

# The Board of Governors of The Cundill Funds

- From the Chairman: Michael A. Meighen, Q.C.

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June 18, 2002

Mr. John Stevenson, Secretary  
Ontario Securities Commission  
20 Queen Street West  
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Toronto, Ontario M5H 3S8  
Via e-mail: [jstevenson@osc.gov.on.ca](mailto:jstevenson@osc.gov.on.ca)

Ms. Denise Brousseau, Secretary  
Commission des valeurs mobilières du Québec  
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Via e-mail: [consultation-en-cours@cvmq.com](mailto:consultation-en-cours@cvmq.com)

Dear Mr. Stevenson and Ms. Brousseau:

## **RE: CONCEPT PROPOSAL 81-402**

We are pleased to submit our comments with respect to Concept Proposal 81- 402 for your review and consideration.

The Board of Governors of The Cundill Funds has been in existence for some time now. The Board was constituted under the Master Declaration of Trust in 1995 and represents all five of the Cundill Funds. Prior to becoming a Trust, while still under a Corporate structure, the Cundill Funds were overseen by a Board of Directors since 1975. The Manager of the Cundill Funds is Mackenzie Financial Corporation. The Board of Governors and Board of Directors has always had a majority of independent members.

The Governors on our Board are as follows:

F. Peter Cundill  
O. Margaret Davidson  
Kerry A. Ho

Neil Lovatt  
Michael A. Meighen  
Helen M. Meyer

Michael Peers  
Bryan J. Reynolds  
Peter W. Webster

In general, we welcome the proposals and hope that our comments will be useful to you. We would encourage a focus on principles rather than rules, as a focus on rules can lead to excessive cost and complexity.

Please feel free to contact me if you need any clarification on any of the comments.

Yours truly,

Michael A. Meighen, Q.C.  
Chairman, The Board of Governors  
of The Cundill Funds

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## CONCEPT PROPOSAL 81-402

### Striking a New Balance: A Framework for Regulating Mutual Funds and their Managers

#### ISSUES FOR COMMENT

- 01. 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:

The renewed framework does represent an improvement over the current regime in that it introduces for the first time, mandatory governance oversight by a committee composed of a majority of members independent of any parties providing services to the mutual funds and its unitholders. Our view is that an increased level of fund governance is called for in Canada. We also feel that this framework represents an improvement over what currently exists today.

- 02. After reading the staff research paper and the text box above, what is your opinion about the 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 support your proposed approach. We do not favour any of the alternatives proposed or the status quo.

- 03. 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:

No comment.

- 04. 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:

No comment.

- 05. 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:

No comment.

- 06. 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:

The process needs to be transparent to investors to add any real value to them. The proposals outlined are a big step forward.

- 07. 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:

The Chair should set the Agenda for Governance Committee meetings in conjunction with management.

- 08. 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 Quebec civil law?**

Response:

One of the structures that is outlined as a type of governance agency is a registered trust company. We think that this will have conflicts of interest. If it is contemplated that the board of directors of the trust company fulfill this role, then it could be argued that the director's legal obligation is to the trust company and not to the unitholders of the mutual fund.

We believe that there should be a common approach to fund governance across all mutual funds. This is similar to the approach that requires public companies to have a board of directors and this would be more understandable to the investing public. If experience proves that there are exceptions, these should be treated on a case-by-case basis.

Anything that can be done to improve the public's knowledge and understanding of the mutual fund industry should be considered.

- 09. 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 that the Board of Directors for the fund manager should not be the governance agency for the fund due to the conflicts of interest. This would not be in keeping with the concept of independence. We agree in general with Steven's description of conflicts.

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

Response:

No comment.

- 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 believe that it should be left up to individual fund groups to resolve this issue for themselves.

Experience will tell whether it is possible to have one agency for all of a manager's funds. There may be problems with one fund governance agency's ability to oversee a very large number of funds with differing aims and objectives and subadvisors (i.e. investment advisors). It is expected that the manager would manage its funds in a common manner to reduce complexities, which may allow for one governance agency.

- 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 there is a broad pool of talent of individuals within Canada and abroad who have the qualifications to serve as members of the governance agency. It would be helpful if recruiters were to go beyond the traditional pool of talent for board members.

One of the key issues is to have an adequate number of members on the governance agency to fulfill committee requirements and to perform the duties and obligations of the 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:

We agree with the definition of independence. The definition should be broadened to include that members must also be independent of any major suppliers to the management company (i.e. subadvisors). Independence should be a matter of fact, not interpretation. As on board of directors it would make sense to have some representation of management on the governance agency.

We suggest a requirement of 2/3's of the members must be independent. This would provide a better balance of power on the governance agency than a simple majority.

- 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:

The responsibilities as listed are appropriate. The “sticky” issues would be around expense and cost allocations, brokerage allocation, soft dollar transactions, proxy voting and related party transactions. In addition to monitoring expense allocations, the governance agency should also review whether the unitholders are receiving adequate value for the management fees paid. There should be a separate audit committee to review financial statements. The governance agency should review and approve mutual fund disclosure documents, as this is not dissimilar to approving the financial statements of the funds.

- 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:

It would be good protection for the unitholders to have the governance agency review and approve investment policies such as the use of derivatives, stock lending, etc, but the governance agency should make sure that it is not involved in the research and investment process. That is not its job.

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

Response:

Yes, if they have knowledge of accounting rules and procedures and of financial reporting. It would be desirable if one of the members of the audit committee were a Chartered Accountant or someone who has financial statement expertise.

- 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:

We agree with your stance; why should members of a governance agency have more protection from liability than members of Boards of Directors?

- 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 agree with your position that where governance agency members have discharged their duties in accordance with an appropriate standard of care, and who incur personal losses as a result of a lawsuit, may seek indemnification from the fund.

- 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:

Yes, we believe we have adequate insurance coverage for our members.

- 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 feel it is acceptable for the manager to make the initial appointments providing that the majority are independent.

In our case, this is not an issue because the majority (2/3's) of the appointees are independent.

- 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:

The issues are real because the governance agency members have to oversee the manager. In our case, the majority who are independent have been involved in appointing subsequent members.

- 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:

Our answer to both questions is no.

We believe in the concept of the governance agency reporting to unitholders and the rotation of governance agency members and fixed terms.



- 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:

We do not believe that the regulators should set any limits on governance agency member compensation. There will be a range of the number of funds, number of members and other factors that will make it difficult to set appropriate limits for the entire industry. There is enough market information available to make sure that members are adequately paid in comparison to a peer group in Canada.

We do not believe that the manager should be involved in setting the compensation in that it sends the wrong message regarding the relationship between the manager and the governance agency. We do not have a problem with the manager supplying the competitive data to the governance agency.

While independence of governance agency members may or may not be compromised if the manager set and paid member compensation, the more important point is that governance agency member compensation should be paid by the funds to underline the fact that the members are to ensure the best interest of the investors. Thus, we are in favour of the governing agency setting the member compensation and having it paid by the mutual funds.

We do not object to the manager having a veto power as described.

- 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 believe that the governing agency should not have the power to terminate the fund manager. The process as outlined will provide an effective incentive for the manager and the governance agency to resolve disputes.

- 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:

Annual performance assessments of the governance agency and its members should take place. The removal of individual members for non-performance should be dealt with by the agency. The governance agency should have a committee which deals with governance matters as it relates to the agency itself, including annual assessment and tenure.

- 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 information that is listed to be disclosed is a good starting point. We feel that over time disclosure will improve with experience.

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

Response:

This whole process, starting with Glorianne Stromberg's report, has taken so long that the CSA should use its collective will to get this legislation effective as soon as possible. We would suggest the end of 2002 for implementation. Once effective, it should be feasible for the mutual fund managers to have governance agencies up and running within a six month period. This CSA Concept Proposal, regardless of how the legislation deals with some of the specific issues, has given them a useful road map of the larger issues to be addressed. The first item of business for the manager would be to choose the governance model (assuming that the legislation allows flexibility); the next would be to have to governance agency members chosen and appointed. The agency itself will be required to be heavily involved in the drawing up of its mandate, its procedures and its responsibilities. It would seem that six months would be sufficient time to choose the model and appoint the members.

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

Response:

Training specific to the mutual fund industry should definitely be offered. Also a complete review of the investment objectives and policies of the funds on which they are governing should be conducted as well as exposure to the money managers. It would be useful for members to have some relevant experience. This would mean that they are familiar with setting mandates, priorities and processes, and with governance requirements. Ongoing training, whether formal or informal, is always important.