THE INVESTMENT FUNDS INSTITUTE OF CANADA
L'INSTITUT DES FONDS D'INVESTISSEMENT DU CANADA
151 YONGE ST., 5TH FLOOR, TORONTO, ONTARIO, M5C 2W7 TEL 416 363-2158 FAX 416 861-9937

June 4, 2002

John Stevenson, Secretary
Ontario Securities Commission
20 Queen Street West
19th Floor, Box 55
Toronto, Ontario
M5H 3S8

and

Denise Brousseau, Secretary
Commission des valeurs mobilieres du Quebec
800 Victoria Square, Stock Exchange Tower
P.O. Box 246, 22nd Floor
Montreal, Quebec H4Z 1G3

Re: IFIC Response to CSA Mutual Fund Governance Concept Proposal 81-402

The Investment Funds Institute of Canada ("IFIC") appreciates the opportunity to comment on the Canadian Securities Administrators ("CSA") mutual fund governance Concept Proposal 81-402 "Striking a New Balance: A Framework for Regulating Mutual Funds and Their Managers" (the "Concept Proposal").

We believe the ongoing pursuit of enhanced investor protection to be a laudable aim and are pleased to lend our support to assist in the development of the initiatives that have been articulated by the CSA in the Concept Proposal. At the outset, we wish to urge the CSA to consider alternatives to the independent governance agency model, including the three options discussed in the Concept Proposal. We also have a number of other significant concerns and comments and wish to bring the most prominent of these to your attention by outlining them at a high level in the following summary. Please note that our views are more fully articulated in the following document that is attached as Appendix "A" to this letter.

Existing Regulatory Inefficiencies Must be Addressed Prior to the Implementation of the Concept Proposal Initiatives

The mutual funds industry in Canada is heavily regulated and the existing system is inefficient and problematic. The rules that govern our industry are frequently subject to

inconsistent application and varying interpretations. These problems are exacerbated by the fact that our regulatory framework is administered through 13 different regional regulators who remain only loosely coordinated with only partially harmonized provincial laws.

The Concept Proposal initiatives will be of no benefit to Canadian mutual fund investors if they are simply added as layers to the pre-existing inefficiencies of our current regulatory regime. Underlying and long-standing problems must be addressed first and, accordingly, a cost-benefit analysis of a fund governance regime must be preceded by a comprehensive review and restructuring of the existing regulatory framework into which a fund governance structure would ultimately be integrated.

The Importance of Ensuring Nationally Standardized Initiatives: With regard to both the Concept Proposal initiatives and the existing regulatory regime, it is imperative that an amalgamation of the existing framework and new proposals result in a more streamlined and unified regulatory framework. Some of the specific goals of this renewed framework must be to provide for simpler, reduced and more "functional" regulation (whereby similar products are regulated in a similar manner).

The industry in Canada lacks a uniformly coordinated and administered regulatory regime. We urge the CSA to remain cognizant of the fact that one of the fundamental realities of this absence of uniformity is that any one jurisdiction is capable of raising the regulatory bar, while the consent of all 13 jurisdictions is required to lower it. A non-standardized implementation of the Concept Proposal initiatives thus has the potential to greatly increase the transactional expenses that would be borne by Canadian mutual fund investors. Added expense and further impairment of service to unitholders is unacceptable to our members and the industry will not likely be amenable to lending its support to any proposal that is not implemented and adopted in a standardized and uniform manner across all jurisdictions in Canada.

Areas in Need of Urgent Regulatory Reform: Apart from the general need for a more streamlined regulatory framework, there are a number of existing regulations that we would highlight as priorities that require particular and immediate attention. In this group we would include the related-party underwriting rules (the "60-day rule"), inter-fund trading restrictions, fund-on-fund and principal trading rules.

"Quid Pro Quo": There is a pressing need in our industry for a "quid pro quo" that will reduce and streamline existing regulations concurrently with the introduction of the new regulatory requirements that will accompany the fund governance and manager registration initiatives contemplated in the Concept Proposal. Many of the regulatory restrictions to which our industry is currently subject were introduced precisely because of the absence of a fund governance regime (e.g. those dealing with concentration and liquidity as well as many of the related party rules). With the proposed introduction of fund governance in Canada, these rules become redundant and immediately unjustifiable as a cost borne by our members and as a continued part of our regulatory framework. We are amenable to considering the implementation of some manner of fund governance regime. However, as an industry, we cannot endorse or otherwise support this initiative in any form unless it is accompanied by a concurrent relaxation of

the regulatory restrictions that a system of fund governance would render either moot or redundant.

The Concept Proposal's Cost/Benefit Analysis

Costs have been Underestimated: The Concept Proposal estimates costs at no more than 0.016 percent of total industry assets under management. We believe that this estimate is significantly understated and does not fully take into account many of the costs that would be necessarily incurred to implement and render operational the Concept Proposal initiatives (e.g. costs of additional regulatory burden, capital requirements, insurance/liability concerns, recruiting costs).

Moreover, expressing the cost burden to the industry in terms of total assets under management by the industry is misleading. This manner of explanation obscures the fact that the total assets that the industry manages are distributed with great disparity among small and large firms. Smaller firms will pay significantly more of the cost as a proportion of assets under management than will larger firms. As a consequence, a total cost of 0.016 percent would follow the disparity in distribution of managed assets throughout the industry, translating into a cost burden that, on an individual firm basis, would range from manageable to operationally oppressive in its impact.

Minimum Capital Requirements

We do not understand the need for a minimum capital requirement and note further that we do not agree with the reasons that the CSA have chosen to articulate as to the useful purposes that such a requirement would serve. The CSA have also not addressed the very significant issue of how minimum capital would be calculated. Minimum capital requirements amount to a tax that will effectively punish firms for each substantial new mandate that they win and will achieve little more than to act as a barrier to entry into the industry, forcing the closing and/or consolidation of smaller firms.

Power to Call for the Termination of the Manager

Unitholder Meetings Are Inappropriate Mechanisms for Resolving Fund Manager/Governance Agency Disputes: Unitholder meetings are costly endeavours and in addition to the added expense that would be borne by investors, we are of the opinion that an investor meeting to terminate the manager would be poorly attended and ineffectual. Consumers purchase mutual fund units because they wish to invest their money while being able to delegate the administrative and management aspect of their investment to professionals.

Mutual fund investors, by conscious choice, pay to have management issues competently addressed on their behalf. They will thus be ill-motivated and disinclined to become involved in precisely the types of matters that they have already paid to have dealt with and resolved for them.

The most important decisions that investors make in choosing one fund over another are the initial selection of a particular fund and a specific fund manager. These fundamental choices are made by each investor and their willingness to be members of a group of

unitholders is predicated upon the ongoing recognition of the initial selection decisions that they make as individuals.

The ability to reconsider these decisions is already available to individual investors through a right to redeem their mutual fund units. This is the only appropriate mechanism for retaining or "terminating" the fund manager as it recognizes that each investor should be able to stay with or leave the fund manager in the same manner that they selected it. A proposal to put fund manager termination to a unitholder vote would thus be both redundant and inappropriate as it would take away from individual investors their right to choose the fund manager.

Fund Governance and Fund Manager Roles are Not Equal: Fund governance is intended to ensure appropriate oversight of the manager. In delineating the scope of this oversight role, particularly with respect to the proposal to vest independent governance boards with the power to call for the termination of the fund manager, we urge the CSA to remain mindful of the fact that their roles are not equal or similar. The legitimacy of a fund manager to act on behalf of unitholders arises from the agreed assumption of continuous public accountability and the fulfillment of specific objectives. An independent governance board would not be charged with or specifically chosen to fulfill these responsibilities and thus cannot be vested with the same level of authority and legitimacy that comes only with their assumption.

Excusing Investors from Their Obligation to Pay Deferred Sales Charges: When investors decide to purchase mutual fund units, they agree to pay a commission fee. This fee is structured to be payable at the time of purchase ("front end" load) or when the fund units are eventually redeemed ("back end" load). In return for the fund manager's promise to deliver a specified product and/or service, the investor becomes obligated to pay for these products/services. This relationship is a contract that excludes consideration of an independent governance agency as it exists exclusively between the fund manager in its capacity as a commercial product/service provider and the investor as the purchaser/consumer of products/services. Requiring a consumer to pay for the products/services that they have already received is not a penalty. When mutual fund units are purchased on a deferred sales charge basis, fund managers pre-pay these charges on behalf of investors. The amount of these pre-paid charges is neither nominal nor insignificant and fund managers should have an unimpaired right to earn these amounts back in accordance with the terms of their management contracts. Allowing a free exit in any circumstance is thus potentially abusive in the hands of opportunistic investors and oppressive as it violates contractual rights and obligations that have been negotiated and assumed in advance and in good faith.

Summary: We wish to reiterate the urgency of the concerns that we have canvassed above in brief. These issues are of fundamental importance to our members and it will be difficult to make progress with respect to the development/implementation of the Concept Proposal initiatives unless these matters are given priority and resolved in an expeditious manner. We are committed to responsive and meaningful participation in the consultation process and look forward to working in collaboration with the CSA to further our common objective of strengthening and ensuring the vitality of an already sound and vibrant industry.

We would welcome and look forward to the opportunity to discuss these matters with you further. Please feel free to contact either John Mountain, Vice-President Regulation by email at jmountain@ific.ca / by telephone at (416) 363-2150 x 271 or Aamir Mirza, Legal Counsel at amirza@ific.ca / (416) 363-2150 x 295.

Yours truly,

Original signed by John Mountain
Vice President, Regulation on behalf of

Honourable Thomas A. Hockin
President & Chief Executive Officer

cc: CSA Chairs
Rebecca Cowdery, Manager Investment Funds Regulatory Reform – OSC
YuMee Chung, Legal Counsel Investment Funds Regulatory Reform – OSC
Pierre Martin, Legal Counsel Service de la reglementation – CVMQ
Bob Bouchard, Chief Administrative Officer & Director – MSC
Patricia Gariepy, Legal Counsel – ASC

APPENDIX “A”

CSA Mutual Fund Governance Concept Proposal 81-402

Scope of the Concept Proposal - the Need to Maintain Sight of Broader Issues

Our members are committed to responsive and meaningful participation in the consultation process that the CSA have undertaken with the release of the Concept Proposal and believe that addressing the questions set out may be a worthwhile exercise. However, we are also of the opinion that the CSA’s scope of inquiry is narrow and loses sight of some of the broader and fundamental matters that we feel must be kept in the forefront of this discussion.

The formal comment of the Investment Funds Institute of Canada (“IFIC”) does not address itself to the questions that were set out in the Concept Proposal. The Concept Proposal initiatives are of fundamental importance in their potential impact upon the operations of the industry in Canada. While there is general agreement and understanding among our members as to the high level implications of the Concept Proposal initiatives, many issues are contentious and there are a variety of opinions as to how concepts should be considered in operational terms and addressed. We therefore think it more appropriate for the individual questions to be addressed in detail by our members as this, in our view, will allow for a focused and more representative expression of their thoughts and concerns on these matters.

The Need to Pursue Investor Protection While Fostering/Preserving a Streamlined and Commercially Viable Industry

The fund governance regime broadly outlined in the Concept Proposal is an ambitious undertaking. We are pleased to lend our support to any initiative that has as its object enhanced investor protection. However, as an industry, we must consider the overall impact of CSA’s proposals upon our business operations and ensure that these initiatives are pursued and implemented in a financially viable and responsible manner. We trust that the aims of our industry in this respect are similar to those of the CSA. The fundamental purpose of the Concept Proposal can only be to provide Canadian mutual fund investors with a more efficiently operating and cost-effective regulatory framework that will facilitate the delivery of improved service while preserving investor choice.

The Concept Proposal is a General Overview Document

The Concept Proposal presents a high level introduction to the initiatives being contemplated by the CSA. The questions that the CSA have raised for industry comment require us to consider its individual aspects in isolation and respond in a piecemeal manner. As our thoughts on the Concept Proposal will be informed by the overall impact of the proposed initiatives on our industry, we cannot respond to questions on any one part prior to an understanding of the whole. Moreover, we regard the Concept Proposal to be very much an overview document and are unable to address detailed questions with only a general understanding of the CSA’s proposals. Some of

the areas in which we require fuller explanation include a defined scope for independent governance-agency member duties and liability along with a more fully canvassed projection of total costs.

We do, however, wish to note by way of preliminary comment that the concept of fund governance cannot be meaningfully assessed in isolation and there is little point in integrating a streamlined and rational fund governance structure into an existing regulatory regime that is both cumbersome and inefficient. Accordingly, a cost-benefit analysis of a fund governance regime must be preceded by a comprehensive review of the inefficiencies of the existing regulatory framework into which a fund governance structure would ultimately be integrated.

The Importance of Ensuring Nationally Standardized Initiatives

The CSA have indicated that they wish to pursue a broad and non-prescriptive approach to fund governance. If a fund governance regime is ultimately brought into being, we are concerned that it may be implemented in a non-uniform manner across Canada as a result of differences in interpretive guidance that may be issued by the various provincial regulatory authorities.

The industry in Canada lacks a uniformly coordinated and administered regulatory regime. We urge the CSA to remain cognizant of the fact that one of the fundamental realities of this absence of uniformity is that any one jurisdiction is capable of raising the regulatory bar, while the consent of all 13 jurisdictions is required to lower it. A non-standardized implementation of the Concept Proposal initiatives thus has the potential to greatly increase the transactional expenses that would be borne by Canadian mutual fund investors. Added expense and further impairment of service to unitholders is unacceptable to our members and the industry will not likely be amenable to lending its support to any proposal that is not implemented and adopted in a standardized and uniform manner across all jurisdictions in Canada.

Mutual Fund Investors

Purchasers of mutual fund units differ from investors who research, buy and monitor stocks on an individual basis and the distinctions between the two classes of investors gives rise to significant implications.

An investor who purchases units of a mutual fund acquires a broadly diversified basket of securities, relative liquidity and a specific professional manager/management style. The acquisition of a particular style of management is perhaps the most significant part of the purchase. Investors in mutual fund units buy them in preference to individual securities precisely because they are afforded the ability to select and appoint an appropriate proxy for a decision-making process that is required but that they are disinclined to personally engage in.

By selecting a specific mutual fund, mutual fund unit-holders make many of the decisions that a board would make in a conventional public company environment while considerably obviating the need for others. Investor selection of a manager and the specific investment strategy promoted and adopted by the particular management style renders it unnecessary to choose a chief executive or determine and approve a strategic

direction for the fund. Moreover, since unit-holders can directly discipline fund management through the exercise of redemption rights if they are dissatisfied with performance, there is a limited need to have independent monitoring and assessment of fund management performance and compensation setting.

Competitive Market Forces Discipline Mutual Fund Manager Conduct and Should Not be Discounted

The mutual funds industry in Canada is highly competitive and the multiple funds that operate in this country undergo a constant struggle by competing in the same market and for the same investor dollars.

Mutual fund managers must continuously offer and successfully sell units in the market so as to ensure an ongoing ability to replenish redeemed assets. This function lies at the heart of a fund manager's success and profitability and ensures that the fund manager, as the owner of a business enterprise, has a long-term interest in the welfare of the fund and its ongoing appeal to current and potential investors.

In attracting investors and setting the basic features of a fund, the fund manager will be necessarily limited by the competitive restraints imposed by the market and a fund whose basic features are not comparable to those of its peer group will quickly lose appeal with investors.

There is a significant degree of overlap between the best interests of shareholders and the wishes of fund management. The adoption of a fund governance regime, in any form, must recognize the commercial mechanisms of strenuous competition and the need to preserve and enhance firm reputation and how these factors continually ensure the alignment of fund manager and investor interests. We are of the view that a realistic appraisal of these forces as entrenched elements of the Canadian mutual funds market will illustrate that they are not antagonistic to the goals of our industry's regulatory framework but rather work in conjunction with it.

The Current Regulatory Regime

The mutual funds industry in Canada is perhaps one of the most heavily regulated industries in the world. The regulatory framework that our industry currently operates in governs in minute detail almost every aspect of our business. The inefficiencies of this stringent and proscriptive regulatory regime are further exacerbated by the fact that it is administered by 13 different regional regulators who remain loosely coordinated with only partially harmonized provincial laws.

The Existing Regulatory Framework Has Problems

The rules that govern our industry are frequently subject to inconsistent application and varying interpretations. In addition, routine and straightforward applications, filings or requests for amendment are often the object of lengthy delays in processing.

The CSA must assume responsibility for lowering costs that they can control and act to minimize repeated expenses that are incurred as a result of procedural/process inefficiencies. The reluctance to address these problems in a uniform and expeditious

manner continues to give rise to increased and costly transactional expenses that are ultimately borne by Canadian mutual fund unit-holders.

The CSA clearly acknowledge some of these inadequacies in the Concept Paper. Among the problems highlighted by the CSA are the shortcomings of a prohibition-based approach to regulating conflicts of interest, and an approach to addressing related party transactions that is too restrictive insofar as it prohibits transactions that are innocuous or even beneficial to investors. In addition to this the CSA have acknowledged that they often do not have the necessary insight into a fund manager's business to know when to give discretionary relief from regulatory prohibitions.

The Industry is Maturing and Less Able to Bear Continually Increasing Costs

The mutual funds business in Canada has been described by the CSA as "maturing" and it is broadly recognized by the industry as such. This maturation is accompanied by a more intense degree of rivalry, a narrowing of profit margins, slower growth and increased competition from substitute products.

These hallmarks of maturation are the current realities of our industry and we must now work to foster and preserve its growth and long-term viability as we can no longer take the health and success of the industry as being granted.

When work on the Stromberg report began in the middle of the 1990's our industry was perhaps more able to bear rising cost pressures. This is no longer the case and the CSA, in light of the maturation of our industry, must be careful not to assume that the mutual funds industry in Canada is as resilient and as able to absorb new costs now as it might have been in the past.

Recognizing the Fluid Nature of Market Opportunities – the Pressing Need to Ensure that Regulatory Reform Keeps Pace with the Industry

It has been the unfortunate practice of the CSA to put off addressing straightforward regulatory reforms by subsuming consideration of individual rule changes within a larger discussion of regulatory amendments. This process has ultimately only served to continually bring new major issues to the forefront while the industry has been left waiting for the resolution of outstanding requests that have been continually obscured and pushed back.

Securities Lending Rules

Securities lending was first tabled for discussion with the CSA during the early 1990's with a view to developing rules to permit this practice. While groups such as pension funds have been permitted to make use of securities lending since the middle of the 1980's, the mutual funds industry was given permission to engage in this practice only in 2001.

The time lag between the industry's request for relief from securities lending prohibitions and the final release of the rules was so pronounced that a fundamental market shift occurred in the interim rendering securities lending less attractive to the industry as a whole. The consequences today are apparent and although securities lending has been

permissible for one year, a changed market has caused the industry to move very slowly to adopt a practice that it once vigorously petitioned for.

Inter-fund Trading Rules

As another example, we cite the prohibitions against inter-fund trading and the outdated rules that continue to unnecessarily prohibit an efficient investment practice that would allow for greater investor returns with virtually no additional assumption of risk.

Application for exemptive relief from the inter-fund trading prohibitions was made by one of our members in the early 1990's and we note with disappointment that almost a decade later the industry is still waiting for a resolution to this matter.

Conflicts of Interest

The current rules surrounding conflicts of interests, including the 60-day underwriting rules, fund of funds and related party transaction relief represent yet another area where regulatory initiative is urgently required. The industry has petitioned the CSA at length for regulatory relief with respect to the conflict of interest rules. However, years of patient waiting have yet to produce any result and as an industry we remain in an all too familiar and unfortunate circumstance that can only be described as an entrenched reluctance to take definitive action by providing relief from these prohibitions.

The slow pace adopted by the CSA in addressing these and other issues of regulatory reform has resulted in lost opportunities and increased costs to investors and is thus incongruous with the CSA's mandate of fostering fair and efficient capital markets.

The Need to Ensure that Regulatory Reforms Occur Concurrently with the Introduction of Fund Governance/Manager Registration Initiatives

The Concept Paper does not address the timeline for the reformation of the existing regulatory framework. This has left the industry extremely concerned that the CSA will undertake this work only after a system of fund governance has been developed, implemented and is working successfully.

The experience of our industry with a willingness on the part of the CSA to address needed regulatory reform in a timely manner has been poor. If existing regulatory problems are left until after fund governance initiatives have been introduced, we are concerned that the long needed restructuring of our regulatory framework will, once again, be left unresolved.

The concerns of our industry are historically justified and we anticipate that our members may face being encumbered with the duplicative and costly regulatory burdens of a fund governance regime without any streamlining of the current regulatory framework. We are thus of the opinion that our members may be left with nothing but the worst of all possible scenarios if the Concept Proposal initiatives and the reformation of our existing regulatory regime are not pursued concurrently.

We are cognizant of the difficulties confronted by the CSA who must modify the existing regulatory regime so as to accommodate a system of fund governance while

simultaneously ensuring the smooth operation of the overall framework. At the same time, the CSA must take care to ensure that it does not compromise the integrity of those aspects of the existing regulatory framework that do provide some measure of adequate and satisfactory investor protection.

We recognize that these are not easy issues to resolve and we are pleased to lend our assistance to the CSA in developing the best manner in which to approach and negotiate these significant challenges.

However, we remind the CSA of its own commitment to and the pressing need for a "quid pro quo" that will reduce and streamline existing regulations concurrently with the introduction of new regulatory requirements that will accompany the fund governance and manager registration initiatives contemplated in the Concept Proposal.

Many of the regulatory restrictions to which our industry is currently subject were introduced precisely because of the absence of a fund governance regime. With the proposed introduction of fund governance in Canada, these rules become immediately redundant as a duplication of regulatory burden and are thus unjustifiable as a cost borne by investors and as a continued part of our regulatory framework.

We are not convinced of the tangible value that the adoption of fund governance will add to investors in the Canadian mutual funds industry. However, we do appreciate the potential perceptual benefits that may accrue as we recognize that the concept of fund governance is an initiative that has received credence and been adopted in other jurisdictions. As a consequence we are amenable to considering the implementation of some manner of fund governance regime. However, as an industry we cannot endorse or otherwise support this initiative in any form unless it is accompanied by a concurrent relaxation of the regulatory restrictions that a system of fund governance would render either moot or redundant.

We thus strongly recommend that the CSA not wait for a fully implemented and operational fund governance regime to address and ameliorate some of the more archaic rules that persist in mutual fund regulation. The unnecessary limitations that these rules place on the industry along with the cost of over-regulation serve only to delay the development and delivery of well-designed investment products and services and thereby operate to the determent of the Canadian investing public.

Demographics of the Mutual Funds Industry in Canada

The market participants that comprise the mutual funds industry in Canada are not a homogeneous group and vary with respect to their size, resources and market positions.

The larger firms have spent many years as part of the industry in Canada. They have, as a consequence, had the opportunity to significantly shape its development through an ongoing process of innovation while helping to guide the evolution of its regulatory regime by sharing, through years of collaboration and informed comment, their amassed body of knowledge and practical experience with regulators.

Larger firms are thus an established presence in the market and continue to guide both product and service innovation for the mutual funds industry in Canada.

Smaller and emerging firms maintain the vibrancy of our industry by ensuring that the overall market remains varied and competitive with respect to product/service offerings while also providing boutique and specialized services to particular market segments.

These two types of firms, while being subject to the same regulatory regime, have different operational needs that should be taken into account when overall regulatory reform, fund governance and manager registration initiatives are being considered.

The Demographics of the Industry Justify Considering the Adoption of Fund Governance on a Non-Mandatory Basis

As noted above, the large and small firms in our industry are currently subject to one regulatory framework while having different needs. Large funds, because they are established and possessed of greater resources, would be better able to bear the costs of a fund governance initiative. However, they are also in greater need of a relaxation of the current regulatory restrictions that prevent them from initiating product and service innovation that would be beneficial to their broad investor base.

Many smaller firms may not desire or benefit from an overall regulatory relaxation to the same extent that larger firms would. All smaller funds would, however, be more seriously affected by the cost consequences of fund governance and the proposed minimum capital requirements (both of which are addressed later on in our submission).

As an alternative, we suggest that the CSA consider a proposal that initiates regulatory relaxation concurrently with the implementation of a fund governance regime but that ties and renders the benefit of a simplified regulatory framework to and contingent upon the adoption of some form of fund governance by fund managers.

Under this arrangement, implementation of fund governance by firms would be voluntary but with the understanding that simplified rules would not be available to firms who failed to adopt a system of fund governance. Firms that choose not to adopt fund governance because of an established level of comfort with both the existing framework and regulation of their conduct via a more rule-based process could be subject to an enhanced rule based regime that would ensure comparable but more structured regulatory oversight.

Benefits of Adopting Fund Governance on a Non-Mandatory Basis

We think this proposal to be of mutual benefit with significant advantages accruing to both investors and regulatory authorities.

The industry in Canada, without avoiding their obligations to mutual fund investors, would be given a real chance to participate in the regulatory process. Individual firms would have the flexibility to determine how to address the practical issues of fund governance in the most streamlined manner and with regard to the needs of the market segments that they serve.

From a regulatory perspective, adoption of this proposal would indicate an awareness and commitment on the part of the CSA to the fundamental principal of legal equality by ensuring that all firms in the industry are treated equally, irrespective of size, resource and market position.

It would also serve as recognition on the part of the CSA that the industry in Canada is not homogeneous and that given the disparities among industry participants, an equitable result is not likely to follow from the uniform imposition of the same regulatory framework.

This proposal would moreover allow and necessarily require a varied, enhanced and stronger regulatory presence to implement a fund governance regime for the industry while administering a rule based regulatory oversight for those firms who choose not to adopt some manner of fund governance.

Proposals to Institute Mutual Fund Manager Registration

We are unsure as to why the CSA feel compelled to propose the institution of a system of manager registration. Securities legislation across the various provincial jurisdictions already sets out a defined standard of care that is applicable specifically to mutual fund mangers. In addition, mutual fund managers fall within the definition of "market participant" and as such they are already subject to oversight, control and regulation by the CSA in those jurisdictions which utilize the concept.

Moreover, the CSA exercise review and approval authority over prospectuses and through this function can also maintain control over mutual fund managers by making prospectus renewal contingent upon meeting any additional requirements that the CSA might specify.

Self-Regulatory Options for Manager Registration: Industry Experience in Exercising Oversight – The IFIC Code of Personal Investing

Alternatively, we query why the CSA has not articulated a willingness to consider the development of an industry oversight model to address the issue of mutual fund manager registration.

Based on the experience of our industry with self-regulation in the area of personal investing, we are of the opinion that a self-regulatory model is a viable alternative that has a legitimate role to play in establishing and overseeing a manager registration framework.

In 1996, a committee was established by IFIC's board of directors for the purpose of advising IFIC as to the regulation of personal investing activities by mutual fund investment managers. The recommendations of this group were summarized in a code that would have each mutual fund organization designate and vest an independent person with the authority to oversee personal investing activities. The proposed code was implemented in substance by IFIC in May of 1998 and thereafter adopted as an industry standard.

The IFIC Code of Personal Investing as a self-regulatory model to oversee personal investing conduct across the industry in Canada has now been satisfactorily in use for a period of four years. We are not, to date, aware of any criticism on the part of the CSA as to the approach or initiative taken by the industry in developing a code of acceptable practices and exercising oversight to ensure compliance on a day to day basis.

Mutual fund managers have both the experience and operational familiarity with the industry and its practices to exercise competent oversight over the process of manager registration and some manner of industry oversight would, in our view, be a practical and efficient way to administer and oversee such a system.

Minimum Capital Requirements

We do not understand the need for a minimum capital requirement and note further that we do not agree with the reasons that the CSA have chosen to articulate as to the useful purposes that such a requirement would serve. The CSA have not undertaken any economic research to empirically demonstrate the necessity for a minimum capital requirement in our industry. In addition, the very significant issue of how minimum capital would be calculated has also not been addressed.

We are of the opinion that minimum capital requirements amount to a punitive tax that will achieve little more than to act as a bar to entry into the industry and force the closing and/or consolidation of smaller firms, ultimately resulting in less choice for Canadian investors. We do not wish our comments on this issue to be construed as endorsing a modified minimum capital requirement. However, we think it important and necessary to point out that in addition to being an unjustified demand upon the resources of our industry, calculating minimum capital on the basis of assets under management is wholly inappropriate.

The Concept Proposal sets out the following three reasons that the CSA have considered in support of the imposition of minimum capital requirements:

- Capital will require mutual fund managers to maintain adequate financial resources to meet their business commitments
- Capital will ensure that mutual fund managers have the ability to satisfy any major legal claims which may be made
- Capital will offer some protection against the risk that the mutual fund manager will collapse and not meet its liabilities

The size of a mutual fund manager has little to do with the total dollar value of assets that it may have or is capable of having under management. Thus, a small manager, with relatively low overhead costs (staffing, equipment and fund support systems) could have significant total assets under management. There is not likely to be any significant correlation between total assets under management and the assets required by a manager to perform its duties competently and maintain support systems for the funds that it manages.

In the context of the insurance industry's segregated fund product, the assets under management are owned by the insurance company that is managing them and the

relationship between the insurance company and the consumer is one that is based in contract. Given the ownership of assets by the insurance company, a statutory minimum capital as a prerequisite to entry into the industry makes sense as it provides a guarantee for the assets that the managing insurance company owns.

Mutual fund managers, in contrast, do not own or exercise an ownership interest in the funds that they manage. They are simply administrators of assets that are owned by the unit-holders of the fund. The process of asset administration is quite transparent and the assets are held by the custodian and not the fund manager.

Any legal claims that might arise against fund managers will be related to the duties that they are charged with performing. These are, as already noted, administrative in nature and not related to liability that might arise from the exercise of an ownership interest. It is thus excessive to address liability for potential legal claims arising from administrative responsibility, by way of capital requirements that are tied to total assets under management.

We think it inappropriate to use minimum capital requirements as a safeguard against the risk of mutual fund manager collapse. This risk bears a greater relation to the nature of its business than to total assets under management and would thus be better addressed by a minimum capital requirement that is based upon a prudential risk assessment of the individual manager's business as opposed to total assets under management.

Proposed Minimum Capital Requirements will be Punitive when Funds Experience Rapid Growth in Total Assets Under Management

Firms in our industry frequently experience rapid growth in total assets under management over a very short period of time. A minimum capital requirement that is fixed as a percentage of total assets under management would create very significant difficulties in these circumstances. Mutual fund managers would be compelled to match every increase in total assets under management with a proportionately revised minimum capital and this, in each instance, would require a relatively large sum of money to be raised within an extremely short notice period. The practical end result would be to virtually penalize firms with an added tax for each substantial new mandate that they win. Moreover, fund managers may have no business need for increased capital in their operations. Compelling fund managers to maintain minimum capital amounts that are above levels necessary to operate would result in a significant and deleterious impact upon their business cost structures.

In addition, an unseen cost to a minimum capital requirement is the Large Corporations Tax ("LCT") and as capitalization requirements increase, firms in the Canadian mutual funds industry will experience a corresponding increase in amount of LCT that they will be liable to pay.

Implementing Both Minimum Capital and Insurance Requirements is Redundant

The Concept Proposal indicates that both minimum capital and minimum insurance requirements would be established for mutual fund managers. We have reviewed the reasons articulated for both of these requirements and find them to be measures that are

designed to protect against the same types of risks. As we have already noted, the function of a mutual fund manager is a transparent process that is related exclusively to the administration of assets that it does not own and that it can only access in limited circumstances. We cannot find in these functions of a mutual fund manager anything that would justify the redundancy of both minimum capital and minimum insurance requirements. We are thus of the opinion that the proposed institution of both of these measures is an unnecessary burden upon the resources of our industry.

A Reexamination of the Concept Proposal's Cost/Benefit Analysis

The costs of creating and operating a governance agency are addressed in part C of the Concept Proposal. It is stated that these costs would represent no more than 0.016 percent of total industry assets under management.

We believe that the economic analysis undertaken on behalf of the CSA by the OSC's Chief Economist significantly underestimates the costs associated with the adoption of the initiatives set out in the Concept Proposal.

However and even if we were to presume the accuracy of the Commission's findings as to cost, expressing the cost burden to the industry in terms of total assets under management by the industry is misleading. This manner of explanation obscures the fact that the total assets that the industry manages are distributed with great disparity among small and large firms throughout the industry. Smaller firms will pay significantly more of the cost as a proportion of assets under management than will larger firms.

As a consequence, the total cost of 0.016 percent will follow the disparity in distribution of managed assets throughout the industry and will translate into a burden that, on an individual firm basis, ranges from one that can be managed to one that will be operationally oppressive in its impact.

Cost Consequences Arising form Unlimited Liability

Salaries of Governance Agency Members

The Concept Proposal contemplates that governance agency members would be permitted to set their own levels of compensation and that their salaries would be paid either from fund assets or by the fund manager. The only recourse available to the manager in the event that compensation is believed to be unreasonable is the expensive and often ineffectual mechanism of calling an investor meeting. We are of the opinion that this flexibility as to who pays is inappropriate and that governance agency member salaries should be payable exclusively out of fund assets.

The CSA must bear in mind that fund governance initiatives would represent unitholder interests and be for the protection of unit-holders of the fund and not the fund manager. Having the fund manager pay independent governance agency member salaries does little more than to move any conflict of interest that might exist from the fund manager to the governance agency members who are being paid by, and thus practically beholden to, the fund manager. In addition to this, if fund managers were to pay governance agency member salaries, even the perception of independence from the manager would be lost. We note that in a post-Enron world, both the reality and perception of

independence from the manager will be important if the CSA's fundamental objectives are to be achieved.

Given that unlimited liability of governance agency members is being contemplated, we are of the opinion that they will set very high salary levels as compensation for the unlimited personal liability that they will be forced to assume.

Unlimited liability will also render it more difficult to find qualified individuals who are willing to accept a position on a governance agency and this lack of candidates who are both willing to serve and adequately qualified to do so will drive up the salaries that these positions will command.

Director Insurance

We are unsure if director's insurance will be available for independent governance agency members. Representatives from the insurance industry have indicated that they cannot accommodate exposure to unlimited liability. While a delineation as to the scope of independent governance agency member duties by way of a regulatory standard of care would assist in an assessment of risk, they noted that a quantitative limit of liability would still be required in order to realistically estimate the cost and type of coverage.

Director's liability insurance will have cost implications irrespective of its availability. If such insurance is not adequately available, it will drive up even further the cost of finding qualified candidates. If insurance is available, we are unsure as to what it will cost. However, given unlimited personal liability, the proposed scope of independent governance agency member duties and the difficulties of the insurance industry in realistically quantifying unlimited liability for the purposes of establishing premiums, we anticipate that this cost may be significant.

Support Staff

Independent governance agency members will want dedicated administrative staff to support their functions and we question whether this additional cost has been accurately factored in on an industry wide basis in the OSC's cost/benefit analysis.

Unlimited Personal Liability Giving Rise to Enhanced Need for Expert Opinion

We are of the opinion that individuals who do accept positions on governance agencies will retain multiple experts from various disciplines (i.e. accountants/lawyers) and will be reluctant to act in any circumstance that might give rise to liability without their prior written opinion and/or sign off.

The advice of these professionals will be costly and ultimately reflected in the fund's expenses and thus borne by investors.

The Concept Proposal specifies only a minimum mandate for governance agency members and this flexibility is unwarranted as, in our view, it leaves governance agency members free to expand their mandate in a manner that would permit micro-management of the fund. The incentive to become more actively and inappropriately

involved in the day-to-day operations of the fund would arise as part of an effort to avoid exposure to the potentially onerous consequences of unlimited liability.

We strongly urge the CSA to adopt a cap on the potential liability of governance agency members. Unlimited liability will only serve to provide a practical incentive for governance agency members to incur costs and interpose themselves in the operations of the fund in a manner that places their personal welfare in conflict with the best interests of unit-holders.

Power to Call for the Termination of the Manager

The Concept Proposal contemplates an independent governance agency that would have the ability to suggest a termination of the mutual fund manager by calling a unit-holder meeting.

A unit-holder meeting is an expensive manner in which to resolve disputes between governance agency members and the mutual fund manager. This expense would be added to the already considerable costs that are borne by investors.

We think, moreover, that an investor meeting to terminate the manager would be ineffectual. Consumers purchase mutual fund units because they wish to invest their money while being able to delegate the administrative and management aspect of their investment to professionals. Mutual fund investors, by conscious choice, pay to have management issues competently addressed on their behalf and will thus be ill-motivated and disinclined to become involved in precisely the types of matters that they have paid to have addressed and resolved for them.

In addition, the Concept Proposal does not address whether the mutual fund manager or the independent governance agency would control the proxy mechanism through which unit-holders would be expected to participate.

A Question of Legitimacy

In addition to the above noted considerations, we wish to remind the CSA that it is the business of a mutual fund manager to make decisions on behalf of the fund's unit-holders. The legitimacy to act in this manner is conferred by investors themselves who, at first instance and through an exercise of individual judgment, select a particular fund manager from among a host of market participants to whom they will entrust their funds and the fulfillment of their investment objectives.

A mutual fund manager cannot coerce individuals into subscribing to units of its fund neither can it force them to refrain from redeeming them. Fund managers thus serve at the pleasure of investors and have no ability to ensure the security of their tenure through compulsion.

The right and privilege to continue to act on behalf of unit-holders is thus earned and subject to reaffirmation on a continual basis, as nothing bars an investor from moving to a more appealing product/manager combination.

The Concept Proposal contemplates that independent governance agencies will serve in an oversight capacity. In delineating the scope of this oversight role, particularly with respect to the proposal to vest independent governance boards with the power to call for the termination of the fund manager, we urge the CSA to remain mindful of the fact that their roles are not equal or similar. The legitimacy of a fund manager to act on behalf of unit-holders arises from the agreed assumption of continuous public accountability and the fulfillment of specific objectives. An independent governance board would not be charged with or specifically chosen to fulfill these responsibilities and thus cannot be vested with the same level of authority and legitimacy that comes only with their assumption. The CSA should thus take care not to empower governance agencies to an extent that would potentially give them the ability to undermine or impair the conscious choices made by individual investors.

Back Office Systems Support

Many mutual fund managers administer their funds through proprietary back office systems. A dispute with a governance agency that leads to the early termination of the fund manager will likely result in the removal of the back office system that is supporting the funds. Having to find a manager with a comparable reputation and management style will thus be further complicated by also having to replace an entire back office system with one that can be quickly and smoothly integrated without undue disruption to the administration of the funds.

Disclosure and Investor Rights – the Need for Investors to be Connected to their Governance Agency

The Concept Proposal asks whether an investor who does not like the elected/appointed governance agency members be allowed to exit without penalty.

We are particularly concerned with this question and the manner in which the CSA have chosen to articulate it. A discussion of the appropriate remedy for investors who are dissatisfied with the elected/appointed governance agency members and the pre-existing contractual obligation of investors who decide to purchase mutual fund units on a deferred charge basis are distinct issues. In joining these issues together, the CSA have inappropriately combined the unrelated rights and obligations that they individually give rise to.

Paying Deferred Sales Charges to Redeem Fund Units - Fulfilling a Contractual Obligation Should not be Equated with Being Subject to "Penalty".

A mutual fund manager offering units of its fund(s) for sale, promises to deliver and/or procure and ensure the delivery of a stated set of products and/or services. When an investor decides to purchase these mutual fund units, they often agree to pay a commission fee. This fee is structured to be payable at the time of purchase ("front end" load) or when the fund units are eventually redeemed ("back end" load).

The investor in return for the fund manager's promise to deliver a specified product and/or service becomes obligated to pay for these products/services.

This relationship is a contract that excludes consideration of an independent governance agency as it exists exclusively between the fund manager in its capacity as a commercial product/service provider and the investor as the purchaser/consumer of products/services.

Requiring a consumer to pay for the products/services that they have already received is not a penalty. Allowing investors to avoid their contractual obligations is potentially abusive as it creates the ability to violate contractual rights and obligations that have been negotiated and assumed in advance and in good faith.

Manager Pre-Payment of Deferred Sales Charges

Deferred selling commissions are paid to the dealer by the fund manager and are used to pay for services that the dealer has provided.

Since the security-holder is purchasing the mutual fund units on a deferred charge basis the commissions that fund the dealer's services are pre-paid by the mutual fund managers. Fund managers assume this expense in advance and on behalf of unit-holders in order to secure a right to earn an income stream. This income will in turn cover their front-end investment.

If a manager is terminated prior to having earned back its initial investment, it is deprived of an income stream for which it has contracted and advanced funds on behalf of investors. In this circumstance the fund manager would be left with a debt for which it will not be reimbursed. This is an inequitable outcome that would, without corresponding benefit, unravel and render untenable the complex and established financing arrangements that have evolved to support deferred sales charge regimes. No mutual fund manager will be willing, or should be expected, to contract for an income stream and undertake the assumption of a liability on a pre-paid basis if they can be potentially deprived of the one and forced to absorb the other.

Canvassing Alternative Regulatory Options

There are a number of regulatory initiatives that, if undertaken, would operate to significantly reduce the burden borne by the industry. Among the most prominent of these are the following:

A single, national (or pan-Canadian) regulator: we are all too well acquainted with the enormous and unjustifiable burden of dealing with 13 separate regulatory authorities. Moving to a more coordinated system would considerably alleviate time and resource cost pressures while improving the ability of our industry to support the streamlined implementation of other regulatory initiatives

Enhanced harmonization among the disparate securities regulatory authorities: failing the adoption of a single regulator, support for a move towards increased harmonization would be helpful. This initiative is currently being led by the Alberta Securities Commission, however, without broader support, it is far from clear whether or not their efforts will be successful.

A move towards more “functionally” based regulation: mutual funds are subject to competition from a large variety of substitutes including segregated funds, pooled products, exchange traded funds, “folios” and wrap accounts. Some of these substitute products are subject to some of the same regulations as mutual funds, but not all. In most cases, the regulatory burden is significantly lighter for mutual fund substitutes.

As these alternative products become more dominant, developing parity between regulatory regimes becomes increasingly important. Similar products need to be regulated similarly. This notion has been a matter of public discussion for a number of years and we note that its significance is reiterated by the CSA in the Concept Paper.