Borden Ladner Gervais LLP
Lawyers • Patent & Trade-mark Agents
Scotia Plaza, 40 King Street West
Toronto, Ontario, Canada M5H 3Y4
tel.: (416) 367-6000 fax: (416) 367-6749
www.blgcanada.com

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October 19, 2007

VIA EMAIL

Joint Forum of Financial Market Regulators
c/o
Neil Mohindra
Acting Policy Manager
Joint Forum Project Office
5160 Yonge Street
Box 85, 17th Floor
North York, Ontario
M2N 6L9
jointforum@fsco.gov.on.ca

Dear Sirs/Mesdames:

Re: Proposed Framework 81-406 Point of Sale Disclosure for Mutual Funds and Segregated Funds – Published for comment on June 15, 2007

We are pleased to provide the members of the Joint Forum of Financial Market Regulators (the Joint Forum) with comments on the above-noted proposed Framework (the Proposals).

These comments are those of lawyers in BLG's Investment Management practice group and do not necessarily represent the views of the firm or our clients, although we have incorporated feedback received to date from our clients into this letter.

We have several overall comments on the Proposals, and also some specific comments on the proposed Fund Facts document.

1. Support for the Joint Forum's General Goals

We fully support the general goals of the Joint Forum with the Proposals: that is, to recognize the shortcomings of the current disclosure regimes for both mutual funds and segregated funds and to make it easier for investors to have a basic and correct understanding of the potential benefits, risks and costs of investing in a fund and to be able to meaningfully compare one fund with another. We commend the Joint Forum on its on-going work to build on the 2003 consultation paper *Rethinking Point of Sale Disclosure for Segregated Funds and Mutual Funds* and in particular to continue to emphasize the continuing need for harmonized regulation (where appropriate) of mutual funds and segregated funds, given their similarities.

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2. **Support for Disclosure Rules that Recognize the Important Role of Advisors to Investors**

We urge the Joint Forum to develop the rules that will implement the Proposals, keeping in mind the important role of advisors to investors in mutual funds or segregated funds. Securities of mutual funds can **only** be acquired by investors who work with a registered dealer and its registered representatives, unless a dealer registration exemption is available. Similarly, segregated funds can only be acquired through licensed insurance agents. In our view, it is critical to keep in mind that investors in either fund product do not acquire those funds after only reviewing a prospectus or other written information about those funds. In all cases (other than investors who acquire mutual funds through discount brokers), the investor is relying on the advice of a registered or licensed representative, including, in many cases, recommendations of that registered or licensed representative.

While written information about a particular fund or funds is important, particularly for the reasons we outline below, we believe that a continued regulatory focus – and recognition – of the importance of the "know-your-client" and suitability rules in the context of mutual fund and segregated fund investing through registered dealers and licensed agents is equally, if not more, important. As we will articulate in greater detail in this letter, we believe the Proposals do not sufficiently recognize the role of an advisor in the sales process and appear to reinforce the popular, but unfounded, belief that investors actively review and make decisions on their own based solely on the written disclosure they receive about a fund.

3. **Need for Regulatory Articulation of the Purpose of Disclosure**

The Joint Forum describe three principles that underpin the Proposals: (i) providing investors with key information about a fund; (ii) providing the information in a simple, accessible and comparable format; and (iii) providing the information before investors make their decision to buy.

While we do not necessarily disagree with these principles, we urge the Joint Forum to keep in mind the other purposes for disclosure that were discussed in the Joint Forum's 2003 Consultation Paper, particularly those discussed under the heading "Why do we ask for the disclosure we do?", which can be summarized as:

- The need to inform consumers. The statement "consumers need to have reliable accessible written information above and beyond verbal communications and sales material" is particularly apt and echoes statements made by the Canadian Committee on Mutual Funds and Investment Contracts in their important 1969 study. At paragraph 14.10, the Committee states, after acknowledging the importance of information provided to investors by advisors ("salesmen") during the investing process: "In implied recognition that the verbal content of the salesman's presentation cannot effectively be controlled, requirements are applied to the literature used; the most important manifestation of this is in the prospectus requirement …"

- Defining the fund and the duties of the operator

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- Using disclosure as a check and balance
- Educating consumers
- Allowing for comparisons among funds

In our view, the Joint Forum identified appropriate principles in the 2003 Consultation Paper and proposed, in that Paper, a disclosure system that took into account those principles.

4. **Need to Differentiate between Disclosure of Dealer Information and Fund Information**

In our view, the Proposals reinforce today's difficulties with the disclosure documents for mutual funds in particular, which is that these documents are used to relay information not only about the particular fund and its management and administration, but also about the distribution process and the investor's relationship with distributors (advisors and dealers) of that fund. We believe that the CSA's proposed approach manifested in Proposed National Instrument 31-103 to mandate that registrants provide a relationship disclosure document to clients at account opening is the better approach to ensure information about the dealer's role in distributing funds is provided to investors. In this way, important information about dealer compensation and incentives can be provided, as well as their relationships with the funds that they are distributing. This will mean that the fund-specific documents can focus on providing meaningful information about the fund, its management and administration.

We believe that it is critical that the Proposals be harmonized and developed closely with the proposed relationship disclosure documents. The proposed Fund Facts document must be integrated with the proposed relationship disclosure document, and vice versa. Greater attention must be paid to ensuring that the appropriate information is provided in the Fund Facts (information related to the fund and its management and administration) and in the relationship disclosure document (distribution information and dealer-specific information, including specific information about the forms of compensation the dealer and advisor are receiving or will receive in respect of fund sales).

We note that the concept of differentiating between "fund" disclosure and "dealer" disclosure was first proposed by Glorianne Stromberg in 1994 in her report *Regulatory Strategies for the Mid-'90s*. Ms. Stromberg recommended that investors receive a "point of sale disclosure document" at point of sale, which was to be prepared in two parts – one part to be completed by the fund manager and the second part to be completed by the dealer. While we believe this two-part document has practical difficulties – we believe the concept and the rationale behind Ms. Stromberg's recommendation are the same as what we suggest above[1].

[1] We note that Ms. Stromberg's 1994 disclosure proposals are in some ways consistent with our recommended approach, although we disagree with some of her proposals where they went beyond what we believe is necessary to meet reasonable investor expectations and would impose cost burdens or be difficult to implement in practice.

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5. **Need for Analysis of the Costs and Benefits of the Proposals**

We recognize that the Joint Forum considers that it has conducted sufficient research in the intervening period since the 2003 Consultation Paper, including interviews with investors and advisors about the Fund Facts document. We understand that the Joint Forum believes that the research it conducted with investors and advisers on the Fund Facts document has given it appropriate feedback on the content and style of the document and that no additional interviews beyond the few individuals involved is necessary to develop this document.

However, we believe this research must be supplemented by focused cost-benefit analysis and additional research, including investor research, into the actual system of delivery and use of the Fund Facts document. We believe that the practicalities of the proposed disclosure system needs additional exploration and various alternatives, including technological solutions, need to be considered further before a formal rule can be developed to replace existing regulation. In our view, a proposed rule must be capable of relatively easy compliance, without undue expense. Industry participants must be given sufficient time to come up with the compliance and technological systems that are necessary to provide for that compliance.

6. **Need for Recognition of Today's More Technologically Adept Society**

The Joint Forum indicated in the Proposals that "access equals delivery" is not considered appropriate for Canadian investors and that Canadian investors are particularly opposed to this. We urge the Joint Forum to continue its research into this issue. Is this really still a valid objection? We know that Canadian's use of the Internet is even greater today than was cited in the 2001 statistics quoted in the 2003 Consultation Paper at footnote 10.

We point out that the Canadian securities regulators are increasingly insisting on disclosure documents being posted "prominently" on fund manager websites, presumably in recognition that investors can easily access this information, so long as it is readily available and investors know about the information and where they can locate it. We urge the Joint Forum to recognize the validity and accessibility of website postings.

At the very least, we recommend that investors be given a choice on how (or whether) they wish to receive a document, including a choice on being given the ability to access the document on a website.

7. Proposals Must be Developed with a Recognition of the Entire Disclosure System

We urge the Joint Forum to develop the Proposals in light of the entire disclosure system – with particular recognition of the advances made in the last five years in continuous disclosure for funds. In our view, a point of sale disclosure system must be built upon and in recognition of both the regulatory theory and practice surrounding the continuous disclosure regime.

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A point of sale disclosure system (which includes the prospectus) is designed to be given to an investor the first time he or she invests in a fund. Once that individual becomes an investor, then he or she relies on the information provided in the continuous disclosure documents to keep up-to-date on what and how that fund is doing. In making any additional investment, that investor has no need for a further prospectus (or Fund Facts) because he or she has access to information that is up-to-date and complete.

We strongly recommend that the point of sale disclosure regime recognize the above-noted theory and practice and only require a point of sale document (Fund Facts or prospectus) to be given out at the time the investor makes his or her first investment in a fund. If this investor is already an investor in a fund at the time that he or she makes an additional investment, then no further point of sale disclosure document will be necessary. The Joint Forum proposes that no point of sale disclosure document be delivered in respect of periodic investment plans – we see no difference in the theoretical and practical underpinnings for this proposal and our recommendation. Otherwise, investors will receive duplicative and potentially confusing information on additional investments. In addition, making this change will practically and realistically recognize the investment process when additional investments are being made.

8. Proposals Should be Developed to Change Entire Prospectus Disclosure Regime

In the Proposals, the Joint Forum focuses on the Fund Facts document and the "cooling off" rights of investors in mutual funds and segregated funds. We urge the Joint Forum to develop a complete disclosure regime when developing the proposed rules to implement the Proposals. We recognize the boldness of some of our suggestions, but feel that the regulators should take a more holistic approach that recognizes the matters we articulate in this letter, rather than make incremental amendments to the disclosure documents that are costly to implement and may be difficult to explain to investors.

(a) We believe that the Fund Facts should not simply be an add-on to today's disclosure documents, in the case of mutual funds, the simplified prospectus and annual information form. While these documents will no longer have to be printed to be delivered to investors, there is still a cost to complete them and, in our view, the information contained in them is today duplicative and inconsistent with the aims of the Joint Forum regarding simplifying our disclosure system. In addition, as noted above, we believe that the prospectus disclosure system must be harmonized with the continuous disclosure system, which means that these documents must be reviewed in light of the advances in the continuous disclosure system.

We are strongly in favour of a foundation document for a fund of the nature described in the 2003 Consultation Paper[2], but urge the Joint Forum to consider allowing funds in a fund family to combine disclosure into one central foundation document. This foundation document should not be

[2] This is consistent with Glorianne Stromberg's "base disclosure document". We note that we disagree with Ms. Stromberg's suggestion that this document also be delivered to investors at the point of sale and her proposal that each fund have its own base disclosure document.

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considered a reversion back to the pre-2000 "simplified prospectuses" or even the pre-1986 "prospectuses" for mutual funds, but a simple, but complete, discussion of the important material facts about the operations, management, structure and administration of a fund that would not repeat information contained in the continuous disclosure documents. The foundation document would (to the greatest extent possible) be "evergreen". The combination of the foundation document and the continuous disclosure information would allow a fund to disclose all material facts about the fund so that disclosure would be "full, true and plain", as required by securities laws.

(b) We also urge the Joint Forum to reconsider the filing and renewal requirements contained in insurance and securities regulation. With respect to mutual funds, we recommend that the Canadian securities regulators consider the following changes:

(i) Requiring point of sale disclosure documents to be updated whenever a "material change" occurs, or whenever the fund manager believes the information contained in a particular document is no longer correct. This would be a flexible, rather than a prescriptive requirement. There would no longer be a requirement to annually refile a prospectus disclosure document, as a pro forma document, which gets reviewed by regulators before being formally filed. Rather a more flexible approach would require a document to be filed when changed[3].

(ii) Requiring regulatory filings whenever a point of sale disclosure document is changed as described above.

(iii) The CSA would review disclosure documents in the context of the entire disclosure package: point of sale, continuous disclosure and, for compliance purposes, also sales communications, on a periodic basis for all mutual fund families. This approach would free the CSA staff from the necessity and expectations that some review of prospectus documents must take place at the annual review period. We support a move away from the current focus on prospectus documents to a more complete compliance-review focus on all regulatory disclosure documents.

(iv) We recognize that there is a need for a specific trigger so that funds would only be qualified for continued distribution if a particular filing has occurred. We recommend that a more principles-based requirement be considered, rather than today's requirements of annual pro forma and final renewals of prospectuses.

[3] Ms. Stromberg's recommendation was for the base disclosure document to be refiled every three years, rather than annually.

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9. **Preparation of Fund Facts**

We agree that some form of simple written disclosure statement needs to be given to investors at some point in the investment process – we point out that virtually all fund managers prepare such written material for distribution to investors. We also agree with the concept of a simple two-page document per fund, which would be in addition to more complete documents (although as noted above, we believe the simplified prospectus and annual information form regime requires revamping to become one central foundation document). Our central issues around the preparation of the Fund Facts are as follows:

(a) The Proposals do not recognize the huge logistical implications for a fund manager in having to prepare a Fund Facts for each series or class of units of a fund, three or four times a year, in English and also in French (if the funds are sold in Quebec). We believe that significant logistical issues would arise even if the Proposals only required a single Fund Facts for each fund (and not of each series of that fund), however, the Proposals requiring a Fund Facts for each series, seems overly burdensome from any perspective. Given our views on the contents of a Fund Facts document (described below), we believe that a single Fund Facts document per fund is all that should be necessary.

(b) The Proposals prescribe the updating required of a Fund Facts – at least three times a year, which would be the practical result of the Proposals, since most funds do not have renewal dates that coincide perfectly with their annual and interim financial statement filing dates. As we describe above, we recommend a more flexible, less prescriptive approach be adopted. Given our views on the contents of a Fund Facts document, we believe that these documents should not require such constant updating.

(c) The Proposals should reflect the possibility that technological solutions may be developed for posting Fund Facts on line – making them available for access (and printing) by dealers, sales representatives and investors, alike. From a logistical perspective, we believe the Proposals must recognize that Fund Facts may likely not be delivered by fund managers in printed format to dealers for delivery to investors – rather, posting onto a website (whether their own or a central industry website) may be the appropriate and least costly solution. We recommend further consultations with industry participants on this point.

(d) We also recommend further consultation with industry participants about the need for a single Fund Facts per fund. We believe that investors may consider that they are better served by having access to a document that compares and contrasts different mutual funds in a fund family in order to understand the full range of investment options. Certainly, this format may lessen the logistical and cost burden on industry participants.

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10. **Delivery of Fund Facts**

As we note above, we agree that a Fund Facts document should go to first time investors in a fund at some point in the investment process. However, we disagree that this point must always be *before* the trade, given the logistical issues that we understand confront industry participants, particularly registrants and insurance agents distributing funds. These very same logistical issues can surely be said to confront investors who wish to invest in a fund without any further delays.

At the very least, we strongly recommend that an investor be able to waive receipt of a Fund Facts, given that not all investors, even first time investors, will feel the need for such a document. Again, as we note above, we recommend that a Fund Facts not be required to be delivered on any subsequent purchase of a fund, where the investor already owns securities of that fund. We refer again to our first comment on the need for reinforcement of the duties of registrants and sales representatives when dealing with investors in funds.

We also point out that the "before the trade" component of delivery of Fund Facts proposed theoretically would permit a sales representative to give his or her client a package of Fund Facts (one for each series of funds he or she may *ever* recommend, assuming those funds have December 31 year-ends) on March 31 (which would be after the date a Fund Facts had to be updated), which would allow the client to trade in any security of those funds at least for the next six months, without having to receive a specific Fund Facts for the particular fund chosen at the time of trade – until such time as the Fund Facts for those funds needed to be updated to reflect a material change or in conjunction with the semi annual statements (assuming no renewal was required in the interim). Would this approach be consistent with the intent of the Joint Forum behind the Proposals?

11. **Cooling Off Rights**

We agree with the changes proposed by the Joint Forum for mutual fund "cooling off" rights (assuming such a right is considered necessary), but we strongly recommend that this right not be open-ended. As the Proposals are written now, it would appear that an investor would have an infinite right to withdraw from the purchase if a Fund Facts was not delivered to them before or at the point of sale, even where a dealer attempts to cure such defect by delivering the Fund Facts after the trade. In addition there is no certainty as to what an investor could do to make such a claim or what a dealer would be able to do to refute the claim. As drafted, the investor would be able to make this claim and exercise cooling off rights months, if not years, after a trade occurs. This would permit an investor to use this cooling off right for purposes completely unrelated to its original intention, including market timing.

This would provide for considerable uncertainty for funds and fund managers, given that the withdrawal from the purchase would have to be treated as a redemption from the fund. Since delivery of the Fund Facts is a dealer obligation and is out of the control of the fund and the fund manager, perhaps it would be appropriate for a client to be able to claim the purchase money from the dealer who failed to deliver the document.

We recommend some time limit be imposed on exercise of this right and a recognition that the default can be cured by delivery at some point after the trade.

We also recommend that the Proposals acknowledge or explain why investors in segregated funds do not have similar cooling off rights. Why are mutual fund investors being given this right, when it is not also given to segregated fund investors? Given that the aim of the Joint Forum is to harmonize the regulation of segregated funds and mutual funds, we find this difference in essential rights to be curious.

12. **Liability for the Documents**

We recommend further consultation on the liability of funds and fund managers for the disclosure contained in Fund Facts, and the other prospectus and continuous disclosure documents. This is an important issue and deserves specific attention and analysis, given the complicated legislation across Canada giving investors so-called statutory rights for prospectus disclosure, as well as continuous disclosure. We are unclear how the prospectus rights would work in the context of an investor who receives only a Fund Facts document.

The Fund Facts published by the Joint Forum contains less than complete disclosure about the availability of other prospectus and continuous disclosure documents. The theory behind giving investors a simple two-page document is that this document is deemed to incorporate by reference (which it does not appear to do at the present time) all of the other permanent disclosure documents, so that, in effect, investors are deemed to receive the other documents when they receive the Fund Facts. This is important for investors so that they can take action on any misrepresentation that may appear in one of the other documents, even though it doesn't appear in the Fund Facts. It's also a very important concept for the fund company and the fund, since the Fund Facts, will of necessity, have many omissions of "material facts", given its simplicity and style of drafting. Having the other documents incorporated by reference, means that investors will not have any rights of action for such omissions, assuming the information is contained in the other documents. This is the approach taken with National Instrument 81-101, which has worked well in practice.

13. **Contents of the Fund Facts**

Our central recommendations about the contents of the Fund Facts are:

(a) Industry participants must have some flexibility to prepare them in ways that make sense for their funds. It is not clear from the Proposals exactly how prescriptive the Fund Facts form (rule) would be – but excessive prescription will run the risk of making all Fund Facts look the same (which would not inspire investors to read them, since their importance would be muted and could conceivably easily confuse readers) and requiring a fund manager to include disclosure about a fund that it believes is inappropriate or misleading. As we highlight below, the sample Fund Facts published by the Joint Forum does contain several aspects that we believe are inappropriate and potentially misleading.

(b) Disclosure that is subject to constant change should be minimized so as to allow for minimized need for updating of the Fund Facts. This would mean, for example, that MER and costs of a particular fund should be taken from the year-end financial statements (and not be required to be updated). We question the necessity for Fund Facts to contain performance disclosure given the wide availability of this information in other sources, including the continuous disclosure information and reports such as those readily available to dealers and sales representatives, such as Morningstar.

(c) We are concerned as legal advisers to the industry just how we would advise our clients about compliance with a rule that requires disclosure to a particular grade level of the Flesch-Kincaid readability tests, although we recognize that these tests are used by some government offices in the United States and software programs such as WORD have options available to test documents against these tests.

We feel a rule of this nature would need serious transition timing, given the current standards of disclosure in the industry today and the need to learn writing methods necessary to meet those tests.

We wonder if these tests, and the suggested Grade 5 level, are even appropriate for Canadian investors, the vast majority of whom are adult and literate. Writing to a Grade 5 level would, in our opinion, mean that the writing would be extremely simple, with complex information provided in much more simplistic form than present. This would allow only for very generalized statements to be made, without any of the necessary explanation provided. Misunderstandings may arise. We recommend further consultation be undertaken by the Joint Forum on the need and appropriate levels for these tests.

We note, for your information, that this letter is apparently written at a Grade 12 level according to the Flesch-Kincaid test built into BLG's WORD software. We also note that we are unable to double-check that this test is the correct test the Joint Forum mentions in the Proposals, although we assume it is. Any rule would have to clearly allow industry participants to use tests built into commonly used word processing programs to ensure that no additional costs were imposed by this rule.

(d) Disclosure about costs should either be given per series – or the most commonly held series should be highlighted – and information given about how the investor can get similar information about the other series options available. Otherwise a simple Fund Facts would become quite complex very quickly.

(e) Information about sales charge options should be given for each available option to ensure that investors can have a complete understanding of their available options, including no-load options. We do not understand the insertion of tick boxes in the Joint Forum's sample document. Are these

tick boxes to be completed by someone? The information under the heading "what else you should know" should not be prescribed and we recommend further consultation with industry participants about the specific wording used by the Joint Forum, given that we believe that some of the wording is not correct and potentially misleading. The 10 percent free redemption right should be referred to under the DSC option.

(f) As we outline in our comment above, the Fund Facts document should be restricted to information about a fund, its management and its administration, including costs. Information about the distribution or dealer compensations should be left to the dealer and particular sales representative, either as part of the relationship disclosure document or as part of a separate dealer-mandated document. We would not object to a requirement that requires general disclosure of sales incentives paid by a fund manager, although we note several issues with potentially misleading statements made under the heading "how does my adviser get paid?" in the sample Fund Facts published by the Joint Forum and recommend that the Joint Forum permit flexibility in drafting or seek further feedback on the exact words to be used.

(g) Disclosure about the investment mix should not be mandated by the Joint Forum, other than the general disclosure requirement. Different categories may be more appropriate for some funds than others – fund companies will have the best understanding of the appropriate categories than can be outlined in a regulatory form. For example, for a global technology fund, using the format proposed in the Proposals, the Fund Facts would show that the fund is invested 90 percent in the technology sector and 10 percent in "other". This does not appear to provide the investor with the requisite meaningful information.

(h) The disclosure under the headings "how risky is it?", "are there any guarantees", "who is this fund for" and "how has the fund performed" contained in the sample Fund Facts for the Equity Fund is curiously negative about mutual funds and appears to be quite prescriptive. Would all funds have to include an explanation point with a bold face statement about certain investors being warned not to buy a fund, for instance? Would a fund have to highlight the number of years "when people owned this fund lost some of the money they had at the start of year"? We feel strongly that this latter statement is not only curiously negative about funds (i.e. it neglects to state that there were seven years when the fund had gains), but it is misleading. An investor only loses money when he or she redeems at a time when the fund is down from where it was when he or she first invested. When a fund is held for a period of time, it is misleading to speak of "losing money". No such money has been lost.

14. The Proposals do not deal with the regulatory filing fees that would be payable (or not payable) in conjunction with the filings of the new Funds Facts and the other disclosure documents. We recommend strongly that the Canadian securities regulators work together to rationalize the filing fees payable so that (i) fees are

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levied on the same filings, assuming that all commissions feel that fees must be paid to all provinces in respect of a filing and (ii) do not influence compliance behaviour. On the last point, we note that the Ontario Securities Commission does not charge fees for amendment filings for prospectuses. In our view, this was a very welcome change to the fees levied by the OSC, since now decisions about whether or not an event is a "material change" requiring a prospectus amendment can be made without regard to cost considerations (which remain considerable in provinces outside of Ontario). We strongly recommend that the securities regulators closely examine how regulatory filing fees can be rationalized across Canada in conjunction with moving forward with the Proposals.

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We thank you for allowing us the opportunity to comment on the Proposals and we commend the Joint Forum on its work to date on this important initiative. Please contact the following lawyers in our Toronto, Ottawa, Vancouver and Montreal offices if the Joint Forum members would like further elaboration of our comments. We would be pleased to meet with you at your convenience.

- John E. Hall (Toronto office) at 416-367-6643 and jhall@blgcanada.com
- Rebecca A. Cowdery (Toronto office) at 416-367-6340 and rcowdery@blgcanada.com
- Kathryn M. Fuller (Toronto office) at 416-367-6731 and kfuller@blgcanada.com
- Steve Thomas (Ottawa office) at 613-787-3539 and rsthomas@blgcanada.com
- Jason J. Brooks (Vancouver office) at 604-640-4102 and jbrooks@blgcanada.com
- François Brais (Montréal office) at 514-954-3142 and fbrais@blgcanada.com

Yours truly,

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