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From : Fonds des professsionnels inc.
Re : Concept proposal 81-402 on a framework for regulating mutual funds and their managers

Dear Mrs Cowdery & Mr. Martin,

We are pleased to respond to your request for comments on the concept paper *Striking a New Balance: A Framework for Regulating Mutual Funds and their Managers* by the Ontario Securites Commission "OSC" as principal jurisdiction and the Quebec Securities Commission "CVMQ" as participation jurisdiction for this project.

You will find in this letter : General comments, Specific comments, and Concluding remarks.

Fonds des professionnels inc. is a Quebec based professionals' associations owned company that acts as fund manager, investment advisor and distributor of it's own family of mutual funds for the benefit of it's members. In other words, the clients of the funds are ultimately the owners of the manager.

Our mutual funds are established by a trust agreement and an unrelated registered trust company acts as Trustee. The manager is incorporated (shares controlled by non-profit organisations) and assumes the functions of the advisor; as such it is registered at the CVMQ as an investment advisor.

GENERAL COMMENTS

The confusion of mutual funds units with equity shares of corporations has mislead some observers into perceiving investors as owners of mutual funds. This ill-founded view is then invoqued as ground to give investors control over the funds… It must be recognized that while the assets of funds do belong to investors, the funds themselves do not. The seemingly forgotten point is that mutual funds are products that have been created by and belong to managers!

Mutual fund managers are the ones that assume the business risk and invest their time and money in creating these fund structures and brands. Most mutual funds are created by a trust agreement establishing that the fund's assets belong to investors and that the managers are responsible for its management.

By creating the investment products, the industry plays a critical role in delivering valuable alternatives to investors. As owners of these products, fund managers are the ones who have the option to continue enhancing their commercial value, to collect the fruits of their efforts by selling to another manager or to discontinue their offering.

Great care must be taken not to "socialize" the industry by transferring the present management role and ownership into the hands of unit holders or to anyone else. Investors can't assume the role of creating investment value for their funds and it is illusory to think they should or possibly could. If managers were at risk of losing the results and benefits of their endeavours and business interests at the whim of groups of investors or of any third party, their creativity would greatly diminish. Ultimately, investors would lose the benefit of these important contributors.

The best defense to ensure that the products are competitive and meet investors' expectations is the customers' ability to choose among a vast array of offerings, and the ability to dispose and change their mutual fund holding.

Investors currently have the ability to walk away. Sure, there can be a disposition cost (deferred sales charges can be as much as 7%), but such charges are not unreasonable when viewed in the historical context of commissions on stock transactions (they used to cost 3% to 5% to purchase and then another 3% to 5% at disposition…).

The key is better Point-Of-Sale "POS" disclosure. This would help ensure the clients' understanding of the products they are buying and the costs involved.

We view the goals of reframing regulation as being :

1) to better address investor protection issues;
2) to improve the regulatory process for managers in terms of relevance and efficiency; and
3) to establish the legitimate investor rights and ways to enforce them while preserving manager's interest in developing investment alternatives for investors.

We strongly believe the keys to a better mutual fund environment are through :

1) Manager, Advisor, Distributor and Salesperson registration;
2) Disclosure (Product description, Point Of Sale, Periodic reports, Material change);
3) Know-Your-Client rule enforcement and Self-helping the investors.

In our view, implementation of the Concept Proposal poses a serious threat to the quality and diversity of investment alternatives available to investors. The industry's flexibility and profitability would be reduced as a result of the increased regulatory burden with no real advantage to investors. This can only lead to reduced competition and product innovation.

SPECIFIC COMMENTS

(see the suggested issues in the march 1, 2002 publication for comment)

Q1.

We agree that we cannot simply continue adding to the existing regulation and that a new framework, specific to mutual funds would be a great improvement.

We agree that a flexible framework should be preferred over a prescriptive regulatory regime. Given the important differences amongst industry participants, flexibility in managers' structure and operations is essential to make it easier for them to deliver better products at a lower cost to investors. The flexible approach is also the only practical approach to deal effectively with the ever changing environment of the financial services industry.

We also share your belief that the shift in emphasis to the fund manager is the most efficient way to improve regulation and address the current shortcomings. The focus on the mutual fund managers should go a long way to achieve the regulatory goals you have set out.

In fact, we would applaud an enlightened adoption of such two changes because they take into account the specific nature of the investment product, the diversity of the Canadian mutual fund industry and the rapidly evolving competitive arena of financial products and services. These may be the most significant aspects of the proposed changes, and we endorse the approaches you are considering.

Q2.

Alternative 1) The "non-regulatory" approach would be inadequate as we believe some minimum standards are necessary in terms of registration and disclosure (form and content).

Alternative 2) The "reliance on auditors" approach would not be entirely adequate. Auditors could certainly oversee disclosure, but would probably not be best suited to deal

with the protection of unit holders against investments made under circumstances of conflict of interest.

With this approach, a separation of mandates would be necessary to avoid conflicts of interest; the auditor charged with overseeing the governance aspects should not be eligible for the financial auditing of the products.

Alternative 3) The “managers having free hands with their governance boards” approach seems adequate as long as an arbitration mechanism allows the governance board and the investing public to present their case in the event of disputes or unresolved conflicts.

Alternative 4) The “non-registration of managers” approach is not an acceptable approach to protect the integrity of the industry and investors confidence. Manager registration allows better control and flexibility than product registration.

Q3.

Where the individual investors are involved, the same framework should be applied to sponsored investment funds, commodity pools, hedge funds and other investment schemes where a “manager” owns the investment product (vehicle) but the assets are the property of investors.

Q4.

The essential elements and distinguishing aspects amongst investment vehicles should be addressed by considering two basic questions :

1. Who owns the investment product ? (who assumes the business risk, reaps the business reward and controls of: the structure, the marketing variables, the operations and the brand of the investment product being offered?)
2. Who owns the assets ?

Q5.

About the fifth pillar (investor rights), we suggest the following:

Investors have a right to receive the product and service they paid for. • Regulators must design the governance agency so that it can confirm compliance with the representations made.

Investors have a right to adequate disclosure and adequate advice from registered salespersons. • Regulators must design the governance agency so that it can approve disclosures on matters like : investment objectives, advisors, distributor, MER, conflicts of interests and other considerations. • Regulators should continue to play a role in managing registration of distributors and salespersons.

Investors have a right to best efforts to minimize conflicts of interest situations by all parties involved. • Regulators must design the governance agency so that it can ensure that no investments or dealings are a detriment to investors wealth.

Q6.

The governance concepts introduce the risks of granting a number of powers to the agency that many find objectionable.

We believe that the governance agency should not have any power over the manager's fund and should not be allowed to communicate with unit holders. It should only present it's case for arbitration to the regulatory commissions to resolve disputes.

Arbitration by the regulatory commissions would enable the governance agency to exert real influence over the practises of the manager.

The combination of good disclosure and the investors' ability to swith to other investment products is by far the best tool to make management responsible and to ensure product performance. Beyond these two essential elements, the governance agency could in some regards help oversee the management of the funds and could possibly add a small amount of value to investors.

Q7.

We do not have any additions to suggest for the five aspects relating to corporate governance practice.

Q8.

As we stated in Q1, we agree that a flexible framework is a much preferred approach than a more prescriptive regulatory regime. We do not see any practical problems to this framework that would compromise the regulatory objectives.

Q9.

We agree with David Steven's assessment of the conflict of interest that arises when a fund manager's owners, board of directors or it's shareholders proposes to act as the governance agency.

A separation between the Manager and the governance agency is critical if it is to act independently.

We feel it is important to emphasise the following point : Managers must retain control of the funds, as they are the creators and owners of the product. The governance agency's goal must be limited to ensuring that clients receive the product and service as they are

disclosed, and that clients are not penalised by investments made in conflict of interests situations.

Q10.

We agree with your analysis and proposal for “investor-operated” mutual funds.

Manager’s owners, board of directors or it’s shareholders CAN act as governance agency without conflict of interest. Furthermore, it can be reasonably expected that they will maintain their leadership in terms of industry’s best practises.

Not allowing them to organize freely would penalise investors as a result of the higher regulatory costs with no added benefit.

Q11.

Yes, there is a practical limit to the number of funds that members of a governance agency can oversee. The members should be responsible to establish themselves if they are capable of fulfilling their tasks and responsibilities; and they should accept or refuse their mandates accordingly.

The scope of the oversight should reflect the goals and responsibilities of the governance agency. The governance agency should be free to adapt to the funds they oversee. The use of guidelines should be limited to the purposes of education and training (of the agency’s members).

Q12.

We believe the industry will be able to recruit qualified governance members. A manager that manages funds for the benefit of clients will be in a better position to retain qualified governance members than will those who would provoke conflicts…

Thus, at Fonds des professionels inc., a majority of board and committee members are elected by our client base through their professional associations. These “client representatives” and the independent experts have shown a remarkable interest in the good management of the funds; they are dedicated to the enhancement of benefits to unit holders.

Q13.

We have no suggestions to improve the proposed definition of independent member. We believe independent members should represent the majority.

Q14.

We agree with the following duties and responsibilities:

a) Require the needed information and meet with representatives of the fund's manager to seek answers and discuss issues.
b) Identify the manager's policies and procedures. Approve and monitor the manager's compliance with these procedures.
c) Consider actions to be taken where there has been material non-compliance.
d) Monitor to ensure compliance with the fund's stated objectives and strategies.
   i) Review and approve the financial statements
   ii) Communicate with internal and external auditors
   iii) Approve any change in auditors
h) Approve the manager's policies regarding transactions with related parties… and transaction requiring prior approval.

We disagree with the following duties and responsibilities :

e) Consider and approve the choice of benchmarks. Monitor fund performance against these benchmarks.
f) Establish it's charter.

We disagree with e) because we do not believe it is the governance agency's role to assess performance and management capability. The governance agency should simply ensure that disclosure is fair, and adequate.

We disagree with f) because it creates an unbalanced structure without checks and balances. The manager should be involved in many matters regarding the charter. The governance agency should accept a charter that it finds reasonable. Arbitration by the securities commission should resolve the disputes.

Q15.

We do not see any other specific policies or procedures the governance should review and approve.

We believe that the use of derivatives does not require special attention from the governing agency.

Q16.

We believe the governing agencies can be good in their auditing role, but given the limited power they should legitimately have, the structure's cost and management burden do not seem to be the most effective means for dealing with auditing functions.

Q17.

We do not see a need to limit liability of governance agency members. Adequate insurance should be paid by the funds. In the end, it comes down to integrity; that is why registration of governance agency members is important.

Q18.
A statement of care would help governance members judge their actions. An excessively high standard such as a prudent expert rule would undoubtedly deter good potential candidates from assuming the positions to the point of creating a problem. An equivalent to the prudent man rule should be sufficient and would not be a deterrent.

Q19.
Our governance members are members of the board of directors and committees. They have director's and officer's insurance.

Q20.
We have serious reservations on the idea of a perpetual self-appointment by the governance agency.

The governance agency members should be nominated by the managers. We suggest appointments for three (3) year mandates, with a third of the agency's mandates due for reappointment every year. We would also suggest a two-term limit.

Q21.
We believe it should be the responsibility of managers to appoint governance agency members. Investors could present their case for arbitration (to the regulatory commission) if they have reasonable doubts about the performance of governance agency members. An arbiter could force the manager to replace members.

Q22.
Dissatisfied investors about governance appointments should not be able to walk free from the defered sales charge, but they should be able to present their case to the governing agency if the "delivered product" proves to be different than "as disclosed".

Governance agency members should be registered. A condition for registration should have sufficient competence to perform their duties. A specific training could be made available to those without investment and product knowledge.

Q23.
The manager should propose a budget that would be part of the management expense ration ("MER") to the governance agency. The budget could include an hourly rate, a maximum number of hours, a working budget (office supplies, meeting place, etc…) and specific advisory services on a need basis.

The regulatory commissions should act as arbiter in the case of dispute over the budget.

Unit holders could call upon the regulatory commissions to act as arbiter and present their case if they find the compensation to be excessive.

Q24.

As we stated in the first in the general comments, then in Q3, Q4, Q9, and Q38, the manager is and must remain the owner that controls the fund. It is inconceivable that the governance agency (or the investors for that matter) could have the power to terminate a manager.

Arbitration at the regulatory commission should resolve disputes.

Q25.

In the event of a non-performing governance agency members, both unit holders and the manager should be able to present their case for arbitration.

Q26.

We suggest that the governing agency's reporting should be limited to "one page" in the annual report. Other disclosures could be made by way of SEDAR for the knowledgeable and interested investors. Along with reports of special events, these SEDAR disclosures could include a simplified annual report on the agency's structure, activities and findings.

Point-Of-Sale disclosure on the governance should be limited to brief and general descriptions. Our experience shows that if it is too detailed, investors just don't read it.

The governing agency's "Report to investors" in the annual report should be approved by the manager (in this case again, arbitration would settle disputes).

In all matters of communication with clients, the main challenge the agency faces is getting investor's attention and getting them to understand the information and the issues. In that light, the agency should focus on helping the manager simplify it's language so as to reach the most investors.

Q27.

We suggest a two or three year phase-in period for the framework and establishment of governing agencies.

Q28.

Something like a seminar (two days at the most) for governance agency members should be made available.

Q29.

As stated in the general comments, then in Q1, Q2, Q4, and Q5, we agree that the manager, the advisor, the distributor and the salespersons should be registered.

We agree that manager registration is a preferred approach than product registration.

The conditions should be based on their ability to be entrusted with their duties and their high level of integrity.

Q30.

The governance should in no way be involved in the evaluating the manager's qualifications, proficiency and investment performance. As stated in our general comments, then in Q39, we believe that a combination of good disclosure and the investors' ability to switch investment product is the best approach to ensure that only the best managers and products survive in the market.

We agree that the regulatory commissions should assess the adequacy of the managers' qualifications and proficiency. In fact we would find it most appropriate if it is part of the managers' registration process.

Q31.

The manager's financial situation has no bearing on its funds financial situation, therefore a minimum capital level is not a requirement to protect the assets of investors. Furthermore, managers do not (and cannot) guarantee that a fund will be offered indefinitely; thus their business commitments towards the funds are limited.

Should a manager have going concern problems, a mutual fund can be sold to another manager which will assume it's control and operations, or it's offering can be discontinued (in which case no deferred sales charges should be applied). In the worst case, the assets of a mutual fund are protected from the liabilities of a collapsing manager.

Requiring that every business have "the ability to satisfy any major legal claim which may be made" would shut down the entire economy. Why would you want to start with the mutual fund industry?

The current cashflow basis valuation seems appropriate, with the ability to let unit holders walk free of deferred charges in certain circounstances.
We estimate a reasonable capital level for a manager to be the equivalent of 6 months of operating budget plus ability to let the unit holders walk free of deferred charges.

Q32.

We believe it's the manager's responsibility to manage it's going concerns. Should a list of insurable risks be drawn, it should focus solely on protecting investor's assets, and exclude the manager's going concerns.

Q33.

The list of essential controls seems to cover all relevant aspects.

For the most part of the industry, trust companies are involved in aspects relating to the essential internal controls. They are most likely to be handling the asset side (investment portfolio valuation) and the liability side (trust ownership accounting) of mutual funds. Internal procedures are already articulated and parties independent of the managers are involved.

Participation of auditors in the review of internal controls is unlikely to raise investor's confidence level. The additional benefits would be insignificant. We feel the current level of involvement of auditors is sufficient and adequate.

Q34.

The provisions respecting "Section 5900 Reports" would be of great assistance to managers. In fact, it is important that the manager be able to discharge some of the most complex monitoring of third party service providers. It would be unreasonable to demand otherwise.

Q35.

The focus must be placed on competency and integrity. We do not have any additional conditions to suggest for a manager's registration.

Q36.

We believe that product regulation should essentially focus on disclosure.

We believe the restriction on investments in other mutual funds should be removed. It is to the benefit of the investors to allow the fund-of-fund practise. The main advantages are: 1) Having one fund or portfolio per strategy allows the investment process to be more efficient and performance to be enhanced and harmonized more easily; 2) Having one fund or portfolio per strategy reduces costs to investors; 3) Smaller bottom funds can reach critical mass with the support of other (top) funds, thus broadening the product line available to investors.

As a rule, more general principles and guidelines are preferable to a restriction based regulation. Both the investing public and the industry would benefit from such a revision of NI 81-102.

The concept of the current prospectus should be preserved. Standardising the information makes it easier for the clients and their advisers to understand the product they are purchasing or holding. Performance and other information that can be obtained in a more timely fashion than by way of an annual document should be removed from the prospectus and the notice. Publication of the documents on the internet would be sufficient.

A standard “2 pages Point-of-sale document” would be very beneficial to the investing public. It would improve general awareness and ensure that adequate disclosure is actually communicated and understood by investors.

Q37.

We believe that an independent governance agency will address the managers’ conflicts of interest and can represent fairly the interests of investors even if the manager appoints its members.

Q38.

As stated in our general comments, we feel many of the view expressed in the concept proposal concerning the rights of mutual fund investors are erroneous when they link ownership of a fund's assets to ownership and right to influence the management of funds.

Q39.

Depending on the goals, scope of influence of the governance agency, we see a threat of significant cost increases to the manager that would be passed through to investors.

Most, if not all benefits expected from the governance agency could be accomplished by increased disclosure by the manager and at the point-of-sale.

CONCLUDING REMARKS

Please pay special attention to our views on the power of disclosure and on the legitimate rights of managers.

We commend you on the professionalism you have shown and the care you have exercised until now to balance the needs and interests of both the industry and the investors.

Once again, we appreciate the opportunity to comment on this proposal and, should you have any questions or seek elaboration on our views, please do not hesitate to contact us.

Sincerely,

(S) Jean-François Paris

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I would like to thank Mr. Frédéric Bélanger, First Vice-President and Mr. Roland Lefebvre, Vice-President for their collabaration in these comments to the regulatory commissions.