds industry is structured so as to foster transparency and the development of our regulatory regime has seen the operations of our industry become increasingly transparent. The commitment of our members to improving the regulatory framework of our industry for the benefit of Canadian mutual fund investors is long-standing. We are of the view that this commitment has been amply demonstrated by a dedication of time, resource and expertise, over the course of many years, for the express purpose of assisting individual securities commissions and the CSA in the reasoned development of our regulatory framework.

From our perspective, the proposed disclosure with respect to proxy voting practices has not been considered with a view to the importance and materiality of this information to the average investor. We find this proposed disclosure to be somewhat indiscriminate and unwarranted. Moreover, the specific disclosure requirements of NI 81-106 are vague. We note that the draft language of Form 81-106F1 Contents of Annual and Quarterly Management Report of Fund Performance ("Form 81-106F1") Part B, section 1.2(h) is not helpful in providing guidance as to what matters would be required to be included in a discussion of proxy voting practices.

We do not believe that a portfolio manager's record of proxy voting is widely desired by Canadian mutual fund investors or is meaningful in assisting them to make buy, hold or sell decisions or is otherwise conducive to greater investor protection.

In our view, the disclosure of proxy voting practices would inappropriately politicize mutual fund portfolio management. We think that the disclosure of this information is being sought by special interest groups that wish to use the proxy voting practices of fund managers and the Canadian investment funds industry generally as a vehicle to further their respective social and political agendas. In addition, the disclosure of proxy voting practices would weaken rather than strengthen mutual funds' ability to promote strong corporate governance by essentially repealing confidential voting, a fundamental shareholder right. Confidential voting is, in our view, a useful and important tool in improving corporate governance and promoting a spirit of accountability.

To the extent that the CSA determine that proxy voting disclosure is necessary and appropriate we are of the view that such a requirement should, in the interests of materiality, be instituted only with respect to portfolio holdings that represent 10% or more of the total value of the portfolio.

Financial Statements

***CSA Question 2**: The CSA invite comment on whether the financial statement requirements set out in the proposed Rule meet the needs of the users of the financial statements. Does the amount of detail provided in the proposed National Instrument assist with the preparation, consistency and comparability of the financial statements? Is the proposed National Instrument too detailed? Is more detail or specific direction necessary?*

The majority of investment funds currently prepare and file six-month interim financial statements. Should all investment funds be required to prepare and file quarterly financial statements in addition to the proposed quarterly management reports of fund performance?

Filing and Delivery Requirements – Proposed Time Periods for Filing of Annual/Interim Financial Statements

NI 81-106 includes proposals to shorten the time periods for the filing of both annual financial statements (from 140 to 90 days after year-end) and interim financial statements (from 60 to 45 days after the end of the interim period). The CSA have stated that these time periods have been shortened in an effort to improve the timeliness of information so as to better ensure that it will be more current and relevant to investors and advisors in their investment decisions.

We do not think that investment funds should be required to prepare and file quarterly financial statements. The experience of our industry indicates significant disinterest on the part of investors with respect to existing levels of disclosure. We note also that mutual funds, unlike public companies, already release important fund information by determining and providing the fund's net asset value on a daily basis. Moreover, as already noted, quarterly financial disclosures would likely promote an inappropriate investor bias towards short-term performance. Quarterly reporting is thus, from our perspective, unnecessary and not justifiable as it would give rise to significant additional costs while offering no real advantage or commensurate benefit to the average Canadian mutual fund investor.

We also note that NI 81-106 would require firms to provide more financial disclosure in less time as the proposal to shorten time periods for filing comes simultaneously with the proposal to increase the amount of detail required in these same financials through the prescription of additional line items.

The preparation of financial statements is a time intensive endeavour that requires a coordination of efforts and various inputs, including those of firm accounting and marketing departments, prior to the submission and presentation of financial statements for board review and approval.

Ensuring that this process is carried out and completed in a meaningful way is already challenging under the existing time constraints and will become even more so with the proposed shortening of filing deadlines. This is particularly true in the case of the proposed 45-day period to file interim financial statements, a requirement that the industry is unlikely to be able to meet. We strongly recommend that the 60-day deadline for filing interim financial statements be preserved and that the deadline for the filing of quarterly management reports of fund performance be extended to 60 days.

The CSA appear to regard the preparation and delivery of financial statements to investors as a single matter that is controlled, with respect to both its process and timelines, exclusively by our members. We wish to emphasize that this is not the case as the production times and process of firms that our members engage to satisfy printing, delivery and fulfillment requirements are, to a significant degree, outside of our ability to re-engineer.

We urge the CSA to take greater cognizance of the process of preparing, producing and delivering financial statements from an operational perspective as significant aspects of this process are either not within the control of our members or cannot be performed in a quicker or more consolidated manner.

If the CSA is inclined to expedite delivery, it should do so with respect to information that it knows investors actually use and consider. From our perspective, information that is not used by the average Canadian mutual fund investor will not be rendered more useful by delivering it faster and with greater frequency. We urge the CSA to avoid the shortening of filing deadlines simply for the sake of disseminating information more quickly.

Financial Statements - Proposed Additional Line Items

The additional line items that have been prescribed generally require the provision of information that, in our view, would not be material from the perspective of being useful in assisting the typical Canadian mutual fund investor in making informed investment decisions.

Financial statements are all too easily obscured and rendered unintelligible by additional information and in seeking to prescribe additional line items, the CSA must remain particularly aware that "more is not necessarily better" by ensuring that proposed financial statement disclosures adopt and adhere to the concept of materiality. While we are cognizant of the fact that a materiality disclosure standard may marginally reduce the comparability of financial statements, it will provide users with more meaningful and relevant information.

Statement of Investment Portfolio/Summary Statement of Investment Portfolio

NI 81-106 contemplates that financial statements include a Statement of Investment Portfolio and a Summary Statement of Investment Portfolio. Requiring both of these statements is, in our view, functionally redundant and the CSA should amend the requirement so as to require the inclusion of only one of these two statements.

We think that it would be of greater practical utility to include only the Summary Statement of Investment Portfolio. A summary of major holdings could provide key information that would still likely be current at the time of investor review. A summary statement would thus highlight important information in a focussed manner while avoiding marginally useful detail that might obscure the statement and thereby detract from its overall utility to the average Canadian investor.

With respect to how a Summary Statement of Investment Portfolio would address the disclosure of portfolio holdings, we recommend that disclosure be limited to the top ten holdings of the portfolio plus any holdings that represent more than five percent of portfolio value.

Disclosure of Risk and Volatility

CSA Question 3*: The CSA invite comments on whether alternative methods of disclosing risk and volatility should be used. For example, should there be disclosure of the fund's best and worst quarter returns or disclosure of the correlation of the fund to a benchmark index? Is there additional disclosure that would provide useful information to the investors and advisers?*

Risk/Volatility

Discussions of risk/volatility are, in our view, inherently problematic and generally misunderstood. The industry has no adopted convention or established consensus as to what the best measures of risk/volatility are. Measures of risk/volatility are backwards looking and therefore of limited practical utility in predicting future volatility. Moreover, these measures are highly technical and therefore of almost no use to lay persons. We are of the opinion that the disclosure of these measures will give false comfort to regulators while serving only to confound investors. As a consequence, we do not believe that requiring mandatory discussions/disclosure of risk/volatility would be appropriate or assist in providing investors with practical or meaningful information.

Further Information

Thank you again for the opportunity to provide you with the thoughts of our members on this important proposal. Please feel free to direct any questions or comments that you might have to either John Mountain, Vice-President - Regulation by email at jmountain@ific.ca / (416) 363-2150 x 271 or Aamir Mirza, Legal Counsel at amirza@ific.ca / (416) 363-2150 x 295.

Yours truly,

Original signed by Thomas A. Hockin

Thomas A. Hockin
President and Chief Executive Officer

Appendix "A" - Section Specific Comments

NI 81-106	
Section	**Comment**
1.1 – Definitions	Note: This comment is raised in the context of section 4.4 (Statement of Investment Portfolio) which requires disclosure of investments at "current value" The definition incorporates by reference certain provisions from NI 81-102 that IFIC previously commented on because of problems in determining value in the prescribed manner. The problems with determining value in certain circumstances were discussed at length with the Fair Value Working Committee. We disagree with the need to prescribe the manner of valuation as we believe that prescribing the manner of valuation lacks the flexibility necessary for companies to calculate what they deem to be "fair value". All securities should have a "current value" which is equal to market value or fair value and Fund Companies should have the ability to determine what that market value or "fair value" is in accordance with their constating documents or policies.
1.3(1) – Interpretation	Multi-class interpretation between sections could be clearer
1.3(4) – Interpretation	Consideration should be given to including a seed capital exemption in this section
2.1 and 3.1 – Filing of Annual/Interim financial statements	Given the current volume of mailing, the proposed filing deadlines (25% and 36% reduction in interim and annual filing deadlines respectively) are aggressive. We believe that these revised timelines might be easier to meet if the definition of "Filing" is revised to remove the requirement for simultaneous "delivery" of hardcopy financial statements to security-holders **or** electronic information dissemination for financial statements and management reports to investors (i.e. via email or website) is permitted.
2.2 – Delivery of Annual Financial Statements	Delivery requirements under NI 81-106 do not coincide with those of NI 54-101. Ss. 2.2(1) requires a fund to annually send a request form to each registered holder and beneficial owner of its securities asking whether they wish to receive a copy of the fund's

	annual financial statements. The same requirement in respect of interim financial statements is set out in s. 3.2(1). Under NI 54-101, intermediaries are required to obtain instructions as to whether clients wish to receive or decline to receive certain types of materials, including financial statements and annual reports, but they are only required to do so upon the opening of the account, not annually. We query why investment funds (i.e. fund managers) would be required to send a request form annually. S. 2.2(2) provides that the request form shall be sent to beneficial owners in accordance with NI 54-101. Once again, under NI 54-101, clients of an intermediary may decline to receive certain materials, including (a) financial statements and annual reports that are not part of proxy related materials and (b) materials that are not required by corporate or securities laws to be sent. The request form contemplated by s. 2.2(1) of NI 81-106 does not fall into either of these categories because (a) it is not itself a financial statement or annual report and (b) it is required by securities law to be sent (i.e. s. 2.2(1) of NI 81-106 is mandatory). Accordingly, if s. 2.2(2) is left as written, a client who holds mutual fund securities through a dealer and who has informed the dealer under NI 54-101 that they do not wish to receive financial statements would, nevertheless, receive an NI 81-106 request form from each fund company whose products the client owns asking whether the client wishes to receive financial statements. We do not think that this outcome is the CSA's intention. We are of the opinion that s. 2.2(2) should be amended to read "An investment fund shall send the request form referred to in subsection (1) to the beneficial owners of its securities in accordance with the requirements of National Instrument 54-101, provided that an investment fund shall not be required to send the request form referred to in Subsection (1) to beneficial owners who have declined to receive said financial statements and annual reports in accordance with National Instrument 54-101. Funds should not have to send the request form to anyone who holds through a dealer,

	since, in accordance with 54-101 the dealer is required to obtain their instructions as to whether they decline to receive financials or agree to receive financials. We should be able to rely on the instruction received by the dealer.
2.2(1) – Delivery of Annual Financial Statements	"no cost to security-holders" should be redrafted so as to read “no **direct** cost”.
2.2(3) – Delivery of Annual Financial Statements	"returning a completed request" – should allow for 1-800/web based replies exclusively - optional mail reply (more costly); rules should clearly set out and define "return delivery options". Clarify this section by providing instruction/comments on how to deal with new clients. Will the return request be a box on an application form, to be updated annually with all other clients or presumed to be on a supplemental list until first request as ongoing client?
2.3(1)(d) – Contents of Annual Financial Statements	Reference to Item 3 should be to Item 4
2.3(1)(d) and 3.3(d) Contents of Annual/Interim Financial Statements	This new statement should replace the statement of investment portfolio rather than be a supplement, as it would provide meaningful information to investors. If both statements are maintained, additional costs will be incurred without any incremental benefit to security-holders. Disclosure of portfolio holdings should be limited to the top 10 holdings of the portfolio plus any holding that exceeds 5% of portfolio value.
2.3(1)(g) – Contents of Annual Financial Statements	Requiring financial statements to adopt the prescriptive format of management reports is contrary to the evolutionary nature of GAAP. While a prescriptive format might be acceptable for the management report, financial statements should be flexible as long as they are not inconsistent with the management report.
2.3(1)(g) and 3.3(g) - Contents of Annual/Interim Financial Statements	The format of financial highlights differs from current practice (revenues and expenses and realized gain on securities and foreign exchange to be disclosed separately). Given the mutual fund environment, where investment trading is the business of the entity, we do not believe this disaggregation provides any meaningful information. In addition, the statement represents additional work for two quarters (already prepared for interim and annual statements), including past performance amounts.
3.3(a) - Contents of Interim Financial Statements	Comparative statements should be for the last audited statement of net assets (as required by CICA Handbook Section 1751) rather than the corresponding period for the preceding financial year. The requirements of this section should follow/be in accordance with GAAP.

3.3(d) - Contents of Interim Financial Statements	Item 3 should be changed to read Item 4.
4.2 - Statement of Net Assets	Specific line items should not be mandated – all disclosures should be subject to materiality.
4.2: 5. & 7. - Statement of Net Assets	These amounts could alternatively be included in a Statement of Investments.
4.3 - Statement of Operations	Again, specific line items should not be mandated – inclusion of information should be based on materiality Points 3., 4., 6., 13. and 15. are new and other revenue, salaries and other expenses have been removed. Security-holder information costs: it would be useful for the CSA to provide a definition for this term and indicate explicitly what costs are meant to be included here.
4.3: 4. - Statement of Operations	Revenue from securities lending should only be required to be disclosed if material.
4.3: 11. - Statement of Operations	Why are security-holder information costs required and transfer agency fees (typically one of the highest costs) not required?
4.3: 15. - Statement of Operations	This item should come before 4.3: 14. and a line item "total expenses" should be added. In addition a further line item "net investment income (loss) before provision for income tax" should be added before "provision for income tax, if applicable" {4.3: 16.}. 4.3: 15. - Footnote [3] – reference to "expense cap that would require security-holder approval to change" should be explained more fully.
4.4 - Statement of Investment Portfolio	Please see comments on section 4.3 above. Points (3) and (6)(d) are new. Numbering of items with (4) should be changed to alpha references
4.4(1) – Statement of Investment Portfolio	Private company (non-reporting issuer) holdings mutual funds and labour sponsored funds frequently hold several classes of securities of single issuers. This requirement for disclosure of each designation is superfluous information which is not useful to a unitholder because they do not have access to the financial statements of the investee companies. We would propose that for private company holdings the fund be allowed to aggregate designations of equity and debt into a reduced number of line items where the designation differences are deemed not material, with disclosure of the aggregate number of shares or face value of debt instruments and cost of these securities with an annotation that discloses these as

	aggregated private company holdings.
4.4(4) 7.& 9. – Statement of Investment Portfolio	We recognize the importance of providing the credit rating for OTC derivatives when the counterparty's credit rating has dropped below the "approved credit rating" but query the requirement to continue to provide the credit rating when the counterparty is at or above the "approved credit rating". For fund investors the only relevance for OTC derivative instruments is that the counterparty has an approved credit rating. Consideration should be given to only require disclosure in the notes to the financial statements indicating that counterparties have approved credit ratings as required by regulation.
4.5 – Statement of Change in Net Assets	Please clarify, by stating explicitly whether or not it is acceptable to summarize security activities for several classes of funds together (i.e. by just presenting the totals for the fund).
4.7(1)3.(c) Notes to Financial Statements	The requirement in this subsection is too detailed. This information is explained in the prospectus. We believe that a simple overview of the differences between classes or series, in the interests of clarity, is sufficient.
4.7(1) 4. - Notes to Financial statements	Soft dollars - the requirement relating to allocation of brokerage transactions is new – this information is likely not available to most fund companies or within funds. Please clarify as to how allocation to specific funds would be made if based upon aggregate trades placed.
4.7(2) - Notes to Financial statements	Immaterial amounts from temporary overdrafts due to either redemptions or trade errors (e.g. failed trades etc.) should be excluded from the disclosure requirements of this section. For funds that engage in short selling, the financial statements will reflect the proceeds from securities sold short as liabilities. Clarification is required as the disclosure required by 4.7(2) 1- 4, is not meaningful for funds engaging in this type of strategy. Consideration should be given to specifically exclude liabilities arising from short selling activities.
4.8 – Inapplicable Line Items	"…for which there is nothing for the investment fund to disclose" – not "nothing" rather "nothing material" should be used – again, all requirements to disclose/exemptions from requirements to disclose should be based on materiality (i.e. disclose if an item is material/no obligation to disclose if an item is non-material).
6.6 – Exemption for Short Periods	Please clarify period subsequent to non-disclosed >3 month period. Is this meant to be 5.5 months or 3 months and 2.5 months go reported only as part of YTD?
7 – Specific Financial	Should be included within Part 4 so that all financial statement disclosure items are in one

Statement Requirements	location for ease of finding information. Definition of collateral (cash and other) – should define concept of control over securities and/or cash (see Part 3.1 of Companion Policy)
7.2(1) – Repurchase Transactions	"An investment fund, in the statement of investment portfolio…shall …disclose…the name of the counterparty of the investment fund". There should be no requirement to name the counterparty, instead the investment fund should be required to disclose the counterparty's credit rating. What is the rationale for requiring that funds disclose the date of transaction? Will repurchase transactions be part of the borrowing disclosure requirement in 4.7(2)?
7.3 – Reverse Repurchase Transactions	Again: the requirement should be to disclose the credit rating of the counterparty instead of its name. What is the rationale for requiring funds to disclose the date of transaction? The aggregation of individual positions should be permitted if they are immaterial when considered overall.
7.4 – Incentive or Performance Fees	Since the implementation of the requirement to include incentive or performance fees (IPA) in the MER, funds that have an IPA expense typically do not disclose, even though they could, what the MER would have been without the IPA. In the cases were funds had an IPA expense that was negative and thus lowered their MER, those funds disclosed the lower MER without explanation because they currently have that option. We believe the MER should fundamentally be a relevant piece of information that prospective purchasers and unit-holders can use to compare funds expenses. This is no longer the case and could be prevented with a requirement for a second MER when there is an IPA expense. For transparency purposes, only breaking it out in the statement of operations is not enough.
7.5 – Costs of Distribution of Securities	We concur with the requirement to expense costs of distribution of securities in the period they were incurred and to cease the fund's ability to further amortize these costs. However, doing this will necessitate a change in accounting policy for certain funds, particularly Labour Sponsored Funds. Clarification should be given on transitional rules i.e. changes in accounting policy under GAAP normally should be accounted for retroactively with re-statement of prior periods. With respect to investment funds this is clearly not practical. Additional guidance should therefore be provided.

	Note: Certain IFIC members have received guidance from OSC staff that the requirement to expense these distribution costs “in the period in which they incurred” precludes those funds that already amortize these expenses over periods of time from doing so. In addition, several labour sponsored funds have received NI 81-105 orders that allow this amortization over a specified period. Most of these orders have sunset clauses that would be triggered by the implementation of this rule. Please provide blanket relief from this section for those funds.
8.1(1) - Binding of Financial Statements	This requirement is too prescriptive and we do not understand what existing problem the CSA is trying to correct. This requirement will only serve to reduce the industry’s ability to find ways to reduce costs to investors. Prohibition on binding of management reports will lead to duplication of information. Does this preclude use of columnar format for financial statements (i.e., where statements for various funds are bound in one book and presented by type of statement (SNA, SO, SCNA, etc.)? Moreover, there are positive advantages associated with binding management reports of all funds into one document as this manner of presentation can provide investors with a better tool in deciding upon how to build their investment mix. Clients usually invest in more than just one fund so as to use the benefit of diversification.
8.3 – Labour Sponsored Funds	This section would seem to allow a labour sponsored fund, assuming they do receive a formal valuation, to elect to present the statement of investment portfolio in accordance with section 4.4 or section 8.3 at their option regardless of how they have reported in the past. Is it the CSA’s intention that a fund can opt one year to file in accordance with section 4.4, file the next year in accordance with section 8.3 and then be able to return to file in accordance with section 4.4? If it is, we believe this would not be helpful to investors. This section provides two alternatives for meeting the disclosure requirements of section 4.4 with regards to securities for which a market value is not readily available. The first alternative consists of disclosing the current value of each individual security; the second alternative consists, in lieu of disclosing the current value of each individual security, of disclosing an aggregate adjustment from cost to current value and the filing of a formal

	valuation relating to these investments, in accordance with Part 9. These two alternatives appear to suggest a different level of assurance being provided by the auditor's report on the financial statements and will only serve to cause confusion in the marketplace.
8.3(1)(b)(ii) – Labour Sponsored Funds	We recommend the reference to "formal valuation" (later explained in Part 4 of the Companion Policy), be changed to "valuation report". The use of the word "formal" has a specified meaning in other jurisdictions and could be taken out of context by unit-holders. The term "valuation report", in our opinion, is less potentially misleading. The Companion Policy should include guidance as to how a fund should disclose this information.
8.5(a) – Group Scholarship Plans	The reference to year of "eligibility" should be replaced with year of "maturity". There is a difference between maturity and eligibility and the reference here should be the maturity (i.e. the date on which the scholarship agreement matured). Eligibility refers to the eligibility of the student to receive education scholarship payment. In addition, with respect to group scholarship plans, the requirement to include a statement of highlights in the financial statements is not relevant. There is key information that is required disclosure which is set out in Part 8.5 of the proposed National Instrument and this is more important than certain other information contained in the financial highlight requirements. These plans do not make distributions in the way that mutual funds do, in addition, the number of units outstanding is not relevant for these type of plans. There may however, be some relevance in disclosing MER and portfolio turnover rates which could be accommodated in the notes to the financial statements if necessary.
9.1 – Independence of Valuator	We do not consider it "a question of fact" as to whether the valuator is independent as Secton 4.2 of the Companion Policy does not indicate whether a fund's Auditors qualify as independent. Generally for most labour sponsored funds, these two service providers are the same entity and we assume that if the fund's Auditors are the Valuators the question of independence has already been settled. If a fund's Auditors were not considered independent, it would require the duplication of many functions that need to be performed by the Auditor and Valuator and would in turn substantially increase the audit and valuation costs to the fund.

	In carrying out the audit of the fund, the Auditor is using experts to assist in the audit of the current value of the private investments. These experts can be either in house specialists or outside consultants. As a result of the audit, a valuation report is issued on the value of the Class "A" shares of the fund and sent to the Ministry of Finance. This report is a by-product of the audit and not a formal valuation on the investment portfolio for other purposes. In order to provide useful information to shareholders, the CSA should consider requiring more disclosure in the prospectus on the valuation methodology followed by the fund, including the inherent risks associated with the valuation.
9.2 – Disclosure Concerning Valuator	We think that the information required in parts (a), (d) and (e) provides no additional benefit or comfort to unit-holders and should not be required.
9.4 – Filing of Formal Valuation	Labour sponsored funds have always filed a valuation report with the Ministry of Finance as required by the Community Small Business Investments Fund Act with a copy to the OSC pursuant to the Securities Act (Ontario). As the existence of this report is a requirement of this tax program, we do not believe this report should be publicly disclosed. The unit-holders ability to obtain the valuation report on SEDAR in our opinion does not provide any further level of comfort since every labour sponsored fund is already required to have this report. This requirement increases the audit risk and inevitably will result in an increase of costs to the funds.
10.1 – Requirement to File an Annual Information Form	Our understanding is that this section preserves and does not detract from the requirement to file an AIF pursuant to NI 81-101. We understand 10.1(2)(a) as setting out an exception to the requirement to file an AIF – this exception being when the fund has filed a current prospectus pursuant to NI 81-101 (as the filing of a current prospectus pursuant to NI 81-101 already requires the concurrent filing of an AIF). We would ask that the CSA confirm our understanding of this section. In addition, clearer language should be used to more explicitly describe the obligations that are preserved and required by this section. As well, a clearer explanation of the exceptions and how they operate in relation to the existing NI 81-101 requirements to file an AIF should be incorporated.

13.1 – Restricted Share Disclosure Requirements	The information required by NI 51-102 has never been provided to investment fund unit-holders in the past and we query why it would be now. This could amount to a substantial increase in information to unit-holders by certain funds, which in our opinion is unwarranted and not useful or relevant to fund unit-holders. We ask that this requirement be removed.
14.1 - Change of Auditor	We understand that the alignment of investment funds reporting to other reporting issuers is the overall goal. In this regard, obtaining shareholder approval for a change in auditors for non-investment fund issuers is practical since they are already required to hold annual general meetings. However, since investment funds do not hold annual general meetings, the requirement to have security-holder approval for a change in auditors is not consistent with acting in the best interests of security-holders (i.e., the costs of holding such meetings is prohibitive and leaves investment funds without any recourse). As a consequence, we are of the view that the requirement to have a unit-holder vote to change auditors should be removed and replaced with a requirement to notify unit-holders
15.2(2) – Documents Available on Request	Delivery of requested documents within 3 business days of receipt of request – instead of "within 3 business days" change this requirement to read as soon as practicable after receipt of request. Please clarify the meaning of "delivery" – is delivery intended to mean getting documents into the mail or to the investor (note that the latter meaning would imply the use of a courier).
Form 81-106F1	
Section	**Comment**
Part A, Item 2 – Front Page Disclosure	References to documents being provided "at no cost" should be changed to read "at no **direct** cost"
Part B, Item 1 – Management Discussion of Fund Performance	Requirements are too specific. Although many items appear to give fund managers the flexibility to decide if a subject is material or not, this report may become a compliance checklist for fund managers to ensure that they disclose everything that is required. Fund managers, to avoid the risk of not complying with NI 81-106, may comment on all items

	whether material or not. These additional layers of disclosure will increase the amount of text and dilute the message. This will discourage many investors from reading the MRFP. We believe that this section of the guidelines should be more general and should be left to the discretion of the fund managers to determine which points they will talk to the client about in their annual and quarterly fund reviews.
Part B, Item 1.2(d) – Results of Operations	This subsection should require a discussion of significant changes only and not significant components.
Part B, Item 1.2(e) – Results of Operations	Does "Results of Operations" mean performance? Please clarify/define what is meant by the use of this term in this subsection.
Part B, Item 1.2(g) – Results of Operations	Add to this subsection: "Other than normal operating activities, otherwise disclosed in the notes (e.g. mgmt. fees etc)".
Part B, Item 1.2(h) – Results of Operations	This requirement should be removed - we do not think that this information would be useful or meaningful in assisting the average investor in making investment decisions. Purchasers of mutual funds pay for professional management services so that they can have these types of issues/discussions addressed and resolved on their behalf.
Part B, Item 1.2(j) – Results of Operations	This section should be amended so as to specifically exclude overdraft amounts and margin and/or short selling situations.
Part B, Item 1.3 – Risk	This requirement duplicates the obligation set out in section 1.2(f)
Part B, Item 1.4 - Performance	Is "Performance" the same as "Results of Operation"? If not, please clarify how they are different. If so, this section duplicates the requirements of section 1.2(e)
INSTRUCTION	*"Provide an analysis of any ratios reported in the statement of financial highlights, and discuss any changes to those ratios since the previous MDFP".* This should be amended to require a discussion of any **material** changes to reported ratios.
Part B, Item 2 – Financial Highlights	This item is duplicated in the financial statements, which increases the size of the MRFP unnecessarily. Interested investors can consult the financial statements which present the same information that is requested in Item 2.1. We do not believe that the financial highlights would be an important added value for investors in order to understand the MDFP. In our view, the MDFP should be clear by itself if explained concisely and in plain language.
Part B, Item 2.1(1) – Financial Highlights	Instead of a single number, the requirement to show key financial information about the Fund's financial performance should be for **up to** the past 5 years, so that this number does

	not have to be changed from fund to fund
The Fund's Net Asset Value per [Unit/Share] – Chart	"Total revenue and "total expenses" per security does not add meaningful information and is not required under U.S. GAAP or in the CICA Research Report "Financial Reporting by Investment Funds". Accordingly the Statement of Financial Highlights should only be required to disclose "net investment income (loss)" per security Is it mandatory to present this information in the specific order that the chart presents it? Please clarify how to do this ($/units) in circumstances where unit values change from start to finish. How is disclosure for a period of less than 12 months to be presented? Please explain why realized gains (losses) and unrealized gains (losses) for the period have been split. These numbers are not stand-alone items and should be reviewed together as representing market action. There is no added value to investors in splitting these amounts and we recommend that the requirement be amended so that these amounts are shown together in a single line item that discloses realized gains (losses) and unrealized gains (losses). Total Increase (Decrease) from Operations – Distributions: "From net income" should be changed to read "from **other** net income". Distributions: "from dividends" should be changed to read "from **Canadian** dividends". Distributions: "from realized gains" should be changed to read "**from gains**". *"Distributions were [paid in cash/reinvested in additional [units/shares] of the Fund"* – Add "**or both**".
Ratios and Supplemental Data - Chart	**Total Return** should be a required inclusion in this chart where total return figures are included as part of financial statements. *Number of [units/shares] outstanding* – This information should be deleted from the Management Report of Fund Performance as it is redundant and does not add significant value for investors.
Part B, Item 2.1 – Financial	" *Management expense ratio is based on total expenses for the stated period and is*

Highlights	*expressed as an annualized percentage of daily average net assets during the period".* What if this figure is not calculated daily? The word "daily" should be removed and this section should be amended to read "…as an annualized percentage of average net assets during the period".
Part B, Item 2.1(4) – Financial Highlights	This is contrary to current industry practice (also not required under U.S. GAAP or recommended in the CICA Research Report). Disclosing gains/losses from securities separately from gains/losses on foreign exchange related to securities would unnecessarily complicate the process. The "realized and unrealized gains and losses" per security should be one amount as this amount is a balancing amount necessary to reconcile the change in net asset value per security with the other per security information provided.
Part B, Item 2.1(5) – Financial Highlights	If selected financial information must be shown individually for each class of a multi-class fund, is there still a requirement to show financial highlights for each class?
Part B, Item 2.1(6)– Financial Highlights	This requirement is too prescriptive and does not take materiality into account (i.e. if $10 NAV OK, if $1000 NAV is immaterial). Requiring disclosure of turnover to two decimal places is unnecessary and adds no value for investors.
Part B, Item 2.1(10) – Financial Highlights	This requirement is not practical as it would require disclosure of changes in fund expense ratios (the other part of the MER) that occur throughout the year.
Part B, Item 2.1(11) – Financial Highlights	Please clarify how the restriction against disclosing portfolio turnover rates for money-market funds would impact firm disclosure of the portfolio turnover rates for derivatives or passive index funds (as these funds invest in money market instruments). Portfolio turnover rate should also not be required for certain other funds, for which the turnover rate is not meaningful – e.g. RSP clone funds, futures funds or fund of fund structures.
INSTRUCTION – Calculation of the Investment Fund's Portfolio Turnover Rate	What if daily values are available? This requirement is too prescriptive.

Part B, Item 3.3(1)(b) – Annual Compound Returns	Clarification should be given as to the definition of date of "inception", i.e. do the CSA mean the date that the fund was created or the date of first sale?
Part B, Item 4 – Summary of Portfolio Investments	This section again duplicates the Financial Statements. The CSA suggest that this section will replace the Top Ten Holdings requested in 81-101F1 but the requirements under Item 4 (2) (a) and (b) force the MRFP to increase its size much more than what was presented in the simplified prospectus. Moreover, Item (2) (b) will force fund managers to copy exactly what is in the Statement of Investment Portfolio presented already in the Financial Statements. This is an excessive cost that investors will have to bear. We believe that the disclosure of the fund's top ten holdings plus any holdings that represent 5% or more of total portfolio value is a more appropriate disclosure in the MRFP.
Part B, Item 4(2)(b) – Summary of Portfolio Investments	As noted above, disclosure should be limited to the top 10 holdings of the portfolio plus any other holdings that represent more than 5% of portfolio value. Would this subsection include the disclosure of illiquid securities?
Part B, Item 4(3) – Summary of Portfolio Investments	We do not think that this requirement will provide investors will meaningful information.
Part B, Item 4(3)(a) & (b) – Summary of Portfolio Investments	Please clarify how derivatives are to be accounted for under these subsections. We think that the requirements of subsections 4(b)&(c) are substantially provided pursuant to the requirement set out in subsection 4(2)(b) – please clarify
Part B, Item 4 – INSTRUCTIONS (4)	For fund of fund holdings, the requirement should be to disclose holdings of the bottom fund as at the most recent quarter end of the bottom fund, so as to minimize the opportunity for front-running/free-riding practices by sophisticated fund outsiders.
Part C – INSTRUCTIONS – General Discussion Concerning the Nature of MDFP	This text should be shorter.
Part C, Item 2.1 – Financial Highlights	We believe that the presentation on separate lines of the total revenue, total expenses, realized gains (losses) for the period and unrealized gains (losses) for the period will not have an added value for the investor. The investor already has the MER, which provides information as to the proportionate expenses of a fund. In addition, the investor also has the statement of operations which also provides information as to the proportion of expenses

	versus revenues and of realized versus unrealized gains and losses.
Part C, Item 4 – Summary of Portfolio Investments	This information is redundant with respect to the information presented on the statement of investment portfolio. Most statements of investment portfolio already break portfolios down into subgroups and cover the items listed as requirements in the summary of portfolio investments.
NI 81-106CP	
Section	**Comment**
1.4 – Signature and Certificates	Are signatures not required on the SNA? Please clarify.
2.6(1) – Delivery of Financial Statements	Please clarify by indicating more explicitly what is meant by "Investment funds are reminded that they remain subject to all applicable corporate law requirements that may still require delivery of annual financial statements to security-holders."
2.6(3) – Delivery of Financial Statements	"Such notices may alternatively be sent with account statements or other materials sent to security-holders by an investment fund as is convenient to the investment fund." This would appear not to be in compliance with the requirements of NI 54-102.
4.2(2)(a) – Independent Valuators	A Fund's auditors may be disqualified from being the Independent Valuator by virtue of their being insiders, an associate or an affiliated entity of the investment fund at one time or another. If a fund's Auditors were not considered independent this would require duplication of many functions that need to be performed by the Auditor and Valuator and would in turn substantially increase the audit and valuation costs to the fund.

Appendix "B"

May 5, 2000

British Columbia Securities Commission
Alberta Securities Commission
Saskatchewan Securities Commission
Manitoba Securities Commission
Ontario Securities Commission
Office of the Administrator, New Brunswick
Registrar of Securities, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland
Securities Registry, Government of the Northwest Territories
Registrar of Securities, Government of the Yukon Territory

All c/o John Stevenson, Secretary
Ontario Securities Commission
Suite 800, Box 55, 20 Queen Street West
Toronto, ON M5H 3S8
Jstevenson@osc.gov.on.ca

- and to -

Claude St. Pierre, Secretary
Commission des valeurs mobilières du Québec
800 Victoria Square
Stock Exchange Tower, PO Box 246, 17th Floor
Montréal, Québec H4Z 1G3
claude.stpierre@cvmq.com

Dear Sirs/Mesdames:

RE: SECURITIES LENDING AND REPURCHASE AGREEMENTS - PROPOSED AMENDMENTS TO NATIONAL INSTRUMENTS 81 - 101 AND 81-102

We are writing in response to the request for comments from the Canadian Securities Administrators ("CSA") regarding the proposed amendments to National Instruments 81-101 and 81-102 released on January 28, 2000. A duplicate copy of this submission is enclosed, along with an electronic version stored on diskette formatted in MS Word.

General Comments

Our Members are very pleased that the CSA have published draft rules that will enable mutual funds to engage in securities lending, repurchase and reverse repurchase transactions. This represents a very positive step for the industry. For some mutual funds, these rules present an opportunity for them to expand beyond their current participation in reverse repurchase transactions, while for others, they may signal the beginning of their participation in these markets. As our Members broaden their participation in these markets we trust that there will be an opportunity in the future to raise and consider additional issues arising from these rules.

Term to Maturity for Qualified Securities Purchased in a Reverse Repurchase Transaction

Paragraph 2.14(1) 3 restricts funds to purchasing qualified securities with a remaining term to maturity of 365 days or less. Our Members strongly contend that this condition will completely frustrate their ability to participate in the reverse repurchase market. The other conditions imposed in subsection 2.14(1) are in themselves adequate to minimize risk concerns and therefore we would strongly encourage the CSA to eliminate the term limit on the collateral for reverse repurchase agreements.

"Qualified Security"

The CSA specifically sought comment about whether the definition of "qualified security" should be expanded to include other instruments as eligible collateral for securities lending arrangements and repurchase transactions. Our Members would like mutual funds to have the ability to actively participate in these markets and broadening the definition of "qualified security" to include other instruments such as letters of credit, bank paper and high quality commercial paper would help achieve this objective.

102% Collateralization

Our Members are content with the suggested level of 102% collateralization of securities loans and repurchase agreements, as this is consistent with the current industry standard.

Term Limits

The term limits proposed for securities loans and repurchase and reverse repurchase agreements are overly restrictive and may operate to limit the usefulness of engaging in these types of transactions. Our Members suggest that the other conditions stipulated in the rules provide sufficient protection against risk and that accordingly, there should be no term limit for securities loans and the term limits for repurchase and reverse repurchase agreements should be extended. Our Members believe that the appropriate limit for repurchase and reverse repurchase agreements is 90 days, and believe that such limits, in conjunction with the other conditions, will not jeopardize the fund or the interests of its investors.

Term to Maturity of Qualified Securities Purchased with Cash Collateral

It is proposed that a fund ensure that any qualified securities it may purchase with cash provided as collateral or in consideration of securities sold have a term to maturity of no longer than the term of the securities loan or the repurchase transaction. In the case of securities lending, since the loan is in effect a demand loan, a mutual fund would have to invest in overnight instruments to ensure it can meet the demand loan requirements. This could severely undermine the return the fund might earn on the investment of cash collateral. Similarly, if the qualified securities purchased with cash delivered as part of a repurchase transaction must have a term to maturity no longer than the term of the repurchase agreement, the mutual fund would have to purchase overnight or extremely short-term securities to meet this condition, resulting in a similar impact on return. Ideally, our Members would like to see a term limit on collateral for securities loans and repurchase agreements of 365 days, but would consider a limit of 90 days to be reasonable. We would accordingly suggest that the requirement to match the term of the securities loan with the term of the qualified securities purchased with cash collateral be reconsidered.

Mandatory use of Agents

Our Members do not believe that the operational risks associated with repurchase agreements warrant the mandatory use of an agent for repurchase transactions. These transactions must be settled through the fund's custodian in any event and the other conditions that must be met to engage in these transactions, in our view, are adequate to minimize possible risk. In addition, mutual fund managers are also already subject to the same standard of care that would be required of any agent retained by the manager. Pension plans and other investment funds already successfully administer their own repurchase transactions without the requirement of an agent. Imposing this requirement on mutual funds drives up the cost of engaging in these transactions while only incrementally minimizing risk.

Conclusion

We appreciate the opportunity to comment on the proposed amendments to NI 81-102 and 81-102 CP. Should you wish to discuss any of these comments, please do not hesitate to contact the undersigned at 363-2150 ext. 473 or by e-mail at lbyberg@ific.ca.

Sincerely,

THE INVESTMENT FUNDS INSTITUTE OF CANADA

"Leslie Byberg"

Leslie Byberg
Senior Counsel

cc: Tom Hockin
John Mountain
Regulatory Steering Committee
Accounting Advisory Sub-committee
All Manager Member Senior Officers

June 29, 2001

To Members of the Canadian Securities Administrators Mutual Funds Sub-Committee:

Ms. Noreen Bent (BCSC)
Mr. Wayne Alford (ASC)
Mr. Bob Bouchard (MSC)
Mr. Paul Dempsey (OSC)
Ms. Anne Ramsay (OSC)
Mr. Darren McKall (OSC)
Ms. Rhonda Goldberg (OSC)
M. Pierre Martin (CVMQ)

Dear Sirs/Mesdames:

Re: Calculation and Presentation of Management Expense Ratios under National Instrument 81-102

As mentioned in our March 23, 2001 letter regarding amendments to National Instruments 81-101 and 81-102, we are writing to provide you with some comments on the provisions relating to the calculation and presentation of management expense ratios under National Instrument 81-102 ("NI 81-102"). This submission was developed through the Accounting Advisory Sub-committee in consultation with the Regulatory Steering Committee.

The Purpose of the MER

The changes introduced in NI 81-101 and NI 81-102 with respect to MERs seem to have expanded the purpose of the MER. Traditionally, the MER has been an expression of the fund's expenses relative to its assets. It has now become an indication of the maximum cost of ownership of fund securities. That shift is apparent in the inclusion of the provisions relating to non-optional fees, charges and expenses external to the fund in ss. 16.1(3) and (4) of NI 81-102.

Our Members have misgivings about this fundamental shift in the purpose of the MER as it relates to its presentation and disclosure in the audited financial statements, for a number of reasons.

1. Information about the cost of ownership of fund securities may be helpful information for investors, but it does not belong in the MER contained in the fund's audited financial statements that are presented in accordance with Generally Accepted Accounting Principles. The MER should be focused on showing the expenses related to the management and operation of the fund in relation to the fund's assets.

2. The requirement to include in the fund's MER non-optional fees, charges and expenses charged outside of the fund that do not form part of the fund's books and records is problematic. The accounting firms involved with the audit of our Members' mutual funds have raised a concern that in some situations, it may be difficult, if not impracticable, to obtain sufficient appropriate audit evidence relating to the MERs

when the relevant information is outside the scope of the records being audited. Information which may be relevant to unitholders, but which is not derived from the fund's own financial records, should not be included in the fund's audited financial statements.

3. Information on fund expenses presented in the financial statements should be relevant and useful to all users of those financial statements. Restricting the presentation of MER to a "worst case scenario" when management or other fee rebates are offered does not present useful and fair information relevant to all users. In fact, it may mislead a significant number of users who are receiving rebates and incurring lower indirect costs, but for which no relevant lower MER is disclosed.

4. The concerns outlined above were not apparent when the inclusion of non-optional fees in the MER was first proposed in NI 81-102. A number of products and services have since emerged that invite a reconsideration of the treatment of non-optional fees, charges and expenses under Part 16.

Our Recommendations

1. Amend Part 16 of NI 81-102

As noted above, our Members believe that cost of ownership information does not belong in the calculation of the fund's MER set out in the fund's audited financial statements. Accordingly, we are asking the CSA to consider removing the provisions in Part 16 relating to the inclusion of non-optional fees, charges and expenses incurred outside the fund in the calculation of a mutual fund's MER.

In addition, restricting the presentation of the MER to a "worst case scenario" when management or other fee rebates are offered does not present useful and fair information relevant to all users of the financial statements. We request that the CSA also consider amending ss. 16.1(5) of NI 81-102 to permit funds to present a range of MER information which includes amounts reflecting the minimum and maximum fund expenses taking into consideration any applicable management or other fee rebates. Within that range of possible MER's we suggest that the "actual" MER that represents the net expenses incurred by the fund as a percent of its average assets should also be disclosed. Please see Appendix "A" to this letter which provides you with examples of this suggested MER calculation and presentation.

2. Disclosure of Fees and Expenses in the Simplified Prospectus

Important information about the cost of owning mutual fund securities is already conveyed to investors in the simplified prospectus, in Part A, Item 8, in the tables showing fees and expenses directly payable by the investor and the illustration of different purchase options. We believe that this is the appropriate place to disclose the non-optional fees, charges and expenses mentioned in ss. 16.1(3) and (4) of NI 81-102.

3. Treatment of Non-Optional Fees

A specific sub-issue that has been raised in the broader discussion of non-optional fees involves the appropriate way for funds to present management expense ratios for certain classes of securities. For example, there has been discussion about how to account for the fees that may be charged to holders of "F" class mutual fund securities which are usually held through wrap, fee for service or asset allocation programs in which the dealer and investor negotiate the fee paid by the investor to the dealer for the program.

We understand that it has been suggested that the fund manager offering the securities determine the maximum amount that an investor may be charged by a dealer in connection with holding those securities, and reflect that maximum amount in the MER as a non-optional fee, charge or expense paid directly by the investor in connection with holding those securities under ss. 16.1(4) of NI 81-102. The discussion that has ensued, we understand, has focused on whether the fund manager that offers these types of securities has any control over the fee that the investor may pay in connection with holding the securities.

The requirement to reflect non-optional fees in relation to these types of securities should depend on whether the manager offering them has control over the fee that may be charged by the dealer pursuant to the terms of a written agreement with the dealer. If the fund manager does not have control over the fee the dealer may charge to the investor in connection with holding the securities, the simplified prospectus should simply disclose that a fee may be charged in connection with holding those securities.[1] We understand that this kind of disclosure has been accepted in recent prospectus filings.

In cases where the manager does have control over the fee that the dealer may charge to the investor in connection with holding the securities this should be included in the simplified prospectus under the relevant tables discussed above.

4. Disclosure by Dealer

We understand that there are requirements on the dealer to provide disclosure about fees to an investor. We suggest that in conjunction with the simplified prospectus, investors should also receive an appropriate level of fee disclosure from the dealer offering the service or program to the investor.

Caps on Management Expense Ratios

On a different point, we would like to confirm our understanding of the appropriate method for presenting a capped management expense ratio. In cases where the fund manager can change the capped amount without notice to securityholders or securityholder approval, we understand that it is acceptable to present the capped amount, supplemented by note disclosure explaining the impact of the cap on the MER. In cases where the cap cannot be changed without notice to securityholders or

[1] A sample of the disclosure that could be provided is: " Class F Units are held by investors who participate in fee based programs through their dealers. These investors pay their dealers an annual fee which is negotiated by the investor directly with the dealer".

securityholder approval, we believe it is appropriate that only the capped amount be disclosed.

Conclusion

We would welcome the opportunity to meet with you to discuss these proposals in more detail. Please feel free to contact me or my colleague Leslie Byberg, if you have any questions or would like to discuss them further. I can be reached at (416) 363-2150 ext. 271, or by e-mail at jmountain@ific.ca, and Leslie Byberg can be reached at (416) 363-2159 ext. 473, or by e-mail at lbyberg@ific.ca.

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PERSPECTIVE

Vol. 7 / No. 3

June 2001

The Potential Effects of More Frequent Portfolio Disclosure on Mutual Fund Performance

by Russ Wermers[1]

1. OVERVIEW

The U.S. Securities and Exchange Commission (SEC) is considering changes to the disclosure requirements for the semiannual and annual reports provided by mutual funds to their shareholders.[2] These periodic shareholder reports discuss fund investment strategies and recent performance. In addition, they contain a variety of other information, including the fund's financial statements and a list of the fund's current investments. These shareholder reports must be sent to fund owners within 60 days after the end of the reporting period.[3]

After the SEC announced its intention to revise shareholder report requirements, several groups submitted petitions calling for more frequent disclosure of a fund's portfolio holdings to its shareholders. In particular, the petitioners requested that the SEC require funds to disclose holdings on a monthly or quarterly basis, within either 30 or 60 days after the end of the month or quarter.[4]

This issue of *Perspective* examines the potential effects of more frequent portfolio disclosure on the performance of mutual funds. This study concludes that, with more frequent portfolio disclosure, the total return shareholders receive from mutual fund investments would likely be lower than that under the current disclosure standard. The principal reasons for this conclusion are summarized as follows.

- **Front running of mutual fund trades could significantly increase, which could increase fund trading costs.**

  More frequent portfolio disclosure would enable increased "front running" by professional investors and speculators. Armed with more timely and comprehensive portfolio information, these investors would be better positioned to anticipate fund trades and thus capture the price impact by trading securities ahead of a fund. Such front running could result in higher prices for fund purchases of securities and lower prices for fund sales. Higher trading costs translate into lower realized returns for fund shareholders.

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[1] Department of Finance, Robert H. Smith School of Business, University of Maryland at College Park.

[2] See Paul F. Roye, Director, Division of Investment Management, U.S. Securities and Exchange Commission, "Remarks Before the Securities Law Procedures Conference [of the] Investment Company Institute," December 7, 1998, p. 3 (www.sec.gov/news/speech/speecharchive/1998/spch238.htm).

[3] Investment Company Act Rule 30e-1(c).

[4] For example, see the letter and supporting memorandum from Mercer E. Bullard, Fund Democracy, LLC to Jonathan G. Katz, Secretary, U.S. Securities and Exchange Commission, June 28, 2000.

- **Free riding on mutual fund investment strategies could increase, limiting a fund's ability to fully benefit from its research.**

  More frequent disclosure of portfolio holdings would enable outside investors to obtain the benefits of fund research and investment strategies without incurring the costs. Outsiders would be able to either duplicate a fund's portfolio holdings or identify and adopt the proprietary investment techniques and strategies of the fund. An increase in free-riding activity could reduce the returns that funds provide to their shareholders by causing security prices to move before a fund could fully implement its investment strategies.

- **The cost of providing liquidity to fund shareholders could increase.**

  Mutual funds offer investors liquidity through the daily issuance and redemption of fund shares. Timely estimates of the net flow of new cash to funds from these activities are currently available to the public. With more frequent portfolio disclosure, professional investors and speculators would be able to identify the securities that a fund would likely buy or sell to accommodate these cash flows. As a result, front running of trades would be facilitated, thereby increasing liquidity-motivated trading costs and lowering returns.

- **Tax-management strategies of funds could become more costly.**

  More frequent disclosure would facilitate front running of tax-motivated trades of mutual funds, as professional investors and speculators would be better able to identify securities that funds might sell toward year-end to offset realized capital gains. Front running of tax-motivated trades could reduce pre-tax returns through higher trading costs and impair a fund's ability to provide shareholders with better after-tax returns.

"With more frequent portfolio disclosure, the total return shareholders receive from mutual fund investments would likely be lower than that under the current disclosure standard."

The magnitude of the costs arising from more frequent portfolio disclosure would depend upon the investment and trading strategies of a fund, as well as upon its size and particular investments. As a consequence, some funds and their shareholders would be less affected by more frequent disclosure than others. Indeed, some funds currently provide their shareholders with portfolio holdings information more often than semiannually. Other funds, however, do not provide more frequent information, which likely reflects a concern that such disclosure could adversely affect fund performance.[5]

The remaining sections of this paper detail the likely effects of more frequent portfolio disclosure on mutual fund returns. Section 2 discusses how more frequent portfolio disclosure facilitates front running and increases fund trading costs. Section 3 evaluates how free riding could be facilitated by more frequent disclosure and, thus, reduce fund returns derived from investment research. This section also considers how free riding could increase the direct research costs borne by fund shareholders. Section 4 discusses how more frequent portfolio disclosure could increase the costs of providing liquidity to shareholders through the daily offering and redemption of fund shares. In addition, Section 4 describes how the cost of providing tax management services through tax-sensitive trading strategies might increase with more frequent disclosure.[6]

2. TRADING COSTS, FRONT RUNNING, AND PORTFOLIO DISCLOSURE

Recent research on mutual fund performance finds that mutual funds can identify securities that are either over- or underpriced.[7] Furthermore, the research finds that funds capture "abnormal

[5] Institutional investment managers (including investment advisers to mutual funds) with investment discretion over $100 million or more of certain U.S. equity securities are required to file a schedule with the SEC listing these securities at the end of each quarter. The filing, called Form 13F, is due within 45 days after the end of the quarter and is made public shortly thereafter. Institutional investment managers may request confidential treatment with respect to certain disclosures on Form 13F. In addition, investment advisers are not required to disclose which funds or accounts hold the securities disclosed on Form 13F.

[6] Much of the information in this report is drawn from academic research, as well as from interviews with various market participants. Mutual fund managers and traders were interviewed to better understand the risks they deem important regarding more frequent disclosure of holdings data. Wherever possible, to validate and gauge the relative importance of these risks, academic research and high-quality databases were consulted. Also, interviews were conducted with several experts both within and outside the mutual fund industry who are knowledgeable in institutional investor tax issues as well as market microstructure issues relevant to the involvement of institutional investors in markets.

[7] See, for example, Russ Wermers, "Mutual Fund Performance: An Empirical Decomposition into Stock-Picking Talent, Style, Transactions Costs, and Expenses," *Journal of Finance,* 55 (2000), p. 1658.

returns"—returns in excess of that on a benchmark—with strategies exploiting these mispricings.

These abnormal returns, however, are relatively small and can be erased by inefficient trade execution. For example, financial research shows that stocks purchased by equity mutual funds, on average, have an abnormal return of one percent during the year following the purchase.[8] This figure is computed before factoring in the trading costs associated with the purchase of the stocks, which are estimated to be 0.55 percent of the value of a stock on the New York Stock Exchange (NYSE) and 1.0 percent for a Nasdaq stock.[9] Moreover, the trading cost can vary widely, ranging from an estimated 0.3 percent for a small-sized trade of a large-capitalization stock to 4.1 percent for a large-sized trade of a small-capitalization stock.[10] Trading costs clearly have the potential to eliminate extra returns offered by superior stock-picking strategies if the trades cannot be executed efficiently.

More frequent disclosure of portfolio holdings has the potential to raise the trading costs of mutual funds. Armed with knowledge of recent portfolio holdings, speculators and other professional investors would be better able to anticipate the trades of actively managed mutual funds. These outside investors may then attempt to trade ahead of mutual funds in order to capture the temporary impact—especially of large mutual fund trades—on prices of the traded securities. This activity, known as "front running," can cause security prices to "move against" the impending fund trade, thereby driving up the overall costs of securities trades and reducing the expected investment return.[11]

A current example of how front-running activity drives up mutual fund trading costs is provided by the recent controversy surrounding the move to decimalization by the NYSE. In this case, the shift to trading in one-cent increments allows specialists and floor traders to step more easily in front of large institutional buy orders by purchasing shares at a slightly higher price than that offered by the institution. This front running is done in anticipation of the institution increasing its bid price above the price that the specialist paid in order to complete the trade. This process, which is commonly referred to as being "pennyed," benefits the front runner while driving up mutual fund trading costs.[12]

"More frequent disclosure of portfolio holdings could raise the trading costs of mutual funds."

The remainder of this section discusses, in more detail, the likely effect of more frequent portfolio disclosure on mutual fund trading costs. The discussion starts with a description of the components of mutual fund trading costs, presents empirical evidence of their relative importance, and then analyzes the potential effects of more frequent disclosure on these components of trading costs.

Components of Trading Costs

The cost of executing a security transaction has two components. The first component is the direct commission paid to the broker for executing the trade. A recent study estimates that direct commissions account for about one-third of total trading costs for large-capitalization equity trades.[13]

The second and larger component, representing two-thirds of the cost of executing a large-capitalization equity transaction, is the trade-impact cost. This cost is the price concession that a buyer or seller must offer to induce a counterparty to make a trade. For instance, when a mutual fund or other institutional investor wishes to buy a security, it may need to offer to buy shares at a price in excess of the currently quoted market price to attract sellers.

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[8] Hsiu-Lang Chen, Narasimhan Jegadeesh, and Russ Wermers, "The Value of Active Mutual Fund Management: An Examination of the Stockholdings and Trades of Fund Managers," *Journal of Financial and Quantitative Analysis*, 35 (2000), pp. 353-55.

[9] Plexus Group, "Quality of Trade Executions in Comparative Perspective: AMEX vs. Nasdaq vs. NYSE," (American Stock Exchange Publication) August 1996, p. 9. The Plexus study included trades during 1995 by different types of institutions, including pension funds and mutual funds.

[10] Donald B. Keim and Ananth Madhavan, "Transactions Costs and Investment Style: An Inter-Exchange Analysis of Institutional Equity Trades," *Journal of Financial Economics*, 46 (1997) pp. 275-77.

[11] "Front running" is sometimes used to describe specific activities that are illegal under federal securities law, such as trading ahead of an order on improperly obtained information (for example, in violation of an investment adviser's fiduciary duty to its clients). In this article, however, the term encompasses trading activities not prohibited by securities laws because they are based upon lawfully obtained information.

[12] See, for example, Jeff D. Opdyke and Gregory Zuckerman, "Decimal Move Brings Point of Contention From Traders," *The Wall Street Journal*, February 12, 2001 p. C1.

[13] Stephen A. Berkowitz and Dennis E. Logue, "Transaction Costs," *Journal of Portfolio Management*, 28 (2001), p. 67.

This price concession is a large part of the cost of acquiring a security, and clearly affects the return on the purchase. Although the trade-impact cost for large-capitalization stocks is significant, smaller-capitalization stocks and other securities traded in thinner markets can have even higher impact costs, which, in turn, represent a much greater proportion of the overall cost (market impact plus broker commissions) of executing these trades. More specifically, impact costs are directly related both to the size of the transaction and to its size relative to the volume of outstanding shares. In addition, trading costs can rise substantially if transactions are conducted over a short time span.

The trade-impact cost of executing a security trade can be further separated into two components relating to events that occur between the time that the order is conceived by the mutual fund manager and the time that the order is executed. The first component is the price drift that occurs between the time the portfolio manager places an order with the fund's trader and the time that the trader places the order with brokers. Price drift results, in part, from the leakage of information that occurs as the mutual fund trader communicates with brokers and other market participants in a search for liquidity for the trade. The price drift during this pre-trade period has been estimated to average 0.17 percent of the dollar value of an institutional stock trade made on the NYSE during 1995 (Figure 1).[14] A significantly higher cost of 0.44 percent was estimated for trades on the Nasdaq market.

Although the pre-trade price drift can be costly, a substantially larger cost is represented by the second component of trade-impact costs. This cost is due to the price movement that occurs between the time that brokers receive an order from the fund trader and the time that the actual trade is executed.[15] This cost is estimated at 0.25 percent of the value of an institutional trade on the NYSE and 0.55 percent for Nasdaq trades.[16] Leakage of information is an important part of this cost, as well as the price concession necessary to bring liquidity into the market.

FIGURE 1

Average Institutional Trading Costs, 1995
(in fraction of security value, stated in percent)

	NYSE	AMEX	Nasdaq
Pre-Trade Costs	0.17	0.18	0.44
Execution Costs	0.25	0.24	0.55*
Direct Broker Commissions	0.13	0.18	0.01
Total Costs	0.55	0.60	1.00

**Nasdaq execution costs include, in most instances, an implicit brokerage commission.*

Source: Plexus Group, "Quality of Trade Execution in Comparative Perspective: AMEX vs. Nasdaq vs. NYSE," August 1996, pp. 6-10.

Information Leakage and Trading Strategies

Trading costs for mutual funds can be substantial, amounting to at least an estimated 0.48 percent of equity fund assets during 1994.[17] As a consequence, mutual funds are sensitive to trading costs, especially trade-impact costs, as they frequently trade in blocks of 10,000 shares or more and sometimes in blocks of up to several million shares.

In stock trades of these magnitudes, information leakage is a risk that can significantly contribute to the overall cost of transactions. As a result, a fund often splits a large block into a series of small orders carried out over several days or weeks to avoid detection by potential front runners. In some instances, the series of transactions might even take several months to complete, especially if the securities involved are thinly traded or if the transaction represents a large fraction of the total shares outstanding. Long-term portfolio revisions are becoming more common, especially with the increasing number of

[14] Plexus, "Quality of Trade Execution," pp. 6-10.

[15] The completed trade package may represent the execution of the package through either a single transaction or a series of transactions. Figure 1 shows the average cost of executing a trade package across both types of strategies.

[16] It is important to note that Nasdaq execution costs normally include an implicit brokerage commission.

[17] Wermers, "Mutual Fund Performance," pp. 1681-85, uses periodic mutual fund portfolio holdings data to infer trades and to estimate this cost. This approach understates the actual number of trades, as well as the actual costs of these trades.

very large funds, many of which have investments concentrated in relatively few stocks.[18]

To illustrate this point, consider a $10 billion fund wanting to liquidate a position in a stock accounting for 3 percent or $300 million of its assets. Assuming a price of $50 per share, the fund would have to sell six million shares. Large block transactions of 10,000 shares would require the fund to execute 600 separate transactions. Such a large-scale portfolio revision might be conducted over several weeks or months to minimize trading costs. Trying to squeeze the entire transaction into a shorter period would likely raise the per-share costs of selling the six million shares. In practice, the fund must weigh the higher cost of selling the shares quickly against the risk of information leakage in a sale spread over weeks or months. At a minimum, information leakage would compound the difficulty of obtaining a cost-effective execution of the stock sales over a protracted period.

"In large stock trades, information leakage is a risk that can significantly contribute to the overall cost of transactions."

Although fund traders and managers are aware of the costs of information leakage and attempt to minimize it, maintaining secrecy about impending trades is difficult. Many outsiders are involved in the execution of a trade, especially one broken into a package of smaller transactions. Besides the brokers handling the trade, other agents involved in the transaction include custodians, transfer agents, and market makers. At every step in the process, there is high potential for information leakage, as the incentive to trade on privileged information is very large.[19]

Index funds provide an example of a front-running problem caused by the availability of complete information on the funds' portfolios.[20] Speculators often make trades after the announcement of a change in the index's composition but in advance of the revision. Stocks scheduled to be added to an index are purchased, while stocks scheduled to leave an index are sold short. In contrast, index funds delay trades until the compositional changes become effective in order to minimize tracking error. As a result, index funds are exposed to increased trading costs arising from the price-pressure effects of the earlier trades. Many index funds have recently reacted to front running by concealing their index-revision strategies, and by devising more sophisticated strategies.[21]

Effect of More Frequent Portfolio Disclosure

Fund trading costs. More frequent disclosure of portfolio holdings, such as disclosure on a monthly basis, would raise the risk that speculators would be able to detect when a mutual fund trader is attempting to acquire or dispose of a large block of shares. Specifically, outside investors would be able to use recent information on fund holdings to determine with greater precision when a fund is likely to be in the market to buy or sell large blocks of a certain security. With this information, they could more easily attempt to front run the fund's transaction, thereby raising trading costs and lowering expected returns.[22]

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[18] In a recent conversation, the head trader of a fund complex with some large concentrated funds stated that, with many very large-block orders, only a few parties are willing or able to handle the opposite side of the trade. Thus, liquidity is very limited for these trades. The trader also stated that very large blocks are increasingly being broken up into smaller blocks to minimize the temporary price impact. In an analysis of institutional stock trades during 1986-1988, Louis K. C. Chan and Josef Lakonishok, "Institutional Trades and Intra-day Stock Price Behavior," *Journal of Financial Economics*, 33 (1993) pp. 177-79, found that the majority of trades were broken into packages of smaller trades. Also see Louis K. C. Chan and Josef Lakonishok, "The Behavior of Stock Prices Around Institutional Trades," *Journal of Finance,* 50 (1995), pp. 1150-54.

[19] An illustration based on the large-scale trade discussed above helps to show the potential profits from front running. As mentioned earlier, the average one-way trading cost of a stock on the NYSE is 0.55 percent of the value of the trade. If front running increases this cost by 0.20 percent (20 cents per $100 traded), then front runners could conceivably capture a profit of $600,000 across the block trades. With many large-block mutual fund trades occurring every business day, the potential profits from engaging in front running as an ongoing strategy are enormous.

[20] See E.S. Browning, "Making Index Revisions Sends Markets Into a Frenzy," *The Wall Street Journal*, July 26, 2000, p. C1. The article describes how hedge fund managers and traders on brokerage-firm desks make trades after the announcement of a change in the composition of a stock index in order to front run index mutual funds.

[21] Another example of front running is given by Susan Pulliam and Gregory Zuckerman, "At Hedge Fund, Debate Emerges," *The Wall Street Journal*, February 1, 2001, p. C1. This article describes how trading desks of Wall Street firms began circulating lists of large-scale technology stock holdings of hedge funds during the spring 2000 sell-off in Internet stocks. These lists helped speculators to short-sell shares in technology stocks before some large hedge funds could effectively liquidate their holdings.

[22] Many mutual fund investment advisers are currently required to disclose publicly, on a quarterly basis, aggregate holdings of certain equity securities across all accounts that they manage. (See note 5.) Such disclosures likely facilitate a certain degree of front running, and it is possible that front-running activity has increased in recent years with the development of the SEC's EDGAR database and the public's electronic access to it. More frequent disclosure of *fund-specific* information would give speculators additional information about the activities of individual fund managers, further enhancing the ability to front run.

In addition, an outsider observing a sequence of large block trades in a particular security would be better able to surmise (using recent portfolio holdings data) the identity of the fund making these trades and the likelihood of further block trades by this fund. A fund needing to execute a sequence of several trades in a security may unknowingly "tip its hand" through its early trades, especially when the total number of shares owned by the fund are more accurately known as a result of more frequent disclosure.

> *"More frequent disclosure would raise the risk that speculators could more easily attempt to front run the fund's transactions."*

In short, by heightening the potential for front running, more frequent disclosure would raise trading costs for mutual funds. In turn, this would translate into lower fund returns. For any one trade, the increased trading costs may be small. Aggregated across many trades and time, however, the cost would be substantial and could significantly impair the return a fund provides to its shareholders.[23,24]

Proponents of more frequent disclosure have suggested that a lag of 30 or 60 days between the portfolio holdings date and the date of disclosure would prevent front running.[25] For some trades, this statement may be true. For example, it is likely that the lag would protect small trades in liquid securities characterized by quick execution. Potential profits from front running are small in this case, and speculators would generally be deterred. However, larger trades, which have much more significant price impacts and take longer to complete, are much more enticing targets for front running, even if there is some uncertainty in using portfolio holdings data from the past.

Possible responses to more frequent portfolio disclosure. Because more frequent portfolio disclosure could lead to increased trading costs to mutual funds from front running, funds could be expected to attempt to minimize the adverse consequences. For example, some mutual funds might be reluctant to trade securities, especially in illiquid markets, even when their investment strategies dictate otherwise. Such a reaction would serve to reduce the profitability of security research efforts by funds. In addition, funds might react by attempting to trade large blocks of securities over a shorter period to avoid detection. However, faster execution implies larger market impact costs, even in the context of current portfolio disclosure standards. For example, a mutual fund currently executing a large trade of several million shares over a period of a week, rather than a period of several weeks, would likely incur trading costs of as much as (or perhaps even more than) double or triple the costs of the slower execution strategy.[26]

3. INVESTMENT RESEARCH AND PORTFOLIO DISCLOSURE

Actively managed funds incur substantial expense in hiring managers and analysts with stock-picking talents. For example, funds may hire experts in the technology, healthcare, utilities, and financial services industries to identify attractive investment opportunities in these sectors. Correspondingly, managers of these funds must effectively implement the portfolio strategies that result from this research if they are to deliver profits to fund shareholders.

This section describes how outside investors, armed with more frequent portfolio holdings information, could share in these research-derived profits by duplicating the holdings or portfolio strategies of a fund. These "free-riding" activities, although benefiting outsiders, can prevent a fund from fully realizing the potential returns from its manager's research efforts by moving security prices before a fund manager can fully implement a strategy. In addition, free-riding activities can result in fund shareholders bearing higher direct research expenses since they would effectively cover the research costs of outside investors.

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[23] The potential gains from front-running trades are even greater in those securities widely held by mutual funds. For example, in the second half of 1994, equity funds purchased 6.6 million shares in Sun Microsystems or about 7 percent of outstanding shares. These purchases would have represented more than 600 block trades of 10,000 shares or more than five large block trades per business day. Had monthly portfolio information been available at the time, funds would certainly have found it difficult to fully implement these trades without incurring high market impact costs because of front running.

[24] For example, if increased portfolio disclosure causes fund trading costs to increase from their current level of about 0.50 percent per year to 0.60 percent per year, then, over 30 years, the value of an initial investment of $10,000 in a mutual fund that yields 12 percent per year (before trading costs) is reduced by almost $7,000.

[25] See letter from Fund Democracy, pp. 4-5.

[26] Estimated based on the regression model for transactions costs in Keim and Madhavan, "Transactions Costs and Investment Style," pp. 277-85.

Free Riding

Nature of the Free-Riding Problem. Although mutual funds are generally able to identify mispriced securities,[27] profits from the research tend to accrue over periods ranging from 12 to 18 months after the date a newly acquired stock is first added to a fund's portfolio.[28] During this period, funds are vulnerable to free riding by institutional and individual investors outside the fund.

Free riding is an externality—an economic benefit to one party arising from the activities of another for which the benefiting party makes no payment. Where externalities arise, there may be a need to protect proprietary research. To illustrate, consider a pharmaceutical company that invests time, money, and intellectual capital to develop a new prescription drug. The company and the public stand to gain if the new medication is effective. Once developed, however, the medication could be easily produced and sold generically by other drug companies for their own economic gain at far less cost, unless prevented by patent laws. Without the temporary protection afforded by these patent laws, the pharmaceutical company might conclude that the investment in developing effective new medications is not economically worthwhile.

The disclosure of a mutual fund portfolio enables a similar free-riding externality. The management of a mutual fund devotes time, money, and intellectual capital to identifying promising investments. To the extent that the fund is successful, its shareholders benefit. However, outside investors, armed with knowledge of a successful fund's portfolio holdings, can mimic these holdings, thus capitalizing on the fund's research at no cost to themselves.[29]

Reverse Engineering. In addition to allowing the direct mimicking of a fund's security holdings, frequent portfolio disclosure would facilitate reverse engineering, another type of free-riding activity. Reverse engineering occurs when an outside investor applies statistical techniques to data on publicly reported holdings to infer the stock-picking strategies, strategic choices, or even the holdings of specific securities. For example, several academic studies have used portfolio holdings from mutual fund SEC filings to infer the types of stocks and strategies chosen by the fund industry.[30] Increasing the frequency of portfolio disclosure makes this type of inference more feasible as well as more precise.[31, 32]

"Armed with knowledge of a successful fund's portfolio holdings, investors outside a fund can mimic its holdings, thus capitalizing on the fund's research at no cost to themselves."

[27] Wermers "Mutual Fund Performance," p. 1658.

[28] Chen, Jegadeesh, and Wermers, "Value of Active Mutual Fund Management," p. 355. The authors show that positive, abnormal returns accrue to the stocks most widely purchased by the mutual fund industry over the 12 months following the first date that these stocks appeared in a publicly disclosed portfolio list. Since trades can occur anytime during the six months between the dates of the current and prior publicly disclosed portfolio list, new stocks appearing in the current portfolio list represent trades that occurred up to six months prior to the date of this list. Thus, abnormal returns accrue for up to 18 months following trades.

[29] Internet-based investment-pooling services in which investors can buy a large portfolio of small positions in individual stocks for an annual fee—and can trade these stocks—would appear to offer one means by which individuals might be able to mimic fund investment strategies.

[30] For example, Mark Grinblatt, Sheridan Titman, and Russ Wermers, "Momentum Investment Strategies, Portfolio Performance, and Herding: A Study of Mutual Fund Behavior," *American Economic Review,* 85, (1995), 1088-1105, show that quarterly or semiannual portfolio holdings data can be used to determine whether a mutual fund uses a strategy of buying stocks that are past "winners" and selling stocks that are past "losers." In addition, the paper provides a measurement of the degree to which a fund employs a "momentum strategy." More frequent holdings information would make such a measure even more precise.

[31] The availability of monthly—or, to a lesser extent, quarterly—data would allow a much more precise measurement of the motivation for mutual fund trades. For example, fund trading strategies based on analyst earnings forecast updates or on earnings announcements could be much more reliably measured with monthly or quarterly holdings.

[32] Potential profits from this type of free riding are similar in nature to profits gained from mimicking reported portfolio holdings. Although reverse-engineering a strategy is certainly a more difficult task than simply mimicking reported portfolios, the former strategy, once determined, can be implemented without the delay inherent in portfolio reports. For example, if a fund's strategy results in the purchase of a stock at the end of September, an outsider, using the fund's strategy, might purchase the stock at roughly the same time rather than waiting for the next fund portfolio holdings report.

Effect of Free Riding on Fund Performance

Free-riding activities, either through direct mimicking of fund portfolio holdings or through mimicking the (reverse-engineered) strategy of a fund, can substantially impair a fund's performance. As noted above, some investment strategies may take an extended time to implement due to the realities of implementing large-scale trades. For example, if monthly disclosure of portfolio holdings were required, even with a 30- or 60-day reporting delay, a fund may not have sufficient time to fully establish a position before outsiders discover the fund's purchase activity. Outsiders, interpreting a fund's purchase as a signal that its research indicates the security is underpriced, might begin purchasing the security. As a result, its price might be driven up, causing the fund either to forego completion of the purchase program or to incur a higher average price than otherwise would have been the case. In either event, the fund's realized return would suffer, and shareholders would not benefit fully from the fund's research efforts.

Similarly, a fund's return might be reduced if outsiders detect that the fund is liquidating an overpriced security over an extended period. These outsiders may liquidate the holding from their portfolios, driving the price down before the fund completes its sale of the holding. And, as noted above, outsiders may even be able to use frequent releases of portfolio holdings to reverse engineer the strategy of a fund and use the information to trade and move the prices of securities without waiting for the release of the next portfolio report.

> *"Free-riding activities can substantially impair a fund's performance."*

Mutual fund returns might also be reduced by another consequence of free riding either through the direct mimicking of portfolio holdings or the reverse engineering of strategies. The externality provided by frequent portfolio disclosure permits investors to benefit from fund research without incurring the cost of actually owning fund shares. As a result, some investors may choose to utilize the research of the best funds by mimicking their portfolios or their strategies while paying nothing for that research. In the process, fund assets would fall or grow more slowly over time, leaving a larger portion of research-related expenses to remaining shareholders.

Frequency of Portfolio Disclosure and the Potential for Free Riding

Current portfolio reporting standards, which require semiannual disclosure with a 60-day lag, limit potential free riding. Occasionally, a portfolio report might contain information on a security purchased during the weeks immediately preceding the date of the publicly disclosed portfolio list. However, the combination of a six-month reporting period and a 60-day reporting lag, along with uncertainty over the exact date the security was purchased, reduce the potential returns outsiders can garner from mimicking the reported portfolio. Stated simply, a potential free rider might receive a portfolio list too late to capture the majority of the profits from the fund's purchase of a stock.[33]

Requiring funds to report portfolio holdings more frequently than semiannually, even with a 60-day lag, would substantially increase the potential for free riding. If holdings were disclosed monthly, for example, a security purchase would be reported, at most, three months after its purchase date. Thus, the majority of the stock's abnormal return could be captured by outside investors. These investors would be able to buy a stock, at most, only three months after a fund had purchased it and then reap the benefit of the abnormal return over the following three to five quarters.

The expected return from such a strategy can be substantial. Evidence from a recent academic study demonstrates that less than half of the total abnormal return earned from the purchase of a stock by a mutual fund occurs during the first quarter after the date the stock first appears in a publicly disclosed (semiannual) portfolio list; the remainder is earned during the following three quarters.[34] The study actually understates the level of return made possible by monthly disclosure. That is, it cannot measure

[33] While filings on Form 13F (see note 5) may currently facilitate some degree of free riding, more frequent disclosure of portfolio holdings on a fund-by-fund basis would exacerbate the potential harm. Disclosure of portfolio holdings on an aggregate basis on Form 13F can obscure changes in the holdings of individual funds and thus make it difficult to mimic the strategies of particular funds or fund managers. For example, Fund A within a fund family might purchase 1,000,000 shares of IBM one week after Fund B of the same family sold 1,000,000 shares of IBM. The strategy of each fund would be safeguarded by the aggregate nature of the Form 13F filing, which would show no change in holdings of IBM shares across the fund family.

[34] Chen, Jegadeesh, and Wermers, "Value of Active Mutual Fund Management," p. 355.

the abnormal return accruing between the time the stock is actually purchased and the date the stock first appears in a publicly disclosed portfolio list, which can be up to six months later in the current reporting regime.

For example, a mutual fund may report its portfolio holdings as of the end of June and December. If the fund purchases a stock at the end of September, the purchase will be reported to the public five months later, or about at the end of February.[35] The study discussed above shows that, of the abnormal return earned during the period after December, less than half is earned during the first quarter of the following year. With monthly disclosure and a 60-day reporting delay, this September stock purchase would be reported two months later, or about the end of November (60 days after the end of September disclosure date). Thus, monthly disclosure would allow a free rider to capture the entire abnormal return available during the period after December and capture the abnormal return earned in December.

Possible Responses to Free Riding and Reverse Engineering

Frequent disclosure of fund portfolios would likely lead to free riding and reverse engineering of actively managed funds that have established a record of successful investing. In such circumstances, a fund likely to be subject to these activities might respond in several ways. For example, it might choose to reduce expenditures on securities research. Or, it might skew its portfolio choices and strategies toward those with a short-term horizon. Finally, a fund's manager might alter the timing of purchases and sales of portfolio securities, for example, by delaying the purchase of a new investment until after the portfolio report date.

> *"Free riding and reverse engineering of actively managed funds could cause funds to deviate from their optimal investment strategies and reduce returns to shareholders."*

Such responses would be intended to control costs, protect shareholders, and limit the adverse consequences of free riding and reverse engineering on fund returns. Nonetheless, by causing the fund to deviate from what its manager deems the optimal investment strategy, the fund's return could be reduced.

4. OTHER CONSEQUENCES OF MORE FREQUENT DISCLOSURE

More frequent disclosure of securities holdings could have other effects on the management of fund portfolios. In particular, managing the portfolio in response to shareholder cash flows could become more complicated, as could managing the portfolio to limit capital gain distributions to investors. In these instances, more timely information on fund holdings would enhance the ability of outside investors to front run mutual fund trades.[36]

Increased Liquidity Costs Associated with More Frequent Disclosure

Mutual funds provide an important service to the investing public by issuing and redeeming shares on a daily basis. This liquidity service, however, subjects mutual funds to variable and often unpredictable inflows and outflows of cash that can be substantial. For example, during the first quarter of 2000, 10 percent of U.S. equity mutual funds had inflows amounting to 31 percent or more of their average level of assets during that period. Another 10 percent experienced asset outflows of 12 percent or more during the quarter.

Investing cash inflows in securities or liquidating securities to meet outflows has the potential to impose a cost on shareholders in the form of lower returns than would have occurred in the absence of such flows.[37] This cost could occur for two reasons. First, funds must hold cash in their portfolios to buffer unexpected flows. Second, trading costs are incurred in response to these flows as the funds attempt to move back to

[35] As noted above, funds must report their portfolio holdings with a 60-day lag at semiannual intervals.

[36] Both of these strategies require information about holdings of individual funds. Hence, information about holdings on a complex-wide basis, as is provided on the quarterly reports on Form 13F, would be of limited use to those seeking to trade on the basis of cash flow or tax strategies.

[37] Unexpected cash outflows from shareholders are likely a bigger potential problem than inflows due to the avoidance of short-selling by most funds. Specifically, outflows can require the sale of an existing position, while inflows may be invested to increase holdings in existing positions or to initiate new holdings. However, inflows can also be a problem, as many funds focus their investments in a given sector, such as small-capitalization technology stocks, which constrains their investment choices.

their desired level of cash holdings. Two recent studies have estimated flow-related costs at between 0.7 and 1.4 percent of assets per year for equity funds.[38]

More frequent disclosure of mutual fund portfolios would tend to increase the cost of providing liquidity to mutual fund investors. Speculators can already estimate flows for most funds on a timely basis by using publicly available information or information compiled by data services specializing in the estimation of fund flows.[39]

Increasing the frequency of portfolio disclosure would only increase the precision with which outsiders could identify securities that might be traded in response to cash flows. Mutual funds might respond to the enhanced ability of speculators to front run liquidity-motivated trades in several ways. Those funds with highly variable flows might maintain higher cash balances. Other funds might move their portfolios toward more liquid securities to hedge against the possibility of unexpected, long-term redemptions. Finally, some funds might choose to close to new investors to limit the attractiveness of the fund to front runners. For shareholders in these funds, the smaller size would translate into higher direct expenses per dollar of assets, as funds would forgo cost efficiencies that normally occur as they grow.

"Managing a fund's portfolio in response to shareholder cash flows could become more complicated with more frequent disclosure."

Effect of Frequent Portfolio Disclosure on Tax Efficiency

A mutual fund must distribute its net realized capital gains to shareholders to avoid fund-level taxation. These capital gain distributions are taxable at the shareholder level if the shareholder holds the fund in a taxable account rather than in a tax-deferred account such as an Individual Retirement Account or an employer-sponsored retirement plan.

Many fund managers are sensitive to the tax consequences of their investment strategies. One investment strategy that a fund can employ to reduce taxes is to offset realized capital gains with realized losses. Offsetting transactions can occur throughout the year; however, effective tax management often results in bunching of the offsetting transactions in October.[40]

Tax-motivated trading has the potential to expose funds to front-running activities because of the seasonality of these trades.[41] Current portfolio disclosure regulations, however, likely deter attempts to front run tax-motivated trades, as it is not possible to track mutual fund holdings more frequently than semiannually. In contrast, more frequent disclosure would enable speculators and professional investors to develop estimates of losses and gains in fund holdings by tracking portfolio changes over time. With this information, traders could more closely identify securities that a fund or a group of funds would likely liquidate in tax-related transactions toward the end of the tax year.

[38] Wermers, "Mutual Fund Performance," p. 1685, placed the estimate at 0.7 percent, and Roger Edelen, "Investor Flows and the Assessed Performance of Open-End Mutual Funds," *Journal of Financial Economics,* 53 (1999), pp. 454-61, estimated 1.4 percent.

[39] Some information-service companies provide estimates of weekly or semiweekly mutual fund flows.

[40] The Internal Revenue Code effectively requires mutual funds to distribute by December 31 their realized capital gains for the 12-month period ending October 31 of that year.

[41] Scott Gibson, Assem Safieddine, and Sheridan Titman, "Tax-Motivated Trading and Price Pressure: An Analysis of Mutual Fund Holdings," *Journal of Financial and Quantitative Analysis,* 35 (2000), pp. 369-86, provide evidence that the market impact of tax-motivated trades can be high due to the commonality in trading across funds and the seasonality of these trades.

In response, funds might execute tax-motivated trades earlier in the year, which would reduce the ability of these funds to accurately forecast the number of such trades needed by the end of the tax year. The result would be a less than optimal implementation of a tax-management trading program, with corresponding losses owing to unnecessary trades as well as an inability to engage in last-minute tax-minimizing trades due to the widespread knowledge of funds' recent portfolios. For example, a mutual fund manager may decide, early in the tax year, to sell some securities that have decreased in price from their tax-basis price. This trade would represent an attempt to decrease the impact of capital gain distributions to shareholders at the end of the tax year that arise from sales of securities which have increased in price over the year. However, a market decline in the months following the trade may make such a trade unnecessary, with the effect of increasing the trading costs of the fund.

"Front running of tax-motivated trades could reduce pre-tax and after-tax returns to fund shareholders."

5. CONCLUSION

Increasing the frequency of portfolio disclosure beyond the current semiannual requirement, even subject to a delay in reporting, would facilitate front running, free riding, and other speculative activities that could, in turn, lower the returns many fund owners would receive from their investments.

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Appendix "D"

This firm offers a subscription service called the "iDayo Indicator™"
(Institutional Data Analysis Yields Opportunities)

Quotes from the iDayo website

"We all get stock tips from informed people from time to time, but this information is usually from a limited or biased source. By contrast, the iDayo Indicator™ investigates hundreds of sources, providing some of the best information on the street. ***Why not pick the minds of the best money managers in the world to help build your portfolio?****"*

(emphasis supplied) (from www.iDayo.com, Questions and Answers, July 16, 2001)

"The iDayo Indicator™ allows you to take advantage of the wealth of research conducted by institutional money managers. These professional managers invest an enormous amount of time and money performing research and analysis. The iDayo Indicator allows you to benefit from this work by identifying stocks where these independent researchers have arrived at the same conclusion - that the stock should be bought or it should be sold."

(from www.iDayo.com, Why does the iDayo Indicator™ Work?, July 16, 2001)

"The iDayo Indicator™ Uses Sound Market Theory. It looks for situations where **many** independent money managers, who usually have performed extensive research, agree on a stock's prospect … By its very nature, the Indicator identifies companies that are already being bought by the institutions. In many cases, the Indicator turns positive just at the point in time when the market movers are beginning to buy the stock, when momentum is just beginning to build. We alert you when these situations arise."

(emphasis in the original) (from Why Does the iDayo Indicator™ Work?, July 16, 2001)

"What is the iDayo Indicator™? The iDayo Indicator™ gives you instant access to the recent buying and selling activity of hundreds of professional money managers for any individual stock. We organize and analyze this information for you clearly showing whether there has been heavily disproportionate buying or selling in the stock by the professionals."

(from the iDayo Indicator™, Questions and Answers, July 16, 2001)

"What does the iDayo Indicator™ do? The ability to highlight disproportionate or uneven buying or selling activity by institutional funds is the cornerstone of the Indicator and why it is so revolutionary … It is based on a sophisticated formula that takes into account the importance of each transaction to the fund."

(from the iDayo Indicator™, Questions and Answers, July 16, 2001)

"Why is the iDayo Indicator™ so powerful? When the professionals act in unison, it's often a sign that they have uncovered important information that individual investors don't yet know about. The Indicator acts as an early momentum signal and allows you to get into the stock before other investors while momentum is just beginning to build."

(from the iDayo Indicator™, Questions and Answers, July 16, 2001)

"Where does the data come from and how quickly does it reach your system? Buying and selling activity is determined by comparing a fund's most recent holding report with its previous holding report. Our database captures fund holding data from over 12,000 public and private equity funds. Public funds must report their holdings to the federal government twice a year, but many report more frequently. Approximately 70% of these funds report on traditional quarter end dates and the rest use other dates… [This data] flows to us on a weekly basis. Each Thursday, we receive the latest filings from hundreds of funds which are then integrated into our site by midday Friday."

(from the iDayo Indicator™, Questions and Answers, July 16, 2001)

"Is the iDayo Indicator™ unreliable because it is based on 'stale' information? Absolutely not. It is true that the data we are looking at is from information that the funds reported 6 to 12 weeks ago. However, funds usually make big commitments to particular holdings for a long-term investment; so it is unlikely that a fund will reverse a large buy in a short time frame. More importantly, momentum in a stock's price builds over time. Momentum trends often result in upward price movement over many months or even years. Only *four weeks* after the close of each quarter, the iDayo Indicator™ begins to identify stocks that institutions and mutual funds are accumulating on a large scale, stocks whose future the market is just beginning to discover…our track record confirms this theory."

(emphasis in original) (from the iDayo Indicator™, Questions and Answers, July 16, 2001)

from Wall Street Journal Interactive, March 2000

"Fund managers have a lot of access to information that most of us don't have… [The iDayo Indicator™] help[s] investors tap into the brains of mutual fund professionals."

"Wouldn't it be nice if you could just sit back and relax while thousands of mutual-fund managers pooled their expertise to help you cobble together an award-winning portfolio? Well, that may not be so far-fetched after all. [iDayo] is trying to provide the virtual equivalent of this scenario for individual investors."

From Philadelphia Business Journal, February 2001

"Looking for a stock that institutional investors overwhelmingly are buying? iDayo can find it. … iDayo Indicator™ finds the stocks where the heaviest percentage of investors are buying."

"Can I see [the Indicators] performance results? Yes. The portfolios of highly rated stock we post for subscribers have consistently outperformed the market averages."

This firm offers a subscription service called "Institutional Piggyback"

Quotes from the B4Utrade.com website

"Wondering what the leading brokerages, top fund managers, & market-moving individuals are buying & selling? Then click here for Institutional Piggyback."

(from *www.b4utrade.com*, Home Page, July 16, 2001)

"Company Info. Our Institutional Piggyback Tool is yet another tool that can't be found anywhere else on the web. This tool acts as a "robot" which sorts through SEC filings so that, with the simple click of the mouse, you can see what Morgan Stanley, George Soros or Fidelity is buying in the Tech sector for example."

(from *www.b4utrade.com*, Company Info, July 16, 2001)

"**What's available on B4Utrade.com?** B4Utrade.com is the online trader's dream site! B4Utrade's premier service gives subscribers unlimited access to the most powerful tools on Wall Street [including] "The ability to "piggyback" the leading brokerages, fund managers & market-moving individuals."

(from *www.b4utrade.com*, Frequently Asked Questions, July 16, 2001)

"**How does Institutional Piggyback Work?** Piggyback Wall Street´s most influential Institutions or market-moving Individuals with just 3 easy steps!

1. Choose whether you are looking to identify BUYING INDICATORS or SELLING INDICATORS.
2. Choose your institutional screening criteria: First, select Sector(s), Exchange(s), Price(s), Volume(s) and Market Cap. (If nothing is chosen, all is assumed.) Then simply check off the desired institutions under BROKERAGES and/or FUND MANAGERS and/or check off the desired names under INDIVIDUALS.
3. Click on PROCESS SEARCH. This will allow you to view the stock(s) that meet the criteria you have selected."

(from *www.b4utrade.com*, Frequently Asked Questions, July 16, 2001) *from Chicago Sun Times, September 2000*

"If you want to know what [prominent investors or] the big institutions are buying or selling, there's an "Institutional Piggyback" section … designed to track their big block trades--long before [they] are required to report their current holdings."

from Silicon Valley.Internet.com, August 2000

B4Utrade "provides all of the typical services found on other financial Web sites, … but includes atypical looks into institutional trends (detailing current institutional buying or selling indicators, promising users a chance to "piggyback" on specific financial institutions."

This firm offers fee-based access to a service called "Mutual Fund Holdings Database"

Quotes from the AMGdata website

"About Holdings. The AMG Holdings Database is a relational complex of security and fund specific data that allows users the capability to view both fund holdings and security holders. The Holdings Database gives users the unique ability to move back and forth between funds and securities, making it easy to get accurate and up-to-date liquidity information on today's most interesting funds and securities. The database has been designed to provide users with multiple capabilities such as singular fund or security searches, general holdings research, or customized holdings reports that can be retrieved directly from the AMG web site -- all available in Excel format."

(from www.amgdata.com, AMG Mutual Fund Holdings Database, July 12, 2001)

"[About] the new AMG Online Holdings Site. An extended product line is now available to provide you with a wide range of holdings data including fund specific holdings and the mutual funds holding both domestic & international securities. Answer questions such as: What funds are selling AOL and Microsoft? . . . Design a one-time or ongoing report based on your specific holdings interests. Customized database or report access is available. . . . Database subscriptions are available that allow you to download all data in the Holdings Database. Relational holdings information can then be used directly in conjunction with your own internal resources."

(from www.amgdata.com, Holdings Products, July 12, 2001, emphasis in original)

"What is the difference between a fund and a security search? Fund searches allow you to obtain current holdings for any of the funds in the holdings database. Download the reports directly to your computer in Excel format and sort the portfolio to view its top holdings, regional allocation and top buys & sells. Security searches allow you to select a security or group of securities and view the mutual funds that hold them. By downloading the report directly to your computer in Excel format you can sort the information to retrieve the largest holders, who is buying and who is selling."

(from www.amgdata.com, AMG Mutual Fund Holdings Database, FAQ, July 12, 2001)

"How timely is the data in the Holdings Database? The holdings information is retrieved from annual and semi-annual N30D filings. AMG receives these documents electronically within 24 hours of their filing and makes every effort to enter them in a timely manner."

(from www.amgdata.com, AMG Mutual Fund Holdings Database, FAQ, July 12, 2001)

“Database Coverage. Holdings information is available for over 5,600 share classes valued at $3.4 trillion: Top 30 Fund Complexes: Equity & Taxable Bonds (excl gov); All High Yield debt; Equity funds >$500 million in assets; Balanced funds >$500 million in assets; All International & Global Debt and Equity”

(from www.amgdata.com, AMG Holdings Database, Demo, July 12, 2001)

“**AMG Holdings Database.** Relate Funds to their holdings. What securities are Funds...

- Buying?
- Selling?
- Holding?”

(from www.amgdata.com, AMG Holdings Database, Demo, July 12, 2001)

“Select By Sector. You can narrow your search by selecting the type of fund you are interested in.”

“Select A Fund. Search for an individual fund or scroll through the complete list of available funds.

“View Fund Holdings. Holdings can be sorted by any data point. To see the largest holdings, you can rank your query by market value. . . . You can sort your query to identify new positions and portfolio changes within the last 6 months.

(from www.amgdata.com, AMG Holdings Database, Demo, July 12, 2001)

This firm offers a service called FastCheck ®

Quotes from the iDayo website

"Stock Tools. Institutional money flow is a crucial barometer of market sentiment, and is often a leading indicator of a stock's price. iDayo's stock tools show whether institutional buying or selling is disproportionately heavy in a given stock. These tools provide advisors and investors for the first time with a window on the decisions of professional money managers."

(from www.idayo.com, Product Summary, July 16, 2001(pdf file))

"**FastCheck** tracks the institutional ownership of individual stocks and shows whether the professional money is flowing into or out of any stock. It identifies the top institutional holders according to criteria specified by the user. Our unique search engine helps users explore the total institutional picture."

(from www.idayo.com, Products, July 16, 2001)

"**FastCheck** gives advisors and individual investors the edge by providing in-depth information about a stock's institutional picture. FastCheck provides an instant summary of the institutional buying/selling in a stock over the most recent quarter, clearly showing whether a trend is emerging. FastCheck also allows users to generate customized lists of a stock's top 25 institutional holders according to various search criteria. Customized searching allows users to explore the institutional ownership picture according to the user's individual needs and interests …. "Provide[s] a wealth of insight into the day-to-day maneuvers of institutional investors" - Money.com."

(from www.idayo.com, FastCheck, July 16, 2001)

"**FastCheck** provides a variety of solutions as illustrated below:

I have a list of favorite stocks that I am thinking about buying. Before I jump in, though, I want to know whether the professional money is flowing into or out of this stock. How can I tell whether the professionals are accumulating a stock or selling it?

FastCheck will tell you! Our instant summary of institutional buying/selling activity will clearly show you what the professionals are doing with the stock. Compare total number of shares bought to the total sold. Compare the total number of buys to the number of sells. You can even see which professionals were buying and which were selling."

(from www.idayo.com, FastCheck, July 16, 2001)

"Users can drill down to progressively deeper layers of information, all the way down to how many shares a given fund bought or sold during the quarter. The 'top holders' section of the service has a unique feature that allows users to generate customized lists of top institutional holders according to variable criteria. Searches can be targeted to fund classification (growth, value, etc.), fund type (public mutual funds, banks, insurance companies, etc.), fund size, and more. The user can also rank holders according to various criteria, including number of shares held, greatest percentage of the fund's assets in the stock, and number of shares bought/sold."

(from www.idayo.com, Product Summary, July 16, 2001(pdf file))