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Re: CSA Mutual Fund Governance Concept Proposal

AIM Funds Management Inc. (AIM) submits the following in response to Concept Proposal 81-402 *Striking a New Balance: A Framework for Regulating Mutual Funds and their Managers.*

Fund Governance

Along with many other participants in the mutual fund industry, AIM recognizes that there is an imperfect identity of interests between mutual fund managers and mutual fund investors. There are a number of ways to deal with this. AIM has chosen to establish for its mutual funds organized as trusts an advisory board to represent the interests of investors. Our advisory board has many of the features contemplated in the Concept Proposal, including a majority of independent members whose roles and responsibilities are set out in a charter document and in terms of reference for the standing committees.

AIM believes that its advisory board provides invaluable assistance and guidance to it in discharging AIM's duties as a trustee and manager of the AIM and Trimark funds. It has been argued that the standard of care and fiduciary obligations incumbent on a mutual fund manager are

sufficient to protect investor interests, and that independent oversight by a governance agency is not needed. AIM has found that in practice, it is not so easy to separate the interests of the manager and the obligations of fiduciary. The board of directors and management of AIM is, at bottom, concerned with maximizing returns to its shareholders and to the shareholders of AIM's parent company, AMVESCAP PLC. The advisory board of the funds has as its focus not the share price of AMVESCAP PLC, but rather the soundness of an investor's investment in an AIM fund. AIM sees value in splitting the two roles, so that it is clear who is responsible for what.

These observations have been made by other commentators and do not require further elaboration here. We support the principle of an independent governance agency for retail mutual funds.

That said, we find the description of the roles and responsibilities of the governance agency contained in the Concept Proposal to be insufficiently precise. No governance agency should be asked or required to do more than is realistic or practical. From our experience, what is practical is for a governance agency to be roughly parallel to a board of directors of a public company in terms of composition, tenure, responsibility, frequency of meetings, committee structure, liability and D&O/E&O coverage and compensation. Generally, boards of directors do not, for example, undertake to "identify the policies and procedures…that are material" to an issuer. They do not "approve and monitor….compliance with policies and procedures". These tasks are the job of management and management's professional advisors where appropriate. The board's role is to ensure that the appropriate structures are in place so that *management* is properly identifying its own key policies and procedures and seeing to it that they are executed. The governance agency, which can be expected to meet perhaps 6 or 8 times per year, should not be tasked with trying to understand what policies and procedures mutual fund managers should have in place. The governance agency should not be put in the position of having to second-guess management. AIM would prefer if the responsibilities of the governance agency were articulated as "to receive reports from the manager as to its policies and procedures…to inquire if the manager has a process for selecting appropriate benchmarks for fund performance and if that process is being consistently followed…etc."

Every board and every board member worries about liability. If the governance agency is charged with too much responsibility, i.e. too much open-ended liability, the thing simply will not work. Fund companies will not be able to find qualified people willing to serve.

A great deal has been said about cost. To us, the issue is not whether cost has been accurately assessed in the Concept Proposal. Because AIM has a large base of assets over which to spread the costs of having our advisory board, we have found that the cost of our advisory boards has no discernible impact on our MERs or on fund performance. We appreciate that this may not be the case for smaller fund complexes. We would suggest that once in place, the incremental cost of a governance agency will be relatively unimportant in the context of other issues facing the industry, such as T+1/STP. However, cost is connected to liability and specifically to the limitation of liability. The best way to keep costs down is to have D&O/E&O premiums which are adjusted to reflect risk. This will reward fund complexes which have robust and rigorous governance and compliance regimes, and further advance the cause of investor protection.

Registration of Mutual Fund Managers

In informal discussion with Ontario Securities Commission staff, we have been advised that the registration of mutual fund managers is part and parcel of the proposed regulatory framework. To change metaphors for a moment, manager registration is said to be one of the central pillars, necessary for the fund governance structure to stand. We are unable to understand why this is so.

Specifically, we require an explanation of the need for minimum capital, and for that matter, minimum insurance. Minimum regulatory capital is a concept borrowed from the regulation of financial institutions where soundness and prudence and protection of deposits are primary concerns. As you are aware, mutual fund assets must be lodged with a third party custodian. So minimum regulatory capital is not needed to ensure that a mutual fund investor is able to get his or her redemption proceeds if the manager becomes financially troubled. The Concept Proposal cites three considerations, which may be summarized as (i) adequate financial resources for business commitments; (ii) satisfaction of legal claims; (iii) assurance that a manager will be able to meet liabilities. We suggest that market discipline and the regulatory controls now in place are adequate to address these considerations. Furthermore, the Concept Proposal is attempts to cover off risks inherent in everyday consumer commercial transactions. When I purchase an automobile, I take the risk that my car company may not be around to honour its warranty or to satisfy my lawsuit for product liability. As far as we are aware, no one has suggested minimum regulatory capital requirements for car manufacturers or distributors. We rely on certain minimum standards as to automobile safety and similar measures. AIM remains unconvinced that the cause of investor protection will be advanced significantly by imposing minimum regulatory capital requirements on mutual fund manufacturers.

AIM is also uncomfortable with the Concept Proposal's suggestions for implementation of internal controls, systems and procedures, as well as the monitoring of external service providers. Again good business practice and prudence would dictate that fund managers address these matters. We are concerned that once this process becomes bureaucratized, it will become "one size fits all", so that all fund companies, regardless of their size, business mix or complexity, will be forced into one mold. We urge the CSA to seriously reconsider the need for and the extent of manager registration, and also to re-think whether governance agencies and manager registration need to stand or fall together.

AIM would be pleased to explore the ideas advanced in the Concept Proposal in further detail with the CSA. Please feel free to contact the writer at 416-228-4789 or at susan_han@aimfunds.ca.

Yours truly,
AIM FUNDS MANAGEMENT INC.

"Susan Han"
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