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May 4, 2001

Mr. John Stevenson, Secretary
Ontario Securities Commission
20 Queen Street West
Suite 1900, Box 55
Toronto, Ontario
M5H 3S8

Dear Sir:

Re: Proposed OSC Rule 45-501- Exempt Distributions

The Investment Counsel Association of Canada ("ICAC") is pleased to have an opportunity to respond to the Ontario Securities Commission's April 6, 2001 request for comment on Proposed Rule 45-501. This submission has been prepared on behalf of the Government Relations Committee of the ICAC.

Our comments relate to the impact of the proposed rule on portfolio managers and the use of the proposed accredited investor exemption in section 2.3.

We are encouraged by the Commission's decision to have Commission staff review the impact of exempt market rules on investors utilizing portfolio management services through pooled funds. We had hoped that this would have occurred earlier as part of the development of the proposed rule. We recognize that the focus of the initiative was the financing activities of small and medium sized businesses and that the provision of investment management services is an entirely distinct activity. Recognition of this fact is an important step in a process that we trust will lead to the adoption of a regulatory scheme that more effectively addresses the needs of clients using portfolio management services.

The direction to Commission staff to examine the use of in-house pooled funds appears to reflect an acceptance by the Commission that there is a need for a fuller understanding of the regulatory needs surrounding the portfolio management industry. However, the Commission plans to proceed with a proposal that removes certain prospectus

exemptions that are integral to the ability of managed accounts to continue to obtain pooled portfolio management services. We submit that grandfathering/transitional rules are necessary and appropriate in the circumstances pending the outcome of the completion of the separate initiative to examine in-house pooled funds and their use. Changing the rules without facilitating a transition is problematic for the portfolio management industry. Some of these problems are identified below:

Individuals

We are hopeful that many individual clients of portfolio managers will meet or exceed the specified qualification criteria set out in 1.1 (m) & (n) for accredited investor status. For managed accounts meeting accredited investor status, the portfolio manager will be able to invest the managed account in any amount of units of pooled funds without minimum thresholds and that is an improvement to the current regime. However, if an individual client under a discretionary managed account agreement is already invested through in-house managed pooled funds and does not meet either the financial asset or net income tests, then, without transitional provisions, significant ramifications are expected:

- Managed accounts who are already unitholders of one or more pooled funds will not be eligible for an asset-mix shift if deemed appropriate by the portfolio manager;
- Managed accounts will not be eligible to receive additional units of the pooled fund in which it is already invested (through the reinvestment of distributions for example);
- Managed accounts could be managed by the portfolio manager on a segregated basis at higher costs to the client without the same benefits of diversification; or
- Managed accounts could be terminated by the portfolio manager.

Ongoing Compliance Obligations

Without transitional provisions, abolishment of the former prospectus exemption regime and implementation of the new regime on an effective date yet to be determined will necessitate the portfolio manager contacting all existing discretionary managed account clients resident in Ontario to obtain and/or confirm specific personal financial information, to determine whether accredited investor tests are met. Compliance obligations of this nature would be ongoing for portfolio managers under the proposed rule.

The Notice states in part: "…the financial asset and net income tests are to be satisfied only at the time of the trade. The seller has no continuing obligation to monitor the purchaser's accredited investor status after the completion of the trade." For a managed account of a portfolio manager, under the proposed regime, it is not that simple. When a portfolio manager is managing money of a managed account through a pooled fund investment vehicle, in order for additional securities to be issued, the proposed rule would require that the Portfolio Manager contact the client of the managed account each time a trade occurs. This would include for example: asset-mix shifts requiring redemption of units from one pool e.g. equities and reinvestment in another pool e.g. bonds; the reinvestment of distributions and the investment of additional funds provided by the client. These events triggering trades could be expected to occur at different

times, with different frequency and to affect a number of clients. For individual clients, the Portfolio Manager would need to confirm either that the financial assets of the client still exceeds$1,000,000 or that the client still has a reasonable expectation of exceeding in the current year, threshold net income levels.

The concept of contacting a managed account every time a trade occurs is not in keeping with the nature/definition of a managed account and creates onerous and unworkable compliance responsibilities. We submit that new regimes should be set up to encourage and facilitate compliance. These ramifications do not meet that objective nor do they meet the stated objective of a "simple system".

Transitional Provisions Needed

1. Individuals

To facilitate continuing investment management of existing client assets through in-house managed pooled funds, we suggest adding the following additional paragraph under the definition of "accredited investor":

a managed account established prior to the coming into force of this rule, providing that this clause will cease to be in effect after the coming into force of any legislation, regulation or rule in Ontario relating to the distribution of units of in-house managed pooled funds;

2. Fund on Fund Investment 1.1 (V)

For clarity, we suggest adding the language in bold: " a mutual fund or non-redeemable investment fund that, in Ontario**, after the coming into force of this rule,** distributes its securities only to persons or companies that are accredited investors."

Additional Concerns

3. The definition of accredited investor does not include minor children, minor grandchildren and dependants of persons mentioned in subsections 1.1(m) and (n). The notice suggests that children and other family members of accredited investors can be given the benefit of acquisitions through the use of trusts or other structures which would fall within paragraph (y) and {aa} of the definition. Paragraph (y) is limited to accounts fully managed by a trust company. Paragraph {aa} is limited to circumstances whereby all of the owners of interests, direct or indirect, legal or beneficial, are persons or companies that are accredited investors. The only paragraph available for clients with assets beneficially owned by minors or dependants under estate plans would require the entity used to have net assets of at least $5,000,000 (1.1(t)) and that is well in excess of the financial asset tests for an individual and spouse of $1,000,000 (1.1 (m);

4. The proposed rule perpetuates an unlevel playing field whereby an "account that is fully managed" by a trust company qualifies as an accredited investor and is not disqualified from acquiring a security of an in-house managed pooled fund [1.1

(y)] unlike a "managed account" under 1.1 (x). Furthermore, a prospectus exemption for private mutual funds is continued (3.3) so long as the promoter or manager of the mutual fund is a trust company. We submit that these provisions should be part of the review undertaken by commission staff together with subsection 72(2) of the *Securities Act* (Ontario) that recognizes only a trust company to be acting as principle when it trades as agent for accounts fully managed by it.

5. "**Financial Assets**" **definition**: the companion policy should be further clarified to confirm whether the assets in a client's RIF's are to be included in the calculation of that client's financial assets.

6. E**xempt Trade Form 45-501F1**

Under paragraph 4(b) of former Form 20, listing the names of managed accounts of a portfolio manager on an exempt trade report was not required provided the list of clients/investors was made available for inspection at the issuers office in Ontario. As it would appear that references under Form 45-501F1 would require amendment, this practise should be continued/grandfathered to preserve the confidentiality of clients of portfolio managers investing through in-house managed pooled funds in the exempt market. The identity of managed accounts should remain confidential given the private nature of the discretionary contractual relationship between a Portfolio Manager and client.

The Commission's concept proposal to revise the fee regime acknowledges that the information contained in exempt trade reports is not necessary for the proper regulation of the industry. We support initiatives to eliminate the requirement to file exempt trade reports for investments through in-house managed pooled funds to ease administrative burdens and to meet regulatory objectives of efficiency, streamlining and regulatory paperwork reduction.

7. **National in Scope - Harmonization**
As indicated previously, it is our view that the initiative to revamp the exempt market should have been national in scope to harmonize exempt market regulation across all Canadian jurisdictions for compliance purposes and to facilitate ease of doing business in Canada. We encourage the Commission to work closely with other members of the Canadian Securities Administrators towards this goal.

Conclusion

The proposed rule will have a significant impact on the business activities of our members and an even more significant impact on the investment alternatives available to their clients. We are supportive of the commission staff studying the use of pooled funds by the portfolio management industry. We are encouraged that this item is on the agenda of the business plan of the Commission. However, pending the outcome of the review, we urge you to include transitional provisions in the proposed rule. For the reasons highlighted above, transitional provisions are needed to facilitate compliance for portfolio

managers with established discretionary managed accounts until such time as the study on pooled funds is complete.

We appreciate the opportunity to comment on the proposed rule. We would be happy to participate in the process of regulatory-industry consultation on investment management using pooled fund investment vehicles.

Yours very truly,

On behalf of the Government Relations Committee

per:

Sharon J. Morrisroe, B.A. LL.B.
Committee Member
/sjm

cc. Mr. David Brown, Chair OSC
Mr. Douglas Hyndman, Chair CSA
Ms. Margo Paul - OSC
Mr. Blumberger - OSC
Ms. Rebecca Cowdery - OSC