

Ontario Securities Commission  
20 Queen Street West  
Suite 1903  
Box 155  
Toronto, Ontario  
M5H 3S5

Attn: Mr. John Stevenson  
Secretary

Dear Mr. Stevenson,

**Subject: Proposed OSC Rule 45-501 Exempt Distributions -Pooled Funds**

I am making the following comments on behalf of R.A. Capital Management Inc. with regards to the proposed ruling as it applies to pooled funds.

I have over 20 years in the investment industry, and I have managed up to \$1.7 billion. I have worked with the following types of funds for over 20 years:

- Pooled Funds
- Corporate Funds
- Mutual Funds
- Pension Funds
- Segregated Funds

I formed R.A. Floyd Capital Management Inc. in November of 1999. R.A. Floyd Capital Management Inc is licensed as an Investment Counselor/Portfolio Manager and Limited Dealer. Our pooled Fund was launched on June 1, 2000. We formed the company to provide a product to a growing number of Canadians that wished to have their money managed professionally but did not want all the fees associated with a mutual fund.

We very much appreciate the opportunity to provide the OSC with our feedback regarding the proposed rule. We were delighted to hear that the commission was making some long overdue changes to the sophisticated investor rule. We believe that the proposed changes to Rule 45-501 could be much more progressive and equitable for the average consumer.

We wish the commission to consider the following points:

**1. Management of Funds:**

The same investment professionals that manage mutual funds manage pooled funds. The risk profiles and the liquidity of the two products are similar. Yet the OSC appears to have chosen to widen the gulf of restrictions against pooled funds and their managers.

The pooled fund product provides consumers a diversified product with generally lower administrative costs than a mutual fund. If the proposed asset & income tests become law, many investment counselors will shift their business to separately managed plans. The overall effect of the legislation will be to raise the risk profile of investors and increase the overall cost to have the money managed.

**2. Risk Profile:**

The potential of losing 100% of one's investment is possible with a hedge fund or a private placement.

The possibility of losing 100% of one's investment in a diversified pooled fund with a broad number of securities is not possible unless the entire financial system collapses.

Since the risk profile of a pooled fund is arguably less than a hedge fund or private placement then why should the asset and income tests be the same as much riskier products?

**3. Education:**

The educational requirements to become an Investment Counselor/Portfolio Manager as laid out by the commission are very stringent.

Many investment counselors are Chartered Financial Analysts and they have undergone an extensive educational program (minimum 750 hours as outlined on the OSC's website) to become portfolio managers. The CFA designation is bound by a strong code of ethics that is focused on integrity, knowledge and upholding a high standard of ethical conduct.

The onus of the investment counselor is to construct an appropriate risk profile and asset mix requirement for each client. As a pooled fund manager, we are focused and trained for the preservation of a client's investments. The majority of portfolio managers are self-regulating. The OSC does not need to place such restrictive operating procedures on pooled fund managers by having such limiting requirements for pooled funds.

#### **4. Statistics In Relation To Asset Test:**

##### **United States:**

The United States is roughly 10 times the population size and wealth factor of Canada.

In the United States in 1999 out of 121 million tax filers:

- 1.47 million people had income of over \$250,000.
- And 3.67 million individuals reported income from \$125,000 to \$250,000

These two categories represent 4.25% of the total number of filers. The United States can tolerate a higher minimum investment requirement.

##### **Canada:**

In Canada in 1997 out of a total of 21.1 million tax filers:

- Only 60,000 individuals made over \$250,000
- And only 100,000 individuals made \$150,000 to \$250,000

Both of these groups together represent only 0.76 % of the total number of individuals that filed their income tax returns in 1997.

In 1999, only 38,900 households in Canada had discretionary assets over \$1,000,000 and household income over \$200,000. Clearly from these statistics, the asset and income test are too restrictive if less than one percent of the total population would qualify.

With the advent of lower investment requirements for the accredited investor we find it difficult to understand why the commission has chosen to substantially increase the asset and income tests for investors. If one were to use a benchmark of investing 15% of one's assets with a higher risk investment and using an investment requirement of \$25,000, then one would expect that a prudent amount of total assets required would be approximately \$166,000 of discretionary assets (not including one's house).

One approach that could be used to improve the asset and income tests would be to use a sliding scale on the asset requirement starting from \$400,000 limiting the amount of the investment at that level.

The province of British Columbia is currently using a more reasonable asset test of \$400,000 with a minimum investment of \$25,000.

We feel that based on the Canadian statistics mentioned above, that few individuals would qualify as accredited investors.

The Floyd Growth Fund was launched June 1, 2000.

- The funds' assets total approximately \$1.3 million.
- There are 23 clients.
- Out of 23 clients, only 3 would qualify as accredited investors.

We have canvassed a number of senior executives in the investment field as well as other professionals in other industries and they whole-heartedly agree that the asset test and income tests for investing in pooled funds is too restrictive within the Canadian context.

We would like to know if the commission has current numbers that reflect:

The total dollar value of the existing pooled funds being managed in Ontario?

Total numbers of existing clients that will NO LONGER meet the asset test?

And what dollar values those clients would represent?

We are very concerned that with the proposed asset tests and income requirements, very few Canadians would be able to enjoy the benefits of a pooled fund and would reinforce a very elitist and prejudicial approach to investing in Canada.

## **5. Existing Clients**

There is another factor that needs to be considered, and that is the existing clients of the many pooled fund products that exist in Ontario.

Many of our clients will now have their accounts frozen at current levels. We have heard similar comments from other pooled fund money managers, and like us, very few of their clients would qualify as accredited investors.

The financial future of these individuals has now been severely restricted. These individuals should be grandfathered in the new Ruling and they should be able to add to their investments.

At the minimum, existing unit holders of pooled funds should be able to reinvest their annual distributions back into the fund. For many investors with locked-in or regular registered retirement saving plans the effect of the proposed legislation would restrict the capital that gets paid back to them in the form of dividends or capital distributions.

Further discussions should take place regarding pooled funds. Pool Fund clients have a right to know what the OSC is proposing. Until the OSC's revised proposal was issued April 6, it was difficult to approach our clients and discuss what proposals were being considered. Everyone we talked with in the industry thought that the OSC was going to adopt a policy similar to BC. Clients that purchased our fund under the seed capital ruling were looking forward to adding to their accounts.

## **6. Trusts**

### **Family:**

Many family trusts and beneficial organizations are managed as extensions of family assets with similar criteria, yet the commission has chosen to place an even more onerous asset test on them than the accredited investor. We continue to assert that the commission should reexamine the asset tests and exclude these groups from the much larger corporate requirements.

### **Small Non-profit/Charities:**

Most of these associations are volunteer based organizations and as such they have a very strong need to preserve their assets and have them properly diversified and professionally

managed with lower fees. Yet the commission has chosen to place an even more onerous asset test on them, than the accredited investor. We continue to assert that the commission should reexamine the asset tests and exclude these groups from much larger corporate requirements.

## **7. Corporate Accounts/Small Pension Fund Accounts**

### **Corporate Accounts:**

A large part of the Canadian economy is derived from small business. Without these businesses our economy would not function. Under the proposed rule, small corporations would not have the opportunity to take advantage of having their assets managed by a seasoned professional at a low cost.

### **Pension Accounts:**

Many small pension funds are too small to be separately managed. Without the ability to be pooled, these plans, would not be properly diversified. A number of small corporations that wish to take advantage of a pooled fund and have their employees pension assets properly diversified with lower risk would no longer be possible.

The commission again has chosen to place an even more onerous asset test on small pension funds than the accredited investor. We continue to assert that the commission should reexamine the asset tests and exclude these groups from the restrictive requirements.

## **8. Accredited Investors**

Another group of individuals that should be acknowledged as accredited investors are investment professionals that may not qualify by the asset or income tests, but clearly have the investment knowledge to make proper investment decisions.

## **9. Banks & Trust Companies**

We also believe that giving banks and trust companies the status of accredited investors also creates an unfair playing field between the investment departments of these organizations and investment counselors. Why should these institutions carry a preferred status when they are conducting the same financial operations as other investment counselors?

## **In Conclusion:**

The emphasis of the proposal should be on fair disclosure so that the investor can make up his or her own mind. Due to the onerous and restrictive income and asset tests many investors will be precluded from investing in a more cost effective investment product.

We feel very strongly that the commission should at the very least, defer a decision regarding rule 45-501 and 45-504 with respect to pooled funds until such time as the committee has had a chance

to complete their investigation currently underway and to review the ramifications with respect to pooled funds.

We look forward to participating in the review of the Commission's proposal with regards to the treatment of pooled funds and acknowledge that pooled funds carry less risk than private placements or hedge funds by reducing the requirements for investment in this product.

We look forward to working with the commission on arriving at a fair and equitable ruling for all concerned.

Sincerely yours,

Robert A. Floyd, CFA  
President

RAF/js

cc: Mr. David Brown, Chair OSC  
Mr. Erez Blumberger, Legal Council Corporate Finance Branch OSC