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Acting Policy Manager  
Joint Forum Project Office  
Joint Forum of Financial Market Regulations  
5160 Yonge Street  
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Re: Comments on Point Of Sale Disclosure Framework Proposal 81-406

Dear Sir:

We are writing on behalf of Morningstar Canada, a Canadian subsidiary of Chicago-based Morningstar, Inc., a leading provider of independent investment research. Morningstar Canada produces the popular PALTrak and Morningstar Advisor Workstation investment-fund research tools, and is a major source of Canadian investment fund information through [Morningstar.ca](http://Morningstar.ca) and [MorningstarAdvisor.ca](http://MorningstarAdvisor.ca). The firm's fund analyst team assesses hundreds of mutual funds and other products offered in Canada. Morningstar's fund reports are the industry standard and are trusted by financial professionals and retail investors nationwide. Morningstar, Inc. provides data on approximately 230,000 investment offerings, including stocks, mutual funds and similar vehicles. The company has operations in 16 countries and minority ownership positions in companies based in three other countries.

The proposed 81-406 framework recognizes the importance of providing critical information to investors in a clear and easy-to-understand fashion. When considering whether to buy a fund, investors are often confronted with lengthy legal documents and flashy marketing material. As a result, investors may not understand the information given to them or are misled by overly positive assertions. While it is difficult to cover all the bases in a single document, we think the Fund Facts sheet is good starting point and can assist investors in making more informed decisions.

## Recommendations

### 1. Annual Expenses

In our opinion, central to the proposed framework is the requirement to disclose the fund's total annual expenses. Many studies conducted by Morningstar and academic institutions have concluded that a fund's ability to outperform is largely dependent on its cost structure, and keeping fees low will be particularly important if future market returns are less generous than they have been in the past few years. Hence, we consider the full disclosure of annual expenses as a rather essential piece of information in the Fund Facts document.

We don't believe that simply stating the management expense ratio (MER) is sufficient. A fund also incurs trading costs that are not disclosed in the MER. These costs, as measured by the trading expense ratio (TER), can range dramatically depending on a number of factors such as (a) the size of a fund, (b) the liquidity of the market, and (c) investment style. In some cases, we have seen TERs higher than the fund's MER, which has seriously hampered its ability to consistently outperform its peers and benchmark. Hence, annual expenses should include the fund's MER and TER.

Investors would also benefit from the inclusion of a table that illustrates how fees affect returns over a one-, three-, five- and 10-year basis based on a hypothetical investment of \$1,000 (akin to the table disclosed in the prospectus).

A fund's MER on a standalone basis doesn't provide investors with a frame of reference in determining whether or not a fund is competitively priced. As such, we believe investors will be better served if the Fund Facts sheet includes the average or median MER of the fund's respective Canadian Investment Funds Standards Committee (hereinafter 'CIFSC') category.

### 2. Performance

A fund's performance versus its stated benchmark should be included in the Fund Facts document. In particular, a table showing the fund and benchmark's one-, three-, five- and 10-year annualized return provides a good vantage point in determining a fund's relative performance.

### 3. Risk

The fund's risk level, as it fits on a scale that is based on the Investment Funds Industry of Canada (IFIC) *Recommendations for Fund Volatility Risk Classification*, doesn't sufficiently capture a fund's inherent risk, which includes the likelihood of permanent loss of capital. We propose that the fund's best and worst 12-month return be shown in this section.

The IFIC risk scale also doesn't address the fact that some 'risky' funds can actually reduce volatility when integrated into a well-diversified portfolio. We suggest adopting the practice of categorizing a fund as a *core fund* or *complementary fund*. Specialty, sector, and geographic-specific funds would fall in the camp of complementary while balanced funds and broadly based equity/fixed-income funds would be considered core offerings.

#### **4. Foreign Currency Risk**

The multi-year rally in the Canadian dollar has in some cases put a major dent in the returns of funds with significant amounts of foreign currency exposure. Investors would surely benefit from understanding the benefits and risks of owning an unhedged portfolio versus a hedged one, and vice versa. With respect to unhedged funds, this can be achieved with a brief statement like: "*The fund does not hedge its foreign currency exposure. As such, the rise in the Canadian dollar against other currencies will hurt performance*". In the case where a fund employs a fully hedged policy, it would be beneficial to state: "*Foreign currency exposure has been fully hedged to the Canadian dollar. As a result, currency fluctuations will not affect future performance.*"

There are instances where portfolio managers do not abide by a predefined hedging policy, instead opting to actively manage the portfolio's currency exposure. In these circumstances, it should be noted that the level of foreign currency risk can increase or decrease depending on the manager's outlook. At any rate, the issue of currency risk should be addressed within this document.

#### **5. Holdings Data**

The Fund Facts sheet should include a pie graph depicting the fund's asset mix. Although this may seem redundant in the case of an all-equity or fixed-income fund, a fund's asset mix can materially differ from its stated investment objectives and what its name implies. For instance, we have encountered situations where so-called bond funds have maintained small but significant exposures to equity in an effort to boost returns. It would be unlikely that this strategy would come to light if only the top ten holdings and sector breakdowns were shown.

Having played an integral role in the construction of the new CIFSC fund categories, we are confident that funds in a particular category exhibit reasonably homogeneous risk characteristics. The CIFSC ensures this through careful examination of each fund's current and historical underlying portfolio holdings. An investor, therefore, can be confident that a fund selected from a CIFSC category will contain the risks (or safety) associated with that particular fund category. Hence, it is recommended that a fund's CIFSC category be stated on the Fund Facts sheet with a brief definition of that category.

## 6. Sales Charge Options

A section should be created for no-load funds with the following statement: "*This fund doesn't charge an initial or deferred sales charge when you buy and sell this fund, respectively*". We would also like this section to identify other available share classes and provide a breakdown of their sales structures.

## 7. Availability of other Documentation

While retail investors may be more inclined to read a fund's legal documents if they know what is available, they may be reluctant to review these documents due to their lengthy and complex nature. We suggest including a definition and brief description of the annual information form, prospectus, and management report of fund performance. At the very least, investors will have a better understanding of these documents and feel more comfortable engaging in further research.

In summary, we support the proposed framework 81-406 and believe the Fund Facts sheet should provide investors with more meaningful information in an easy-to-understand format. We have outlined a number of recommendations that should help investors make the right decision when considering whether to purchase a mutual or segregated fund. Should you require any addition information, please feel free to contact us.

Sincerely,



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