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June 20, 2007

**VIA E-MAIL**

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**RE: RESPONSE TO REQUEST FOR COMMENTS – PROPOSED NATIONAL INSTRUMENT 31-103**

BMO Investments Inc. ("BMOII") welcomes the opportunity to provide this submission in response to your request for comment on proposed National Instrument 31-103 ("NI 31-103").

BMOII applauds the Canadian Securities Administrators ("CSAs") for their efforts to harmonize, streamline and modernize the various, often complex and incongruous, registration regimes across Canadian jurisdictions. The purpose of this letter is to identify and provide context in relation to specific concerns we have with certain of the proposed provisions. Below is our response to certain of the questions raised in the *Notice and Request for Comment*, as well as our perspective on other aspects of NI 31-103.

***Question #1: What issues or concerns, if any, would your firm have with the proposed fit and proper and conduct requirements for exempt market dealers? Please explain and provide examples where appropriate.***

To meet the proficiency requirements proposed for representatives of exempt market dealers ("EMDs"), current salespersons of a mutual fund dealer and their supervisors would have to obtain additional industry education in order to sell, and oversee the sale of, exempt products. It is unclear why the Canadian Securities Exam has been selected to be the anchoring educational requirement for exempt market salespersons, or why present educational and training requirements for salespersons acting on behalf of a member of the Mutual Funds Dealers Association ("MFDA") are insufficient, particularly in light of "Know Your Product" obligations that require MFDA dealers to provide robust training specific to the products they offer, including focused KYC and suitability protocols, that would likely be more meaningful to the sale of exempt products than a generic, largely duplicative, industry course.

At the dealer level, BMOII asks the CSAs to consider whether an additional dealer registration is necessary for mutual fund dealers who enter the exempt product marketplace, as the ability to distribute exempt products could be efficiently subsumed within their mutual fund dealer registration and SRO membership. In fact, the MFDA already provides regulatory oversight to its members with respect to due diligence, training and sales conduct specific to the sale of exempt products.

***Question #3: Registration for managers of all types of investment funds (other than private investment clubs) is proposed. Are there managers of funds for which the risks identified are adequately addressed in some other way and therefore registration as a fund manager may not be necessary? If so, please describe the situation.***

We commend the CSAs for introducing the "Investment Fund Manager" registration category, which will create a more level playing field and bolster investor protection by bringing into the registration regime entities that would otherwise not be required to register at all. BMOII wishes to highlight its unique position as both a mutual fund dealer (and member of the MFDA) and the manager of the BMO Mutual Funds. In addition to continuing its mutual fund dealer registration and SRO membership under NI 31-103, BMOII would also be required to register as an "Investment Fund Manager". BMOII submits that the CSAs consider exempting from the fund manager registration category firms that are SRO members where, like BMOII, their minimum capital requirement as prescribed by the SRO would be no lower than $100,000. Additional registration for such firms may be duplicative and unnecessary because the rationale for requiring them to register as a fund manager is sufficiently addressed by the (in most cases overlapping) requirements of their dealer registration category and SRO membership. For instance, BMOII meets the MFDA's financial reporting and Level 4 solvency requirements and is audited annually by the MFDA to ensure compliance with these criteria. As an MFDA member BMOII already has a robust complaints management and reporting process and is subject to the MFDA's dispute resolution process. As well, in its capacity as mutual fund dealer BMOII would remain subject to certain key provisions of NI 31-103, including conflicts of interest, record keeping and appointing a UDP and CCO, which would hold true whether required to register as a fund manager or not.

Should BMOII be required to register in both categories, we ask for clarification as to how the financial reporting requirements of each of its categories of registration are intended to work together; would a firm like BMOII continue to complete all MFDA financial reporting requirements as well as prepare financial statements and a calculation of excess working capital as an Investment Fund Manager pursuant to section 4.24 of NI 31-103? BMOII also asks whether the contents of the

quarterly financial statements required for fund managers will be prescribed in NI 31-103 like they are for annual financial statements.

With respect to reporting net asset value adjustments, because the CSAs have not yet defined "net asset value adjustment", BMOII strongly encourages the CSAs not to require such filings for routine or *de minimis* adjustments and consider instead a materiality threshold. Additionally, it is unclear what value this information will give regulators and the investing public as there is little indication in NI 31-103 as to how the CSAs intend to use it or what it is intended to measure.

***Question #12: The Rule requires a registered firm to identify and deal with conflicts. Would a materiality concept be appropriate within the requirement or should that be dealt with at the firm level within the firm's policies?***

BMOII supports the spirit of investor protection that the Conflicts section evokes, and is confident that the CSAs will balance this objective with commercial reasonableness and the duty to provide meaningful disclosure to investors. BMOII is nonetheless concerned that if the conflicts rules articulated in NI 31-103 are taken to their fullest, every aspect of the investor-firm relationship could give rise to a potential or actual conflict of interest and lead to excessive, overwhelming and often irrelevant disclosure to clients. BMOII submits that it would not be practical, reasonable or even prudent to attempt to identify every "potential" conflict of interest, not to mention disclose them all to investors in a meaningful way "when there is a reasonable likelihood that the clients would consider the conflict important when entering into a proposed transaction". Doing so risks diluting investor confidence by giving investors the impression that investing is fraught with conflict when in fact many of the "conflicts" present are simply inherent to any buyer/seller relationship.

BMOII encourages the CSAs to consider not only a materiality concept, but providing more certainty and clarity in this area. A materiality concept alone leaves firms vulnerable to subjectivity as to whether something is material or not, and to the fact that in some cases materiality may only be apparent in hindsight. CSAs may consider identifying a category of conflicts that it believes merit disclosure on the basis that they are the most pervasive within the industry. Otherwise, compliance with the conflicts rules is apt to get unruly and unmanageable, creating more confusion for clients than arming them with meaningful information to help them make investment decisions.

As a general principle, BMOII strongly encourages the CSAs to avoid adding additional layers of disclosure without first critically examining what investors already receive and what they may receive in the future under separate CSA initiatives. Given the various conflict of interest points of disclosure proposed in the Client Relationship Model and Point of Sale disclosure as well as current disclosures required under SRO and other securities regulation (including NI 81-107), we question whether this additional layer is necessary at all.

***Section 4.2 – Time limits on Examination Proficiency***

Further to Part 3 of the Companion Policy, which states that proficiency requirements in NI 31-103 will not apply to SRO members and their registered individuals, it is our understanding that the time limits set out in section 4.2 are included in this exemption. We are in favour of this approach.

***Section 5.3 – Know Your Client***

Although NI 31-103 grants an exception to IDA and MFDA members to many proposed provisions where the subject matter is already dealt with by the SRO, this provision stands out as a section that is vigorously and adequately regulated at the SRO level but from which no exemption is granted.

Although this provision contains language that carries over from National Instrument 31-505, the registration reform project is an opportune time and forum to revisit the utility of requiring registrants to attempt to establish the "reputation of the client". Without guidance and a clear understanding of what the CSAs are interested in specifically, it is unclear whether this proposal is even suited to a retail environment or how, if at all, it is distinct from SRO KYC collection requirements and from current and forthcoming anti-money laundering legislation. As such, BMOII does not support this requirement for mutual fund dealers.

With respect to the proposed KYC requirement to ascertain if the client is the insider of a reporting issuer, BMOII submits that this information is not relevant to the retail mutual fund sales environment and that this requirement should definitely not be required for mutual fund dealers.

The Companion Policy proposes a KYC obligation respecting corporations that would require firms to determine the nature of the client's business or other purposes of the entity, its control structure and beneficial ownership. Again, BMOII submits that information of this nature is irrelevant to the retail mutual fund environment and should not be collected by mutual fund dealers.

***Part 5, Division 4 – Record-keeping***

BMOII is concerned about the distinction the CSAs have made between *activity records* and *relationship records* and the retention requirements for each. Where regulatory proposals will directly impact operations within the branch network and the day-to-day activity of front line sales staff, and given that most of these records are generated at the branch, the CSAs should be especially vigilant in avoiding confusing and overlapping terminology and creating undue administrative burden. The proposed rule suggests on-site storage for at least two years, in keeping with current securities regulation, however it may be an opportune time to revisit this requirement as physical storage facilities at branches are finite. At a minimum, we strongly encourage the CSAs to be receptive to centralized storage and to the conversion and maintenance of paper records into electronic format. Particularly in the case of client emails, which under NI 31-103 would need to be retained for seven years from the date the client ceases to be a client of the firm (although whether retention must be electronic or in printed form is not specified), the costs of physical storage and the difficulties in developing a suitable archival and retrieval system to meet the record retention requirements are overwhelming. Firms' current systems and storage capacity cannot be expected to accommodate the sheer volume of data that would be generated under this proposal, in particular because the retention requirement for relationship records means that firms will effectively have to keep emails, faxes and notes from long-term clients in perpetuity. At BMO Financial Group, all incoming and outgoing emails can be retrieved from back-up servers for a period of seven years from the date of transmission, and we believe this is more than reasonable to meet the principle of maintaining accurate and up-to-date records.

We are confident that the CSAs will reassess their position with respect to record retention to accord more closely with commercial reasonableness, the realities of technological limitations, the need to consider cost effective and environmentally sound alternatives, and a more reasonable time frame in respect of record retention periods.

***Section 5.22 – Reporting Trades Otherwise***

With respect to disclosing "in a report of a trade other than a confirmation" that the trade was in a security of a related or connected issuer of the firm, BMOII submits that an account statement which lists transactional history should not be captured by this proposal.

***Section 5.25 – Statements of Account and Portfolio***

BMOII supports issuing client account statements on a quarterly basis, but is strongly concerned about the blanket requirement to issue statements on a more frequent basis if a client so requests. While BMOII is committed to providing timely, current and accurate reporting to our clients, we suggest further consultation with industry and a cost/benefit analysis on this proposal, as we firmly believe that quarterly statements together with prompt delivery of trade confirmations give investors the information they need to stay apprised of their holdings and make informed investment decisions. BMOII does recognize that some investors desire the convenience of more immediate and environmentally responsible access to up-to-date information about their holdings and as such BMOII, as well as many other industry participants, provides convenient and secure 24-hour on-line access to account information, with fund holdings, prices and transactional history on a daily basis. BMOII also maintains two call centres where clients can speak to an investment representative to obtain up-to-date account and transactional information, in addition to being able speak with an investment professional at any BMO Bank of Montreal branch. Clients can also access our secure automated touch-tone service that allows them to request account information by fax. Investors also have access to public information from research firms such as Globe Fund and Morningstar.

Dealers with a large volume of retail clients could face significant technological hurdles in accommodating customized paper-based reporting requests from individual clients, in addition to the significant layer of mailing, paper and back-office systems costs that would follow and would ultimately be borne by investors. Dealers may require sophisticated and costly systems upgrades in order to be able to store the massive amounts of data generated by more frequent reporting. Dealers would also be challenged to find a suitable registry system to record and implement individual delivery dates, given that presently the process to prepare and deliver statements is automated and bulked. Because the process to accommodate one individual's request would require manual intervention, the incremental cost of accommodating that request would be significantly greater than if the account statement had been produced with the regular batch. BMOII firmly believes that the enormous cost implications of this proposal far outweigh any perceived benefits, which the CSAs have not yet identified, but in any event we urge further industry consultation as well as quantitative evidence to support this proposal. BMOII refers the CSAs to the results from recent investor surveys conducted by IFIC, which found that 91% of investors surveyed are comfortable will the information they are already given to make informed investment decisions.

From a market integrity perspective, BMOII is also concerned that official account statements delivered on an excessively frequent basis could have the undesirable effect of undermining the principle of long-term investing and could inadvertently encourage short-term and frequent trading.

***Part 5, Division 7 – Complaint Handling***

As an MFDA member, BMOII has already adopted a robust complaints management and reporting policy. As such, it is unclear how the two Complaints Handling regimes will work in tandem upon implementation of NI 31-103 for firms subject to both. In addition, we expect MFDA Policy 6 to be rolled out shortly, which would require BMOII to report client complaints to the MFDA. If the Complaints provisions of NI 31-103 are retained as is, BMOII would report complaints to each of the MFDA, the AMF and the OSC. It is unclear what will gained by reporting to three separate but connected regulators. The CSAs may wish to explore opportunities for information sharing at the regulator level.

BMOII also notes that NI 31-103 speaks of complaints made by a person "having an interest" in a product or service, whereas the Companion Policy refers to "client" complaints specifically. If the CSAs intend for this section to relate to client complaints only, there may be an opportunity to clarify that in NI 31-103. In addition, complaints should be defined as being limited to regulatory in nature. Non-regulatory complaints (such as those that relate to service or fund performance) should be noted as being outside the scope of NI 31-103.

The Complaints provisions may create an incongruous result for clients of an industry participant such as BMOII that is both an SRO member and, under NI 31-103, an Investment Fund Manager. As a mutual fund dealer, BMOII is subject to the dispute resolution regime of the MFDA, but BMOII as fund manager would need to identify "manager" complaints and participate in a dispute resolution service for these specific complaints, creating a bifurcated process for our clients. To the extent that clients have similar recourse regardless of whether a firm is overseen by the CSA or an SRO is important to maintain market integrity. Moreover, the definition and scope of complaints should be consistent as between firms under CSA and SRO jurisdiction. On that note, the CSAs may wish to consider providing registrants with additional guidance as to what they envision with respect to the requirement for non-SRO members to belong to a "dispute resolution service".

***Part 8 – Information Sharing***

BMOII supports the principle that industry participants should perform reasonable due diligence prior to retaining the services of an investment representative, but we have significant concerns about the breadth of this section and its potential effects on the investment industry. Principles relating to an employee's reasonable expectation of privacy, accusations of libel, slander and defamation from the former employee, and economic tort for interfering with the former employee's ability to find a new job are all engaged by this proposal.

The proposed requirement to disclose "relevant" and "material" information about a former representative to a hiring firm would put firms in the untenable position of making a subjective determination as to what is "relevant" or "material" to the person's hiring, which often may only be apparent in hindsight. Also, how would firms deal with events that were isolated incidents rather than patterns, or foundational as opposed to gathered from an exhaustive investigation? How could hiring firms assess the quality and legitimacy of the former firm's investigation into the purported conduct? While the CSAs have the benefit of being able to conduct a fulsome follow-up investigation into the veracity of allegations made by former employers, hiring firms cannot be expected to conduct similar reviews to confirm the accuracy of the information they are given, yet the draft rule makes it clear that the hiring firm must carefully consider the information given as part of their due diligence process.

If under NI 31-103 firms will be required to report terminations in a more comprehensive way in its Notice of Termination, then BMOII submits that the CSAs retain full carriage of issues relating to fitness for registration. To transfer this to firms exposes them to unnecessary legal and reputation risk, both on the disclosing end and on the receiving end.

***Notice of Termination***

In addition to our comments to NI 31-103 proper, we also wish to comment on *Proposed Form 33-109F1 – Notice of Termination*. While we support the CSA's efforts to ensure ongoing fitness for registration for individuals, BMOII echoes its comments to the Information Sharing provision as it relates to exposure of firms to liability for providing such information in good faith. Specifically, Question #10 (*Is there any other matter relating to the individual's termination or conduct leading*

*up to it that the firm is aware of, and believes is relevant to his or her suitability for registration?*), in addition to being too broad and subjective to lead to a meaningful response, exposes firms to significant legal, reputation and monetary risk.

Part E of the proposed Form can create significant challenges for some firms. For mutual fund dealers affiliated with financial institutions, the mutual fund salesperson is, often first and foremost, an employee of the financial institution, and their ceasing to be a salesperson of the dealer is often the result of the discontinuing their employment relationship with the financial institution (in that they cannot remain a salesperson of the dealer if the employment relationship with the financial institution is terminated). Therefore, ownership of the details of the termination in such cases will not reside with the dealer but with the ultimate employer, the financial institution, and will be subject to the financial institution's policies and procedures respecting employee privacy and confidentiality of internal investigations.

***Section 9.23 – Mobility Exemption for Registered Individuals***

BMOII strongly supports the spirit of the mobility exemption, but does not agree with limiting registered individuals to 5 out-of-province clients each. This proposal is a victory for investors as it will allow them to preserve their relationships with investment representatives they have come to trust and rely upon, even when the client has moved to another province. BMOII submits that if the CSAs have accepted this approach in principle, then rather than focusing on a numeric cap, regulation should focus on firms having appropriate internal controls to service out-of-province clients and supervise individuals who rely on the exemption.

***Section 9.14 – International Portfolio Managers***

BMOII, as fund manager of the BMO Mutual Funds, retains the services of exceptionally qualified and highly regarded international advisers to manage certain of our funds, and each is duly registered in Ontario. We strongly urge further consultation with industry with respect to the proposal in section 9.14 in order to ensure that the conditions in subsection (2) are designed to have minimal adverse impact on Canadian investors and so as not to disrupt existing relations between international portfolio managers and the Canadian fund managers that retain them. The participation of international actors in the Canadian investment landscape serves to benefit mutual fund investors by exposing them to global markets these firms advise on, and this principle should remain at the forefront of regulation over these entities. BMOII strongly encourages the CSAs to consider grandfathering international advisers that already manage funds in Canada in order to ensure that the Canadian mutual funds presently managed by them are not disrupted by this proposal. Such firms should, however, be required to continue fulfilling the requirements of the "international adviser" category. If the international adviser is meeting its securities obligations in a home jurisdiction where securities registrants are rigorously regulated, such as the United States or the United Kingdom, then perhaps there is also an opportunity for the CSAs to recognize equivalent requirements of these other jurisdictions, which would accord with other areas of NI 31-103 (such as the business trigger) where the CSAs have brought Canadian requirements in line with concepts used in other countries that have modern securities legislation.

***Summary***

Harmonizing and streamlining the registration categories and requirements across Canada is a laudable goal, and the proposals have stimulated a constructive dialogue with industry that we trust will continue through to implementation of NI 31-103. While the proposals are a step in the right direction, registrants must be permitted to continue using reasonable business judgment and

flexibility to develop a compliance regime and internal controls that suit their business structure. This will facilitate smooth and coherent transition into NI 31-103.

Should you have any questions about this submission please feel free to contact the undersigned.

Yours truly,

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