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June 7, 2002

DELIVERED VIA E-MAIL

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Re: CSA Concept Proposal 81-402 - Framework for Regulating Mutual Funds & Their Managers

Investors Group Inc. ("Investors") welcomes the opportunity to comment on the Canadian Securities Administrators ("CSA") mutual fund governance Concept Proposal 81-402 "Striking a New Balance: A Framework for Regulating Mutual Funds and Their Managers" (the "Concept Proposal").

Investors has long believed in and practiced a separation of proprietary and fiduciary operations to the end that its mutual fund operations are overseen by a board of directors of its wholly-owned trust corporation, Investors Group Trust Co. Ltd., the board of which has been at least 50% independent of Investors and its affiliates. Investors takes the position that such a board with a required degree of independence be mandatory for the mutual fund industry having characteristics substantially as those enunciated by Stephen I. Erlichman in his June 2000 report for the CSA entitled Making it Mutual: Aligning the Interests of Investors and Managers - Recommendations For a Mutual Fund Governance Regime for Canada (many of which had been made by Glorianne Stromberg as early as 1995) such characteristics being:

- The board should consist of at least three individuals of whom at least a majority and preferably at least two-thirds are independent of the manager. The definition of what constitutes an "independent" member should be modelled on the Dey Report's definition of "unrelated director" rather than on the complex and detailed rules used in the U.S. Investment Company Act of 1940.

- There should be no restriction on the same individuals being on the boards of more than one or all of the mutual funds in a fund complex.
- The independent members of the board initially would be selected and appointed by the manager. Thereafter the independent members would be appointed by the full board (and not by the manager nor by the independent members alone) or in the case of a corporate mutual fund they would be elected by the fund's shareholders as required by the fund's governing corporate statute, in either case based upon the recommendations of a nominating committee composed of at least a majority of directors who are independent of the manager.
- The compensation of the independent members should be determined by the fund manager.
- The compensation of the independent members, as well as any additional expenses of having a board, should be borne by the mutual fund.
- The board, as well as the independent members as a separate group, should have the power to seek whatever professional advice and incur whatever expenses they reasonably require to carry out their duties, with the cost of such advice being borne by the mutual fund.
- The board should have the general responsibility to supervise the management of the business and affairs of the mutual fund in order that decisions affecting the mutual fund are made in the best interests of the security holders of the mutual fund. The board need not have a detailed list of specific duties, but certain minimum responsibilities should be established. The minimum duties could include: (i) evaluating the performance of the manager in various categories (including in providing an adequate level of service to security holders and in producing acceptable investment returns for the mutual fund, before and after expenses, in comparison to appropriate benchmarks that take into account the mutual fund's risk profile); (ii) reviewing the financial statements of the mutual fund; (iii) checking that the mutual fund is following its investment objectives; (iv) monitoring the manager's compliance with the mutual fund's compliance plan; and (v) making decisions on behalf of a mutual fund whenever conflict of interest issues arise between the mutual fund and any other party. In addition to the specified minimum duties, the board should have the flexibility to determine what else it should do to fulfill its broader general mandate. The board should not have the right to terminate the manager. The board should be given sufficient power to carry out its responsibilities.
- Board members should have a standard of care similar to that of directors of a business corporation.
- Each board would have a chair who could be one of the independent members. The chair should be responsible for managing the processes of the board. The chair should monitor the mutual fund on a regular basis and should be the key person who interacts with the fund manager on issues relating to the mutual fund.

- Each board member should be entitled to be indemnified from the assets of the mutual fund (and, if these are not sufficient, from the assets of the manager) for liabilities incurred while carrying out his or her duties, provided the board member has not fallen below a legally acceptable standard of care.
- The board should be authorized to purchase appropriate liability insurance for the benefit of its members at the expense of the mutual fund, but such insurance should not cover any liability resulting from not satisfying a legally acceptable standard of care.
- If the board and the manager cannot agree on any issues, the board or the manager should report such matters to the CSA or to the security holders of the mutual fund or, in appropriate circumstances, call a meeting of mutual fund security holders to vote on the issues. To whom the report is made and whether a security holder meeting will be called will be a decision of the board or the manager, as the case may be, based upon the nature of the matter in dispute. The CSA, however, should not be required to function as a mediator.

However, Investors submits that as a condition precedent of the imposition of any mandatory governance regime, the following would apply namely:

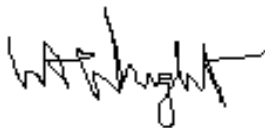
- a quid pro quo be introduced that would reduce and streamline existing regulations concurrently with the introduction of the new governance regime and allow the new governance regime to deal with matters such as related party transactions, conflicts of interest and investment restrictions.

There is no question that the existing inefficiencies in dealing with 13 separate regulatory authorities and, perhaps, a broader financial services regulatory system must be addressed to move to a more coordinated system with national standardized rules and, in particular, the introduction of functional regulation (whereby similar products are regulated in a similar manner. i.e. segregated funds, pooled funds, exchange traded funds and wrap accounts).

Having stated the foregoing, specific responses to the Concept Proposal questions are set forth in Schedule "A" hereto.

Yours truly,

INVESTORS GROUP INC.



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Schedule "A"

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:

Tying the introduction of a governance regime to a quid pro quo for allowing the governance regime to deal with conflicts of interest and related party transactions and introducing other efficiencies such as a national harmonized system (including effective "mutual reliance") and functional regulation dealing with competitive products would be an advance for the industry.

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:

Providing some flexibility to introduction of the governance regime is positive but it must definitely be tied to a quid pro quo for alleviating other burdens of the industry and lead to more harmonization.

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:

Investors believes functional regulation must be introduced to deal with competitive products in a similar fashion.

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:

Competitive products must be dealt with in the same way and, therefore, governance must be consistently applied across all investment products.

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:

Harmonization of rules and an effective mutual reliance system along with the introduction of rules/regulations on a cost/benefit basis would assist the regulatory role.

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:

There should be no statutory cap for governance agency members liability but there should be a due diligence defence built into the model.

The role of the independent governance agency need not be specifically defined but certain minimum responsibilities as set out in the Erlichman report should be established and could include:

The board should have the general responsibility to supervise the management of the business and affairs of the mutual fund in order that decisions affecting the mutual fund are made in the best interests of the security holders of the mutual fund. The board need not have a detailed list of specific duties, but certain minimum responsibilities should be established. The minimum duties could include: (i) evaluating the performance of the manager in various categories (including in providing an adequate level of service to security holders and in producing acceptable investment returns for the mutual fund, before and after expenses, in comparison to appropriate benchmarks that take into account the mutual fund's risk profile); (ii) reviewing the financial statements of the mutual fund; (iii) checking that the mutual fund is following its investment objectives; (iv) monitoring the manager's compliance with the mutual fund's compliance plan; and (v) making decisions on behalf of a mutual fund whenever conflict of interest issues arise between the mutual fund and any other party. In addition to the specified minimum duties, the board should have the flexibility to determine what else it should do to fulfill its broader general mandate. The board should not have the right to terminate the manager. The board should be given sufficient power to carry out its responsibilities.

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:

We feel that modeling the TSX Guidelines, where applicable, is important, particularly when defining independence but otherwise do not feel any important principle consideration has been omitted in the CSA's Concept Paper.

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 flexibility is preferable which should be imposed on a mandatory basis but are unable to comment on his analysis of the civil law in Quebec.

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:

We agree with Stevens' description of the conflicts and would strongly support the governance agency not being the board of directors of a fund manager or its shareholders.

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 analysis and would suggest that many conflicts still exist in owner operated funds to the end that a governance regime should be consistent across all competitive products.

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:

The number of funds administered by a governance agency should be left to that agency to determine but could include all the funds in a related family.

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:

Investors believes that there is a sufficient talent pool to accommodate a governance regime as proposed but would welcome IFIC and others providing training courses for prospective members. Additionally, a fund family should provide an orientation course to new members of the governance agency.

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:

The definition of independent members should model the Dey Report and the degree of independence should be at least a majority of members but preferably 2/3rds.

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:

Roles and responsibilities set forth are appropriate but there should be a catch all to the effect that the governance agency will prescribe such other duties and responsibilities as may be necessary to carry out their oversight responsibility. Investors believes that the governance agency should review and approve mutual fund disclosure documents and material contracts as Investors' trust company board currently does for simplified prospectuses, annual information forms and material contracts.

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:

Governance agencies should consider and review policies and procedures dealing with all material aspects of the operation of a mutual fund and its distribution.

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

Response:

The independent members of the governance agency should be effective in their audit committee role provided such members have the necessary proficiency of experience in the financial industry and/or professional designations relative to their duties.

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:

There should be no statutory cap on the liability of governance agency members but there should be a statutory due diligence defence afforded such members.

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 for governance agency members would be useful in affording a due diligence defence and perhaps the adoption of the "Business Judgement Rule" would help define the standard.

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:

Investors carries directors and officers liability insurance for its public company and its subsidiaries which includes Investors Group Trust Co. Ltd. as trustee of its mutual funds.

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:

Investors believes that security holders do not need to be involved in the election of members of the governance agency for it to be appropriately

functional. By definition of their being independent and subject to legal liabilities should be sufficient to keep them focused on the interests of the security holders. Additionally, the governance agency members could set their compensation to be paid by the funds provided that disclosure be made on appointments, terminations, changes and compensation through the continuous disclosure provisions.

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:

Again, Investors does not feel it is a real issue that the fund manager appoint the governance agency members in that the risk is appropriately addressed through the standard of care imposed upon the governance agency to act in the best interests of security holders.

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:

Security holder redemption rights should not be altered simply by an appointment to the governance agency that some investor is not happy with. Their normal contractual provision should apply and the type of load that they have selected should be paid if they have a change of heart of their investment in the fund. Investors does not think that specific guidelines for qualifications need be laid down by the CSA except to serve on the audit committee which could follow the TSX Guidelines.

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:

There should be checks on balances on the compensation of the governance agency members and, therefore, the fund manager should set the compensation with the compensation to be paid by the mutual funds under management. Given the responsibilities of such members, the marketplace will determine

appropriate pay levels and should be subject to the healthy debate between fund managers and prospective governance agency members.

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:

If the powers of the governance agency members are adequately prescribed, we believe that they will have the ability to discharge their duties effectively through negotiation with the fund manager, an ability to resign en masse, the ability to approach the regulators or the ability to issue a press release.

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:

Independent governance agency members should have a limit on their term of appointment which is open for reappointment upon review and there should be provision for removal of a member upon a two-thirds vote of the remaining members of the independent governance agency.

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:

The proposal to include disclosure and reports as to the governance agency in the point of sale documents is unreasonable. The point of sale documents are already unwieldy and generally not useful to the average purchaser. The appropriate establishment and operation of a governance agency is a compliance item, subject to review by the regulator and, if necessary, disclosure of the operations of such agency could take place in the AIF or in the annual mutual fund report measured against the regulatory guidelines much like that required by the TSX.

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

Response:

Given the length of debate on this issue, Investors thinks that it is not unreasonable for the industry to effect compliance with the requirements within one year of their finalization.

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

Response:

Fund complexes should be able to engage proficient members from the talent pool at large and should also run board orientation programs for new members. As well it would be helpful that trade associations such as IFIC run educational courses for prospective members and issue, from time to time, best practice guidelines for the workings of such an agency.

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:

Registration of fund managers should be mandatory provided it is not duplicative of other registrations such as an advisor or a dealer. The issue of registration arises to prevent virtual fund operations carrying on by hiring out all of the registerable functions through non-affiliated third parties.

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:

Investors believes that registration conditions should be established for fund managers commensurate with other registerable activities and would include proficiency requirements, minimum capitalization and appropriate insurance coverages to ensure that the fund manager had adequate resources to carry on its activities.

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:

Investors agrees that a prescribed level of minimum capital for fund managers should be established for the reasons given by the Concept Proposal including maintaining adequate financial resources to carry on the business, satisfaction of legal claims and some cushion against risk of collapse. We would favour the Steering Group Report recommendation of an amount pegged to asset values but adopt the recommendation by Erlichman for capping such amount at \$5 million.

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:

Investors believes that the specified risks are adequately described but suggest that input be obtained from the insurance brokers that service the industry for guidance on the risks to be covered and recommendations as to levels of coverage. Also, one should consider that any prescribed coverages can be available at reasonable costs.

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. Consultation should take place with the major audit firms to ascertain the level of review and reporting they do on internal controls relative to audit work required to prepare and issue standard financial reporting.

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.

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.

35. 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:

Investors believes 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. Investors suggests 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.

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.

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 but set against general principles articulated in legislation. This should allow for more flexibility without adversely affecting the public interest.

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:

There are certain things that should be changed such as the ability of the fund complex to change auditors without seeking investor approval and changes in indirect control of the manager without seeking investor approval. In each case, regulatory approval should be sufficient and some shorter notice to investors than the current one provided. Generally, an investor's right to redeem should be sufficient. Again, further extension of investor rights should be weighed in the cost/benefit picture and a functional analysis employed whereby competitive products are regulated on a similar basis.

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:

Great regard should be given to reducing the current burden so that any additional costs arising out of the implementation of independent governance agency could be cost neutral to the industry as one must be cognizant of the cost/benefit analysis when viewing the position of mutual funds compared to other investment products in the competitive landscape.