



November 21, 2012

The Secretary
Ontario Securities Commission
20 Queen Street West
19th Floor, Box 55
Toronto, Ontario M5H 3S8
Fax: 416-593-2318
Email: comments@osc.gov.on.ca

Dear Sir or Madam:

Re: Proposed Amendments to OSC Rule 13-502 Fees, and Companion Policy 13-502CP

We are writing to provide the comments of the members of The Investment Funds Institute of Canada (IFIC) in response to the Ontario Securities Commission's (OSC) proposed amendments to OSC Rule 13-502 Fees and Companion Policy 13-502CP released on August 23, 2012 (the "Proposals").

IFIC and its members understand the importance of effective regulation and believe that the mutual fund industry is a mature and thoroughly well regulated industry, in large part through the OSC's efforts. We support the OSC's goal of having market participants pay their fair share of fees that reflect the costs of regulating Ontario's capital markets, however, we find that the Proposals fall short of meeting this objective, and do not address the primary issue - fluctuation of fee revenues throughout the year. Of particular concern to the mutual fund industry is that many of the future cost burdens the OSC cites to support its proposal to increase fees do not relate directly to the regulation of the mutual fund industry and its registrants. As such, we do not find that the OSC has made a case to justify increasing fees across the board, particularly on investment fund industry participants.

Timing of OSC Fee Revenues

We believe the most significant financial issue the Proposals seek to address (the OSC's mid-year shortfall in revenues) is actually a function of the timing of fee payments, and not due to insufficient fee revenues or an inadequate Reserve Fund. Accordingly, we believe it would be more appropriate for the OSC to adjust the timing of its fee receipts rather than to increase its fees across the board in an amount above the rate of inflation, and above its own forecasted increase in costs.

We recommend that the OSC consider introducing a discount for early fee payments as a means to receive a greater portion of its fee revenues earlier in the year. Any decline in revenues to the OSC created by the discount should be more than offset by the reduction in cost of the OSC not having to access its line of credit.

Alternatively, the OSC could consider implementing staggered fee payment deadlines, permitting those participants that are able to calculate their fees on a monthly basis to remit fees, perhaps at the end of June rather than in December, to further even out fluctuations in the OSC's fee receipts.

With respect to the proposed increase in its Reserve Fund, we question the OSC's use of the size of the corresponding reserves held by the Alberta Securities Commission and British Columbia

Securities Commission as a rationale. Both of these commissions derive their revenues largely from fees levied on gross sales in the past year – necessitating greater reserve funds to cover year-to-year variances. The OSC abandoned this fee model in favour of its current fee model specifically to ensure greater fee predictability. If it is able even out its fee receipts, the OSC would continue to have access to its current reserve fund and its Line of Credit facility to fund any shortfalls due to unanticipated or one-off items such as the 2012 review of the Maple acquisition transaction cited in the Proposals.

There is also no present need for the OSC to increase its fee rates since, for the last several years, its fee revenues have been increasing well above the inflation rate, and are expected to continue to do so as markets continue to recover, thereby increasing participants' revenues and issuers' market capitalization.

Disproportionate Fee Burden on Mutual Fund Industry

Our members remain concerned with the continuing disproportionate fee burden on mutual fund industry registrants relative to other capital market registrants and issuers – a long-term issue which is not effectively addressed by the OSC proposals¹. Without additional detail to permit us to calculate the actual impact, any increase in fee rates applicable to mutual fund registrants and issuers will likely maintain, if not worsen, this imbalance.

Notwithstanding the proposal that there be a lower fee increase for registrants than for issuers, our members will still face significant increases, in some cases well in excess of the OSC's stated estimate of a 7.9% increase. One IFIC member has estimated that, cumulatively over the next 3-year fee cycle, its fees will increase by more than 17% over the amount they otherwise would have had to pay under the current fee schedule. This increase not only exceeds the OSC's increase estimate and is well in excess of the current rate of inflation, but it also far exceeds the OSC's anticipated increases in expenses of 5% over the next 3 years.²

This ongoing disproportionate fee burden is more troubling in light of the fact that the mutual funds industry has seen no OSC fee reductions arising out of the establishment of the Mutual Fund Dealer Association (MFDA) as the SRO for mutual fund dealers and representatives. The MFDA (as well as IIROC) was established to be a more efficient and cost-effective day-to-day oversight body for the operations, standards of practice and business conduct for distribution participants, and should, therefore, be producing at least some fee reductions to SRO-member registrants. In no event should such registrants be required to double up or duplicate fees they are already paying to their SRO for oversight.

Capital Markets Participation Fees

We are very concerned that the OSC has, without explanation, changed its policy regarding the ability of fund managers to charge capital markets participation fees to the applicable fund.

¹ Although the current OSC proposal states that there is an intention to address the disproportion in the fee burden, and does provide a very brief statement of the current breakdown between mutual fund registrants and capital market issuers, the detail it provides does not allow for an in-depth analysis of this aspect of the OSC proposals. Commencing with its 2009 Annual Report, the OSC ceased providing disclosure on the relative proportions of participation fees paid by registrants and issuers. The OSC should resume providing this disclosure so that it will be possible to measure the potential success of efforts to correct this imbalance – an OSC objective for a number of years.

² Notice, at page 7804.

When capital markets participation fees were first put forward by the OSC in 2002 as a replacement for the annual prospectus renewal fee³, the draft proposal deviated from past practices by stating that the participation fees could not be charged back to the investment funds they managed or to securityholders of such funds. However, in the final Fee Rule, the OSC deleted the relevant section in recognition that the new capital markets participation fee should be treated as an expense of the fund just as the previous annual prospectus renewal fee had been. This is clearly an administrative cost and, as such, should appropriately be treated as an eligible fund expense, as it is now. To do otherwise would impose higher costs on the industry requiring fund managers either to absorb the costs, or obtain securityholder approval of a fee that they have essentially been paying for a decade. The industry has relied on this policy position since that time and the Proposals offer no rationale for its reversal.

Proportionate Activity Fees

We refer you to IFIC's previous submissions that filings of prospectuses for multiple mutual funds are more cost- and resource-efficient for the OSC. Activity fees for prospectus review are based on the average direct cost to the OSC of staff time in conducting the review. It should require less incremental time/cost to review each additional fund in a single prospectus containing multiple funds, than it would to review individual separate prospectuses for each fund. Accordingly, the associated activity fee schedule for reviewing those additional funds in that same prospectus should decrease after a certain number of funds (e.g., 15 funds), to reflect that lower incremental review cost⁴.

Our members are also concerned about the principle of a variable cost-based activity fee where "designated costs" of work done by the OSC in non-routine, novel or complex regulatory filings exceeds \$300,000 (a cost threshold the determination of which is not explained in the Proposals). Such a concept could result in a filer facing a substantial, arbitrary fee cost well after it has filed its application, without any ability to withdraw the application at that time due to the high cost of review. The OSC is only required to discuss with a filer the application of this fee 'at the time when OSC staff identify that the additional fee may be applicable', which could be months after the application is filed and long after these costs have already been incurred by the OSC. There is no maximum amount for such fees or on the costs that may be included in the fee for services charged by third-party providers hired in connection with the activity. Other than a review of the final invoice by the Director and the Commission, the Proposals provide no indication as to how the OSC proposes to control the expenditure of time, and to avoid incurring excessive expenses and applying variable cost fees to multiple, similar complex filings when reviewing applications for which variable cost fees are payable.

Finally, there seems to be no recourse for the invoiced party if there is disagreement about the amount charged. We recommend that a filer being billed this variable cost-based activity fee should be notified at an early stage when excess costs begin to be incurred, so that it can assess whether to continue with the application. As for formal review, we also recommend that a filer be permitted to seek an Opportunity to be Heard pursuant to section 31 of the *Securities Act* and be provided the

³ OSC Rule 13-502 Fees, published June 28, 2002

⁴ Using the experience of one of our fund manager members as being a typical case study, its total mutual fund prospectus renewal fees paid to the OSC in 2012 @ \$400 per fund were roughly \$60,000 for 5 pro-forma prospectus filings covering in total about 150 funds, with the largest prospectus covering about 86 conventional funds and the smallest being for a single fund. In setting its variable cost-based activity fees the OSC has assumed a cost for staff review time of \$140/hour which if literally extrapolated translates to almost 428 hours of OSC time @ \$140/hr. This pays for one OSC staff member working 24hrs/day for about 18 days straight to review and clear these 5 pro-forma prospectus filings. This does not appear realistic or proportionate.

right to ask the Commission to review the Director's decision to charge such fees and their reasonableness.

Other issues

IFIC's members would also appreciate confirmation that registrants who have already paid a fee for registration in one category will not be charged fees for registration in a second category. The OSC had previously provided guidance confirming this to be the case, however has offered no recent guidance on multiple fees.

We would like clarification of the meaning of section 4.1 of the Companion Policy, that fees 'must be borne' by registrants and not passed on to clients. It would be disturbing if, by this, the OSC intends to dictate cost allocation when market participants have always been permitted discretion to allocate costs on a reasonable and justifiable basis.

We are curious as to why section 4.4 of the Companion Policy limits unregistered investment fund managers to making paper-based filings. In today's technology-driven environment, all firms required to make filings should be offered the choice to file electronically or in paper.

Finally, as the OSC is already experiencing fee revenue increases due to improvements in the markets, we question the need for a new \$500 fee for exempt distribution reports, which will simply result in an additional cost being passed on to the investors of these exempt products.

We appreciate the opportunity to comment on the Proposals. We believe that our comments and recommendations will help to ensure the Canadian mutual funds industry receives good value for the fees it pays, without diminishing the OSC's effectiveness as the industry's primary regulator. Please do not hesitate to contact the writer should you have any questions or require further information regarding our comments.

Yours truly,

THE INVESTMENT FUNDS INSTITUTE OF CANADA



Ralf Hensel
General Counsel, Corporate Secretary
and Director of Policy (Fund Manager Issues)