MILLER THOMSON LLP
Barristers & Solicitors
Patent & Trade-Mark Agents

Scotia Plaza
40 King Street West, Suite 5800
P.O. Box 1011
Toronto, ON Canada M5H 3S1
T: 416.595.8500
F: 416.595.8695
www.millerthomson.com

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Susan Han
Direct Line: 416.595.8167
Direct Fax: 416.595.8695
shan@millerthomson.com

BY EMAIL: jstevenson@osc.gov.on.ca;
consultation-en-cours@lautorite.qc.ca

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

Attention: John Stevenson, Secretary
Ontario Securities Commission

Me Anne-Marie Beaudoin,
Corporate Secretary
Autorité des marchés financiers

Dear Sir/Madame:

Re: Response to CSA Notice and Request for Comment on Implementation of Point Of Sale Disclosure for Mutual Funds

This submission is made in response to the Notice And Request For Comment *Implementation Of Point Of Sale Disclosure For Mutual Funds* issued by the Canadian Securities Administrators (CSA) June 19, 2009.[1]

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[1] Notice and Request for Comment is herein referred to as the "Notice". The proposed amendments to National Instrument 81-101 *Mutual Fund Prospectus Disclosure* are referred to as the "Proposed Rule", Forms 81-101F1, 81-101F2 and 81-101F3 as proposed are referred to as the "Forms" and proposed Companion Policy 81-101CP

General Comments

Providing investors with the opportunity to make informed decisions, by giving appropriate information in a timely manner, is both an industry imperative and an immense challenge. Making the proposed fund facts document the primary document for conveying key information to investors, particularly individual investors, marks a significant step toward the ultimate objective of meaningful and effective prospectus disclosure of mutual funds.

In our discussions with affected parties, certain concerns with the overall design of the Instrument appear consistently. A major concern expressed to us by clients and industry participants is the way in which the Instrument may operate to undermine or appear to undermine the value of the contribution and advice provided by the financial advisor. A second "big picture" concern which emerges from our discussions with industry is the following. Implemented as presently contemplated, the Instrument will mean, in the retail distribution network, a makeover of the present prospectus delivery rules for mutual funds, but not for other products sold in the retail channel. Eventually, without other, additional, regulatory changes affecting such other products, mutual funds risk becoming a product offered predominantly by providers who have captive distribution. Independent dealers and financial advisors will increasingly seek to meet client needs with alternatives to mutual funds and to the mutual fund prospectus delivery regime. The classic retail mutual fund could become a product largely confined to distribution via branches of large financial institutions. The breadth of choice, the vibrancy and the innovation which has characterized mutual funds as a product category will be diminished. An unintended consequence, but nevertheless one which many in the industry believe to be very real.

Role of the Financial Advisor

In the published responses to earlier comments made on Framework 81-406, the CSA stated that

> Nothing in the Framework or the amendments to NI 81-101 is intended to detract from the central role of the adviser. The focus of this initiative is to develop a harmonized, more effective disclosure regime for mutual funds and segregated funds.
>
> We think POS delivery builds on an adviser's existing obligations to determine suitability of all purchases of a mutual fund.

With respect, many industry participants do not share the CSA's confidence that the advisor's role is untouched and indeed is perhaps enhanced with the introduction of POS delivery of the fund facts. In fact, taken as a whole, the Notice and the Instrument leave the reader with the distinct impression that the end investor bears the burden of making the investment decision, and the financial advisor's comments are best taken with a healthy dose of scepticism or at least

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Mutual Fund Prospectus Disclosure is referred to as the "Companion Policy". Together, the Proposed Rule, the Forms and the Companion Policy form the "Instrument."

are not to be relied upon exclusively. For example, why is the delivery regime more burdensome in cases where an investor is relying on a dealer's recommendations, rather than conducting their own research? Why is the reading level required to be at grade 6.0 or less? The CSA's response to public comments indicates that there is a significant proportion of the adult population who have serious difficulty dealing with written material and that levels of investment knowledge and financial capability generally are low. We do not dispute the empirical findings. We do suggest that a properly qualified adviser can assist an investor hampered by low levels of literacy or investment knowledge by compensating for such limitations. The advisor can supplement the written materials with an oral explanation and she can select an appropriate product suitable for a less sophisticated investor. Indeed, the current regulations are consistent with that role for the advisor.

The Struggle for Shelf Space

The second point is that there will be logistical, operational and compliance-related burdens with moving to a POS delivery regime. They will be substantial. For those entities which have the existing infrastructure, it will be relatively easy to offer a limited number of proprietary funds through a branch distribution network. Such a distributor will not need to have as many fund facts documents on hand. Since the manufacturer and distributor are effectively the same enterprise, it will be relatively easy to ensure that the most up-to-date documents are in the branch. The document can be physically handed to the client and thus brought to the attention of the prospective purchaser. Payment can be made by cheque and if the branch is of a financial institution, payment can be made right out of the client's account with the FI.

Contrast this with the situation of an independent financial advisor, who may or may not have the most recent fund facts for the fund and series being considered for the client at hand. If the investor wishes to proceed with a trade, and delivery of the most up to date fund facts is impractical, a determination must be made as to whether the trade is "advisor recommended" or "investor initiated". Even there, the advisor could come to grief if the advisor has not appropriately brought the "existence and purpose" of the fund facts to the attention of the investor and the investor has then expressly declined to receive the fund facts prior to the trade. There is no getting away from the likelihood that for the independent distribution channel, POS disclosure will mean that sales will have to be concluded over the course of several interactions with the client. And even then, the risks of regulatory non-compliance are much higher.

Regulators and others may observe that this is not necessarily a bad thing, and we might be inclined to agree, were it not for the reality that substitute products for mutual funds are readily available. Furthermore, the investment industry has an excellent track record of innovation, both on the product side and on the technology front. Many financial advisors may choose to deal with the increased cost and risk of selling mutual funds by turning to alternative products. And product manufacturers can be counted on to apply the full force of their substantial energies and creativity to the production of such alternatives. Even today, financial advisors can sell separately managed accounts, ETFs, pooled funds to accredited investors, GICs and other deposit instruments to other investors.

In the responses to comments on Framework 81-406, the CSA disagree with the commentators who indicated that POS delivery for mutual funds will result in investors being sold alternative products. To the contrary, the CSA state that "We think mutual funds are a suitable investment product for many investors, and we would expect dealers to continue to recommend mutual funds to these investors." With respect, this is to miss the point about suitability. Financial advisors are under no obligation to scour the investment universe and exhaust every possibility prior to making an investment recommendation. They are at liberty to decline to offer mutual funds to their clients, or to continue to sell mutual funds that clients currently hold but not to add new product to the available line-up. There can be any number of investment choices that are suitable for a client. The observation that mutual funds may be suitable products for a large number of people provides no assurance of popularity when other attractive alternatives are also suitable.

Of course it's reasonable to think that many, perhaps most, advisors who sell mutual funds today will continue to provide mutual funds. But because of the difficulty of effecting switches, they may confine themselves to a few funds and become less receptive to new funds. Over time, mutual funds may no longer be the product of choice as distributors demand, and suppliers produce, more attractive offerings.

Response to Issues for Comment

I) Issues for Comment on the Notice -- See above

II) Issues for Comment on the Instrument

1. On permitting greater flexibility to provide more current information, fund managers should not have restrictions placed on updating the fund facts document more frequently than once annually if they so desire. We note with interest that 2.3.1 of the Proposed Rule, Voluntary Updating of Fund Fact Document, refers to updates occurring at "regular intervals of either six months or three months". This seems to imply that the fund manager must make a determination as to a program of voluntary updating, rather than updating on an ad-hoc basis. Could the CSA comment on whether it is possible for a fund manager to choose to update a fund facts document under 2.3.1 on an ad hoc basis and at irregular intervals?

As a practical matter however, a number of factors will militate against more frequent updates. These factors include:

- Fund managers are already significantly pressed simply to meet existing continuous disclosure requirements
- Very up to date information is readily available from data vendors such as Morningstar or Globefund
- Other than the Top 10 and the investment mix charts, we do not anticipate that there would be significant changes in the fund facts content from quarter to quarter. Any benefit to be gained by more frequent production is unlikely to outweigh the cost

- Producing the fund facts document involves much more than simply adjusting some data on two pages. There are all of the logistical steps involved in translation, layout and formatting, production, communication with the internal sales force and wholesalers, external distributors and dealer back offices and co-ordination with web administrators to place the new documents accurately on the web site on a timely basis, in addition to filing on SEDAR with regulators

- More frequent production increases the risk that distributors will provide a fund facts which is not current, in violation of the Instrument, and thus expose the financial advisor and the dealer to financial and regulatory risk

2. Subsection 7.3(3) of the Companion Policy is of limited assistance in providing guidance to the requirement to "bring the fund facts to the attention of the purchaser". Ultimately, as with other new legislative requirements, the question of how to document and satisfy the requirement to "bring the fund facts document to the attention of the purchaser" is likely to be clarified through litigation and regulatory proceedings. This degree of uncertainty must by necessity result in an increase to distribution costs. Quantifying the incremental cost may be difficult to do with accuracy, but they are real costs despite being hard to measure.

3. The primary thrust of the Notice and the Instrument is to ensure that investors receive the fund facts document "when they buy a mutual fund they do not currently own"[2]. This is the key element which will advance investor protection.

Routine delivery of fund facts with the trade confirmation for subsequent purchases would be going beyond this objective, and the CSA have not articulated what purpose this would serve, nor presented any evidence supporting how such a step would further enhance investor protection or promote other regulatory objectives. Furthermore, setting up systems to include fund facts routinely with trade confirmations for subsequent purchases would present steep operational challenges. Industry representatives will be able to provide detailed discussion on the nature of the challenges. However, they include taking into account, among other common situations: periodic purchase plans (PACs), set up at the fund companies as well as at dealers, and which are a common feature of group RSPs and capital accumulation plans, where contributions may be made every pay period; automatic rebalancing and asset allocation programs; standing orders in which clients have instructed that distributions from fund A be used for the purchases of fund B; investors who use money market funds as a cash management facility, and move in and out of the money market funds frequently. There is a risk that the rule could not be made to work accurately, reliably and in a cost efficient manner. For these reasons, the Instrument should continue to require delivery of fund facts with initial purchases only, as per the original intent.

[2] From CSA Press Release dated June 19, 2009, "Canadian Securities Regulators Take Steps to Improve Mutual Fund Disclosure for Investors".

We are not sure that we follow the reasoning behind the thought that there is a choice to be made between delivery of fund facts with trade confirmations for subsequent trades and an annual option to receive fund facts.

We do not believe that an annual option to receive fund facts documents should be prescribed. National Instrument 31-103 requires that client account statements be sent at least once per quarter. The client account statements will tell the investor which funds the investor is holding. It is a relatively simple matter for clients to request that their advisor send them the most recent fund facts for all of the client's holdings. A client with access to a PC can simply to go online and view the most recent fund facts documents on their own.

The infrastructure which will be needed in order to prepare letters seeking instruction, address and mail the letters, collate and track responses and follow up with new purchasers and then send the fund facts on an annual basis is considerable. We do not believe that this collective effort will appreciably advance investor protection. In our view, investor protection measures like this are most likely to be taken up by those people least in need of them: those who are attentive, have high levels of literacy and ability to deal with written materials and have some pre-existing understanding and sense of their rights as consumers.

However, if the CSA feel strongly that the annual delivery option must somehow be "traded off" against dispensing with the delivery of fund facts for subsequent purchases, then having the annual delivery requirement is preferable. It is the most consistent with the stated policy objectives of the Instrument, as well as being the least disruptive and more operationally feasible.

4. Building into the Instrument a sort of safety valve so that an investor who is adamant about placing a trade in circumstances which do not permit a pre-trade delivery of the fund facts document is wise.

There is also relief from POS delivery for certain purchases of money market funds. The Instrument contemplates that money market funds can be purchased with the fund facts being delivered with the trade confirmation, provided the investor so chooses. We would urge the CSA to consider an amendment so that with respect to money market fund purchases, there is no POS delivery requirement at all, and the fund facts document is invariably delivered with the trade confirmation. Of course, this would not prevent a dealer or adviser from making the fund facts for a money market fund available prior to the trade. But there should be no requirement for the advisor to inquire of the client and then establish or record that the client requested that the fund facts be delivered with the trade confirmation. These steps add risk and complexity to the dealer and the advisor with few if any corresponding investor protection benefits.

5. On the binding of the fund facts documents, flexibility is required to accommodate product variation and innovation. Industry participants are worried less about physical binding, than about which documents can or should be provided together, at one time.

There are two related issues here: the question of "binding" and that of single or multiple fund facts documents for more than one series of the same fund (which the CSA has addressed in its

question III (1)). These issues deal with (i) how do we present information without unnecessary repetition, and (ii) how do we avoid the prospective investor getting "information overload" thus discouraging her from using the document.

The CSA have stated clearly that it is their expectation that the principles of simplicity, accessibility and comparability inform the provision of fund facts documents to investors. Having made the expectations clear, this is an instance where it is more workable to allow fund managers to grapple with the details of designing fund facts as part of product development. It is difficult to anticipate in advance all of the various circumstances in which it may or may not be appropriate for more than one fund facts document to be delivered to the investor at the same time and to prescribe detailed rules in connection therewith.

There are any number of reasons why it may be appropriate and consistent with the principles of simplicity, accessibility and comparability to bind together one of more fund facts documents. For illustration, we describe some situations below.

Many funds are offered in more than one series. The capital of the fund is subdivided, with each such subdivision represented by a different series. The difference between one series and another may be the management fee; typically, a fund will charge a higher management and administration fee if it incurs higher distribution costs in the form of commissions paid to dealers. Where a series is intended to be placed in a fee-based account administered by the dealer, the management fee charged by the fund will be lower, but the client will incur an overall asset-based fee at the account level. In some series, no fee is charged at the fund level and the investment management fee is invoiced to the client outside the fund. A fund may create a new series as it introduces new pricing options. It may also introduce a new series in order to accommodate financing – if the fund has securitized its revenue flow, it may choose to create new series to differentiate those assets in which a portion of the revenue stream has been separated and sold to a securitization agent.

In some cases, the existence of another series of a Fund may be largely irrelevant to the purchaser of a particular series. In other cases, the advisor or the fund manager may wish to demonstrate that the fund is available in more than one series. Dealers and fund managers should be able to choose the series of the funds whose fund facts are delivered together in the manner that makes most sense in the particular circumstances.

Another reason for having different series of the same fund is to accommodate different cash distributions from the funds. In the past several years, funds which offer a predictable cash flow to investors have proven to be very popular. The cash flow can be generated out of current income or in the form of a return of capital. Fund companies have created different series which allow the investor to select the level of cash flow, which is implicitly also a choice about the degree to which the investor is receiving a return of capital and/or foregoing capital gain. In these circumstances, particularly if all of the series cannot be put together in a single fund facts document, it would make sense to permit all the series to be bound together.

6. The CSA release does not specify the exact amount of advance notice fund managers can expect to have prior to the requirement to prepare and file the fund facts documents. There are

a great many funds in continuous distribution today, and planning out the renewal process is often conducted a year or more in advance. Renewals are frequently timed to coincide with the launch of new funds, or changes to existing funds. Where such changes involve obtaining unitholder approvals, the appropriate meetings are factored in. The incremental time and resources which will be needed to prepare what for some fund complexes would be thousands of new pages is substantial. So advance notice is needed. Accordingly, it would be very helpful if the transition were broken out into:

1. **Effective Date of Instrument.** The Instrument would be in force on this date, with certain sections not to be applicable until later dates as provided in the Instrument. The Instrument could provide that any fund not in distribution on the Effective Date is required to file a fund facts along with its preliminary disclosure documents. Any fund issuers wishing to early adopt could file a fund facts document after the Effective Date.

2. **Fund Compliance Date.** The date by which any pro forma renewal filings of the prospectus for funds already in distribution would have to be accompanied by the corresponding fund facts documents. This could be fixed as one year following the Effective Date.

3. **Dealer Compliance Date.** The date by which dealers would be required to comply with the fund facts delivery requirements. This would also be the date on which the current withdrawal and recission rights are replaced with the harmonized cancellation right. This could be fixed as two years following the Effective Date, although we are advised that dealer firms may require additional time to establish procedures and monitoring processes.

In this example, if the Effective Date were to be September 1, 2010, then any fund submitting pro forma renewal documents from and after September 1, 2011 would also file the corresponding fund facts documents. Dealers could continue to rely on the "old" prospectus delivery rules up to August 31, 2012. The fund facts documents could be produced and filed by mutual fund issuers at any time following the Effective Date.

7. We have noted with interest the CSA giving consideration to requiring fund companies to prepare and file fund facts documents prior to proceeding with the POS delivery requirements. This is sensible and will allow all users of the fund facts to gain valuable experience with the document. We would urge the CSA to consider, during any interim period, steps to reduce and rationalize the volume of documents issuers are required to prepare, for example by combining the SP and AIF into a single document.

III) Issues for Comment on Form 81-101F3

1. The flexibility to have a single fund facts document containing multiple class or series disclosure would be welcome. Please see the response to II-5 above.

2. In our experience, the MER is poorly understood, even by a surprising number of people working with investment funds. For that reason, we believe it is best to be as consistent as

possible across all documents and disclosures, in the way that the MER is discussed and disclosed.

NI 81-106 already contains detailed instructions on how the MER is to be calculated and how it is to be used. We should not depart from the rules contained in NI 81-106. Accordingly the MER of a fund should be calculated for annual and interim periods and that number simply inserted into the funds facts, as the Instrument currently provides. There is no need to repeat note disclosure of absorptions or waivers in the fund facts.

The suggestion that the MER in the fund facts should be calculated on a hypothetical basis (i.e. as if the manager had not in fact absorbed expenses) implies that the actual historical MER, which includes the expense subsidy, is somehow misleading to investors. This is not the case. The MER is a ratio: it compares the sum of management fees and costs paid from out of the assets of the fund against the average daily assets of that fund over a certain historical period of time. When a fund is starting up, it will incur certain fixed costs, but the volume of assets over which those costs can be spread will by necessity be small. Hence the fund may have a high MER which will be unsustainable over time. This number would in fact be unrepresentative and we would do a disservice to investors to publish this number in the fund facts as the "real" MER.

3. The SP of an investment fund already contains extensive risk disclosure, as well as comments on suitability. We are sceptical of the incremental benefit of adding another risk rating scale in the fund facts. The risk classification methodology will vary manager to manager, and will unavoidably contain some elements of judgement and subjectivity. This is not to fault the fund manager. According to the best expert opinion, there is no one "right" way to measure risk. Like beauty, risk is to some degree in the eye of the beholder.

We understand that many investor groups and certain advisors insist on the manager providing a risk rating. Notwithstanding that, we invite the CSA to consider whether the risk rating discloses helpful information about the fund which only the manager has or can produce. We submit that the manager has already disclosed all material information about the fund in the SP, AIF and other disclosure documents, and any risk rating is simply an opinion derived from that information. Being an opinion, it merely adds to the chorus of other, perhaps equally valid opinions as to the risks of investing in the fund.

Once a risk rating is provided, there is the unavoidable problem that the rating can be misused. Many dealer compliance departments, with the support and encouragement of regulators, routinely place a risk classification on every holding in a client account. Sometimes every holding in the account is required to have a classification that is "suitable". This is clearly misguided: a concentrated, volatile sector fund with high growth potential and a correspondingly high risk of loss may be a perfectly appropriate holding as a small part of a diversified portfolio, even for an older, more conservative investor. It is the job of the advisor to consider, weigh and apply her professional judgement to arrive at a view as to (i) the risk profile of the fund in question and (ii) its suitability for the advisor's client. In the case of "DIY" (Do It Yourself) investors who dispense with an advisor, the investor is taking on that role and making those judgments. In either case, it is not the job of the fund manager. We

should design our policies so that advisors do their jobs. The danger with risk ratings is that they invite the advisor to abdicate responsibility and to rely inappropriately on the rating, particularly for determining suitability. At the same time, the ratings can result in an advisor being wrongly restricted in her ability to recommend appropriate investments for her clients. The advisor may have a view of the risk profile of a fund which differs from that of the fund manager. (He could for example have a different view on commodities, or for that matter, on the safety of asset backed commercial paper.) But it would be the rare advisor who could with confidence override (or be permitted by his compliance department to override) the risk rating given in a prospectus-like document.

4. See above.

5. See above.

6. It will be difficult for fund managers to know on what basis they can categorize risks into "key" risks and less significant risks. Certain risks may seem very remote or improbable, but have an extremely significant and adverse impact if they were to manifest. Other risks are present every day and are managed every day by the portfolio manager. This type of discussion is difficult to have in such a short document. Readers should instead be referred to the SP for a more complete discussion of risks.

7. It is difficult to know how to respond to this question. How could any reasonable and responsible person oppose being transparent as regards costs? The Form requirements prescribe disclosure of the impact of fees in an admirably clear and direct manner. Disclosure in dollars and cents will not appreciably further the reader's understanding.

8. Investors with a grade 6 reading level will likely have difficulty understanding the description of the make-up of the MER. They are unlikely to derive any meaningful information on which to base an investment decision from the inclusion of the Trading Expense Ratio (TER) and an explanation of same. If regulators consider this to be important information, perhaps readers could be alerted to the fact that the MRFPs contain information on trading costs which costs are in addition to those reflected in the MER.

This concludes our responses to the Notice. If you have any questions, or if we can expand on the forgoing, please feel free to contact the writer at shan@millerthomson.com or at 416.595.8167.

Yours truly,

MILLER THOMSON LLP,

Susan Han