APPENDIX A

Assante Asset Management Ltd.
CSA Concept Proposal 81-402 - Overview

Overview

<u>Scope of the Concept Proposal - the Need to Maintain Sight of the Broader Issues</u>

We 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 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 in agreement with and pleased to lend our support to any initiative that has as its object enhanced investor protection. However, 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 our aims and 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 into.

The Importance of Ensuring Nationally Standardized Initiatives

The CSA have indicated that they wish to pursue a broad and non-rule based 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.

It is thus imperative that the CSA strive to develop and implement standardized initiatives that will be adopted and applied uniformly across all jurisdictions.

Mutual Fund Investors

Purchasers of mutual fund units are dissimilar 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 Proposal. 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.

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.

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

It has been the unfortunate practice of the CSA to put off addressing straightforward regulatory reforms by subsuming the 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.

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 Proposal 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. If existing regulatory problems are left until after fund governance initiatives have been introduced, we are concerned that the long needed restructuring of the our regulatory framework will, once again, be left unresolved.

Our concerns are historically justified and we anticipate that we would be saddled 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 we will be left with the nothing but the worst of all possible scenarios if the Concept Proposal initiatives and the reformation of the 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.

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 independent governance agencies 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 governance agencies 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 independent 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, 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 prejudice and 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 independent governance agencies.

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 independent governance agencies. 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.

The 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 independent governance agencies.

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 purposes 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 a minimum capital requirement would serve. The CSA have not undertaken any economic research to empirically demonstrate the necessity for a minimum capital requirement. In addition, the very significant issue of how minimum capital would be calculated has not been addressed. In our view the capital requirements, if any, should be determined on a risk adjusted basis taking into consideration, in some manner, the distinction in asset classes or the complexity of the investment process.

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. In addition, fund managers may have no business need for increased capital in their operations. Compelling fund managers to maintain minimum capital above levels necessary to operate would result in a significant and deleterious impact on their business cost structure.

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 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 independent governance agencies are being instituted for the protection and as representatives 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 the 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 purpose 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 this expense will ultimately be 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.

<u>Power to Call for the Termination of the Manager</u>

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 considerations of cost and investor apathy, 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 so as not to empower a governance agency to an extent that it would have the ability to undermine or impair the conscious choices made by an investor.

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 steam 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 fund 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 its significance is reiterated by the CSA in the Concept Proposal.

APPENDIX B

Assante Asset Management Ltd.
CSA Concept Proposal 81-402 - Responses to Issues Raised for Comment

---

Question

01. We see our renewed framework for regulating mutual funds as a step towards a more flexible regulatory approach, one that represents a movement away from detailed and prescriptive regulation. By streamlining our regulation, we want to create a regulatory regime that can accommodate changes within the industry and keep pace with changes in other segments of the market and global market places. What are your views on our renewed framework? Will it represent an improvement over our current model?

Response

The extensive scope and the numerous uncertainties of the Concept Proposal call into question a successful implementation. It is difficult to envision the industry and the CSA successfully implementing such a broad proposal. The Concept Proposal is an undertaking of significant scope, containing many recommendations that would usually receive industry and CSA attention as standalone issues (i.e. each of the five pillars should be their own Concept Proposal for the mutual fund industry and the CSA to tackle). Unfortunately, the Concept Proposal leaves too much uncertainty.

Notwithstanding the CSA's efforts to bundle together many significant proposals, it is interesting that they have not addressed what many industry participants believe are two of the key success factors to the launch of a new fund governance regime in this country. It is not possible to address fund governance in isolation without addressing current prescriptive rules and a continued lack of harmonization.

Question

02. What is your opinion about the…[governance] alternatives to our proposed approach? If you believe we should not change the status quo, please explain why. If you favour one or more of the alternatives we set out, please explain why. Are there other alternatives that we should consider?

Response

The prescriptive rules applicable to mutual funds need to be addressed and reduced at the same time as the introduction of this Concept Proposal. The mutual fund industry is already heavily regulated and the Concept Proposal will add yet another layer of regulation.

We are concerned that the CSA will hesitate to reduce regulation, notwithstanding the efforts of the BC Securities Commission to "re-think" what is and is not important.

With the introduction of NI 81-102, the CSA recognized seven areas of regulation that required changes, including inter-fund trading and fund on fund, and proposed to publish proposed rules addressing these. Three years on, these issues have yet to be substantially addressed.

Harmonization is critical to the ongoing success of the Canadian mutual fund industry.

<u>Uniform act and Rules -</u>The mutual fund industry must work towards a uniform act and rules that are adopted nationally and consistently applied in all provincial securities jurisdictions. The lack of harmonization and cooperation among securities commissions' continues to result in promulgation of inconsistent rules across the country on important matters affecting the mutual fund industry and the overall securities industry. This will result in increased costs and lost opportunities to all market participants.

The CSA must take greater cognizance of the costs that mutual fund investors bear. Too many jurisdictions continue to wade into issues that should be left to a single jurisdiction.

Furthermore, the Concept Proposal indicates that broad statements of principles will apply. While this may provide for increased flexibility, it also raises the potential for different interpretations and application by provincial regulators in the absence of a single regulator.

We are also concerned if the Concept Proposal were not to be endorsed by the CSA and some provinces were to go it alone, what the consequential effect would be on the mutual fund industry in Canada. In the event of a multi provincial fund governance regime we believe that the costs would far outweigh the potential benefits.

<u>Question</u>

03. Do you agree that labour sponsored investment funds (where applicable) and commodity pools should be subject to the same regulatory scheme as other mutual funds (considering the specialized rules that we already have for these specialized mutual funds)? If not, why?

<u>Response</u>

<u>Harmonization among Investment Products</u>

We believe that it is necessary to have harmonized rules across different investment products. However, we think that harmonization of rules for multiple investment products will be difficult to achieve by 2004. The industry is currently having difficulty harmonizing segregated funds and mutual funds. This process will be rendered more difficult by attempting to harmonize the regulatory scheme of other investment products including commodity pools, labour sponsored funds, hedge funds and exchange-traded funds.

Regulatory standards are higher for mutual fund accounts than they are for other managed accounts. This inequality seems unjustified as the existing protections for mutual fund investors are already more stringent than for other competing products and other discretionary managed accounts.

Question

04. Which parts of our renewed regulatory framework should be extended or not extended to other investment vehicles—and which investment vehicles? Why do you believe the particular regulation should or should not be extended? What is the essential difference—or similarity—between the particular investment vehicles that mean they should be regulated differently or the same?

Response

With a view to achieving national harmonization, governance must be consistently applied across all investment funds.

The costs associated with fund governance if not applied to other investment vehicles, which are similar in nature to mutual funds and the investors in which deserve an equivalent level of protection, may provide an undue competitive advantage over mutual funds.

Question

05. Although we do not address the fifth pillar of our proposed framework, we invite you to give us your ideas on how we could better carry out our role as regulator.

Response

An enhanced regulatory presence should only be considered if greater attention is paid to the costs of regulation compared to the benefits. The lack of a national regulator has multiplied cost and expense with no benefit to investors. Adding a new registration system and expanding regulatory presence only means more paperwork for more jurisdictions and no increase in investor protection.

The fifth pillar refers to an enhanced regulatory presence in the context of mutual fund managers. Of equal importance should be a regulatory presence with respect to other registrants, such as advisers, i.e. investment counsellors, who provide investment management skills and whose assets under management are significant.

Question

06. As you read this section of the concept proposal, please consider whether you believe our approach will result in mutual funds being monitored by a governance agency that:

    a. effectively oversees the management of the mutual funds
    b. has real powers and real teeth and
    c. adds value for investors

    If you agree or disagree that our proposals will meet these goals, please tell us why. What do we need to change in order to achieve them?

Response

A statutory cap on liability for independent governance agency members is essential. Unlimited liability will do little more than increase fund expenses as governance agency members will want the sign off/assurances of independent experts prior to undertaking any decision that might expose them to liability.

It is important to recognize that mutual fund and corporate models are different with respect to liability. In the context of mutual funds, trustees would still have full exposure and liability even in the absence of and independent governance agency. If an analog to the corporate context is being considered, the role of the independent governance agency in the trust context is more akin to the role of independent directors in the corporate context.

It is also important to note that a difference in individual liability might arise depending upon the legal structure used to constitute the fund (i.e. as mutual fund trusts or mutual fund corporations). It is essential that the regime adopted achieve parity with respect to exposure to liability, irrespective of the legal structure adopted.

With respect to corporate law, we note that there exists a long established jurisprudence relating to the application of the business judgment rule. We are uncertain if the business judgment rule would be considered in the context of the discretion exercised by independent governance agency members and query how this might affect equality of result if the exercise of governance agency member discretion is subject to judicial review. We are of the opinion that a business judgment rule should be adopted for independent governance agency members so as better to define the scope of appropriate exercises of discretion.

In reviewing the questions on fund governance, we question the applicability of the TSE Guidelines on Corporate Governance – in particular, whether they might be partly applicable to fund governance, so as to afford the necessary flexibility while satisfying the CSA's goals of consumer protection.

Has there been any investor focus work done so as to readily identify the expectations of Canadian mutual fund investors regarding governance and as to whether or not fund governance should be voluntary or mandatory to achieve some of the purposes that the CSA was striving for.

The Canadian Mutual Fund Industry is already highly regulated and any additional regulation must clearly identify its consequential benefits. One benefit (provided that), both by way of operating efficiency and cost, is that the trustees would be able to deal with the numerous questions of conflict of interest now regulated by the CSA.

Although some of the goals outlined by the CSA may be achieved, we are concerned that the combined effect of these proposals, including both fund governance and manager registration, will create significant barriers to entry to market participants, will result in smaller managers being unable to offset these additional charges and merging with larger managers, will result in small managers having much higher MERs thereby making their products less attractive to the investor and resulting in the mergers of these smaller firms with larger firms. We do not believe that if these results were to occur that the public has benefited. We are also concerned that, while in principle the unit holders are to bear the costs associated with fund governance, it is likely that larger funds will indirectly absorb some of these costs by absorbing more of the fund expenses. Again, this potentially disadvantages the smaller fund managers who are unable to do so.

Question

07. We kept Canadian corporate governance practices in mind as we developed our proposals. Have we omitted an important principle of corporate governance that you think should apply to mutual fund governance?

Response

We feel that modelling the TSE Guidelines, where applicable, is important. Our response to question 6 is a good starting point in a discussion of a topic which should be evolving rather than attempting massive change in one step. Notwithstanding this opinion, we do not feel that any important principle consideration has been omitted in the CSA's Concept Paper.

Question

08. Having read the Stevens legal research paper, do you believe a flexible approach to fund governance is preferable to a single legal model, such as a board of trustees for all mutual fund trusts? Why or why not? Do you see any practical difficulties with the legal options presented in that paper? Are there any other options we should consider? Do you agree with the analysis of Québec civil law?

Response

We think that the flexible approach to fund governance is preferable and, if the principles enunciated (whether mandatory or voluntary) are broadly framed, they should accommodate any business structure that evolves for the issuance of a mutual fund security. We agree with he proposal's analysis of the Civil Law in Quebec.

Question

09. David Stevens writes about structural and situational conflicts in a mutual fund context. Do you agree with David Stevens' description of the conflicts? We agree with him that serious conflicts arise when the boards of directors of a fund manager or its shareholder(s) propose to act as the governance agency for a mutual fund and we propose to prohibit this. Do you agree with this conclusion? Please explain your answer.

Response

We agree with David Stevens' description of the inherent conflicts when a board of directors of a fund manager or its shareholder acts as the governance agency and would therefore be supportive of a position to disallow this. As indicated in our response to question 6, we strongly reiterate that where the appropriate governance agency has been put in place, such an agency should deal with numerous 'conflict of interest' situations currently prohibited by the governing regulations and which should be the subject of discussion or approval of the independent governance agency.

Question

10. Do you agree with our proposals and our analysis of owner-operated mutual funds? If not, please explain.

Response

We do not agree with your proposal regarding owner-operated mutual funds. In our view, whether or not a fund is sponsored by a closely tied group, inevitably the pool of investors in such funds is much wider than the sponsoring group and should be afforded the same consumer protection afforded any other person buying a mutual fund. The end result should be that wherever one buys a mutual fund, in the Canadian context, one is subject to the same regime of consumer protection.

Question

11. We do not currently propose to specify the maximum number of mutual funds that may be overseen by a governance agency. Is there a practical limit to the number of mutual funds that one governance agency can oversee effectively? Are mutual funds managed in ways that are sufficiently common to all mutual funds so that one governance agency can oversee all mutual funds in a related family? Should we provide guidance to the industry on the scope of oversight for a governance agency?

Response

If governance agencies are mandated, it will be crucial that the regulators provide a clear statement of the roles and responsibilities of governance agencies, and the standard of care applicable to agency members. This statement must make it clear that the role of governance agencies is to oversee the actions of the fund manager in managing its mutual funds to see that it acts in the best interests of investors and not to micromanage (i.e., through "micro-management" or otherwise) the day-to-day management of mutual funds. The statement of this role must be supported by a description of responsibilities that are consistent with this role and do not require the agency members to become involved in management activities. This distinction between oversight and management will make governance agencies fundamentally different from boards of directors that are statutorily authorized to manage.

There likely will be a practical limit to the number of mutual funds that one governance agency can oversee effectively; this limit will be a function of various factors. The primary factor will be the role and responsibilities of governance agencies. Until the role and responsibilities of governance agencies are clarified and finalized, it will be very difficult to assess in any definitive way what the limit will be. In addition, the potential liability to which agency members are exposed may also be a factor that influences this limit. For example, the limit may vary if liability is partly a function of the number of funds (and investors) and the assets the funds oversee (i.e., there may be a limit to the extent of the liability to which members are willing to be exposed).

In most cases, mutual funds within the same fund family are managed in ways that are sufficiently common that one governance agency could oversee all mutual funds in that family. Furthermore, there may be circumstances which may in fact require the governance agency to see over all or a specific group of mutual funds if those mutual fund are part of an overall asset allocation or similar service being provided to the unit holders.

We believe that guidance on the scope of oversight for a governance agency is essential.

Question

12. Do you think fund families will find it difficult to recruit qualified members for a governance agency at a reasonable cost? Do you have any experience with trying to recruit members of a governance agency?

Response

We believe that managers will find it very difficult to recruit qualified members for governance agencies at a reasonable cost. The extent of this difficulty will be largely determined by the role and responsibilities of governance agencies, and the liability to which agency members are exposed. In addition, there is also a limited "talent pool" from which to choose independent agency members. One other factor that does not seem to have been addressed is whether or not members of the governance agency should be allowed to be a member of a competitor's governance agency. It is likely that many fund managers would have great concern in these circumstances over the disclosure or use of competitive intelligence in addition to the conflict of interest members of governance agencies may face or be perceived as facing. If the appointment of the members is in the hands of the fund manager, then it is unlikely these circumstances would arise. However, the consequence of this would be to further limit the available talent pool to select from and thereby further increasing the costs of compensation.

With respect to training programs, the Investment Funds Institute of Canada ("IFIC") would take in active role in providing standardized training to newly recruited independent governance agency members.

We believe that the process of recruiting members will initially be time consuming, expensive, and in most cases required the services of a professional search firm, an extensive search and interview process, and significant fees for the organization engaged to recruit members.

Question

13. Does the definition of independent members make sense to you? Will it be easy to apply to potential governance agency members? If not, can you suggest an alternate definition or the clarifications you think are necessary? What do you think about whether or not we should require a majority or all members to be independent?

Response

We do not object to the definition of independence proposed in the paper; however, we believe that some general guidance or clarification (for example, in a companion policy) would be useful. In particular, we recommend that guidance or clarification be provided regarding parties that might be considered to "be in a position to exert influence upon management of the fund manager".

We do not think it appropriate that all members of a governance agency be independent. In our view, the participation of persons familiar with the day-to-day management and operation of the funds being overseen by an agency is crucial to ensuring that the agency carries out its roles and responsibilities in an efficient and effective manner.

We support the view that it may be appropriate to require a majority of independent members on a governance agency. However, this support is on the basis that this requirement is a necessary pre-condition to a significant relaxation of the current prescriptive conflict of interest rules. . A variation to this approach might (i) make the ability of a fund (or those acting on its behalf) to rely on relief from the conflict of interest rules conditional upon having a majority of independent members, and/or (ii) require managers to disclose in disclosure documents for their funds why their governance agency has differed from regulatory guidelines.

The need for independent oversight may be lessened where fewer potential conflicts are present (for example, in organizations that are not related to entities providing brokerage, custodial or record-keeping functions).

We believe that industry views on the composition of the governance agency will be influenced by a number of factors, including the ability to recruit qualified independent members at a reasonable cost and the details of the mandated appointment/recruitment process and the role the governance agency has in this process. In addition, it is critical that there be an adequate transition period to allow time for managers to establish, organize and recruit members for their governance agencies.

<u>Question</u>

14. Are the responsibilities we describe appropriate for a governance agency? If not, please explain why. Have we neglected to mention any responsibilities that should be ascribed to the governance agency? For example, should the governance agency review or approve mutual fund disclosure documents?

<u>Response</u>

Paragraph a. – In our view, this question relates to ensuring that governance agency members have flexible and adequate access to fund managers. It is essential that the independent governance agency have the right to meet with the fund manager as often as they see fit. Thus we would not be in favour of mandating meetings on any fixed periodic basis.

We responsibilities of the governance agency need to be clearly stated and how those responsibilities are met is then up to the governance agency. There should be an obligation on the manager to cooperate and to provide whatever information and access to personnel the governance agency may reasonably request.

Paragraph b. – Fund managers must have appropriate internal policies and procedures. One of the fundamental purposes of the independent governance agency members would be to review and possibly approve these policies and procedures. This review might be done with the assistance of a schedule provided by the CSA of areas in which fund managers are required to have policies and procedures. We are concerned over the role of and the degree of influence the governance agency may exert in the “approval” process. Our concern is that in the approval process the governance agency may in effect start to micromanage the manager. For example, if the governance agency is to approve the policies and procedures, it may determine that in order to do so, and to minimize personal liability it must retain independent counsel. The effect of this may be nothing more than entirely duplicating the role and associated costs the manager has incurred in having such policies and procedures prepared by or reviewed by its own counsel. If this were to occur we cannot see how this benefits the investors. We are also concerned that if the governance agency does not approve of such a policy and procedure, for whatever reason, the manager should not be prevented from implementing the policy and procedure to meet any applicable regulatory obligations.

Paragraph c. – Non-compliance with internal policy should not give rise to an automatic obligation on the part of independent governance agency members to report to the regulatory authorities. We believe it should be left to independent governance agency members to determine the appropriate remedy for breaches of policy. This will give them the right and option, but not the obligation, to report to regulators but would depend, in practice, upon the severity of the breach in question. We are concerned that if reporting to regulators for policy breaches is made mandatory, a due diligence defense will only arise if such a report has been made, irrespective of whether or not the severity of the breach merited disclosure to regulators. As stated in the Concept Proposal, the governance agency owes its duties to the investors and not the regulators. By requiring the governance agency to report violations to regulators, or even providing them the option to do so, we believe that this may be placing them in a conflict of interest. An alternative may be that the governance agency only has a duty to report material instances of non-compliance to the unit holders by way of press release or other form of communication.

Paragraph d. - Benchmarks are already mandated by regulators through the prospectus review/approval process. The role of the independent governance agency should not be to monitor but rather ensure that there are policies and procedures in place for monitoring to take place. Additionally, a review of fund performance would require governance agency members to examine such things as the individual securities in a fund, fund expenses, fund return after expenses and portfolio turnover rates. Reviews of various fund types (i.e. growth-oriented funds, equity funds) would have to be done in the absence of any consistent industry or regulatory standard as to what constitutes these types of funds. Analysis of this nature would require the governance agency to have resort to considerable expertise and we query how far such a review legitimately fits within the role of an oversight body whose mandate excludes micro-management of the fund. Imposing this responsibility would require micro-management by agency members and is inconsistent with an oversight role.

Paragraph e. – Members of governance agencies will not have the expertise or experience to fulfill this responsibility. However, it may be appropriate for agencies to review reports prepared by managers on a regular basis regarding their compliance with objectives and strategies.

Paragraph f. – Governance agencies should be given their own set of operating by-laws and should have to adhere to them until they opt to formally change them. The responsibilities of governance agencies will be established via regulatory statement and need not be set out in a charter. A charter setting out the operating procedures for each governance agency should be (and in practice, will be) established by the manager, not the governance agency.

In the same way that corporate statutes establish minimum requirements for the operation of board of directors and shareholder meetings, we believe that such minimum standards should be established for governance agencies i.e. quorum, notices, casting votes etc. In this way the standards amongst governance agencies has some specific and definite parameters. The same would be applicable in the context of unitholder meeting.

Paragraph g. – Mutual fund financials are transparent and the numeric/quantitative disclosure that must be set out is already prescribed. As a consequence, review of financial statements by independent governance agency members should be limited to ensuring that the information presented and the manner of its presentation represents meaningful disclosure to unit-holders. Governance agency members should not be required to assume a traditional audit function or required to approve financial statements. If they were to be given such responsibility, then we believe that the managers audit committee should then be relieved all responsibility and liability with respect to the approval of the financial statements and that where necessary any required signature by the audit committee, etc be replaced by the signature of the governance agency.

We are of the opinion that it is appropriate for governance agency members, as representatives of unit-holders, to exercise their discretion to change auditors without a unit-holder vote, particularly in light of the fact that such meetings entail significant expense to unit-holders while being poorly attended.

We agree that it is appropriate for agency members to have a responsibility to receive and review (but not approve) financial statements to the extent such review is necessary to fulfill their role and responsibilities. Similarly, agency members could be entitled (but not required) to communicate directly with internal and external auditors of the funds to the extent such communication is necessary to fulfill their role and responsibilities. In addition, we believe it is reasonable that governance agencies be responsible for reviewing and approving proposals to remove auditors of the funds, provided that this approval is in lieu of any required unit-holder approval.

Paragraph h. – In our view, one of the major purposes of a governance agency is to review, and as stated above possibly approve, the policies of the fund manager about transactions with related parties that involve the mutual funds and determine which transactions can only be carried out with the prior approval of the governance agency.

If this proposal is implemented, there should be a clear statement that governance agencies are not intended to, nor are they permitted to, "micro-manage" the day-to-day affairs of the funds they oversee. This should be supplemented by a list of matters that are not the responsibility of the governance agency.

Question

15. Can you think of any other policies and procedures the governance agency should review and approve? For example, should the governance agency review policies on the use of derivatives?

Response

We think that governance agencies should consider and review policies and procedures for the following:

- sales communications/incentive plans,
- changes to portfolio management teams,
- fund mergers,
- new fund launches,
- policies for funds not subject to prospectus rules (i.e. hedge funds)

Question

16. Do you believe the independent members of the governance agency will be effective in their audit committee role?

Response

Much of the disclosure that fund companies make is transparent and prescribed. Independent members of the governance agency should, therefore, have their oversight duties limited to the review of information presented and the format of its presentation of the purposes of assessing its meaningfulness to unit-holders.

Question

17. The Fund Governance Committee of the Investment Funds Institute of Canada (IFIC) recommends that we limit the liability of a governance agency member for breaches of the standard of care to $1 million. In part because members of boards of directors of corporate mutual funds will not have this limitation on their liability we do not propose to regulate any limits on liability. Also, we are not convinced such a limitation is in the public interest. What are your views?

Response

One million dollars is the general statutory limit of liability for any breach of securities act provisions. The legislature has seen fit to adopt this figure as sufficient to induce compliance with securities legislation and we feel that this limit is appropriate for the liability of governance agency members.

We believe that a limit on the liability of governance agency members is necessary to ensure that managers are able to recruit qualified persons at a reasonable cost. Exposing members to unlimited liability will deter qualified persons from acting as members of governance agencies and will have a significant impact on the cost of the insurance required by members (which will be passed on to investors).

In addition, we are uncomfortable with the suggestion that unlimited liability is necessary to ensure that agency members are adequately diligent in carrying out their duties. In our view, personal exposure for liability of up to, for example, $1 million will provide adequate incentive for agency members to diligently carry out their duties. We do not feel, therefore, that such a limit will undermine the stated purpose for governance agencies or otherwise be contrary to the public interest.

Finally, we do not believe that the absence of such a limit in the corporate context is adequate justification for failing to impose such a limit here because the role and responsibilities of agency members will be very different from those of corporate directors. In particular, corporate directors have the power to manage a company whereas agency members will serve only in an oversight role.

Question

18. Will a regulatory statement on the standard of care for governance agency members allow potential members to assess their personal exposure in so acting? Will potential qualified members be deterred from sitting on governance agencies?

Response

A regulatory statement on the standard of care may be of assistance if it explicitly defines the standard. Adoption of a "business judgement rule" for governance agency members and guidance in the form of a statement of regulatory principles (i.e. explaining "the best interests of the fund") would also help define the standard. In providing guidance, the CSA should be aware that it is the fund managers who are fiduciaries and not the independent governance agency members.

This statement and guidance should also explain how this standard of care (and the role and responsibilities of agency members) differs from that of directors. We believe that potential members will use this regulatory statement and guidance regarding the applicable standard of care, in conjunction with the regulatory outline of their role and responsibilities, to assess their personal exposure.

In our view, potential qualified members will be deterred from sitting on governance agencies if the stated standard of care imposes fiduciary obligations on members.

Question

19. If you have experience with a governance agency for your mutual funds, how have you analysed their liability under common law or otherwise? Have you obtained insurance coverage for the members of your governance agency?

Response

We have not conducted any formal analysis of governance agency members liability under common law or otherwise. We have assumed that this liability would be similar to that of directors, with differences reflecting the distinctive roles and responsibilities of governance agency members.

We understand from others who have obtained insurance coverage for members of governance agencies that, at least in the past, insurers have not had “standard” policies for this type of coverage and have difficulty understanding the role of these individuals. Regulatory guidance on the roles and responsibilities of agency members should be of assistance to insurers.

We are also of the view that the cost for any meaningful level of coverage will be significant. We suspect that such policies may be claims made policies which only provide protection for claims made during the policy period. As such, potential governance agency members may have concerns about the manager maintaining coverage once they have ceased to be members.

Question

20. Are there alternatives to the appointment-election conundrum we outline? Is there another practical way for members to be appointed to fund governance agencies?

Response

Initial Appointment:

We agree with the Concept Proposal that there be an option with respect to the appointment of the first members of the governance agency (fund manager or election by investors). Practically, however, we believe it makes more sense for these appointments to be made by the fund manager. The fund manager is well-positioned to identify qualified prospects and build a governance agency with the necessary skills to carry out the mandate. While we understand the theoretical benefits of having investors involved in an election process, this is impractical given the general costs of unit-holder meetings and the prospect of establishing first-time governance agencies across the industry.

We do not believe it is practical to expect unit-holders to nominate governance agency members given that they are in an even worse position to fully know what the role of the governance agency is to be and what the necessary skills are to carry out the role.

Subsequent Appointments (new appointments and resignations):

We do not feel it is appropriate for the governance agency to fill vacancies on the governance agency or to make further appointments independently of the fund manager. We believe that such appointments should be made by the fund manager and ratified by the governance agency -that this preserves an element of control for the fund manager in the case of a “loose cannon governance agency”.

Secondly, we believe the fund manager is in a better position to identify suitable candidates for the governance agency. We also note that this is consistent with the approach under corporate law, where management recommends candidates for the board. While there is no separate election process, we believe that a ratification process gives the governance agency some involvement in the process and ensures that the interests of investors are appropriately safe-guarded.

Disclosure: Non-independent Governance Agency member

We do not believe that the fund manager should be required to explain, in the case of the appointment of a non-independent member, why that person is not independent. This is unnecessary as long as the board maintains an independent majority. This could be noted in the AIF or in the Annual Report, but separate disclosure is not necessary.

Other Disclosure issues to consider

We understand that the CSA believes that in order to achieve a strong connection between the governance agency and the investors they serve, there must be disclosure and timely communication of appointments, resignations and the like, particularly in the absence of a unit-holder vote on the election of governance agency members.

The Concept Proposal states mutual fund managers will be responsible for:

(i) sending notices to investors, within a reasonable time, informing them about all new appointments and resignations of governance members and filing such notices on SEDAR.

This is not practical because of the costs of sending such notices (preparation, print and mail costs), all of which are borne by investors. Further, this seems duplicative and unnecessary especially if there is to be a separate disclosure in the annual governance report.

A better approach would be to issue a press release and file the press release on SEDAR, consistent with the reporting requirements for similar changes of other issuers. Another alternative would be to simply post this information on the fund manager's web site. This would ensure timely and cost-effective communication through a forum that to which most investors have regular and easy access. We question the materiality of such communication with mutual fund investors and query why the regulators would impose a higher standard on the mutual fund industry than they do on other corporate issuers, a situation inconsistent with the broad concept of harmonization; and

(ii) advance notice of initial compensation and any changes in compensation to governance agency members.

We do not believe that this is material to an investor's decision to continue to hold securities. We believe that the costs associated with such mailings heavily outweigh any investor benefit.

Rather than mail timely written notices to this effect, the CSA should empower fund complexes to leverage off the internet and update such information on corporate web sites. Such information could also be disclosed in the governance agency Annual Report, consistent with the reporting requirements for similar changes of other issuers. We are uncomfortable with disclosure requirements and costs that are not imposed on other products across the securities industry. These costs threaten to unfairly prejudice the interests of fund managers and the potential returns of Canadian mutual fund investors.

We do not believe that investors are as anxious as the CSA to "achieve a connection" with their governance agency. If presented with the option of "more disclosure with its inherent costs" or "less disclosure with its inherent cost savings", we believe that investors would opt for the latter. Canadians want mutual fund performance – and the CSA should be hesitant to impose requirements that will negatively impact "investment returns". In addition, most individuals invest in more than one family of mutual funds and as such the information and the communications which investors would receive may result in only confusing them.

Question

21. What do you think about the issues associated with fund managers appointing governance agency members? Are these real or theoretical? If you act on a governance agency and were appointed by the fund manager, please share your experience with us.

Response

Fund managers have a statutory duty to act as fiduciaries and in appointing independent governance agency members would be obligated to meet this standard of care. We believe that the risk of an insurmountable bias in favour of the fund manager owing to the fund managers' appointment of members of the governance agency is theoretical. We are of the opinion that this risk is appropriately addressed through the standard of care imposed upon the governance agency to act in the best interests of unit-holders.

Governance agency accountability to investors can be demonstrated through the governance agency's annual report to unit-holders. We feel, nevertheless, that care must be taken not to make this an unnecessarily lengthy undertaking that would further increases costs (print, legal, audit) to unit-holders . We believe that investors will have a sufficient nexus to the governance agency if they feel, based on the annual communication, that their interests are being safe-guarded.

If you act on a governance agency and were appointed by the fund manager, please share your experience with us.

We understand that investor turn-out to elect directors of mutual fund corporations has been exceedingly low. We are not aware of a desire among mutual fund investors to engage in and participate at annual meetings for purposes of electing directors, governors etc. We feel that Canadians investors will, in fact, object to requirements imposed by the regulators which could potentially reduce their investment return.

Question

22. Should investors who do not like the elected/appointed governance agency members be allowed to exit without penalty? Do we need to give any guidelines for qualifications of prospective members of a governance agency?

Response

We do not believe it is appropriate for investors to be allowed to exit without paying any applicable deferred sales charge because they do not like the elected/appointed governance agency members. This question underscores the need for the CSA to remain true to the objectives behind the Concept Proposal and maintain a neutral perspective as to the relative importance of the governance agency vis-à-vis the fund manager and the portfolio managers that investors select when buying a mutual fund.

Investors do not have the option to exit without the applicable deferred sales charge (use of the word penalty is inaccurate and misleading) in the situations where, for example, (i) they do not like the new President of the fund manager; or (ii) they disapprove of a new portfolio advisor or a replacement sub-advisor.

When an investor has determined to purchase mutual fund units on the deferred sales charge basis we believe that, for the reasons outlined in the other document forming part of these comment, it is not right or proper for the investor not to have to honour their contractual obligations. If this Concept Proposal were to be implemented as drafted, managers would cease to sell mutual funds on a deferred sales charge basis.

The CSA should not elevate the role of the governance agency to a level equal to or higher than that of the management or portfolio management team. The proposed disclosure requirements seem to suggest that one should make an investment decision more on who the governance agency is than who the manager, advisor, sub-advisor or portfolio manager is.

Do we need to give any guidelines for qualifications of prospective members of a governance agency?

We do not believe the regulators need provide guidelines for qualifications of prospective members of a governance agency. This may be an area where IFIC can play a leading role in helping to create "best practices" guidelines to help to ensure a degree of consistency across the industry.

In order to develop these guidelines, industry participants and IFIC will need greater clarity from the CSA regarding the scope of the role the CSA is actually proposing for governance agency members. This would include a clear articulation of whether the CSA proposes to actually give the governance agency a meaningful role by empowering them with the responsibilities that are currently vested in the CSA. For example, will the CSA give the governance agency the discretion to address those matters that are now addressed by way of applications/regulatory relief (e.g. issues relating to conflicts of interest, prescriptive rules etc.)?

Clarity as to the mandate and responsibilities of the governance agency is also needed so that prospective governance agency members can assess, for themselves, whether they are prepared to act and devote sufficient time to the role – and whether the compensation is sufficient to offset the potential risks of liability.

In terms of other guidance, we do believe that the CSA should specify that there is no prohibition against governance agency members sitting on governance agencies of multiple fund complexes.

Question

23. Some people are concerned about the lack of checks and balances on the governance agency setting its own compensation. We do not currently propose to place any limits on the amount or kind of compensation that may be paid to governance agency members. Should we set limits to give guidance to the industry? Should the mutual fund manager be involved in the process of setting the governance agency's compensation or not? Would the independence of governance agency members be compromised if the mutual fund manager set and paid their compensation directly? What do you think about our proposal that the fund manager be given veto power via the ability to call a special meeting to have investors consider any compensation that the fund manager believes is unreasonable?

Response

We first note generally that constraints must be placed on the ability of governance agency members to set their own compensation. We think requiring governance agency member compensation to be subject to fund manager approval is appropriate as fund managers are better able to factor in all costs and have a defined statutory obligation to act in the best interests of unit-holders/the fund.

We do not believe that the regulators need prescribe dollar value limits on governance agency compensation; however, we feel that there needs be a process for ensuring proper checks and balances on compensation – otherwise, bigger complexes could drive the price of governance agency compensation to levels prohibitive for smaller players. This would increase barriers to entry and otherwise inhibit competition by forcing some out.

In terms of setting limits, this is difficult to do – is it on a per fund basis or on an asset-based basis? There needs to be some flexibility for compensation to be tailored to the circumstances. To the extent that this is market driven, presumably the compensation will have to incorporate risk premium relating to the amount of liability taken on. Otherwise, it may be difficult to attract qualified candidates.

Governance agency compensation could be based, in part, upon compensation surveys developed by third party consultants. IFIC could retain third party consultants (e.g. Hay Management, Towers Perrin, Mercer etc.) to help develop the initial parameters for governance agency compensation. Looking forward, we envision different complexes paying different levels of compensation, depending on their profile, much the way that they do with internal staff today. That said, many, if not most, benchmark their compensation against industry compensation studies.

Should the mutual fund manager be involved in the process of setting the governance agency's compensation or not?

We believe the mutual fund manager should be involved in the process of setting the governance agency's compensation. More specifically, we believe that responsibility for this should be left to the sole discretion of the fund manager.

The governance agency should not be allowed to set its own compensation. While presumably they understand that it is the fund (shareholders) who are paying for this, there is no guarantee that governance agency's won't over-charge and abuse the power they are given . While one would normally leave it to "market forces to decide", there is no market if it is left to the governance agency's sole discretion. We believe this to be inconsistent with the practice in the corporate world where board compensation is determined by management, not by the board of directors.

Would the independence of governance agency members be compromised if the mutual fund manager set their compensation directly?

The independence of governance agency members will not be compromised if the mutual fund manager sets their compensation directly. This is no different than in the corporate world where management fixes the compensation of the board of directors.

Having a fund manager involved in the determination of compensation will not be an abuse of process provided that they adopt and follow the guidelines prescribed by applicable industry survey.

Would the independence of governance agency members be compromised if the mutual fund manager paid their compensation directly?

We believe that the independence of governance agency members could be compromised if the mutual fund manager pays the compensation directly. The payment of fund governance fees by the mutual fund manager is inconsistent with whole notion of independence and oversight by an objective party. The governance agency should be seen as working for the unit-holders – and that means they should be paid by unit-holders. Payment by the fund manager creates a negative perception of bias that threatens to undermine the notion of an independent oversight body.

Other reasons why governance agency compensation must be borne by the mutual fund, as opposed to the mutual fund manager include:

(i) the larger fund managers may be in a position to absorb the costs of mutual fund governance, while the smaller managers have no alternative but to charge all fund governance costs to the fund – not only would this create an unequal playing field, but could make performance information across fund complexes difficult to compare; and

(ii) giving mutual fund managers the option to cover governance agency compensation could result in this becoming a marketing issue (for example, a manager may elect to absorb fund governance costs in the guise of being a good corporate citizen).

We believe the Concept Proposal should mandate that the compensation of governance agency members be paid out of the net assets of the mutual fund and <u>not</u> by the mutual fund manager. However, having said that, does not deal with the issue for a fund manager to then indirectly absorb these costs be determining to absorb corporately other fund expenses to then lower the MER. Even if the manager had to disclose what costs it was absorbing, at the end of the day the result may still be an unequal playing field; however potentially affecting smaller managers to a much larger degree.

What do you think about our proposal that the fund manager be given veto power via the ability to call a special meeting to have investors consider any compensation that the fund manager believes is unreasonable?

Our comments here are based on the assumption that the CSA rejects our view that compensation be set by the fund manager.

Respectfully, we feel that the proposed veto power of the fund manager is both impractical and unrealistic. Presumably, fund managers would conclude that it would be cheaper, and therefore better, for shareholders to absorb the additional compensation costs proposed by the governance agency than go to the added expense and hassle of calling and hosting a shareholders meeting to discuss it. This is a logical proposal in theory but the costs outweigh the benefits, and is not a viable solution given the inherent costs of such meetings, which are borne by unit-holders.

Other issues relating to Governance Agency compensation

We feel that some significant thought should be given as to whether there should be any limitations on compensation – for example, is it possible and/or appropriate that governance agency members receive shares/options from (i) a parent company of the fund manager; or (ii) a manager that is publicly listed? Or is compensation all cash and, if so, a cost borne exclusively by the fund?

Our view is that there should be limits. Compensating the governance agency through shares/options would allow managers or their related parties to absorb fund governance costs. Another concern is that this would trigger a conflict of interest as the governance agency would have monetary interests in a related party of the fund manager (or the fund manager itself) that are potentially inconsistent with the fund/investors. We believe compensation must be all cash and borne solely by the funds (investors).

Another issue to consider is whether governance agency members should be required to invest in the funds they oversee, as a way of demonstrating to investors that their interests are aligned.

<u>Question</u>

24. Will the governance agency have sufficient powers in the event of a dispute with a fund manager? Will it be able to discharge its functions properly? If not, can you suggest alternatives for effective dispute resolution? If you do not agree with our discussion on the powers to terminate the fund manager, please explain why you disagree.

<u>Response</u>

While we believe that there is some merit in providing the governance agency with the ability to call special meetings as a means for addressing disputes, we believe that, practically-speaking, this is not a viable solution given the inherent costs of such meetings. Not only are the costs high, but these meetings require a tremendous amount of work and unitholder/shareholder apathy makes this an unattractive option. We agree with the CSA's comments regarding the logistical challenges of special meetings. In addition to the foregoing we are concerned over the lack of clarity around the meetings of the unit holders including such matters as preparation of the meeting material, the voting structure, whether or not proxys would be allowed and, if so, whether the governance agency would be allowed to solicit proxys, etc.

We recognize that there is a potential risk that special meetings will be called more frequently by governance agencies in the early years, particularly if they have a dispute with the fund manager. There are two reasons for this: (i) lack of clear precedents and (ii) exposure to personal liability. If they are to err, they would likely prefer to err on the side of caution. A potential offset to the risk of frequent special meetings is the fact that in the early days, at least, governance agency members likely will feel compelled to access professional independent advisors (legal, auditors) on a regular basis. While this may be a more cost effective way to address issues and work around disputes with fund managers, there is the potential for significant cost to investors – a cost that will vary from complex to complex depending on the sophistication of the governance agency and their tolerance for risk.

Will it be able to discharge its functions properly? If not, can you suggest alternatives for effective dispute resolution?

We believe the governance agency will have the ability to discharge their duties effectively.

Other powers that the governance agency may leverage as they relate to dispute resolution include (i) the ability to resign en masse; and (ii) the ability to approach the regulators.

If you do not agree with our discussion on the powers to terminate the fund manager, please explain why you disagree.

The governance agency should not be permitted to fire the manager. Neither do we believe that the governance agency should have the power to initiate investor meetings to consider firing the manager; there is too much risk of harm – both to the mutual fund manager/sponsor and investors. Low turn-out and quorum thresholds could make this a high risk game between the fund manager and the governance agency - a game of "chicken" that, unfortunately, investors pay for.

If investors lose confidence in the manager, they can "walk with their feet". It is cheaper for investors to redeem and pay the deferred sales charge (DSC), if applicable, than absorb the costs of a proxy fight and unit-holder meeting. The power to fire the fund manager is something that investors/advisors already have, and should be left to the individual investor.

Other issues relating to Dispute Resolution

The proposal to file a press release (describing the dispute) and amend the prospectus in the event of an unresolved dispute between a governance agency and a fund manager is, in our view, extreme. We are not aware that this is required of other reporting issuers (unless it constitutes a "material change") and query why the CSA would impose more onerous disclosure rules on the mutual fund industry.

From a practical perspective, we are unsure who would write the press release - the mutual fund manager or the governance agency? Clearly this will materially affect the tone and slant. What is the materiality test for an investor over an issue that requires an amendment and what is the timing requirement for purposes of when this must be filed – what is the triggering event? We believe that the materiality test should not exceed the test currently prescribed by NI 81-102.

Question

25. What do you think about our suggested approach for dealing with non-performing fund governance agencies or individual members? Do investors or fund managers need any additional powers or information?

Response

It is proposed that fund managers and governance agency members each be given the ability to call a special meeting of unitholders/shareholders to terminate the appointment of a member and to vote on his/her replacement. Practically, the powers of a fund manager with respect to the governance agency are limited, and unitholder/shareholder meetings are a huge production. They require a great deal of time and work by the mutual fund manager and result in significant costs to the investors in the mutual fund. While we agree that the power to call a special meeting to terminate an governance agency member is one that should be preserved, we do not believe it will be actively used by either side. The cost of removing an under-performing governance agency member may be greater than the benefits of doing so. Further, given the risk to the personal reputation of the governance agency member in question, there may be legal exposure to the governance agency in initiating a vote, especially if it is defeated.

Do investors or fund managers need any additional powers or information?

The governance agency should have the ability to remove fellow governance agency members, without having to go to call a special meeting. We also believe that there should be a prescribed term limit for the independent governance agency members of 3-5 years, at which time they can be either re-appointed by the fund manager or replaced by the fund manager. The non-independent governance agency members should not be subject to the same restriction due as the manager may not have limited resources from which to draw upon.

Question

26. What information do you think investors should receive about the governance agency in addition to, or in substitution for, the information we outline?

Response

Point of Sale Document

We feel that the recommendation to include disclosure of the governance agency members in the simplified prospectus is inappropriate. NI 81-101, as currently drafted, provides that a prospectus should include the key information that investors must consider before making an investment decision.

We do not believe that governance agency information is key information that investors must consider before making an investment decision. We note that NI 81-101 does not require portfolio managers to be disclosed in the simplified prospectus, nor does it currently require disclosure as to the senior officers and directors of the manager or the mutual fund – information that is presumably more relevant to an investors decision to buy a fund. Accordingly, we do not believe that it is appropriate for the point of sale disclosure to disclose the name and background of each governance agency member; the compensation paid to the governance agency etc. Rather, we feel that this should be disclosed in the AIF, together with the disclosure on the officers and directors of the fund manager and other parties.

Our view is that the goals of NI 81-101 have not been achieved. Prospectus documents are already unwieldy – they are very thick, expensive to print and costly for dealers to mail. Adding governance agency information is unlikely to achieve the goal of having investors read the point of sale document before making an investment decision. The prospectus is already filled with stale-dated and often irrelevant information. The proposal to add further disclosure to the prospectus does not, in our view, reflect commercial reality – that investors do not read the prospectus.

Regulation should focus on reducing the contents of the point of sale document and referring investors to web sites and other forums where investors have access to a very thorough document that contains all this of information, including information on governance roles, objectives, conflicts etc. This would serve as a permanent record that can always be regularly updated. Rather than continually amending simplified prospectuses, summary disclosure on web sites could inform and update investors of these changes. We respectfully encourage the CSA to re-examine the disclosure requirements and seek more efficient delivery media.

Annual Reports

The information proposed for Annual Reports dealing with the activities, membership, compensation and unresolved conflicts have some merit; however the question which must be asked is whether this is something investors really want and are prepared to pay for – both in terms of the additional print and mail costs associated with a larger document, and the independent legal fees incurred by the governance agency on behalf of shareholders in having the proposed disclosure reviewed and approved.

We are curious what the regulators expectations are in terms of the disclosure that the governance agency will give in terms of their performance. If there is unlimited liability, is it reasonable to expect the governance agency to be anything other than self-congratulatory?

Corporate level disclosure

We are unclear as to what the CSA is suggesting in this case. If it is to include corporate level disclosure in the form of MD&A, we believe this to be inappropriate given the mandate of the governance agency.

Question

27. How much time do you think we should allow mutual fund managers to develop their governance agencies?

Response

Given the aforementioned uncertainty with respect to the structure and role of the governance agency, we are unable to predict the time required to implement the project. Nevertheless, given that the transition will be a lengthy process and given the industry's participation through the process, it may not be unreasonable to expect implementation to be finalized three to five years following the enactment of the rule. The CSA may also want to consider proposals that would adopt a staggered implementation that is tied to firm size (i.e. where fund governance initiatives would be adopted by larger firms first and followed by smaller firms).

Question

28. What kind of training programs do you think will be necessary for fund governance agency members?

Response

Given the broad scope of the mutual fund business, governance agency members will need a very thorough training program. This will hinge to a significant degree on the qualifications of the individual governance agency members and their actual duties and responsibilities. We have considered whether there need to be separate examinations and/or courses as prerequisites to sitting on a governance agency, and have concluded that this should not be mandated. Rather, this may be an area where IFIC can help to develop a "best practices" guide for governance agency members.

Question

29. What are your views on registration of mutual fund managers? People have told us that they are concerned our proposals will introduce an additional bureaucratic registration system. If you share these concerns, please feel free to share them with us. However, please understand that our aim is to ensure that the mechanics of registration are as streamlined as possible. We are most interested in your views on our proposals about the conditions of registration of fund managers.

Response

We would support registration of fund managers provided that there is no duplication or unnecessary increase in the costs of regulation. We understand that the CSA want such registration in order to give them oversight of companies acting as fund managers and to impose a uniformity of standards across Canada. While we agree with the former objective, we do not agree with the latter if it would create a new registration requirement for companies which are already registered as advisers and/or dealers.

It is also interesting to consider whether registration as both an adviser and a dealer should be required before exemption from fund manager registration - in this context the CSA must review overlap for a manager who is also a member of MFDA.

The Concept Proposal states that:

> "Mutual fund managers will not have to also register as an adviser or a dealer, if they are carrying out those functions."

This suggests that registration in the category of mutual fund manager would be required, even though the company is registered as an adviser and a dealer, but that adviser or dealer registration would no longer be required once a company was registered as a manager. The advisory or dealer activities of some managers are not limited to such activities in the context of the mutual funds they manage.

For example, managers may act as advisors to pooled funds or provide investment advisory services on a segregated account basis. They may also be registered as both mutual fund dealers and limited markets dealers (in Ontario and Newfoundland) in order to trade in both mutual funds, pooled funds and exempt products for their clients.

For these reasons we believe that the alternative should be reframed so that registration as a fund manager is not required if the company acting as fund manager is already registered as an adviser or dealer.

One issue that is not addressed in the Concept Proposal is the question of jurisdiction. We ask that any rule requiring fund managers to register explicitly state the circumstances in which registration in more than one jurisdiction is required, as this is not clear in the Concept Proposal. Currently, unless offering advisory services directly to clients in more than one province or territory, fund managers who are acting as portfolio managers for their funds are only registered as advisors in the jurisdiction in which they carry on business, the funds are based and the advice is being provided, even though the securities of the funds may be offered across Canada. Similarly, in connection with wholesaling activities for their funds (unless they also sell directly to investors), managers are typically registered as dealers only in the jurisdiction in which their funds are based. We believe that this limited registration is appropriate as the manager is providing its dealer and advisory services to its funds in that jurisdiction. Conversely, if the manager was advising clients directly, or trading in fund securities directly with investors, in multiple jurisdictions it should be registered as an adviser or dealer, as appropriate, in such jurisdictions.

If multiple registration is required, we request that the CSA streamline manager registration as much as possible. We suggest that there be a single registration procedure, even if registration is required in multiple jurisdictions, and that the fund manager registration might be an appropriate first stage in implementing a national securities registration.

Conditions of registration

In determining the conditions of registration for fund managers the CSA must be sensitive to the differences in the ways in which fund managers can be organized. These range from a complex company with a large stable of funds and many employees who provide internally all of the services required for its business (whether directly or through affiliated entities) to small companies which act mainly as wholesalers, outsourcing fund administration and investment management to unrelated third parties and trading only through other registered dealers or, alternatively, as portfolio advisers and outsourcing fund administration and most aspects of fund distribution.

We believe that the CSA must structure the registration requirements for fund managers with enough flexibility that the requirements permit different business models. Otherwise these requirements may impose significant, and unnecessary, barriers to entry.

Senior Management Positions

Although it is not clear, the Concept Proposal seems to suggest that registered fund managers have four senior management positions, even though there is no such requirement for other categories of registrants. We do not feel there to be sufficient justification for the requirements for registered fund managers to be different in this respect from those for the other categories of registrants.

The ability to fulfill dual functions is not discussed in the Concept Proposal . We submit that a registered fund manager should not be required to have four separate individuals serve as chief operating officer, chief financial officer, senior administrative officer and senior compliance officer and that multiple roles should be clearly permitted. In this regard we note that the Investment Dealers Association of Canada (IDA), whose members are often engaged in businesses much more complicated than that of fund managers, only requires that its members have two officers. Currently those officers must both be full time, although proposed amendments to IDA By-law 7 would allow one of those officers to be part-time. The IDA also permits a single individual to fulfill a number of positions, for example ultimate designated person, compliance officer and chief operating officer. Similarly, Rule 2.5.2 of the Mutual Fund Dealers Association permits an individual to be both the compliance officer, a trading officer and the chief executive officer, chief operating officer or chief financial officer of a member.

We agree that the functional responsibilities of a CEO, CFO, senior administrative officer and senior compliance officer are part of the business of all fund managers. However, depending on the particular circumstances, including the ability to outsource and size of a fund manager, a single individual might reasonably play multiple roles and part time positions could be justified. For example, in the case of a small fund manager with one or two funds, it may be difficult to justify a full time chief financial officer.

Minimum Proficiency

The Concept Proposal would require all directors and officers of a registered manager to satisfy certain proficiency requirements. We have some concerns with the proposed requirements..

1) outside directors

While we agree that satisfying experience and educational proficiency requirements should be necessary for the <u>inside</u> directors and the officers of a fund manager, we do not think that these should be imposed on the outside directors.

2) officers

We do agree that all officers should complete a stipulated partners, directors and officers exam. However, we do not agree with the suggested minimum of three years experience in the investment fund/securities industry. It may be that someone with broad experience in a less directly applicable field, or indeed another field altogether, might be appropriate as the chief executive officer of a fund manager as CEOs traditionally require vision; integrity and communication skills before industry knowledge. There is no special quality which is distinct to the fund industry as opposed to other industries with or without licensing requirements, which justifies requiring all officers of a fund manager to have direct industry experience. We believe that unwarranted proficiency requirements will serve as barriers to entry. As well we note that for managers located outside of the major urban centers, individuals with the suggested experience may be extremely difficulty to find.

The IDA only imposes experience requirements on persons seeking approval as branch managers, certain traders and advisers and the MFDA only imposes proficiency requirements on trading partners, directors and officers. The CSA have approved the rules of the IDA and the MFDA as being appropriate for the members of these SROs. We do not see why a higher standard of proficiency should be imposed on fund managers than on SRO members or companies registered as advisers and note that the Concept Proposal does not set out any justification for these higher requirements

Question

30. The Fund Governance Committee of IFIC recommends that the fund governance agency be responsible for considering the qualifications and proficiency of management. If the governance agency does not believe the fund manager has the right people to undertake the task of managing the funds, it should require changes. If the fund governance agency has this power, the Committee submits that we do not need to impose regulatory standards.

    We do not agree with the assertion that the fund governance agency should take on this role. Our registration system for advisers and dealers sets out standards for their officers and directors and we think similar requirements should apply to fund managers. We think the governance agency should be responsible for overseeing the management of mutual funds, not for assessing the adequacy of senior management and the directors of the fund manager. Do you have any thoughts on this matter?

Response

At first instance we agree that the governance agency should not be responsible for assessing the adequacy of senior management and the directors of the fund manager. However, while it would be appropriate for the CSA to determine the proficiency requirements for registration, we believe that any such requirements must be flexible enough to recognize that a variety of kinds of experience could be appropriate for a senior role in a fund manager, for example experience in the pension or financial institution industries or with corporate boards.

Question

31. Do you believe a minimum capital requirement is justified? What do you think about the three options that have been recommended to us? Can you suggest an alternative option?

Response

We agree that it is appropriate for the regulators to have in place mechanisms to ensure that a fund manager is adequately capitalized to protect investors in the event of the insolvency of the manager and to ensure that it can adequately operate its business through turbulent markets. However, the proposal to have capital requirements similar to those required of existing registrants (a regime that was brought into force many years ago) does not necessarily protect investors adequately or address the real investor protection issues.

For example, in the event of the insolvency of a fund manager (often due to an unforeseen event), there is no capital available for the winding-up of the business. In recognition of this risk, IFIC is working toward creating a manager contingency fund for these purposes.

We believe that any capital requirements should not duplicate the existing capital requirements fund managers who are currently registrants and should reflect the totality of their businesses (most fund managers also provide asset management services to non-regulated entities and to other clients, or are intending to do so).

The proposed capital requirements are significantly in excess of the current requirements for ICPM's and mutual fund dealers, with no justification being given. We would recommend that, in the event that there are capital requirements for managers, that they be the same as the capital requirements currently in place for ICPM's in Ontario, until such time as the capital requirements for all registrants can be reviewed by the CSA on a co-ordinated national basis.

Furthermore, we see no reason to link assets under administration with the capital required for the business. In fact, given that the asset management business is not a capital intensive business, it seems inappropriate to do so. The proposal also raises the very real problem for a growing manager that they may be required to stop sales of popular mutual funds if they are not able to obtain additional capital needed not by the business, but by a regulation. As well, the quantum of the proposals would create very significant barriers to entry into the mutual fund industry without any material corresponding benefits to investors.

For these reasons, we recommend that either that there be no additional capital requirements for fund managers or that the requirements mirror the current ICPM capital requirements in Ontario (which do not vary based on the assets under administration of the manager) until a national capital requirement is implemented for all registration categories.

Question

32. Is our list of insurable risks complete? We will need to determine the appropriate minimum levels of coverage for the insurable risks. Can you offer us any guidance on this matter?

Response

Fund managers should have minimum insurance coverage and limits, provided that such is available at reasonable rates and that the insurance market will issue such policies routinely to new entrants and to existing market participants. In other words, fitness for registration should be determined by regulators, not indirectly by insurance companies.

The proposed list would appear to include all appropriate risks. We recommend that this list be reviewed with qualified insurance specialists to (1) ensure that it includes all relevant risks, (2) coverage is available for these risks, and (3) these risks are insurable at reasonable costs. Once that information is obtained, the need for such insurance should be reviewed to determine if the benefits outweigh the costs. It should also be noted that in some cases such insurance will only be available on a claims made basis and as such may not provide the protection contemplated by the CSA nor provide the necessary comfort to the governance agency members.

Question

33. Is our list of essential internal controls complete? Do you think our proposal for an auditor review of internal controls is necessary? Why or why not? Do fund managers today routinely ask their auditors to conduct this review?

Response

The list of internal controls should be extended to include the standard internal controls expected of both a mutual fund/securities dealer and an investment counsel / portfolio manager.

We do not believe that auditors should be given the burden of reviewing internal controls beyond their current practices for the purposes of the preparation of their review of the financial statements of the manager. The CICA currently has in place standards for reviews of internal controls (a Section 5900 review) which results in a significant financial cost without, in our view, any significant benefit in these circumstances. Furthermore, any proposed additional reviews by auditors should be discussed in detail with the CICA and major audit firms to determine (a) are they feasible, (b) what is the estimated approximate costs, and (c) whether the industry is prepared to provide such reviews.

We believe that fund managers, like virtually all businesses, do not routinely request their auditors to conduct detailed reviews of their internal controls.

Question

34. It has been suggested to us that the CICA provisions respecting Section 5900 Reports may be of assistance in discharging regulatory obligations of the fund

manager to satisfy itself, and demonstrate on an ongoing basis, that a third party service provider is competent to fulfil the functions in question. Independent external auditors would perform this audit and the report would be filed with the manager and regulators. Do you believe a Section 5900 Report would be useful in this context? Why or why not?

Response

We do not believe that it is appropriate to require third party providers to obtain a Section 5900 report from an accounting firm as a condition of providing services to a manager or a fund. While these are on occasion obtained in the industry, the industry has not found it necessary (relative to the high cost) in order for managers to fulfil their oversight obligations of third party providers.

In addition, when services are provided to managers by third parties, the manager may or may not have the ability to insist on a detailed review by its auditors or on a Section 5900 report.

Question

35. Can you think of any other minimum standard that should apply to fund managers as a condition of registration?

Response

We are not aware of any other minimum standards that should apply to fund managers.

Question

36. Please provide us with your views on how we can best achieve our objectives of re-evaluating product regulation. What changes are most important to you and why are they important? What aspects of product regulation do you think cannot be changed?

Response

We respectfully submit that it is essential that the CSA revise and improve the existing regulatory framework governing mutual funds, prior to or in any event no later than, the time that it implements the new fund governance and manager registration rules. All parties, including both the CSA and the industry, agree that there are a number of areas in which the current regulations are inadequate, unnecessary, or problematic. These regulatory shortcomings increase the regulatory burden borne by the Canadian mutual fund industry, without adding any meaningful regulatory benefit. We submit that the CSA can best achieve its objectives by fixing the existing regulatory problems before adding yet more regulations to an already heavily burdened industry.

In considering changes to the existing rules, we submit that the CSA ought to rank the issues in terms of priority. First, there are a number of existing regulations that do not function well and require urgent attention. In this group, we would include rules related to related party underwriting (the “60 day rule”), inter-fund trading, fund-on-fund structures, and principal trading rules. Second, there are several existing rules that may become redundant or unnecessary once a fund governance regime is implemented and which should therefore be eliminated or significantly revised. This category includes many of the investment restrictions (e.g. concentration, illiquidity) as well as many of the related party rules.

With respect to the first category of regulation, we believe that, whether or not a new fund governance model is introduced, the product regulation falling within this category should be fixed as soon as possible. With respect to the second category, we believe that changes should be made if, and at the same time as, a new fund governance model is introduced

Question

37. Is it realistic to expect that the governance agency will ensure the manager complies with its policies on such matters as related-party transactions? Can this approach replace the current conflicts of interest rules?

Response

We submit that it is realistic to expect that a governance agency will ensure that a fund manager complies with its policies on such matters as related-party transactions. In fact, we submit that a governance agency is in a better position than securities regulators to monitor and enforce such policies, because it will be closer to the mutual funds it governs, it will have a better idea how they operate, and it can act quickly to remedy any issues that may arise.

In our view, the approach of using a governance agency to monitor manager compliance with policies on related party transactions can and should replace the current conflicts of interest rules. The current conflict of interest rules are significantly flawed and should be significantly revised, if not entirely replaced. The approach of allowing each fund complex, in conjunction with its governing agency, to develop its own tailor made rules – perhaps subject to general principles articulated in legislation – should allow for a more finely developed regime that would protect the interests of investors without artificially restraining practices that are innocuous or even beneficial to investors.

Question

38. What are your views on the specific areas that we are re-considering? Are there other changes we should consider in the area of investor rights in light of our proposed renewed framework? Do we need to consider defining additional rights for investors?

Response

It is clear that investors in mutual funds are not generally interested or willing to participate actively in the management of their investment holdings. Consequently, we believe that there should be few, if any, matters that require investor approval prior to implementation. In most, if not all, cases, approval by the governing agency ought to be sufficient. For instance, an "easy case" is that mutual funds should be able to change auditors without seeking investor approval.

The one area in which we would contemplate retaining investor approval would be where there was a change to a new, unaffiliated management company. In our submission, the fundamental choice being made by investors when they select a particular mutual fund is the choice of mutual fund manager. Consequently, this is one issue on which we believe it is reasonable to continue to require investor approval. We do not believe, however, that ownership of the manager corporate entity is a fundamental part of an investor's investment decision. Consequently, we do not support a similar vote with respect to a change of control of a manager as long as the same manager remains in place after the change of control.

In considering the issue of investor rights, the CSA has given notice that it is considering the issue of "minority rights" which could allow fund investors to redeem from a mutual fund without paying any applicable deferred sales charge. We are strongly opposed to any scheme that would waive deferred sales charges.

First, we would submit that "minority rights" are not required since the very nature of a mutual fund is to permit an investor to redeem at current value, at any time. Unlike a corporate environment, in which there may be legitimate disputes over valuation, mutual funds are always priced at fair market value. Thus, there is no need to provide special rights to allow "dissenting" investors to obtain "fair value".

Second, there is no logical connection between a change in a mutual fund and an investor's obligation to fulfill his or her contractual commitment to pay a deferred sales charge, if that is the option he or she selected. Although different funds offer different purchase schemes, most offer investors a choice as to whether they wish to pay a commission at the time they purchase (a "front end load") or when they redeem (a "back end load"). This choice is analogous to a decision about how to finance a new car purchase (e.g. purchase vs. lease). A mechanical problem with your new car doesn't allow you to escape your lease obligation, because the financing arrangement is not considered to be integrally related to the basic soundness of the car. Similarly, an investor's choice of commission structure is not fundamentally connected to the underlying mutual fund that the investor purchased. In our submission, it would be a dangerous and flawed initiative to connect the basic structure of a mutual fund to the choice of commission financing selected, as there is no sound analytical basis for such a connection.

Third, it would be unfair for anyone other than the investor to bear the cost associated with waiving a deferred sales charge. When an investor purchases a mutual fund under a deferred sales charge option, the mutual fund company nonetheless pays a commission to the selling dealer, at the time of the sale, even though no commission is deducted from the investor's principal investment. Typically, this commission payment is financed through a third party, which may include a bank or even public investors. As part of the financing, the mutual fund company typically incurs an obligation to pay an annual fee (the "distribution fee") to the financing party as well as an obligation to pay any back end loads received on redemption. This obligation is a fundamental part of the economic viability of such financing schemes.

If the CSA were to introduce a rule excusing redeeming investors from paying their deferred sales charges, in certain situations, it would be necessary to determine who would bear that cost which the investor is no longer obliged to pay. In our submission, there is no party on whom it would be fair and appropriate to impose this cost:

- the mutual fund itself should not bear the loss, since the innocent investors remaining in the fund have not done anything to justify imposing an additional cost on them;
- the mutual fund manager should not bear the loss, since it has done nothing wrong, and – in any case -- requiring managers to absorb potentially significant deferred sales charge liabilities would effectively foreclose any such transaction since the economics become unviable; and
- there is no basis to impose the loss on the innocent third party financier which has done nothing to disentitle itself to its contractual entitlement.

Deferred sales charge financing is a significant part of the Canadian mutual fund industry. Over the years, the industry has developed complex financing schemes to support deferred sales charge regimes. Any regulatory change that would unravel these financing arrangements would be extraordinarily costly, with no corresponding benefits. In our submission, there is a significant risk that a minority rights regime would be abused by investors who would use it as an excuse, which they otherwise would not have, to exit a fund without penalty. In our submission, the existence of an independent governance agency would provide sufficient protection for investors, and therefore should eliminate the need to provide minority rights.

<u>Question</u>

39. Upon reading the staff research paper, what are your views on the costs of our proposals versus the benefits? Should we take into account other costs? Other benefits?

<u>Response</u>

The benefits to mutual fund investors do <u>not</u> outweigh the costs associated with the current governance structure. It appears the CSA is adding another layer of rules without offering any deregulation as an offset. While fund governance may be an appropriate solution in theory, is it a necessary protection that investors are willing to pay for?

We are very concerned that the added costs associated with the proposed structure [e.g. directors compensation, increased professional fees charged to funds by directors, more prospectus costs (printing, mailing and legal fees] will impact investment returns, to the detriment of the very investors on whose behalf we are striving to build wealth and prosperity. We are also concerned that the media will pick up on this issue, much as they have with MERs in the past. Given the inherent costs and cumbersome structure of mutual funds, mandated by regulators, investors would be better served to seek alternative, cheaper investments solutions. Driving investors away from the mutual fund industry is a distinct possibility they could follow such advice to their detriment as they might forego many of the benefits of mutual fund investing.