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June 7, 2002

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

Dear Mr. Stevenson:

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

The Investment Counsel Association of Canada ("ICAC") is pleased to respond to the request for comment on concept proposal 81-402 (the "Proposal"). This submission is made by the Industry Regulation and Taxation Committee of the ICAC. The ICAC is a representative association for portfolio management firms in Canada, all of which are registered as advisers in the categories of Investment Counsel/Portfolio Manager or the equivalent thereof. Seventy-one firms actively support the ICAC and collectively are responsible for the management of over $450 billion of assets on behalf of high net worth and institutional investors.

Set out below are our comments on certain aspects of the Proposal. The paragraph numbers used in this submission correspond to the relevant question number in the Proposal.

Issues for Comment

1. We fully support the concept of creating a regulatory regime that will be more flexible and able to accommodate changes within the industry and keep pace with changes and other segments of the market and global market places. The current prescriptive regulatory regime unduly limits the ability of industry participants to offer the best products and services to Canadian investors. Any proposal that increases the flexibility of market participants while still ensuring that the interests of investors are addressed where necessary would be a benefit. The Proposal does offer the potential for such increased flexibility but, as noted below, certain steps must be taken to ensure that this increased flexibility is actually that and does not become just another costly layer of regulation. Further, flexibility is a goal we support but only if such flexibility does not come at too great a cost.

   The five pillars that are covered in this document are quite extensive. We feel that it is quite ambitious to attempt to cover all these areas adequately in one document. They are all vital areas

that should be reviewed in the context of the harmonization of the overall securities regulatory system. Without full harmonization of our regulatory regime any proposed changes to the existing system will not provide a streamlined approach that will be able to keep pace with changes in other segments of the Canadian market and also within global market places.

We note that the second pillar of the Proposal, mutual fund governance, while lacking some important details, is significantly more developed than the remaining pillars. In particular, the third pillar, product regulation, is addressed only in a very general way with absolutely no specificity as to scope or timing. In discussions with CSA staff, we have come to understand that the primary focus of the product regulation pillar will be a review of much of the existing prescriptive regulatory regime applicable to mutual funds and a consideration of which aspects thereof could be eliminated if the fund governance pillar was adopted. This is an appropriate focus; one that is largely consistent with the work of the British Columbia Securities Commission and its consideration of the costs and benefits of the current prescriptive regulatory regime (though we agree with the BCSC that a reduction in prescriptive regulation may be appropriate even in the absence of a fund governance regime). Our concern is that the CSA may move forward with the fund governance pillar before it is ready to implement changes to the existing prescriptive regulatory regime. Such an additional laying of regulatory cost would be entirely inappropriate and unjustified. The primary problem with many of the existing prescriptive rules, as acknowledged by the CSA in the Proposal, is not that they don't in fact address the policy issues that they were designed to address but simply that they are too inflexible. As a result, imposing a fund governance regime that would address many of these same policy issues prior to eliminating the relevant prescriptive rules would be inappropriate. It is essential that if it intends to move forward with the fund governance pillar, the CSA expedite its work on the product regulation pillar so that the two may be implemented contemporaneously.

4. We do not feel that the scope Proposal should be expanded beyond retail mutual fund products that are governed by NI 81-102. Mutual funds are a vehicle unique unto themselves as they are a product designed to be sold to (not bought by) a mass audience through a very extensive distribution channel. They serve a very vital function to those people who have not accumulated enough wealth to justify retaining independent investment counseling and portfolio management services directly from a registered adviser. As stated earlier, the members of the ICAC are all registered as Investment Counsel/Portfolio Managers ("IC/PM"). The majority of the assets that are managed by our members are in the form of institutional accounts or private clients. There is a direct contractual relationship between the IC/PM and the client providing for discretionary money management. Many of our members utilize pooled funds to provide greater efficiencies in managing client assets. When we refer to the term "pooled fund" we are referring to a unit trust established under a trust indenture which is not required to have a prospectus under securities law and is not required to comply with the provisions of NI 81-102. It is a vehicle in which institutional, sophisticated and high net worth investors contribute funds that are invested and managed by an investment manager. Pooled funds, unlike mutual funds, are not products that are sold and directed to a mass audience. Pooled funds generally have a considerably lower number of unitholders than a public mutual fund. The investment manager would have a direct relationship with the individual unitholders within a pooled fund and the pooled fund is most accurately seen as an extension of this direct relationship rather than as a separate "product". As part of this relationship our members have ongoing meetings with the unitholders to discuss the portfolio strategy and performance and to keep the unitholder informed of all transactions that are being conducted within the fund. This differs quite dramatically from a unitholder in a mutual fund who

receives semi-annual reports on the financial status of the fund and has no direct contact with the portfolio manager.

Investors in pooled funds do not pay account opening charges, sales commissions or front or back end load fees. They pay a single, transparent fee to the portfolio manager in the same way as they would if their assets were not pooled with assets of other clients of that portfolio manager. Pooled funds are investment vehicles utilized by portfolio managers to facilitate the pooling of client funds for purposes of investment management and offer those clients many benefits. A unitholder has the right to withdraw from the pooled fund at any point in time at no charge in keeping with the contractual right to terminate the services of the investment manager if dissatisfied with the investment management services provided to the client. As recognized by the CSA in the Proposal, mutual funds are often sold on a "deferred sales charge basis" and in such cases, there is a true economic cost to the investor of redeeming units which may represent a significant percentage of the unitholders assets under management and discourage the investor from "voting with his or her feet".

Unitholders in a pooled fund do not need a regulated fund governance body to oversee the management of the fund as the client themselves act as their own governing body through their close relationship with the manager. If the unitholder is an institutional account, in most cases the institution would already have a governing committee set up to review the performance of the manager and ensure the manager is fulfilling its obligations within the objectives and strategies laid out for the particular pooled fund. Pooled funds are in most cases simply an extension of the relationship between a registered adviser and its clients. Our members are required to satisfy significant proficiency and other requirements to obtain registration. Where they manage client assets outside of pooled funds this registration process is the "regime" to which they are subject. Simply implementing the same relationship through the pooling of assets of more than one client does not justify a different regulatory regime.

12. We feel that it would be extremely difficult to recruit qualified members for a governance agency at a reasonable cost. The degree of difficulty will be contingent upon the exact roles expected of these members. With no cap on the liability that the member will be assuming, it is likely to become extremely expensive to recruit qualified people. The Proposal notes that corporate directors are generally subject to unlimited liability and sees no reason why the same should not be the case for fund governance agency members. We would note however that the "business judgment rule" which has been developed by courts over the years offers very clear guidance to corporate directors on the steps they must take to ensure they have satisfied their duty of care. Fund governance agency members however are being asked to assume a fiduciary duty in respect of which there is absolutely no judicial or other precedent to which they can look for guidance. Also, the availability of adequate directors' and officers' insurance and errors and omissions insurance and the cost for those types of coverage and at what cost is an issue that should be dealt with before any proposed changes to any existing regulations. Limiting the liability of these governors would help reduce the overall cost and help to obtain the proper insurance coverage that would be required but it would still not dramatically increase the pool of qualified people.

    With respect to training courses to help increase the pool of qualified people, we do not feel that this is necessarily a viable option. Depending on the overall responsibilities of the governors outlined, we consider training to review the investment performance of investment managers a challenging one as portfolio managers themselves spend years being educated and trained to perform this function. This is recognized in the proficiency requirements that must be satisfied by

individuals wishing to register as advisers. Members may be ultimately required to rely on the opinions of experts which would also add to the overall costs of maintaining a governance agency.

29. As noted above, all of the ICAC members are registered as IC/PM. .Our organization has consistently argued that the existing fragmented nature of Canadian securities regulation and the cost of complying with registration requirements in each jurisdiction must be addressed. Particularly for our smaller members, the registration burden is one of the most problematic components of existing regulation. Adding another layer of registration on to firms where the fund manager is housed within the IC/PM business is not adding any value to the unitholders and is just adding extra expense and bureaucracy to our members. Fund managers already registered as IC/PM should therefore be exempt from any future fund manager registration requirement.

31. We do believe that a minimum capital requirement is justified however the minimum should be set at such a level that it does not act as a barrier to entry into the market, (i.e. $1 million minimum requirement).

    We do not feel that capital requirements should be related to assets under management. The Proposal contemplates that, as the assets under management increase, the capital requirements should potentially increase also. An increase in assets provides economies of scale for a portfolio manager. A fund will be run the same whether it has $10 million or $100 million in assets - it will just own a larger number of shares of a certain investment. A portfolio manager should not be required to raise more capital to manage a larger fund when the staff, equipment, systems and services to support the assets do not change. Also, the probability of the fund manager collapsing and not meeting it's liabilities is decreased as assets increase so it makes no sense to require increased capital.

39. We cannot determine whether the benefits of this Proposal will outweigh the cost because we believe that the costs have not been clearly and accurately considered. The cost of the Proposal will be born either by the individual investors or by the fund managers. The Proposal estimates the average cost will be about 16 bps, however, it is felt that these numbers could be low. We do not know what the cost of insurance would be. We do not know the availability of qualified people to participate on these governance agencies and as a result the type of remuneration that would have to be paid. There are many fund managers who absorb a significant portion of the expense of running their funds because adding all costs to the MERs would negatively impact the managers ability to attract new money into their fund. Even if the 16 bps estimate is accurate, we expect the result of forcing a governance agency upon small mutual fund groups may be to undermine the viability of their businesses. Small managers should therefore be given the option of remaining subject to the existing prescriptive regime or adopting a fund governance agency if the additional flexibility that should accompany the adoption of a governance agency makes it viable from a cost perspective for them to do so. There is a real possibility that forcing a governance agency upon some small managers could result in the piling on of additional costs which could severely impair their ability to compete within the marketplace.

    Also, increasing the MER's of existing funds could have a large negative impact on current unitholders. Unitholders who are quite happy with their fund managers will not perceive any additional benefit to them by this change in regulatory structure and will only see the negative side of it which would be the increase in expenses.

Any change in current regulatory structure should be done within a framework of reducing expenses by simplifying the regulatory regime and harmonizing it, not by adding new layers that will increase costs.

In conclusion, we would like to commend the CSA on the huge initiative that they are undertaking with the Proposal for the mutual fund marketplace. We would like to re-emphasize the need for harmonization amongst all securities commissions to effectively and economically proceed with the proposed framework. Also, the distinction between mutual funds and other investment products (i.e. pooled funds) must be maintained through this process.

Yours truly,

INVESTMENT COUNSEL ASSOCIATION OF CANADA

By: Michael J. Gibson
Chair, Industry Regulation and Taxation Committee