DELIVERED

June 4, 2002

Ontario Securities Commission
20 Queen Street West
Suite 1900, Box 55
Toronto, Ontario
M5H 3S8

Attention: John Stevenson, Secretary

Dear Sirs & Mesdames:

Re: Request for Comments on Concept Proposal 81-402 of the Canadian Securities Administrators (the "Proposal")

We have reviewed the Proposal with great interest and we appreciate this opportunity to provide our comments. We commend the Proposal's recognition of the importance of streamlining mutual fund regulation and its discussion of ideas for mutual fund governance. We agree with the Proposal's objective that it not "layer new regulation on top of old" and believe that the proposed elimination and simplification of product regulation should be implemented concurrently with any adoption of requirements for independent governance agencies. However, there are aspects of the Proposal which are of concern to us. Our principal areas of concern are set out below.

By way of background, TD Asset Management Inc. ("TDAM") is one of Canada's largest managers, advisors and distributors of investment products with approximately $123 billion in assets under management. TDAM provides mutual funds, pooled funds, segregated account management and investment advisory services to individual customers, pension funds, corporations, endowments, foundations and high net worth individuals. The TD Mutual Funds division of TDAM is the sixth largest mutual fund manager in Canada managing approximately $31 billion in retail mutual fund assets on behalf of more than 1.4 million investors. The TD Quantitative Capital division manages approximately $33 billion in mutual and pooled fund assets, primarily in index and quantitative portfolios on behalf of institutional investors.

For the purposes of this submission, we have chosen to limit our comments to those issues which we feel are most important to TDAM and to our clients.

Submissions

1. Regulation of Other Investment Products

Based on our experience in providing a wide array of investment products and services, we would like to highlight the differences among some of them and our reasons why the proposed framework should not be extended to certain types of vehicles. The issues addressed in the Proposal are primarily relevant to conventional retail mutual funds and retail investors and the scope of the Proposal should be limited accordingly. In particular, we believe that the Proposal should not cross over to pooled funds, hedge funds or other products which are offered in the exempt market (collectively, "pooled funds"). Pooled funds, which are distributed to "accredited investors", or under another prospectus exemption, are not currently subject to National Instrument 81-102 ("NI 81-102") and we submit that they should not be subject to a new governance regime which purports to replace or supplement parts of NI 81-102. It has long been accepted in securities law that sophisticated investors do not need the protection of a prospectus and a detailed product regulation and, on the same basis, they do not require the further protections recommended in the Proposal.

It has been estimated that there are approximately $240 billion in assets invested in pooled funds in Canada[1]. Most pooled funds have many fewer investors than typical mutual funds, most of whom are high net worth individuals or institutional investors, such as pension plans or foundations. Institutional investors are often separately regulated with respect to their investments and already have governance structures in place with administrators owing a fiduciary duty to select and approve investments, usually with the advice of consultants and other professionals. Further, unlike retail mutual funds, clients invested in pooled funds typically receive personal reviews with the portfolio managers, and significant changes to pooled funds are not made without their knowledge. They do not generally pay any "loads" in respect of their holdings. It would be a pointless expense to interpose an independent governance agency between a pooled fund manager and these investors or to require that the manager of such pooled funds be registered.

We also submit that the benefits of the Proposal would be comparatively small in the case of mutual funds that are distributed exclusively to fully managed accounts managed by a registered advisor. The prospectus exemption regime in Rule 45-501 includes in the definition of "accredited investor" distributions of securities to portfolio advisors who make investment decisions on behalf of managed accounts. Although Rule 45-501 has specifically excluded distributions of mutual fund securities from the definition of "managed account", we submit that there is less reason to interpose independent governance agencies for mutual funds where professional portfolio advisors, owing a fiduciary duty to their clients, have been granted the discretion to make investment decisions on behalf of these accounts.

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[1] *Benefits Canada*, November 2001, p. 67

Extending the Proposal to such funds would be out of keeping with investment management business practices, could fetter the discretion of a prudent portfolio manager, and would add significant costs to these clients. In most cases, the manager of both the fund and the account are already fully registered as an Investment Counsel, Portfolio Manager, Limited Market Dealer, and sometimes Mutual Fund Dealer. Adding a new Mutual Fund Manager registration requirement to these relationships may be redundant. In addition, such funds are often prospectus qualified not because they are primarily distributed to the retail market, but for convenience in the absence of well developed pooled fund regulation. We understand that the Ontario Securities Commission is considering the development of a pooled fund rule. In the interest of harmonizing regulation and allowing funds the flexibility to select the category of regulations which is most suitable for them, we submit that mutual funds distributed to portfolio managers for full managed accounts be exempted from any new rule arising from the Proposal. In the alternative, we submit that these funds be exempted until such time as a pooled fund rule is developed, and that any new registration requirements not apply to such fund managers.

A further concern was raised by the OSC's chief economist who cautioned that the "…cost-benefit analysis [of the Proposal] applies primarily to actively managed funds where profit margins tend to be wider…For passively managed funds, in particular, where fund management expenses can run under 20 basis points, the potential significant savings to investors in these funds is limited. Adding additional costs to these funds is unlikely to generate significant net savings and could, in the case of smaller mutual funds, make them uneconomical to run." This cost assessment would also apply to many pooled funds and mutual funds distributed to portfolio managers for fully managed accounts, where management fees are similarly low. In fact, the additional expenses estimated in the CSA's Background Research Report could, in some cases, obliterate the cost advantages of pooling.

2. Governance Agency Structure

While we believe that the proposed independent governance agency model has merit in dealing with several potential structural and situational conflicts of interest in the context of retail mutual funds, we are concerned by the uncertain consequences. In the United States, where most mutual funds are organized under the *Investment Company Act of 1940*, there exists a statutory regime for fund governance, which is supplemented by regulation, a general body of law and several decades of experience. However, when governance agencies are grafted upon Canadian mutual funds, predominately organized as trusts and lacking the same underpinning, a disconcerting vacuum could be opened. Although this issue was discussed in the background papers to the Proposal, the Proposal does not provide a clear solution. We address some of these structural concerns below.

In part for this reason, we support the Proposal's flexible approach to fund governance. For mutual funds structured as trusts we agree with the recommendation that either a board of trustees, a registered trust company, or a board of governors interposed between the trustee and the fund manager could qualify as the governance agency. However, in the case where a registered trust company were to act as the governance agency, we are uncertain whether certain parts of the proposed framework would apply. It seems that the trust company itself would perform the functions of the governance agency and not its board of directors in their personal capacity. Presumably, trust and loan companies legislation and the by-laws of the corporation would govern matters such as the election and composition of the board of directors. We would appreciate confirmation that this is the intention of the Proposal.

3. Governance Agency Mandate and Charter

While we agree that there are advantages to permitting flexibility as to the governance agency's structure, there is a concern that granting each agency absolute discretion to define its own mandate could result in a lack of rigor, fragmentation in the market and investor confusion.

The Proposal recommends that each governance agency develop its own mandate consistent with the governance principles outlined in the Proposal and provides a list of minimum responsibilities for the agency. The Proposal further recommends that the governance agency should only be responsible for ensuring that the fund manager has necessary and effective policies, but not to make the day-to-day decisions except for certain matters such as conflicts of interest and benchmark approval. Clearly, the governance agency cannot be available to make day-to-day decisions on issues as far-reaching as compliance with securities legislation, brokerage allocation, valuation of portfolio assets and proxy voting. Several of these functions would also require expertise beyond what the agency might possess. It should not be forgotten how sophisticated and complex our industry is. It is conceivable that mutual fund agency members will require an even higher level of financial literacy and specialised industry experience than do board members of typical public corporations. Such an expansive role might also compel agency members to rely heavily on outside advisors to meet their standard of care at great cost to a fund. Appropriately, the Proposal recommends that the governance agency's function should be to "oversee" and "supervise" the fund manager, but not to "micro-manage" the fund. However, we submit that "supervision" connotes a higher standard than does "oversight". For these reasons, we submit that this fundamental distinction be clarified and entrenched in any proposed rule in a statement that the duty of an agency member only involves oversight (except for specific matters where the agency may have decision making authority). We also submit that the areas for which the governance agency is ultimately responsible to investors (such as approving transactions where a conflict of interest may be perceived) and the areas for which, notwithstanding that the governance agency may have oversight, the manager is ultimately responsible (such as compliance with laws) be clarified.

One of the fundamental functions of the governance agency suggested in the Proposal would be to establish a charter for the agency. There are potential concerns in allowing a charter to be created solely by the governance agency with no checks and balances. For instance, there would be little control to prevent agency members from expanding their mandate and intruding on unrelated affairs of the fund manager. There would also be little control to limit the agency from increasing its size and compensation level beyond what is appropriate and increasing costs to the unitholders. Further, as agency members select their own successors, there is a self-perpetuating element to the structure. The only mechanism suggested by which inept, truant or otherwise unsuitable members of the agency could be replaced is for the manager to call a unitholder meeting. In such circumstances, a costly and disruptive proxy fight could ensue, for which there as yet exist no rules. However, we believe there are simple ways to address these issues.

First, we recommend that the manager establish the charter, including a range size for the agency. Subsequent amendments to the charter could be made by the manager, but approved by the agency. Second, we recommend that there be minimum requirements for agency members analogous to those for corporate directors under corporate statutes. Third, we recommend term limits for members of three to five years. Fourth, we suggest that a system of checks and balances would be more appropriate whereby the manager nominates the slate of successor members who are ratified by the agency. For comparison, we note that the recent rule of the United States Securities and Exchange Commission on the Role of Independent Directors of Investment Companies contemplates a role for the manager in the nomination process. The manager should be permitted to re-nominate existing members or propose a new slate, but the agency would be required to ratify the nominees based on a review of the nominee's independence, attendance, contribution to the agency, and other performance measures. Fifth, as the members would have access to confidential information, we believe that the manager should have the right to restrict agency members from sitting on the governance agencies of other funds.

Finally, although the Proposal recommends that a majority of the governance agency members be independent, there is no mechanism to ensure that management would be represented since the agency could, through the proposed appointment process, effectively squeeze out management members. We believe that strong management representation on the agency would be essential to provide important insight into the details of the fund manager's business and to act as liaison between the agency and the manager. Therefore, the right of the manager to appoint a minority of the members should be codified in any proposed rule and, as an alternative to our suggestion above, the manager could be permitted to appoint the management members, while the all other members would be appointed by independent members.

4. Governance Agency Compensation

On the issue of governance agency compensation, we believe that there are governance problems inherent in the governance agency setting its own compensation. The Proposal suggests that the fund manager will have a veto over this process in its ability to call a unitholder meeting to ask that investors consider whether compensation is unreasonable. However, if a vote were placed with the unitholders to increase the compensation levels for governance agency members, we suspect unitholders will, more often than not, vote against an increase given that this would lead to higher mutual fund fees. Furthermore, the process of holding a unitholder meeting is an expensive undertaking, and unpopular with unitholders. Our experience with unitholder meetings has revealed a high level of unitholder disinterest and very low response rates. As such, we believe that the fund manager veto process for governance agency compensation is both impractical and costly to unitholders.

A more practical approach would be to allow the fund companies to set compensation levels for governance agency members. Market forces will determine whether the fund companies get the right answer. A fund manager has a vested interest in attracting top candidates for its governance agency and if the proposed compensation level is too low, competent agency members will not be recruited. However, a fund company, acting in the best interests of its unitholders, also has a vested interest in keeping mutual fund fees low, and if governance agency members are free to set their own compensation, the risk is that compensation levels will drift upward, thus incurring additional costs to our unitholders. We believe that the fund manager can appropriately make this determination and believe this approach is in the best interest of unitholders.

5. Investor Rights and Dispute Resolution

The Proposal states that you will re-examine whether unitholder meetings need to be called when fundamental changes to funds are proposed. We hope you do re-examine this issue and believe that if fundamental changes are brought under the responsibility of the independent governance agencies, this will go a long way to reduce costs to unitholders. You have suggested that a change of auditors would be an example where the unitholder meeting requirement could be eliminated. We agree that a governance agency would be qualified to make these decisions and, for the same reason, this reform could be extended to all fundamental changes relating to a fund, including mutual fund mergers.

As indicated above, our experience with unitholder meetings has shown unitholders to be disinterested in fund governance matters. With response rates usually well below 10% it is questionable whether unitholder meetings actually reflect the view of the majority of investors. Our experience has also shown us that the issues that matter most to mutual fund investors are

performance and fees. Dissatisfied unitholders are far more likely to “vote with their feet” by redemptions than vote their proxies.

Allowing either the manager or the agency to resolve their disputes by calling unitholders meetings could result in costly proxy fights for which there is no clear procedure and no mechanism for dissident proxy solicitation. The absence of these rules also raises several technical questions where different funds in the same family, or different classes of units within the same fund, would vote differently on matters such as the election of agency members or a change of fund manager resulting from a change of control. Further, allowing the governance agency to terminate a fund manager could result in situations where a misguided board could create orphan funds with no manager. However, any of these situations would certainly have an adverse impact of the fund’s portfolio and could cause more harm to unitholders than benefit. We suggest that alternative forms of dispute resolution would provide investors with the same or better protections, without the associated costs and potential harm to a fund's portfolio. Specifically, we suggest that you consider whether there could be a role for independent arbitrators to resolve certain disputes.

6. Registration of Mutual Fund Managers

With respect to the registration of mutual fund managers, we would first like to state that we hope that the creation of any new category of registration will be considered and implemented in harmony with other registration initiatives. On the Proposal specifically, we are concerned with the option raised that the governance agency be required to review the qualifications and proficiency of a fund manager’s senior management. As discussed in the Proposal, the existing registration system for advisers and dealers sets out standards for their senior officers and similar requirements could quite easily be applied to a fund manager’s registration. We agree with the latter option and the view that the responsibility for establishing the qualifications of senior officers of the manager should remain with the regulators and not downloaded to the governance agency.

We also agree that it is in the best interests of unitholders that a fund manager have minimum capital requirements to absorb unforeseen losses. However, the basing the calculation of capital requirements on assets under management, as suggested in the Proposal, would produce capital requirements far in excess of the needs of larger fund companies. We believe that the inherent business risks are greater for smaller fund companies. As such, we propose that capital level be set at $5 million for all registrants.

7. Product Regulation

As the Proposal states that the CSA is "not interested in simply layering new regulation on top of old", we hope that the proposed elimination of parts of the product regulations will be clear

and concurrent with the implementation of governance agencies. Since the scope of the deregulation described in the Proposal is quite vague, it has been difficult for us to assess the costs and benefits of the Proposal.

The Proposal suggests six specific restrictions which could be eliminated, and three others which could be simplified. Over the course of the past several years TDAM has made extensive submissions to the various commissions on several of these issues. Without simplifying or reiterating our earlier submissions, we agree that the six specific restrictions recommended for elimination should be eliminated. However, with an independent governance agency performing an oversight function, approving policies, and acting as a monitor of the unitholders best interests, we suggest that most, if not all, investment restrictions based on conflict of interest and prudence policies could be eliminated. We query why the Proposal suggests that the other three restrictions, viz. the restrictions on concentration, illiquid assets and investments in other mutual funds, be merely simplified. We note for example that the 10 percent concentration restriction contained in section 2.1 of NI 81-102 was recently modified to provide an exception for index funds. With an independent governance agency in place we see no reason why this restriction could not be eliminated.

There are further product restrictions on which the Proposal was silent and which, we submit, should also be considered for simplification or elimination. The securities lending and repurchase transaction rules in NI 81-102 are one such example. The current rules set strict parameters for securities lending, however, as industry best practices in this area develops, there seems no reason why a governance agency could not approve different securities lending restrictions if they were convinced that there were adequate controls and that it would be in the best interests of the unitholders.

In addition, we recommend that the modification or elimination of the following rules be considered: (i) the self-dealing rules contained is section 4.2 of NI 81-102 and paragraph 118(2)(b) of the Act, (ii) the restrictions on investments in related entities contained in subsection 111(2) of the Act, (iii) the related transaction reporting requirement contained in section 117 of the Act, (iv) the requirement to deliver semi-annual financial statements, and (v) the restrictions on mutual fund investments in mortgages contained in National Policy 29.

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We would be pleased to provide further explanations or submissions regarding the matters raised in this letter and would be more than willing to make ourselves available for any further dialogue relating to the Proposal.

Yours truly,

Robert F. MacLellan

REQUEST FOR COMMENTS ON CONCEPT PROPOSAL 81-402 OF THE CANADIAN SECURITIES ADMINISTRATORS (THE "PROPOSAL")

EXECUTIVE SUMMARY OF RESPONSE FROM TD ASSET MANAGEMENT DATED JUNE 4, 2002

1. We agree mutual fund regulation should be streamlined.

2. We agree that independent governance agencies should be created.

3. We propose that only 81-102 mutual funds be regulated, not pooled funds or managed product which are distributed to accredited investors.

4. We recommend that when a registered trust company becomes the governance agency, you clarify if the directors of that company have liability and if the shareholder of the trust company would elect the directors.

5. We recommend you clarify the distinction between oversight and supervision of the agency when dealing with the manager and the matters for which the governance agency may have ultimate responsibility.

6. For the governance agency, we recommend:

    a. a charter be established defining the min/max number of directors;
    b. minimum requirements for directors;
    c. term limits of 3-5 years;
    d. the manager nominates successors from which the agency chooses;
    e. directors may only sit on one agency at a time;
    f. the manager's right to elect management (related) directors to the agency be codified.

7. We recommend the fund companies set compensation of the independent directors, not the agency itself, nor a unitholder meeting.

8. We recommend that a formal dispute resolution process (with arbitration if necessary) be implemented in lieu of proxy battles or unitholder meetings.

9. We believe the existing registration system for advisors and dealers is adequate. Also, the governance agency should not review the proficiency of the managers executives

10. We agree that a $5 million minimum capital requirement be implemented for all registrants.

11. We recommend that when the proposed new regulation is in force with the independent governance agency, all existing conflict of interest and prudence rule in mutual fund policies be eliminated concurrently.