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October 16, 2009

VIA EMAIL

British Columbia Securities Commission
Alberta Securities Commission
Saskatchewan Financial Services Commission
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
New Brunswick Securities Commission
Registrar of Securities, Prince Edward Island
Nova Scotia Securities Commission
Superintendent of Securities, Newfoundland and Labrador
Registrar of Securities, Northwest Territories
Superintendent of Securities, Yukon Territory
Registrar of Securities, Nunavut

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Dear Sirs/Mesdames:

Re: ***Proposed Amendments to National Instrument 81-101 Mutual Fund Prospectus Disclosure, Forms 81-101F1 and 81-101F2 and Companion Policy 81-101CP and Related Amendments – Comments of Borden Ladner Gervais LLP***

We are pleased to provide the members of the Canadian Securities Administrators (the CSA) with comments on the proposed amendments to National Instrument 81-101 *Mutual Fund Prospectus Disclosure,* the Forms and the Companion Policy (collectively, NI 81-101) published for comment on June 19, 2009.

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

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In the past few years, we commented on both versions of Framework 81-406 *Point of sale disclosure for mutual funds and segregated funds*, and note that many of the comments we are making in this letter echo the comments we made in our earlier comment letters.

We note that the CSA have asked for specific feedback on a number of issues. We address some of those issues through our comments.

1. Support for the Principle of Clear Disclosure for Investors

We fully support the aim of the CSA to improve disclosure for mutual fund investors and to make it easier for investors to have an appropriate level of 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 believe that a Fund Facts document could assist in achieving this objective provided the Fund Facts contains relevant information and is flexible enough to accommodate differences among funds. However, we also believe that an equally effective regulatory approach would be to revert strictly back to the *original and stated* principles behind the simplified prospectus system set out in NI 81-101.

As we will outline below, we strongly recommend that the CSA focus on rationalizing the entire disclosure regime for mutual funds (which the CSA has indicated is a second stage in its disclosure proposals), as opposed to simply layering the Fund Facts on top of the existing requirements. In our view, the CSA's proposals have become so increasingly complex that we recommend that the CSA review its overall objectives and the rationale for introducing these changes to the mutual funds industry at this time.

We do not support the CSA's proposition that the Fund Facts must be physically provided to investors before a trade can be completed. By proposing a pre-sale delivery requirement applicable to only publicly offered mutual funds, when a similar obligation does not exist in respect of other securities a Canadian investor may invest in, the CSA proposals place mutual funds at a competitive disadvantage in the marketplace. This seems inappropriate given the body of rules relating to mutual funds, which, unlike some competitive investments, assure Canadian investors in mutual funds a high degree of liquidity, diversification of exposure and relatively high degree of "safety". The focus on mutual funds in the CSA's point of sale proposals works a disservice to current and prospective investors in mutual funds.

Further, the complexity of the proposals may cause dealers to support a smaller number of funds, and series or classes of funds, on their approved lists in an attempt to manage this added complexity. We also question whether this result is consistent with the CSA's broader policy objectives.

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

We urge the CSA to keep in mind the important role of advisors to investors in mutual 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

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is available. It is critical to keep in mind that investors do **not** generally invest in mutual 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 representative, including, in many cases, recommendations of that registered representative.

We note new proposed subsection 7.2(7) to NI 81-101CP, which may be intended to reflect our earlier comments on the need for continued regulatory focus – and recognition – of the importance of the "know-your-client", "know-your-product" and suitability rules in the context of mutual fund investing through registered dealers. Written disclosure about a particular investment product is important, but equally, if not more, important, are the principles that dealers and their registered representatives must follow when making recommendations to their clients. The Fund Facts may be less important to the client in situations when they are following their advisor's recommendations. Given the reinforced regulatory scheme (through National Instrument 31-103) that imposes obligations on dealers with respect to suitability and dealing with one's clients, we believe that the point of sale initiative puts far too high an importance on disclosure in the context of investors' decision-making and fails to acknowledge the overall regulatory framework.

As we have noted in the past, we believe that the CSA's point of sale initiative reinforces the popular, but unfounded, belief that investors actively review and make decisions on their own based solely or even primarily on the written disclosure they receive about a fund. This is highlighted in the commentary of the CSA provided for in the June 2009 Notice describing the benefits of the proposed system. The anticipated benefits as described by the CSA are, in our view, somewhat *ideal* benefits, but ones that may not be achievable or supported by actual investor behaviour. As such, we believe that the compliance difficulties and costs associated with implementing the proposed changes to NI 81-101, particularly the "pre-sale" delivery requirements, will far outweigh the benefits to investors, which we submit remain somewhat speculative and impossible to substantiate.

3. Continued Need for Analysis of the Costs and Benefits of the Proposals

The CSA's proposals for the preparation and the delivery requirements of the Fund Facts are now significantly more complicated than they were first envisioned and can be expected to result in a significant outlay by all industry participants in order to achieve compliance.

We continue to believe that the research conducted by the Joint Forum into investor sentiment about the Fund Facts 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 in the mutual funds industry. 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.

A proposed regulation or 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 ensure that compliance.

We also point out that costs of preparation of a Fund Facts and any new disclosure document can be expected to be borne by mutual funds as operating expenses, and hence, investors will be effectively paying these increased costs. Where funds pay fixed administration fees, we point out that these proposals will cause additional financial burdens on the fund managers, which may or may not be passed on to investors depending on the fee structures of the funds.

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

We urge the CSA to consider mandating availability and accessibility of the disclosure documents rather than mandating physical advance delivery of documents. 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 CSA to recognize the validity and accessibility of website postings and to reinforce the obligations on participants in the mutual fund industry, including dealers, sales representatives and fund managers, to ensure that investors know how and where they can access this information.

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

5. **Proposals Should be Developed to Change Entire Prospectus Disclosure Regime**

We urge the CSA not to simply layer the Fund Facts on top of the existing disclosure regime for mutual funds. We believe that the CSA should take a more holistic approach, rather than make incremental amendments to the disclosure documents that are costly to implement and may be difficult to explain to investors. We recognize that the CSA indicate that a review of the simplified prospectus and annual information form required by NI 81-101 is a second stage of the overall project, but we are recommending that the entire system be reviewed, before implementing a costly add-on to the disclosure system, through implementing the proposed changes to NI 81-101.

While the simplified prospectus and annual information form will no longer have to be printed or delivered to investors other than on request, there is still a cost to prepare them and, in our view, the information currently contained in them is today duplicative and inconsistent with the aims of the CSA regarding simplifying the disclosure system and ensuring investors have access to full, true and plain disclosure about their mutual fund investments. These documents also must be reviewed in light of the advances in the continuous disclosure system since NI 81-106 came into force.

We are strongly in favour of a foundation document for a fund of the nature described in the CSA's Consultation Paper released in 2003, but urge the CSA to consider allowing

funds in a fund family to combine disclosure into one central foundation document. This foundation document should not be considered a reversion back to the pre-2000 "simplified prospectuses" or even the pre-1986 "prospectuses" for mutual funds, but a simple and 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.

6. Support for IFIC Recommendations

We have had the opportunity to review the recommendations made by the Investment Funds Institute of Canada to the CSA and wish to provide our general support for those recommendations, particularly as they relate to the delivery requirements proposed by the CSA. We note that in some areas our comments go further than the recommendations of IFIC. IFIC and its members have worked tirelessly to develop constructive alternatives and suggestions for the CSA's consideration and we believe IFIC's letter speaks for many in the industry. We chose not to specifically repeat IFIC's comments in our comment letter, rather we decided to focus on areas where we felt our legal expertise would be most valuable or where we see the necessity for changes to the CSA's proposals.

7. Preparation of Fund Facts

We continue to have concerns about the proposals for a Fund Facts document as provided for in proposed NI 81-101.

(a) Logistical and cost implications remain for a fund manager in having to prepare a Fund Facts for each series or class of units of a fund at least once a year in English and also in French (if the funds are sold in Quebec). A dealer firm will also have similar logistical and cost implications in ensuring that its registered representatives deliver the correct up-to-date Fund Facts for the particular series being recommended. Given our views on the contents of a Fund Facts document (described below), we believe that a single Fund Facts document per fund (rather than per class or series) is all that should be required. This approach will allow an investor a more complete picture of the fund and his or her investment options. We believe that the addition of an extra page or two to a fund facts to accommodate the preparation of a fund facts on this basis will not undermine the principle of readability which we appreciate is central to the CSA's proposals.

(b) We strongly recommend against a regime that would, in the absence of a material change, encourage the updating of a Fund Facts more frequently than annually. Any more frequent updating (as proposed in section 2.3.1 of NI 81-101) can be expected to exacerbate the logistical issues raised by the CSA's proposals, particularly for dealers struggling to keep track of

up-to-date Fund Facts for hundreds, if not, thousands of series of mutual funds.

(c) Subsection 5.4(5) of NI 81-101 will allow fund managers to file on SEDAR one electronic file containing all of the Fund Facts for all of the series of all of the funds that are included in the related simplified prospectus and annual information form as part of the prospectus clearing process. In our view, this will be the only workable approach, since filing individual Fund Facts on SEDAR, which for some fund companies will number in the hundreds, would take an unacceptable period of time (likely over a period of days) to complete. However, we point out that this manner of filing Fund Facts will make SEDAR an even less desirable website for investors to access documents relating to their funds than it is today. An investor will not be able to easily access his or her fund's current Fund Facts by looking for it as a stand-alone document on SEDAR.

(d) We urge the CSA to modify section 2.3.2 to provide fund managers *a reasonable period of time* to post Fund Facts to websites *after a receipt* is issued for the prospectus documents. Section 2.3.2, as written, would require a Fund Facts document to be posted on the same day as it is filed on SEDAR, which does not appear appropriate (given that a receipt isn't generally issued on the same day as filing) and does not reflect the length of time it will take to separate out the Fund Funds into single files (for many fund managers, this will be hundreds of Fund Facts), given that they have to be filed on SEDAR as a single document, and post the single Fund Facts individually onto a website.

(e) NI 81-101 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 NI 81-101 must recognize that Fund Facts may likely not be delivered by fund managers in printed format to dealers for delivery to investors – rather, fund managers may choose to post them onto a website (whether their own or a central industry website) as the most appropriate and least costly solution. We recommend further consultations with industry participants on this point.

(f) We do not understand the CSA's proposals to limit how many Fund Facts may be grouped together for delivery purposes. We question the need for the "principled-based" rule proposed in section 5.4 of NI 81-101 about binding being permitted if the stated reasonable person test were met. This test appears to us to be an impossible test to be able to say with any degree of certainty, whether or not it has been met. We believe the CSA's proposed guidance in the Companion Policy regarding binding to be quite arbitrary, particularly as it relates to email delivery and binding of more than 10 Fund Facts together. Further consultation and thought should be given to the packaging requirements, particularly given that an investor can be expected to appreciate receiving a bundle of clearly indexed Fund

Facts, rather than a series of individual paper or electronic files containing single Fund Facts.

(g) We are very concerned as legal advisers to many in the fund 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. We have found that the different tests available for public usage provide for quite different results depending on the system being used. For example, using the F-K test on the Microsoft Word system we use, this letter is written at a Grade 17.4 level, while when we ran this letter through the F-K test available at Google Documents, this letter is apparently written at a Grade 11 level. Further, we understand that various versions of Microsoft Word will produce different results. In addition, the Flesch-Kincaid tests ONLY work on English text. There is no version of the Flesch-Kincaid test that we are aware of that works on French language documents.

We continue to question if these tests, and the suggested less than grade 6.0 writing level, are even appropriate for Canadian investors, the vast majority of whom are adult and literate. Writing to this level would, in our opinion, mean that the writing would be extremely simplistic, with complex information provided in a form that could not allow for an adequate level of information or discussion. This would allow only for very generalized statements to be made, without even a reasonable level of explanation. Misunderstandings will no doubt arise.

Given the issues we note with using the F-K tests, we recommend that the CSA preserve the general requirements for the use of plain language and provide guidance to indicate that fund managers will be expected to implement systems that test for compliance with these requirements. The F-K test could be used as one example for fund managers to consider, among others.

If the F-K rules are maintained, we note that the CSA proposes that a fund manager will be required to certify the F-K level of each Fund Facts at least twice in the prospectus filing process and every time a Fund Facts is amended. This seems to be an unnecessary additional regulatory burden, given the time required to run each document (for larger fund managers, amounting to hundreds of documents) through a suitable F-K test. We recommend the certification requirement be dropped, even if the CSA do not adopt our recommended approach and decide in stead to maintain the F-K test. We point out that the CSA can always ask an industry participant to confirm the F-K level a Fund Facts is written at as part of the renewal or filing process.

8. **Liability for the Fund Facts**

Notwithstanding the CSA's responses to earlier comments we made about the liability of funds and fund managers for the disclosure contained in Fund Facts and the other

prospectus and continuous disclosure documents, we believe additional legal analysis and explanation is required. We remain unclear how the prospectus rights would work in the context of an investor who receives only a Fund Facts document, particularly with the proposal that the Fund Facts be incorporated by reference into the simplified prospectus, along with the AIF and the continuous disclosure documents.

We note section 2.4 of NI 81-101 will continue to provide that the "simplified prospectus" will be the prospectus for the purposes of securities legislation. This section was first included in NI 81-101 when the revised simplified prospectus system based on National Policy Statement No. 36 was adopted, in recognition that the SP was the only document that was delivered to investors, but that the AIF and the relevant continuous disclosure documents were incorporated by reference into that document. Through this legal construct, the investor was deemed to have received all of the disclosure about the fund, even though he or she only physically received the simplified prospectus. This protected the rights of the investor in that he or she could sue for misrepresentations contained in any of the documents incorporated by reference, even though he or she only received the prospectus. It also protected the fund and any other signatory to the AIF, including the fund manager, because the limited disclosure contained in the SP (which, by definition, omits material facts), is modified by the more complete disclosure contained in the other documents.

We do not understand how this regulatory theory will work when the Fund Facts is the only document that is delivered to investors, but the SP remains the "prospectus" within the meaning of securities legislation, and all documents are incorporated by reference into the SP, which is not given to investors.

The Fund Facts will contain less than complete disclosure about the Fund. In our view, consistent with NI 81-101 (and NP 36 before it), the theory behind giving investors a simple two-page document should be that this document is deemed to incorporate by reference 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 limited content and style of drafting. Having the other documents incorporated by reference into the Fund Facts, means that investors will not have any rights of action for such omissions, assuming the information is contained in the other documents.

We continue to believe that further study is required of this concept, particularly as it relates to the rights of investors to sue for misrepresentations and how the other investor rights are tied to delivery of the various documents.

9. **Investor Rights**

It is very difficult for us to provide meaningful comments on the proposals for investors' rights proposed by the proposed amendments to NI 81-101 (including those listed below), given that the CSA explain that "legislative amendments" may be required in some jurisdictions to provide for them. In our view, the CSA should provide for investor rights

that are uniform across Canada. These rights should provide rights for investors in the following circumstances that are consistent with the rights given to investors when making investments in other kinds of securities and that clearly delineate which entity is responsible to those investors and in what circumstances:

- Damages for misrepresentations in the primary disclosure documents (which include the continuous disclosure documents incorporated by reference)

- Rights of investors to rescind or cancel their purchase based on net asset value at the time the right is exercised – we understand that the CSA intend for NI 81-101 to contain the "cancellation right" described in the Framework, but the CSA's recent proposals contain little, if any, information about the proposals for the status of the existing cancellation and rescission rights provided for in most, if not all, of the various provincial securities statutes

- Rights of investors when a disclosure document is not delivered when it is required to be.

We would welcome being able to provide comments on a detailed discussion paper on these issues once the various rights are decided upon by the various members of the CSA and the ability of the CSA to vary securities legislation is determined.

10. Complicated Compliance Systems for Dealers

In addition to the difficulties of ensuring "point of sale delivery", the delivery systems outlined in CSA's proposals will necessitate significantly more complex compliance systems for dealers. Dealers will be required to ensure that their compliance systems catch all of the nuances set out in the proposals (whether a trade is advisor initiated or client initiated, whether it is for a money market fund, whether the client has waived receipt of the Fund Facts and whether the trade is for additional units of a fund the client already owns).

Dealers will also be required to constantly monitor when a Fund Facts has been updated for a particular fund or series. We note in this regard, the "flexibility" given to fund managers in section 2.3.1 of proposed NI 81-101 to update the Fund Facts every six or three months and if one series if updated, then all Fund Facts for that fund must be updated.

In our view, these complexities simply are not justified. The different requirements may seem "doable" and logical in isolation, but in reality when a dealer is supervising hundreds of registered representatives, the complexities become far in excess of any benefits of the different requirements.

We understand that many in the industry, including the Investment Funds Institute of Canada, are providing the CSA with comments on the delivery requirements and are pointing out the significant practical issues raised by the proposals. We urge the CSA to work with the two SROs to determine whether the CSA's proposals are capable of practical implementation with a reasonable ease of compliance, given that significant new requirements will be imposed on dealers and their representatives. We have grave

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concerns about the ability of dealers and their representatives to be able to comply easily with the proposals as drafted without significantly overhauling their compliance systems.

11. Contents of the Fund Facts

Our central recommendations about the contents of the Fund Facts as proposed in the amendments to NI 81-101 are:

(a) Fund managers must have some flexibility to prepare the Fund Facts in ways that make sense for their funds. In our view excessive prescription will run the risk of making all Fund Facts appear the same (which would not help inspire investors to read them, since their importance would be muted and could conceivably easily confuse readers) and of requiring a fund manager to include disclosure about a fund that it believes is inappropriate or misleading.

(b) Disclosure that is subject to constant change should be minimized so as to minimize the need to update 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 need for Fund Facts to contain performance disclosure given the wide availability of this information in other sources, including the MRFPs and in reports readily available to dealers and sales representatives, such as Morningstar.

(c) "Total value" of the fund (Item 2- Quick Facts) is to be provided of the entire fund, and not simply the series covered by the Fund Facts. This point should be clarified by the language used in the Fund Facts (i.e. that the "total value" is not just for the particular series) to avoid confusion.

(d) We strongly disagree with the suggestion in III.2 of the Issues for Comment that MER be disclosed as the gross expenses, without reflecting the impact of any applicable absorptions or waivers. To disclose the MER other than as actual in the Fund Facts, would be misleading to investors, particularly since there is no ability to provide any meaningful explanation about MER in the Fund Facts. Consideration should be given to providing a cross-reference to more detailed disclosure on this issue, given its importance to an investor.

(e) The section titled "what does the fund invest in" must include the fundamental investment objective of the particular fund, as well as its investment strategies. Mutual funds are required to have a fundamental investment objective, and investors should know what that is, along with an understanding of the strategies to be used to achieve that objective. We point out that investors are required to approve any change in investment objective – if they are not given this information, how can they be expected to approve any changes? We do not understand instruction (2) regarding limiting disclosure of investment strategies. How can an investor understand the fund without understanding its investment

strategies? In our view, the CSA's discussion in section 8.1 of the Companion Policy of the importance of "investment disclosure" is undermined by the disclosure restrictions provided for in the above-noted section of the Fund Facts.

(f) We believe that the requirement to include the "Top ten holdings", particularly having this disclosure as of 30 days of the date of the Fund Facts, will draw undue attention to this information for investors. This information will always be out of date for most mutual funds, which could be misleading to investors. Unlike with the MRFPs (and the former SP disclosure) there is no ability for a fund to explain this disclosure or to emphasize that it should not be relied on as a useful picture of the current holdings of the Fund. We recommend this disclosure be dropped (since it is in the MRFPs) or at the very least, the disclosure be provided on a consistent basis as in the MRFPs (as at year end or six month financial period).

(g) The section "for more information" must refer to the availability of the other documents, in addition to the simplified prospectus, and should refer the reader to the website where this information is posted. We don't recommend the Fund Facts direct the reader to the SEDAR website, given the difficulties inherent in finding any documents easily on this website. The required statements starting with "the Fund Facts may not have all the information you need" should be modified to explain that the Fund Facts only contains summary information and that more complete information is provided in the other statutory documents. We suggest stronger language such as "more detailed information is available to you and you will be deemed to have read that information even if you choose not to do so. You can request this information by contacting [manager] at []".

As we outline above, we continue to believe that the SP, AIF and other continuous disclosure documents must be incorporated by reference into the Fund Facts in order for appropriate legal protections to be provided for the investors and the fund and the fund manager. Accordingly a statement as to this incorporation by reference is required, notwithstanding that some may find this statement too legalistic.

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We thank you for allowing us the opportunity to comment on the proposed amendments to NI 81-101. Please contact the following lawyers if the CSA would like further elaboration of our comments. We would be pleased to meet with you at your convenience.

- John E. Hall at 416-367-6643 and jhall@blgcanada.com
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Yours truly,

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