BMO Mutual Funds

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Via Email

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Re: Proposed National Instrument 81-106 – Investment Fund Continuous Disclosure – Comments of BMO Investments Inc.

Introduction

We appreciate the opportunity to once again offer comments with respect to the Canadian Securities Administrator's (the "CSA") Proposed National Instrument 81-106 – Investment Fund Continuous Disclosure (the "Proposed Rule"). We have also participated in preparing The Investment Funds Institute of Canada's ("IFIC") response to the CSA on the Proposed Rule on behalf of the fund industry. We welcome the CSA's efforts to harmonize and simplify continuous disclosure requirements among Canadian jurisdictions.

General Overview

As an overriding comment, we believe the market research commissioned by the CSA does not accurately reflect what investors actually want.

Our experience has been that a very small percentage (less than 5%) of the purchasers of our funds have requested annual financial statements. We are of the view that our experience is typical of the industry as a whole.

Despite the results of the COMPAS survey, we have no doubt that most fund investors would respond differently to questions regarding the information they want to receive from a mutual fund company after receiving voluminous financial statements and/or Management Reports of Fund Performance ("MRFP"), either together or as separate reports, for each fund that they hold, than they did in response to a direct question from a market researcher.

Certain requirements in the Proposed Rule will result in significant cost increases. Most if not all of these additional costs will likely be passed on to unitholders without any appreciable benefit accruing to them. In order to manage the costs and to provide better value to unitholders, we strongly suggest the CSA consider requiring only delivery of annual and interim MRFP on request and remove the requirement for the delivery of annual and interim financial statements and proxy voting records.

Fund financial statements are difficult for most investors to read and to understand and provide little information about the performance of the fund and the reasons for that performance – in absolute or relative terms. That is the only information that a vast majority of unitholders require. The MRFP provides investors with a written analysis of overall fund performance. Commentary in the MRFP could refer to numbers derived from the financial statements, as appropriate. The financial statements could be made available to unitholders on request, but without any requirement on the part of the fund manager to ask investors to respond if they want to receive the financial statements. Fund financial statements could also be made available on the fund manager's website and on SEDAR.

Specific Comments on the Proposed Rule

In the event there are no material amendments to the Proposed Rule in relation to filing, delivery and binding of financial statements and MRFP and proxy voting, we wish to offer the following comments:

Part 2 – Filing Deadlines for Financial Statements

We are concerned about the proposal to shorten filing deadlines for financial statements. As we indicated in our 2002 submission to the CSA's request for comments on the last version of the Proposed Rule, preparing financial statements is time intensive and involves the coordination of efforts of various internal departments and external service providers, including auditors, translators and printers. This is in addition to the time required for the submission and presentation of financial statements to our independent board of trustees for review and approval. Organizing this process to occur within these shortened timelines would be extremely difficult.

Also, a requirement to produce financial statements under shorter timelines, may lead to an increase in the potential for errors, ultimately compromising the quality of the statements and adversely impacting the unitholder's ability to make appropriate investment decisions.

In addition, we seriously question the value in shortening the filing and delivery deadlines of financial statements when such a small percentage of unitholders rely on this information when making an investment decision. As a result, there does not appear to be any compelling reason to shorten the time periods for the filing of these documents, particularly in light of the challenges noted.

We strongly recommend that the CSA maintain the current timelines and avoid shortening filing deadlines simply for the sake of disseminating information more quickly. Alternatively, we recommend that the CSA at least maintain the 60-day deadline for interim financial statements (and interim MRFP) and amend the filing deadline to 120 days for annual financial statements (and annual MRFP).

Part 4 – Management Reports of Fund Performance

The MRFP serve the same purpose for investment funds as the management discussion and analysis does for reporting issuers. It supplements the information in the financial statements and generally gives management's assessment of the past performance and strategic position of the funds. The Proposed Rule requires the filing of the MRFP annually and semi-annually at the same time as the financial statements. This additional requirement to prepare and file a new report and to have it reviewed and approved, coupled with the process of producing the financial statements, will make the deadlines, particularly the 45-day interim deadline, extremely difficult to meet.

The preparation and distribution of the MRFP will involve significant additional time and resources on the part of numerous internal departments (Fund Accounting, Legal, Operations, Marketing) as well as our external partners. Additional costs will likely be incurred in producing and distributing the MRFP, which costs are ultimately borne by the funds.

In addition, the prohibition on binding MRFP has the effect of requiring a separate report for each fund. This stand-alone presentation ignores the importance of overall client portfolio performance and diversification by concentrating on each individual fund's performance. We urge the CSA to allow MRFP to be bound together. We suggest that at a minimum, the CSA allow similar funds to be grouped together such as money market funds and in situations where fund mandates and holdings are identical such as RSP clone funds and their underlying funds. The requirement for a separate MRFP for each fund will also increase costs.

Finally, with respect to forward-looking financial information, we request clarification from the CSA as to whether it is optional or mandatory disclosure. The instructions in section 2.5 of Form 81-106F1 (Contents of Annual and Interim Management Reports of Fund Performance) appear to indicate such disclosure is mandatory, however, CSA comments in Appendix B to the Notice and Request for Comments indicate that the provision of forward-looking information is optional. As indicated in detail in our 2002 comment letter, we have strong reservations about providing mandatory forward-looking information and we urge the CSA to include the provisions of such information in the Proposed Rule on an optional basis only. In addition, we suggest that the CSA include a template for what forward-looking information should look like in the Proposed Rule to ensure consistency in reporting.

Part 5 – Delivery of Financial Statements and MRFP

For the reasons noted above, we strongly suggest the CSA consider removing the requirement for delivery of annual and interim financial statements, and only require delivery of annual and interim MRFP on request. However, in the event there are no material amendments to the Proposed Rule, we wish to offer the following comments:

We ask the CSA to clarify and revise the language of section 5.2(5)4 of the Proposed Rule to indicate whether or not instructions received from clients through annual requests under previously issued exemptive relief orders can be relied upon in the same way as we understand instructions previously received under National Instrument 54-101-Communication with Beneficial Owners of Securities of a Reporting Issuer, can be relied upon.

Section 5.2(3) of the Proposed Rule requires the sending of standing order instructions about delivery to existing clients within three months of the Proposed Rule coming into force (March 2005). This timeline falls during RRSP season, perhaps the busiest time of year for the fund industry, does not leave much time for organizations to begin capturing client instructions, and is incompatible with our year-end reporting.

For example, BMO Mutual Funds have a September 30 year-end. Under section 18.5 of the Proposed Rule, funds must send all clients the initial MRFP for the first financial year -end of the fund after the effective date of the Proposed Rule. For BMO Mutual Funds, the first MRFP will not be required until the period ending September 2005. However, this requirement is not consistent with the standing order instructions under 5.2(3) as those clients that indicate they do not want to receive the MRFP in the March mailing, will, against their instructions, receive a copy of the MRFP pursuant to the requirements in section 18.5. We suggest that section 5.2(3) be drafted in consistency with section 18.5.

Section 5.2(9) of the Proposed Rule requires funds sending financial statements and MRFP according to standing instructions to send an annual reminder to clients indicating that documents are being sent according to the client's instructions and how such instructions can be changed. However, in its response to comments (Appendix B to the Notice and Request for Comments), the CSA indicate that the reminder must include the client's current election. This response appears to indicate that the reminder must indicate each of the documents the client has requested (interim/annual MRFP, interim/annual financial statements, or any combination thereof). This would require an enormous amount of work as the reminder would have to be programmed separately for each client. In addition, this would be expensive as customized mailings are generally more costly to produce than generic mailings. We ask the CSA to clarify this issue and recommend that a client's current election not be required as part of the annual reminder.

Part 7 – Financial Disclosure – Binding

Section 7.4 of the Proposed Rule states that a fund may not bind MRFP for different funds. This requirement precludes the consolidation of the annual and semi-annual MRFP of each fund having the same manager or portfolio advisor and would also preclude the reports being bound together for delivery purposes. The CSA in Appendix B to the Notice and Request for Comments indicate that they will not allow binding so as to avoid "telephone books" being sent to clients. However, the binding of MRFP serves useful purposes for not only those preparing the information, but for distributors as well as clients that wish to see multiple funds in one comprehensive document, rather than separate and numerous documents per fund.

As indicated above, we urge the CSA to allow MRFP to be bound together. At a minimum, we suggest that the CSA allow similar funds to be grouped together such as money market funds and in situations where fund mandates and holdings are identical such as RSP clone funds and their underlying funds. This will better facilitate comparisons between funds, while at the same time, reducing the time and costs associated with the preparation of MRFP.

Section 7.4 of the Proposed Rule also states that a fund may not bind its financial statements with financial statements of another fund unless all information relating to the fund is presented together and not intermingled with the information relating to the other

fund. We disagree with the CSA's comments that presenting informational in parallel columns makes it hard to extract useful information from the financial statements. We further disagree with the CSA's comments that the proposed changes will reduce costs, as a change in the layout of our financial statements will increase our costs.

Part 10 – Proxy Voting Disclosure

We agree with the requirement in section 10.2 and 10.4 to establish policies and procedures in relation to proxy voting and to deliver a copy the policies and procedures upon request to any client without charge. However, section 10.4(2) also requires the delivery of a fund's proxy voting record upon request to any client. Section 10.3 sets out the minimum requirements for a proxy voting record. It would require managers to create a record on a fund-by-fund basis showing what proxies were received and how they where voted.

We do not believe that a record of voting as prescribed by section 10.3 is widely desired by Canadian investors or is meaningful in assisting them to make buy, hold or sell decisions with respect to their investments. The preparation, maintenance and delivery of such a record would involve considerable expense and as a practical matter this information (due to its size and scope) would be very difficult and costly to compile.

People invest in mutual funds in order to delegate the complex process of investment management; proxy voting is a subset of that process. We question the logic in requiring disclosure in great detail about decisions made by a portfolio manager on this one aspect of investment management, but not other important aspects such as valuation, liquidity and strength of management.

Since we see very little demand for this information by investors, we are strongly opposed to the requirement to compile, maintain and deliver a proxy voting record. At the very least, if funds will be required to prepare and maintain a proxy voting record, the Proposed Rule should be narrowed to votes where the fund opposed management's recommendations.

Part 16 - Additional Filing Requirements

There appears to be some inconsistency between section 16.2(2) which states that a fund must file any document required by this Proposed Rule on the same date as or as soon as practicable after the date the fund sends the documents to clients, and section 5.4 which states that a fund must send documents to clients within 10 days of filing. We would ask the CSA for clarification on this issue.

In addition, section 16.2(1) requires a fund to file any document required to be sent to securityholders under the Proposed Rule (except those explicitly excluded). We ask the CSA to clarify whether this means that we would be required to file solicitation of instructions, annual reminders and requests forms in Part 5 of the Proposed Rule.

Part 18 – Effective Date

If there are no material amendments to the Proposed Rule, its implementation will necessitate significant systems, operational and procedural changes. These changes will involve significant additional time and resources on the part of fund accounting, legal, marketing, operations, our Board of Trustees and the fund's auditors.

Since the comment period ends on July 27th, 2004 and it will be some time before the CSA will be in a position to publish the final version of the Proposed Rule, it will be unreasonable to have the Proposed Rule apply to financial statements and reports for financial years of a fund that end on December 31, 2004. It would be more appropriate to have the Proposed Rule apply to years ended after December 31, 2004, to allow the industry to properly prepare to implement the required changes.

Further Information

We thank you for the opportunity to submit our comments and trust that they will be given due consideration.

Should you have any questions, please call Darcy Lake, Director, Regulatory Affairs & Compliance at 416-867-5724 or Kim Cadario, Legal & Policy Counsel at 416-867-6455.

Yours truly,

"signed"

Edgar Legzdins