ClaringtonFunds

June 7, 2002

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VIA E-MAIL: jstevenson@osc.gov.on.ca

Mr. John Stevenson, Secretary
Ontario Securities Commission
20 Queen Street West
19th Floor, Box 55
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Dear John:

Please find attached our response to Concept Proposal 81-402.

Sincerely,

"*Gavin Foo*"

GF/ml

Attachment

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Concept Proposal 81-402
Striking a New Balance: A Framework for Regulating Mutual Funds and their Managers

QUESTION 1: 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: We encourage any regulatory change that protects our industry from abuse and increases confidence in it. Having said that, we feel the current regulatory regime works fine as is. In our view, the proposal is too aggressive, considering there have been no scandals or failures of fund companies in recent memory. There will be added cost and bureaucracy which we feel will definitely outweigh the benefits.

In addition, the concept proposal leaves too much uncertainty, as product regulation, disclosure and investor rights are still not final.

For companies such as Clarington, where the majority of functions are outsourced to third parties (investment management, fund accounting, transfer agent back-office, etc), we believe our oversight function is stronger than if these functions are performed in house. This is because the companies we outsource to have their own compliance requirements and Clarington does its compliance on those same companies. Because compliance is vital, both companies, Clarington and the company to which the service is outsourced, will be equally vigilant. We suggest that the proposal should recognize companies with operational differences, and tailor the regulations accordingly.

Additionally, the key role of the Governance Agency (“GA”) is to address conflicts of interests, so why are the duties of the GA so extensive? How can they simply “oversee” the operations of the manager without micro-managing? Many of the duties, which are proposed to be the responsibility of the GA, should be left to management. The way the proposal reads the GA will effectively be full-time employees, which is both costly and impractical.

It’s important to remember also, that the mutual fund industry has been remarkably free of scandal since the days of Mr. Cornfield, over 40 years ago.

QUESTION 2: 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: We feel the status quo should not be changed based on our response in 1 above. The mutual fund industry is already heavily regulated and the proposal will add yet another layer of regulation, bureaucracy and cost, all of which will be borne by the investor.

QUESTION 3: 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?

Response: Yes, we agree that these investment vehicles should be subject to the same regulatory scheme. They are products that compete with mutual funds and hence should be subject to the same regulations.

Currently, regulatory standards are higher for mutual funds than they are for other managed products. This inequality, in our view, is unjustified.

QUESTION 4: 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: As the CSA states, "Like products should be regulated in a like manner." Pooled funds, labour sponsored funds, hedged funds, segregated funds, exchange traded funds and closed-end funds all compete with mutual funds, and hence should fall under the same regime. This will be a step further towards the goal of national harmonization and to level the regulatory playing field.

QUESTION 5: 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.

QUESTION 6: 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: We disagree that a GA can effectively oversee the management of the funds in an efficient manner. Current fund management company boards work well in this context; they have

the requisite experience and knowledge, without micro-managing the day-to-day operations. From a practical standpoint the GA can only be from the mutual fund industry because of the industry-specific knowledge required. This seriously limits the pool of possible members.

The proposal will give the GA too much power and the temptation to micro-manage will be strong. It will also be costly, and will not add value to investors. For smaller fund companies, in particular, the result will be an increase in MERs. This could, in many ways, be seen as a barrier to entry.

The mutual fund industry is already highly regulated and any additional regulation must clearly identify the benefits and justify the additional costs.

An important change to the proposal would be a statutory cap on liability for independent GA member. Unlimited liability will do little more than increase fund expenses, as GA members will want the sign-off/assurances of independent experts prior to undertaking any decision that might expose them to liability.

It is also important to note that a difference in individual liability might arise depending upon the legal structure used to constitute a fund (i.e. 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.

QUESTION 7: 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: No, we do not feel that any important principle consideration has been omitted in the CSA's Concept Paper.

QUESTION 8: 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 a flexible approach to fund governance is preferable and should accommodate any business structure that evolves for the issuance of mutual funds and similar securities.

QUESTION 9: 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: With respect, we disagree with Mr. Stevens. A quick comment on each topic follows (Stevens Report, Page 18):

(1) Does not apply to Clarington. Our company has no pecuniary interest as our service providers are all unconnected to Clarington. The vast majority of fund companies with a pecuniary interest relationship would never pay for less than excellent service. To do so would put their business in jeopardy.

(2) MERs would rise and unless performance was outstanding their performance would not be competitive.

(3) Every fund company has external auditors who audit this very item. Mr. Stevens is saying these auditors cannot do the job. Perhaps the auditors should be required to report directly to the regulators.

(4) Fund companies must be competitive or else they will go out of business. Competition will minimize abuses of this type. Fund companies are more than ever aware, because of press comment, of the need to be as fair as possible with MERs.

(5) Trailer fees are not illegal. In fact, they are very beneficial as they stabilize the incomes of the independent sales force (important in bad markets) and reduce the temptation of selling for desperately needed income. Also, these fees are pretty much standard across the industry, providing no incentive as suggested by Mr. Stevens.

(6) The MER is the MER. Whatever the shenanigans that occur the MER can only go so high before the fund becomes uncompetitive.

(7) This is putting the worse case scenario on the industry. While there may have been a few (out of hundreds of thousands) cases of this we suggest it is very unlikely. Most funds are sufficiently large that scarce securities are never an option for the fund.

(8) This would be the dumbest thing a fund company could do. Very hypothetical concern.

(9) Unlikely. We suggest most fund companies watch this carefully as public knowledge of such an infraction would be deadly for the company's reputation.

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

Response: We disagree that owner-operated mutual funds should be treated differently than mutual funds, as they are identical products. We also compete with them for the same investors, so the same level of investor protection should be afforded.

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: We agree that there should be no specified limit as to the number of mutual funds a GA oversees. However, there will be a practical limit depending on the structure of the fund complex, the complexity of funds themselves (multi-class; fund on funds; etc), and the nature of the investments in the funds (one that uses derivatives and complex instruments versus one that do not; etc).

However, the overriding issue that impacts this is the role and responsibilities of the GA. Until the role and responsibilities of the GA are clarified and finalized, it will be very difficult to assess in any definitive way what the potential limit will be.

In addition, the potential liability to which GA 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).

If the GA is adopted, specific guidance should be provided as to the scope of its oversight. This would put all managers all on a level playing field. This will also provide a framework in which to work and what the expectations are.

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 it would be very difficult to find qualified members for the GA. Mutual funds are specialized and quite different from most operating corporations. There will be a cost to obtain members with the requisite knowledge, as there is a limited talent pool available. In addition, the personal liability of members will be a huge deterrent for any member.

The extensive duties and responsibilities mean that being a GA member is a full-time job and must have a great deal of knowledge about the daily operations of a mutual fund. Not only will this be very costly (members will want to be adequately compensated for any potential liability), but also how many individuals are willing to do this full-time?

The report mentions "training" of independent GA members. This will be a lengthy, costly and perhaps impossible task. It's difficult enough to educate company directors who have not been directly involved in the fund industry but may have excellent accounting or investing background in the complexities of managing a mutual fund company.

We foresee that the recruiting process will be time consuming, expensive, and requiring the services of a professional search firm. There will be 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: Our strong belief is that our current board of directors (the independent directors) is well suited to carry out the governance work. It is very much in their best interests to ensure excellence in this area. However, we do not believe that all members should be independent, as the participation of persons familiar with the day-to-day management and operation of the funds being overseen by a GA is crucial to ensuring that the GA carries out its roles and responsibilities in an efficient and effective manner.

QUESTION 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?

Response: We strongly and firmly believe that the responsibilities the CSA proposes are inappropriate for the industry in general and especially inappropriate for a company of Clarington's size. A very real danger exists for the GA to micro-manage. This temptation will become stronger the longer the individuals are in place. This could well happen even with the best of intentions and will certainly happen to those members who tend to build empires or are of an interfering nature. Also, the bigger the role the bigger the remuneration. If we look for a formula for disaster it would be an unlimited ability to increase job responsibility, the surrounding bureaucracy and the remuneration attached to it. Even without malicious intent, human nature is such that good people can slip into bad behaviour.

Will the GA be able to overwhelm the fund company with requests for studies, research, arcane data and the like? This paragraph says "whatever information"! Again, human nature will tend to enlarge the definition of "whatever". Over the long term nature will always fill a vacuum. Many of the duties listed would require audit and/or legal opinions that the GA would need to rely on. Again, this is very costly. For instance, the GA must approve internal controls. Very few people have the qualification to do this; one would need to engage experts and consultants.

Many of the responsibilities of the proposed GA are the responsibility of management and ultimately the board of directors. This is clearly a duplication of effort and a waste of valuable resources.

The fund industry consists of large, medium and small fund companies. Some of the smaller companies, such as Clarington, are providing some of the best products and service. They also remind larger companies that they must not rest on their laurels or the young upstarts will take their market share. Some large companies are subsidiaries of the largest companies in the world. For them money is no object. This is not the case for the smaller companies such as Clarington. The extra cost is not just in extra salaries for GA members, but in vital time required by company management and staff to service what could be ever-increasing requests by the GA.

Remember that the GA will be able to write its own ticket in salary, other costs and the size of the support function to be supplied by the fund company. The cookie box is "open and there is no one watching."

In the event of a dispute, the watchdog (the GA) of the fund company can go to the huge expense (mail cost alone is a fortune) to call a general meeting (to which very few people in the past have attended). And how will the voting go? How would one vote faced with a disagreement between "the fund company" and a regulator mandated "independent governance agency"? The high ground, by definition, is with the regulator. After all, what are regulators for but to catch the bad guys!

Will the GA be qualified to approve performance benchmarks? Some funds may have several benchmarks; some may have no benchmarks applicable to them. Some funds will be much more volatile than any benchmarks or markets. Furthermore, the regulators dictate index comparisons when they review prospectuses. What will the GA do, or ask to be done, about that? Micro-Manage!

The GA will be forming committees and sub-committees. Now, that's definitely not encouraging! Upon reading this our sarcastic gene thought, "We always needed a large and growing bureaucracy so we cannot lower MERs and grow our company." Seriously, it's terrifying to have attached to any company, a bureaucracy (growing) that is setting its own terms without any effective oversight or limits. We could be witnessing the first appearance of such an entity in the Western Capitalistic World…exciting stuff!

Perhaps the main function of the GA will be to see that the fees and allocation of the expenses across the various funds are done fairly. The danger is that this body will endeavour to bring the fees down to the lowest point possible. To argue that this would not be the case would be to ignore a basic fact of human nature. A company's responsibility to shareholders is to endeavour to make as high a profit as possible consistent with building their business and selling their product. This is a basic trait of a capitalistic society. If prices get too high, other suppliers enter the business with lower prices forcing the prices down overall. A Government appointed body with the ability to fix prices (this is what this would be) would be socialism revisited. And we know how successful socialistic societies have been. We suspect that even the suggestion that there would be an outside government appointed body ruling on profitability of a publicly traded fund company would be disastrous for the price of that company's stock.

All of these concerns are very real. This cannot be left to vague phrases such as "all of this will be handled fairly." It cannot be left to the final judgement of unitholders who, as mentioned above, will obviously take the advice of the government appointed body. After all, the governance committee was set up by the government for which they voted for to "look after their interests." The company will never win in any dispute with this agency. With all of this baggage, why would anyone risk starting up a new mutual fund company? Without new blood in any industry, there would be less competition and little infusion of new ideas and new products resulting in a stagnant complacent business sector.

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 feel no other policies should be reviewed. Relating to derivatives, this is what the portfolio manager does; how can the GA intelligently question their use if the manager feels it is right for the fund and within regulation?

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

Response: No, we do not feel the independent members of the GA will be effective in their audit committee role. Much of the disclosure that fund companies make is transparent and prescribed. As a result, they must have their oversight duties limited to the review of information presented and the format of its presentation for the purposes of assessing its meaningfulness to unitholders.

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: The liability risk to GA members, even if a limit is set, will still be a huge disincentive to take on this responsibility. It would lead to them being ultra-conservative, and lead to the interfering of the day-to-day operations. Again, we see added unnecessary costs with little benefit! There will be direct costs as well, such as the cost of the insurance required by members (which will be passed on to investors).

Nevertheless, we believe that a limit on the liability of GA members is necessary if there is to be any chance at all of attracting qualified persons at a reasonable cost. Exposing members to unlimited liability will deter qualified persons from acting as members of governance agencies.

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: We believe a statement of standard of care is a good thing. However, depending on the extent of it, it may deter members from participating if they feel uncomfortable with the specific standards regarding their own personal exposure, even with limited liability, and 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 had no experience with GAs.

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: We strongly disagree with the proposal regarding GA member appointments. Why would there be suspicion about fund managers appointing members? The fund manager is well positioned to identify qualified prospects and build a GA with the necessary skills to carry out the mandate. If there is indeed suspicion then it appears to us that the regulator must consider fund managers and their board of directors of poor character and unable to be trusted. However, if the new GA is adopted, regulators can be sure that the fund industry, even if it disagrees, will work hard and work fairly to make the new procedure work as well as possible. Any effort to 'sabotage' the new GA system would obviously be detrimental to the success of the fund company involved.

While we understand the theoretical benefits of having investors involved in an election process, this is impractical given the general costs of unitholder meetings. We do not believe it is practical to expect unitholders to nominate GA members given that they have no experience to fully know what the role of the GA is to be and what the necessary skills are to carry out the role.

Unitholders generally would not care about notices to them regarding new appointments or resignations of GA members. With hundreds of thousands of unitholders, this will be extremely costly to do, and the costs will inevitably be passed onto investors.

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: See response in 20 above.

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: Allowing investors to exit deferred load funds without charging a fee would be open to huge abuse. Many companies, including Clarington, obtain funding to pay commissions to financial advisors based on best estimates of early redemption rates. The possibilities of a rule that could allow mass redemptions due to a presumed dislike of a GA member would be comical if it was not so wrong minded.

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: GA members will have to be smart people. They will not take long to discover that they will get any pay increase they want if they keep the total amount under the substantial cost of calling a unitholder meeting. Of course not all members would be so Machiavellian to conduct themselves in that manner. However the possibility does exist. The regulator must place a limit on the compensation, perhaps based on the number of funds to be monitored. The monitoring of a company with 250 funds will be more costly than one with 20 funds.

Hence constraints must be placed on the ability of GA members to set their own compensation. We think requiring GA member compensation to be subject to fund manager approval is appropriate as fund managers are better able to factor in all costs and already have a defined statutory obligation to act in the best interests of unitholders and the fund. We feel there needs be a process for ensuring proper checks and balances on compensation – otherwise, bigger complexes could drive the price of GA compensation to levels prohibitive for smaller players like Clarington. This would increase barriers to entry and otherwise inhibit competition by forcing some out.

QUESTION 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.

Response: We feel the "framework's" view that calling special meetings of investors for any and all disagreements between a fund company and the GA will not work. The result could well be a profusion of special meetings that are more costly than realized. Not only are the costs high, but these meetings require a tremendous amount of work and shareholder apathy makes this an unattractive option. Imagine the scorn that would be expressed by investors and media on an industry that is in such apparent disarray and confusion. And remember the GA will always have the perceived "highroad" in any dispute with management.

The regulators should be careful not to release upon an important and well run industry (these changes are not being implemented because of system failure but in case failure will occur sometime in the future) a "motherhood" regulation that has the potential to spiral our of control and wreak havoc on one that is working and has worked well.

The question is not whether the GA has enough power, it is whether the fund company will have enough power. To repeat – the GA as the child of the regulator (by many citizens

perceived as the government) established to monitor fund companies (the bad guys, otherwise why would the all knowing, all helpful government establish it) would clearly be perceived as taking the high road and would prevail, we contend, in all (not some) disputes.

If we consider this from an investor's point of view and if the dispute is in some activity of which he/she is not highly informed, he/she would automatically look to the Government (the GA) to give him/her the most honest opinion. The fund company is truly in a lose-lose situation!

Investors presently have the right to fire a manager. Today this would probably only occur if a manager was failing the standards currently set by regulators. We cannot recall this ever happening. The wide-open ability of the GA to fire a manager through a special unitholder meeting (where the GA owns the high road) is a frightening prospect. If investors lose confidence in the manager, they can "walk with their feet". It is cheaper for investors to redeem and pay the DSC, if applicable, than absorb the costs of a proxy fight and unitholder meeting. The power to fire the fund manager is something that investors already have, and should be left to the individual investor.

It is unclear as to whether the GA has the ability to fire the manager, as in "the portfolio manager of the individual fund," and/or fire the mutual fund manager as in "Fidelity or Clarington Funds." If the proposed legislation intends that the GA can, indeed, fire the portfolio manager, then we will have a small body of people taking over from the mutual fund company one of the most important aspects of the business. Would one year underperformance justify firing? Or, would it be two to three years? Would we end up with a spate of firings all of which backfired a few years later when the fired manager, under a different environment, comes storming back and beats the field? To have anybody but the mutual fund company be responsible for this function could be tantamount to passing over the keys to the business to the GA. Doing this would be akin to having an outside body attached to a cereal maker with the ability to stop the company making a particular brand of cereal or insisting that they manufacture that cereal by a different process.

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 GA members each be given the ability to call a special meeting of unitholders to terminate the appointment of a member and to vote on their replacement. Practically, the powers of a fund manager with respect to the GA are limited, and unitholder meetings are a huge production and a huge cost. These are never well attended anyway! They require a great deal of time and work by the 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 a GA member is one that should be preserved, we do not believe either side will actively use it. The cost of removing an under-performing GA member may be greater than the benefits of doing so.

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: We feel that the recommendation to include disclosure of the GA members in the simplified prospectus is inappropriate. NI 81-101 provides that a prospectus should include the key information that investors must consider before making an investment decision. We do not believe that GA information is key information that investors must consider before making an investment decision. We also note that NI 81-101 does not currently require disclosure regarding the senior officers and directors of the manager or the mutual fund – information that is presumably more relevant to an investor's decision to buy a fund.

Prospectus documents are already unwieldy – they are very thick, expensive to print and costly for managers and dealers to mail. The prospectus is already filled with stale-dated and often irrelevant information. The proposal to add further disclosure to the prospectus does not reflect reality – that investors do not read the prospectus.

We do not agree with the additional disclosure in the Annual Reports dealing with the activities, membership, compensation and unresolved conflict, etc. This is something investors do not want and are not 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 GA on behalf of unitholders in having the proposed disclosure reviewed and approved.

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

Response: Given that the transition will be a lengthy process and given the industry's participation through the process, it would be reasonable 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: GA members must, at a minimum, be trained on fund accounting, trust accounting, transfer agency and portfolio valuation, derivatives, financial reporting, expense allocation, regulations (National Instruments) and OSC disclosure requirements. This will be extremely time consuming and costly to do.

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 agree that registration for fund managers is a good thing, since now fund

managers will then meet minimum standards. This will level the regulatory playing field. This is with a caveat that there be no duplication or unnecessary increases in regulatory costs.

In determining the conditions of registration for fund managers the CSA must be sensitive to the differences in the ways in which fund managers are 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 such as Clarington 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, especially to the smaller, less complex organizations such as ours.

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: We feel very strongly that the GA should not be responsible for ensuring the qualifications and proficiency of management. To let this occur would put the GA in the position of running the management company. The existing registration system takes care of this. Again, we don't want micro-management!

We stress 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 the 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 senior administrative officer. Again, this would add additional costs that would put smaller companies such as Clarington at a disadvantage.

Regarding minimum proficiency requirements, why must directors have three years in the industry? Why would anyone think that a senior corporate executive (CA/MBA) not bring to the

position huge experience in management, accounting, leadership, board committees and more and not be able to soon understand fund industry issues. Imagine this person not qualifying while a broker or a mid-management person in client service at a fund company, each with three years experience, would. Incredible!

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 do not agree that there needs to be minimum capital requirements for fund managers. One reason provided is "to support the assets of fund investors". However, the fund assets are held in trust for unitholders, and are in separate custody hands. They are not assets of the fund manager itself, so why the capital requirement? Investors have no ownership of the manager, only the fund.

The CSA did not explain why assets under administration is the best benchmark for determining minimum capital. Are the risks to investors directly commensurate with assets? Capital is needed so the manager can meet its business obligations, legal claims, etc. A company does not need 50 basis points in capital to meet business requirements in time of failure. Insurance should cover legal claims.

The minimum capital requirements as recommended are too high, and will put Clarington offside. As our fund assets grow, it will be extremely difficult, if not impossible, to meet the requirements, as they are linked to fund assets. The CSA provides no justification for the requirements.

The requirements favour the very large fund companies over the small and medium size companies. It creates a barrier to grow for smaller companies – instead of reinvesting funds, money needs to be set aside on the sidelines in a war-chest of that magnitude that we believe is not needed! The financial constraints could create forced consolidations in the industry, leading to less choice for investors. The overall reason for the new GA is to reduce risk, so why new large capital requirements? This is overkill, and definitely increases the risk of failure of the smaller managers!

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: The insurance requirements are again overkill. Clarington's board currently reviews annually the adequacy of insurance coverage for both risk and coverage, and ensures they are reasonable compared to our peer group, and makes sense from a business point of view.

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: We agree that the list of internal control procedures is adequate, and is prudent for managers to have these anyway. However, we do not agree that the external auditors need to review and report on them. This will create extraordinary costs, as highly detailed audit procedures will be involved for them to be satisfied. Also, if there are weaknesses noted, what would the ramifications be? Also, what is considered appropriate internal control procedures? What is considered appropriate for one company might not be appropriate for another.

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 as a condition of registration.

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 have no comment on this.

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: Not realistic, again micro-managing!

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: We have no comment on this.

QUESTION 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?

Response: Clarington's opinion on the proposal is that we believe the overall costs will far outweigh the benefits.

Specifically, 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), cost of additional staff to meet their information needs, cost of increased capital, etc.) 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, investors would be better served to seek alternative, cheaper investments solutions. Driving investors away from the mutual fund industry is a distinct possibility. How ironic this would be, as the very regulations proposed to protect them leads to no investors to protect!