

May 7, 2001

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

Dear Mr. Stevenson:

Re: Proposed OSC Rule 45-501 – Exempt Distributions

We are writing in response to the request for comments in the April 7, 2001 Notice of Proposed OSC Rule 45-501. A diskette with an electronic copy of the submission, formatted in MS Word, is also enclosed.

Members of The Investment Funds Institute of Canada (“IFIC”) are pleased that many of the concerns raised in our December, 2000 submission were clarified or addressed in the latest draft of Proposed OSC Rule 45-501 (the “Proposed Rule”). However, our Members still have some concerns with the Proposed Rule discussed in more detail below.

Harmonization

In the Notice preceding the Proposed Rule, the OSC has indicated that it will continue to pursue the possibility of developing a harmonized regulatory regime for the exempt market. We strongly encourage the OSC and the other securities regulatory authorities to work toward this goal.

Accredited Investors

We note that the OSC received many comments on the impact of the monetary thresholds that determine accredited investor status for individuals. The proposed thresholds will exclude a number of investors that are currently able to access the exempt markets under the \$150,000 minimum purchase exemption.

In the case of exempt pooled funds, these new income and assets tests will leave many existing investors who purchase pooled fund units under the \$150,000 exemption and applicable pooled fund rulings with no alternative but to maintain an existing investment (with no ability to make additional investments or switch to another for asset allocation purposes) or sell it. An investor who chooses to maintain an existing investment would need to choose a different investment product for future investments. The most obvious

alternative would be a prospectus qualified mutual fund whose MER is likely to be higher than the pooled fund's MER. For many investors, a decision to sell a pooled fund investment may result in a taxable capital gain. Accordingly, we submit that this regulatory change is likely to result in either a tax liability or additional fees to those existing pooled fund investors who do not meet one of the new tests.

Entities like small foundations that are not registered charities and do not have \$5 million in assets, or small corporate savings plans, are also left with fewer investment options. Under the current regulations, they would have been able to diversify with a \$150,000 investment in a pooled fund, but will be precluded from doing so under the Proposed Rule, unless they apply for and are recognized as accredited investors under para. 1.1(u).

Grandfathering

For all of the reasons noted above, we strongly urge the OSC to consider grandfathering investors who have made investments in pooled funds in reliance on the \$150,000 minimum purchase exemption. We ask that those investors be permitted not only to remain in the investments they have made under that exemption, but to also make additional investments under the exemption or under the terms of any relief granted to the pooled fund. As they are already invested in the pools under these conditions, in our view there is no increase in risk to these investors in permitting them to retain their investments or to make further investments in the pools on the same terms.

Transitional Provision

Should the OSC be unwilling to grandfather investors who purchased exempt securities under the \$150,000 exemption, then at a minimum the Proposed Rule should include a transitional provision to allow issuers and investors to adjust to the new requirements. In our view, a transitional provision is warranted for several reasons.

1. Determining whether an investor meets the accredited investor criteria is far more complicated than accepting a minimum \$150,000 investment and a subscription agreement. For example, issuers that offer pooled funds will need time to communicate with investors to determine which of them meet the accredited investor exemption requirements, and which do not.
2. Investors that do not meet the accredited investor requirements will need time to consider their alternatives. Since these investors are often high net worth individuals, there is a certain amount of investment and tax planning that will be involved in transitioning out of pooled funds. For example, redeeming units of a strongly performing fund other than for investment reasons could create a significant tax burden and cause investment gains to be lost. On the other hand, being forced to redeem units when they are depreciated could create unrecoverable losses. An appropriate transition period would permit the investor to monitor his or her investments and determine the most appropriate time to redeem so that taxes on disposition can be minimized.

3. It is also important to consider those investors who remain in a pooled fund. A significant forced redemption of pooled fund units may significantly impact a manager's long-term investment strategy, potentially leading to fund underperformance for remaining investors.
4. Many investors' pooled assets are their lifetime savings (for example, where they have not been members of a defined benefit pension plan). Providing a transition period to allow them to make appropriate alternate investments would acknowledge the prudence these investors have shown in managing their savings.
5. Investors may have privacy concerns when they are asked to verify and certify that they meet the net income or net worth requirements of an accredited investor, and so ample time is needed to familiarize investors with the new requirements, including the certification process.

Our Recommendation

Our Members recommend that the OSC consider adopting a transition period of two years and a day in the Proposed Rule for issuers and investors to conform to the requirements of the Proposed Rule. We would ask the OSC to apply this transition period to both the \$150,000 exemption and to all applicable pooled fund rulings. This transition period would cover three tax years, which would give sufficient time to issuers to determine whether investors meet the requirements of another exemption, and if they do not, to work with investors to complete the requisite investment and tax planning necessary to transition smoothly into another investment. This suggestion balances the desire of the OSC to move to the new exempt market regulation with the best interests of investors that will be directly impacted by the new regulation.

Application for Recognition as an Accredited Investor (para.1.1 (u))

Section 8.1 of the Proposed Rule grandfathers exempt purchasers recognized by the OSC under paragraph 72(1)(c) of the Securities Act (Ontario) (the "Act"). Further, the definition of "accredited investor" includes a "person or company that is recognized by the Commission as an accredited investor". This provision appears more inclusive than the exempt purchaser provisions under the Act in that it does not limit recognition to persons or companies that are not individuals. It would be helpful to clarify in the Proposed Rule or Companion Policy that individuals may be recognized as accredited investors, and to specify who may apply for recognition as an accredited investor e.g. does it have to be the investor, or can the issuer apply on the investor's behalf?

Pooled Funds

In the Notice, the OSC indicates that the detailed comments made in connection with the distribution of pooled funds will be addressed separately and that OSC staff has been charged with the task of proposing a scheme for their regulation. We strongly urge the

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OSC to consult with interested market participants in developing these proposals. IFIC and its Members would be pleased to assist in this process in any way we can.

We appreciate the opportunity to comment on the Proposed Rule. If you have any questions, please do not hesitate to contact me at (416) 363-2150, ext. 473 or by e-mail at lbyberg@ific.ca.

Sincerely,

The Investment Funds Institute of Canada

Leslie Byberg
Senior Counsel, Regulation

Enclosure