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Rebecca Cowdery
Manager, Investment Funds Regulatory Reform
Ontario Securities Commission
P.O. Box 55, 19th Floor
20 Queen Street West
Toronto, ON M5H 3S8

YuMee Chung
Legal Counsel, Investment Fund Regulatory Reform
Ontario Securities Commission
P.O. Box 55, 19th Floor
20 Queen Street West
Toronto, ON M5H 3S8

Dear Rebecca and YuMee,

Your comprehensive effort deserves, at the very least, a comprehensive reply, and while we would be more than happy to take you up on your offer to pay us a visit (and hopefully have you attend our annual directors' dinner and meeting of investors on Thursday evening, May 2), here are some thoughts for the record.

Issue

- 01-02 Our 42 year existence as a successful fund manager, with 58% of “**very** satisfied” investors in 2001, and a majority of unrelated directors, to us is proof that registration of fund managers is not required. Thus, we support Alternative 4.
- 03 Naturally, we’re in favour of a level playing field, but don’t see mutual funds being at a serious disadvantage to other quite different investment vehicles of which we know little about, but none of which is seen as a major threat.
- 06 If one believes that the investor comes first, then our experience is that fund governance is effective. In a 2001 survey of Tradex investors, accurate within four percentage points, 57% stated it was important to provide access to management and investment counsel at an annual meeting, and 62% said it was important that the Tradex Board of Directors comes from the public sector, as the investors do.
- 10 We agree that “owner-operated” mutual funds avoid any conflict of interest concerns. Also, we are pleased that the concept paper could allow Tradex Equity Fund Limited (TEFL), a mutual fund corporation, with a ten member board elected by its shareholders, to be a governance agency. This fund has the exclusive right to nominate the board of directors of Tradex Management Inc. (TMI), the fund manager. Tradex took fund governance one step further beginning in 1992, and has three member fund governance committees for each of its funds. Each

committee is composed of two TMI unrelated directors, and one fund investor, and makes recommendations to the TMI board.

- 12 We have years of experience in recruiting governance agency members, and have had little difficulty, except for female members, which we insist on having. Some of our most effective directors have been volunteers from among our 3,700 investors.
- 13 We agree with the definition of independent, and that only a majority of independent members are required, for the reason put forward in the proposal.
- 14 Audit committees, which are rightly increasing in prominence, should have a chartered accountant as at least one member. Such a critical function is inappropriate for a governance agency. Recruiting CA's as agency members could also be difficult. We also doubt that members would bring much to a review of mutual fund disclosure documents.
- 15 Tradex fund committees annually review derivative policies. They also recommend investment guidelines to be followed by investment counselors.
16. See Issue 14 above.
- 19 It has been the view of our legal counsel that insurance coverage for directors of TEFL and TMI is not imperative because of limited exposure to liability.
- 20 See Issue 12 above. Advertising the positions to the fund investors could involve an enormous screening role for the manager initially, but would be democratic. In our experience, existing board members often can find good replacements among their circle. Enclosed are copies of recent Tradex communications introducing new board and committee members, i.e. Tradex Quarterly Fourth Quarter 2001, Tradex Equity Fund Limited Proxy Circular, Tradex 2002 Annual Meeting Update.
- 21 Since our governance agency appoints the fund manager, it is hard to comment.
- 22 Qualification guidelines for prospective members will be essential to maintain adequate breadth of experience.
- 23 A governance agency setting their own compensation can be a sensitive issue in our experience, and compensation guidance we would support.
- 24 Tradex is an example of a governance agency which has had the power to terminate the manager since 1988, but has never for a moment given the matter any consideration.
- 28 Tradex provides a manual and half-day orientation to all new board members.
- 29 Since the Tradex governance agency controls the fund manager, we would argue that it is possible for a governance agency "to both carry out their fund governance duties and focus on the internal operations of fund managers" See also our response to issue 02.

30 We support the IFIC Committee recommendations. As a dealer which has qualified for membership in the Mutual Fund Dealers Association of Canada, the conditions of registration insofar as officers and directors are concerned are few, applying only to trading officers and a compliance officer. Thus, all four Tradex employees have successfully completed the Officers, Partners and Directors (IFIC) examination. However, Tradex, with assets under management of only \$120 million, cannot justify a chief financial officer, but have an excellent relationship with a chartered accounting firm. As we now search for a new chief executive officer for an Ottawa location, it is not easy to find someone with “at least three years of direct experience working in, or providing service to, the investment fund/securities industry”, which is undefined. There are excellent people with pertinent experience in pension funds, banking, and as members of corporate boards, for example, who could adequately fill the ceo role. Ceo’s traditionally require vision, integrity, and communication skills before industry knowledge. It is the Tradex governance agency which is conducting the ceo search totally independent of management. We do agree that a minimum of four senior management positions are required to provide for inadvertent succession.

The TMI board of directors are all unrelated, with one exception. Its board is identical to the board of the Tradex governance agency, but has not always been so. On election to the board, only two people have had securities experience over the past dozen years, but all were mutual fund investors. See also our response to issue 06. It is worth noting that over its life, TEFL has had more than 100 directors, all but one with federal government experience.

31 The summary of the Stromberg Report recommendation provided as an option in the proposal is missing one sentence from the Report which to us is absolutely critical, i.e. “Considerations might also be given to whether any reduction in these amounts is appropriate where the services required by the manager of the investment fund are outsourced”. Tradex outsources all its required managerial services, i.e. investment counsel, back-office administration, custody, accounting, and legal counsel, and has done so throughout its existence.

Under the May 1, 1988 Management Agreement between the governance agency and the manager, amended in 1991, “any surplus funds after retaining sufficient funds to meet all regulatory requirements” of the manager shall “be rebated pro rata to all mutual funds managed...based on fees paid to the manager by each such mutual fund”. Thus, it was only with the release of the Stromberg report in 1995 and its reference to minimum capital, that TMI began its efforts to retain earnings. By December 31, 2001, after seven years of sacrifice by investors in Tradex funds, retained earnings had risen to [REDACTED]. Share capital is a mere \$10, 10 shares, each with a value of \$1.

We support the concept of minimum capital for the reasons quoted in the Stromberg report, i.e. “to meet...business commitments and to withstand the risks to which the business is subject”. Tradex outsourcing contracts would allow us to wind-up fund management in six months should some disaster befall the three Tradex funds. Regulatory approvals should also be possible within that time frame. Our guess is that capital of between 0.3 and 0.5% of assets under management would allow any outsourcing manager with assets of less than \$200 million to fulfill its obligations in an orderly fashion. However, Tradex would need at least three years notice to be able to comply.

- 32 It has been the view of our legal counsel that directors and officers liability insurance is “not imperative” for the fund manager, partly because the company has only four employees, all of them officers, and one of whom is also a director.
- 33 Our auditor routinely reviews the internal controls of our third-party administrative services provider.
- 34 Tradex has unsuccessfully requested a Section 5900 Report from its former administrative services provider to serve as a monitoring mechanism.
- 38 It is now Tradex policy to conduct an auditor review every seven years largely because a fresh approach is often useful. Should the review result in the appointment of a new auditor, it would be far simpler and more cost-effective to have the governance agency approve it. At present, it is the agency, i.e. TEFL, which recommends the auditing firm to its investors.

In an effort to get my thinking to you promptly, the foregoing is more brief than I would like. However, should you be able to come to Ottawa, I would gladly find the time to pursue the issues with you. Combining a visit with our annual meeting and dinner would be a wonderful opportunity for you to speak informally to our Board members, governance committee members, third-party suppliers, staff and investors. Attendance at the meeting is usually about 125. Regardless, we hope to see you in Ottawa, and congratulations on a thoughtful, thorough piece of work.

Sincerely,

Andrew G. Billingsley
President
Tradex Management Inc.

Encls.