THE INVESTMENT FUNDS INSTITUTE OF CANADA
L'INSTITUT DES FONDS D'INVESTISSEMENT DU CANADA
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September 26, 2002

Mr. John Stevenson, Secretary
Ontario Securities Commission
20 Queen Street West
Suite 1903, Box 55
Toronto, Ontario
M5H 3S8
Email: jstevenson@osc.gov.on.ca

Dear Mr. Stevenson

RE: Ontario Securities Commission Proposed Rule 13-502 – Fees

The Investment Funds Institute of Canada ("IFIC") appreciates the opportunity to offer comments on behalf of its members with respect to the Ontario Securities Commission ("the Commission") Proposed Rule 13-502 Fees (the "Fees Proposal").

IFIC is the member association of the investment funds industry in Canada and its membership includes 72 fund management companies sponsoring 1,933 mutual funds, 98 dealer firms selling mutual funds, and 59 affiliates representing law, accounting and other professional firms.

IFIC members currently manage assets representing almost 100% of all open-end mutual funds in the country. IFIC member funds manage $400.3 billion in assets (representing nearly 95 per cent of the industry) in over 52 million unit-holder accounts.[1]

General Comments

The Fees Proposal has been designed to reduce the overall fees charged to market participants and to simplify, clarify and streamline the current fee schedule so as to more accurately reflect the Commission's cost of providing services. This is a welcome and timely undertaking and we wish to note at the outset that we are pleased by the ongoing efforts of the Commission to attempt to levy fees based on actual participation in the capital markets.

[1] Note: figures representing membership and assets under management by IFIC members are current as at August 31, 2002.

We do, however, have significant concerns and continue to believe that the methodology of the Fees Proposal requires re-examination. We note that our comment letter of May 31, 2001 sought to raise many of our present concerns with the Commission along with a number of other market participants who undertook to review the Fees Proposal and provide the Commission with the benefit of their perspective.

The most recent version of the Fees Proposal does not incorporate or seem to have given serious consideration to submissions made during the previous request for comments and it would appear to us that the Commission doubts the significance and reality of industry concerns. Prior comment on the Fees Proposal raised important and clearly contentious issues and we had hoped for a more thorough consideration of industry comments generally. However, based on the lack of substantive explanation in the release accompanying the Fees Proposal and Staff responses to public comments, industry input seems to have been dismissed summarily and we are discouraged by the Commission's apparent lack of responsiveness to our concerns.

Accordingly, we find it necessary to revisit a number of issues that have already been brought to the attention of the Commission.

We wish to emphasize that of the issues discussed in our comments, the most prominent are the potential shifting of fee/expense burdens to mutual fund managers and the methodology being used to determine gross revenues attributable to Ontario.

1. <u>Fee/Expense Burden Shifted to Mutual Fund Managers</u>

In reviewing the Fees Proposal and its actual impact upon the relationship between our industry and Canadian investors, we find it difficult to escape the conclusion that the Commission is seeking to unilaterally alter the relationship between investors and fund managers by charging participation fees to fund managers that cannot be recouped from either the funds themselves or investors.

From the perspective of our members, the implications that arise from an economic restructuring of the relationships in the industry are among the most obvious and significant of the potential consequences of the Fees Proposal. We are disappointed to see that the structural impact of the Fees Proposal has neither been given serious consideration by the Commission, nor made the subject of frank and open discussions or even acknowledged as an issue meriting further investigation and dialogue with the industry.

It is important for the Commission to recognize that the organization of our industry is tied significantly to how costs are allocated. The industry makes product pricing decisions, organizes complex business structures and establishes contractual relationships on the basis of certain costs, such as regulatory fees, being flow-through expenses that are to be recaptured by being charged to funds under management.

The flow-through character of regulatory expenses is already clearly disclosed to individual investors and we are of the view that the Fees Proposal would inappropriately

alter the pre-existing contractual relationship that exists between investors and fund managers.

Staff responses to concerns surrounding the inability to flow-through regulatory fees to the funds indicate that nothing in the Fees Proposal prevents firms from asking unit-holders for an increase in management fees payable by the funds. We acknowledge that managers could theoretically resort to obtaining investor approval to raise management fees so as to be compensated for the new fees that managers will be made to bear. However, having to seek unit-holder approval to increase management fees would be redundant insofar as the real purpose of this request would effectively be to facilitate the flow-through of regulatory expenses. Attempting to recapture the cost of participation fees in this manner would thus unjustifiably compel fund managers to expend additional resources just to maintain the status quo.

Accordingly, we are of the view that suggesting that firms ask unit-holders to ratify an increase in management fees to recapture the costs of participation fees is a comment that is insufficiently informed by the economic realities of this industry. Moreover, given the high administrative costs associated with unit-holder voting and the current economic environment, it would be both unrealistic and impractical to seek unit-holder approval for an increase in management fees.

We are additionally concerned that potential future costs associated with proposed manager registration initiatives have not been taken into account in the Fees Proposal. We feel compelled to note that there is, in our view, a legitimate basis[2] for the industry's reluctance to place confidence in a regulatory assessment of the impact of overall industry costs and the projected costs of proposed initiatives.

2. <u>Gross Revenue Attributable to Ontario</u>

Dealers, advisors, registrants and each unregistered mutual fund manager (the "subject firms") are to pay an annual participation fee based upon the proportion of gross revenues for the most recently audited financial year that is attributed to the entity's business in Ontario for tax purposes.

We remain concerned with this proposed method of income attribution for the purpose of calculating participation fees in the province of Ontario, as we believe the adopted methodology to be seriously flawed.

In our view the definition of Ontario Percentage, as set out in Part 1 "Definitions", prejudices firms with a permanent establishment in Ontario. Ontario-based mutual fund companies would, under the Fees Proposal, pay fees to this province that are inappropriately high, while still being required to pay fees to other provinces that are

[2] As one of the more prominent examples we cite the development of SEDAR which saw regulatory authorities assuring the industry that the projected costs of this initiative would be less than photocopy and courier expenses already being paid by the industry. It is by now apparent that the costs of SEDAR were out of all proportion to any benefit received by the industry. Without revisiting this issue in greater detail, we wish to emphasize the need for vigilance so as to ensure that the confluence of cost burdens that will be brought about by the Fees Proposal and other regulatory initiatives do not result in actual costs grossly exceeding those that were projected.

based on net or gross mutual fund sales. This, in our view, would clearly be an inequitable outcome as it would result in a regulatory fee burden that is both duplicative and unjustifiably oppressive to the operation of subject firms.

We believe that the Ontario Percentage determination for firms without permanent establishments in Ontario articulates the more equitable test for both Ontario-based and non Ontario-based firms. The most appropriate allocation methodology should use the percentage of assets that are Ontario-based ("Ontario assets" being quantified and calculated on the basis of average daily assets over a year attributable to the capital market activities in the province of Ontario). In addition, and to the extent that assets are derived from fund on fund structures, we think that an allocation model should incorporate a "look-through" to the assets of the top fund.

Section 3.6(3), Part 3 – "Capital Markets Participation Fees" permits a person or company to reduce their specified Ontario revenues for a financial year by deducting sub-advisory fees and trailing commissions paid by the person or company to another registrant in Ontario.

No provision is made for the deduction of sub-advisory fees and trailing commissions paid to firms outside of Ontario and we do not understand why the Commission has elected to prohibit the deductibility of these expenses when they are incurred in other provinces or jurisdictions outside of Canada.

The Commission has already recognized the appropriateness of allowing a deduction for trailing commissions and sub-advisory fees when calculating gross revenues. We wish to emphasize that the appropriateness of excluding these expenses from a calculation of gross revenues lies not in the fact of their being incurred in a particular jurisdiction but rather because of the economic reality that they do not form any part of a fund manager's revenues.

Accordingly we find the limitations set out in section 3.6(3) to be arbitrary and without basis as the fundamental character and inherent deductibility of these expenses does not vary with the jurisdiction in which they are incurred.

Participation Fees as a Disincentive to Locating in Ontario

We are concerned that new firms looking for a jurisdiction in which to establish primary operations will be discouraged from selecting Ontario as participation fees, in addition to the cost of establishing a mutual fund company in this province, will likely provide a strong disincentive to accessing our capital markets.

Our industry lobbied strenuously to have the *Income Tax Act* (Canada) amended so as to enable Canadian firms to manage offshore assets in Canada without negative tax consequences and these efforts were undertaken with the intent of building the investment management business in this country. We are concerned that participation fees will compel asset managers who advise international clients to relocate outside of the province of Ontario. Assets managed for international clients are generally invested outside of Canada and as a consequence fund managers, at least with respect to these

assets, do not benefit in any appreciable way from well-regulated Canadian capital markets.

The investment funds business in Canada has matured and its demographics are constantly changing and marked by ongoing consolidation. We believe that, as a result of this consolidation, it will be relatively easy for larger firms that manage a very significant percentage of the mutual fund assets in Canada to restructure their business and finances so as to allocate and report income outside of Ontario for tax purposes.

Our industry has devoted much time and resource in seeking to establish, within the province of Ontario, an environment that is conducive to fostering the ongoing growth and stability of the investment funds business. We note that our efforts have resulted in mutual benefit that has accrued to both the industry and the provincial economy.

We urge the Commission to take our concerns seriously as a reallocation of income outside of this province is a relatively straightforward manner in which to avoid the application of the Fees Proposal while significantly disadvantaging the economy of Ontario.

3. Tiering of Participation Fees

The Commission has proposed to adopt a tiered fee schedule that would levy fixed dollar amounts within each tier. We find the fee tiers to be extremely broad and, coupled with fixed dollar amounts per tier, note that they would result in inordinate and unjustifiably high jumps in participation fees for nominal increases in specified Ontario revenues (please see the attached Exhibit "A"). We fail to see how an increase in revenues from $49.9 million to $50 million, for example, translates into a doubling of a firm's use of the capital markets of Ontario in a manner that would justify a doubling of participation fees from $75,000.00 to $150,000.00.

While an increased participation fee might be appropriate for a shift in revenues from $50 million to $100 million, it is inappropriate to tie all firms in this or any one of the broad revenue categories to a single fee. The use of the broad revenue categories and fixed dollar amounts that the Commission has proposed would also inappropriately result in firms with very divergent gross revenues having to bear the same participation fees.

We also do not understand why similar increases in revenues result in such disproportionate increases in fees. Exhibit "B" graphically represents how fees would increase in response to proportionate increases in revenue and we are of the view that it is a compelling illustration of how inequitable the Fees Proposal is in this regard.

The Commission, in seeking to establish cost tiers that will ensure the stability of its revenues while being equitable to all market participants, is faced with the challenge of having to reconcile multiple and potentially conflicting priorities. We recognize both the difficulty and necessity of this endeavour and would be pleased to work with the Commission in a reexamination of the Fees Proposal's tiered fee schedule.

4. Activity Fees - Prospectuses For Multiple Mutual Funds

Staff responses to comments on this concern have indicated that combining the prospectuses of two or more mutual funds in a single document does not reduce the amount of time and effort necessary for adequate review.

By way of illustration, Staff cite the example of reviewing the prospectus of one mutual fund versus the prospectuses of 20 mutual funds in a single document. Staff have indicated that in either case the review and issuance of a comment letter must occur within the same 10 day business period and that the use of multiple fund prospectus documents does little more than require staff to work longer hours to meet timing expectations.

We agree that more work is involved in reviewing 20 mutual fund prospectuses as opposed to one and are concerned that the Commission may have misconstrued previous comments on this issue which, in our view, were not meant as suggestions to the contrary. However, while we acknowledge that multiple fund prospectus documents will give rise to more work on the part of Staff, we think that certain efficiencies must accrue with the overlap of material provisions that would be common to a family of funds. We thus find it difficult in the presence of common and overlapping materials to understand how, in the example raised by staff, the need for additional review apparently translates into precisely 20 times as much work.

We are of the view that the activity fees proposed for prospectuses for multiple mutual funds are excessive and continue to think that some form of discount for multiple fund prospectus documents would be appropriate.

5. Regulatory Costs are Disproportionately Borne by the Mutual Funds Industry

Insurance companies and pension funds also participate in the capital markets of this province and enjoy the benefits of regulatory oversight along with firms in the mutual funds industry. However, many of these market participants are not registered in any category with the Commission and so, while sharing equally in the benefits of having access to Ontario's regulated capital markets, are not being made to bear any of the resultant costs. We think it inequitable that the costs of a benefit that is shared by many market participants in this province should be so disproportionately borne by the mutual funds industry. It would, in our view, be more equitable and a greater overall cost reduction to investors if all industry market participants shared these costs equally.

6. Time of Payment/Transition

Section 3.2(1) – "Time of Payment", requires registrants to pay fees by December 31 of each year. Section 3.2(2) indicates that unregistered investment fund managers must pay participation fees no later than 90 days after the end of each financial year.

We note that the effective date of the Fees Proposal has not yet been specified beyond some time in 2003. Without knowing what this implementation date will be, we are unable to assess the potential impact of section 3.2 on our members.

We are concerned that if the selected implementation date is one that occurs late in the calendar year, our members will have to pay a second set of fees under the new Fees Proposal after having only recently paid under the old fee schedule in accordance with their respective prospectus renewal dates.

It further seems to us that fees, both under the old and new schedules, would be payable to the Commission within a single calendar year. Our interpretation of how fees would be payable, if correct, would lead to a significantly increased fee burden on our members during the transition period. We think that it is important to establish a firm implementation date for the Fees Proposal and would generally appreciate the Commission's assistance in clarifying our understanding on the issue of how the industry will be expected to pay fees during the transitional period.

7. The Need to Work Towards a Harmonized Regulatory Regime

There has as of late been much attention devoted to the inefficiencies and mounting transactional costs that our industry and ultimately Canadian mutual fund investors are subject to as a result of the lack of a co-ordinated and unified regulatory regime. The need for new regulatory initiatives to facilitate a move towards a more harmonized regulatory framework has, as a consequence, been the underlying theme of our recent submissions.

The Fees Proposal cannot be harmonized nationally in its present form as it is based upon an allocation methodology that would see gross revenues allocated to provinces with head office locations. We anticipate that jurisdictions that do not have head office locations will be reluctant to adopt such a disadvantageous regime.

Implementation of the Fees Proposal in its current form will thus be most likely to result in an exacerbation of existing inter-jurisdictional tensions. This is unnecessarily divisive and a step in the wrong direction at a time when our industry is seeking to move towards a more streamlined and harmonized regulatory regime.

We strongly urge the Commission to amend the Fees Proposal so as to render it more harmonizable across all provinces as in its current form, while being progressive in concept and well intentioned, it serves as another impediment to one of the most pressing needs of our industry.

Request for Meeting

The Fees Proposal will have a very significant impact on the industry and it is, as a consequence, of great importance to the industry that its perspective and concerns be addressed and resolved in a more considered manner. We would appreciate an opportunity to discuss these matters further and will be contacting you shortly so as to arrange a meeting at a mutually convenient time.

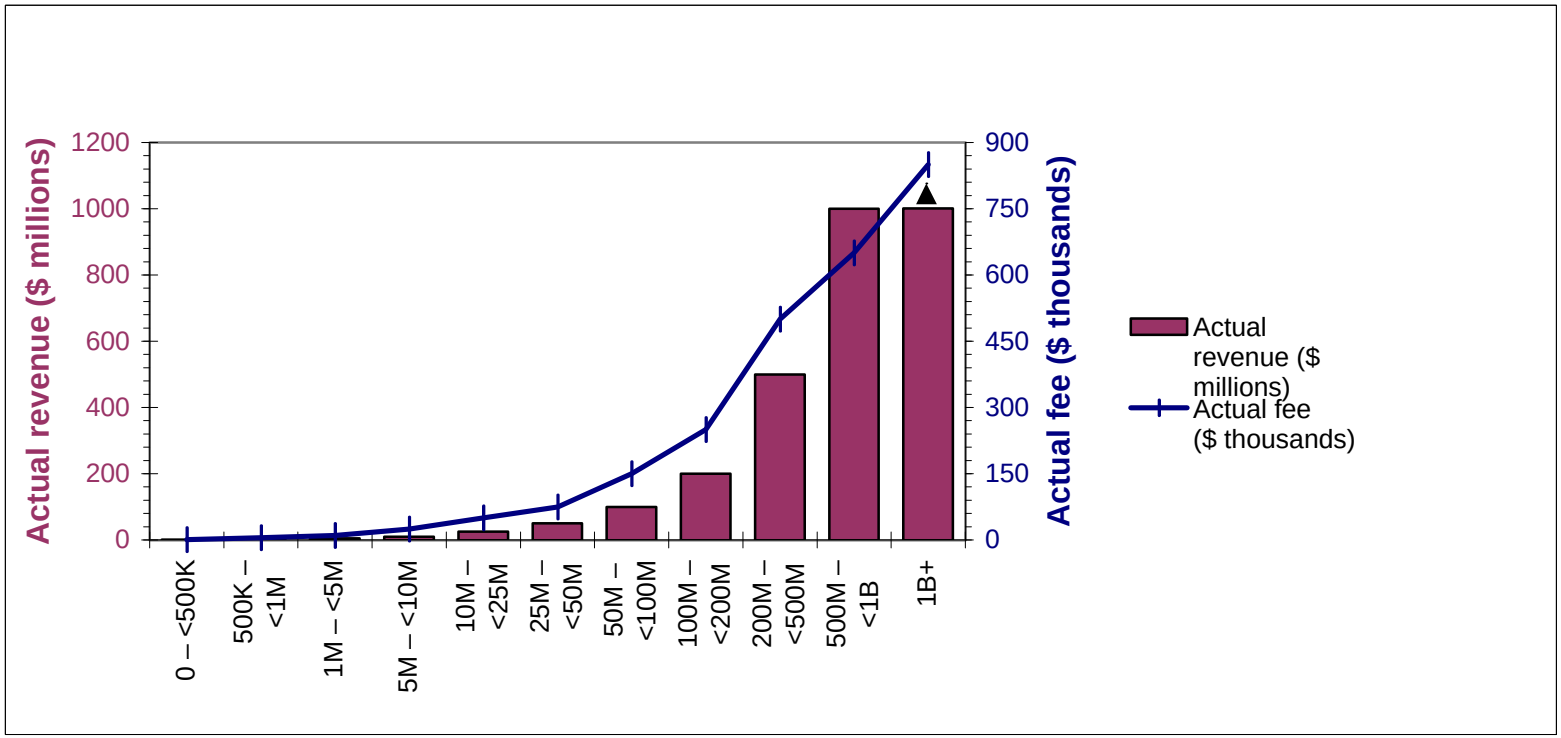
Should you wish, in the interim, to discuss any aspect of our submission in greater detail, please feel free to contact me by telephone at (416) 363-2150 x 271 or by email at jmountain@ific.ca or Aamir Mirza, Legal Counsel at (416) 363-2150 x 295 / amirza@ific.ca.

Yours truly,

ORIGINAL SIGNED BY JOHN MOUNTAIN

John Mountain
Vice-President, Regulation

Exhibit "A"


Actual revenue ($ millions)
1200
1000
800
600
400
200
0
Actual fee ($ thousands)
900
750
600
450
300
150
0
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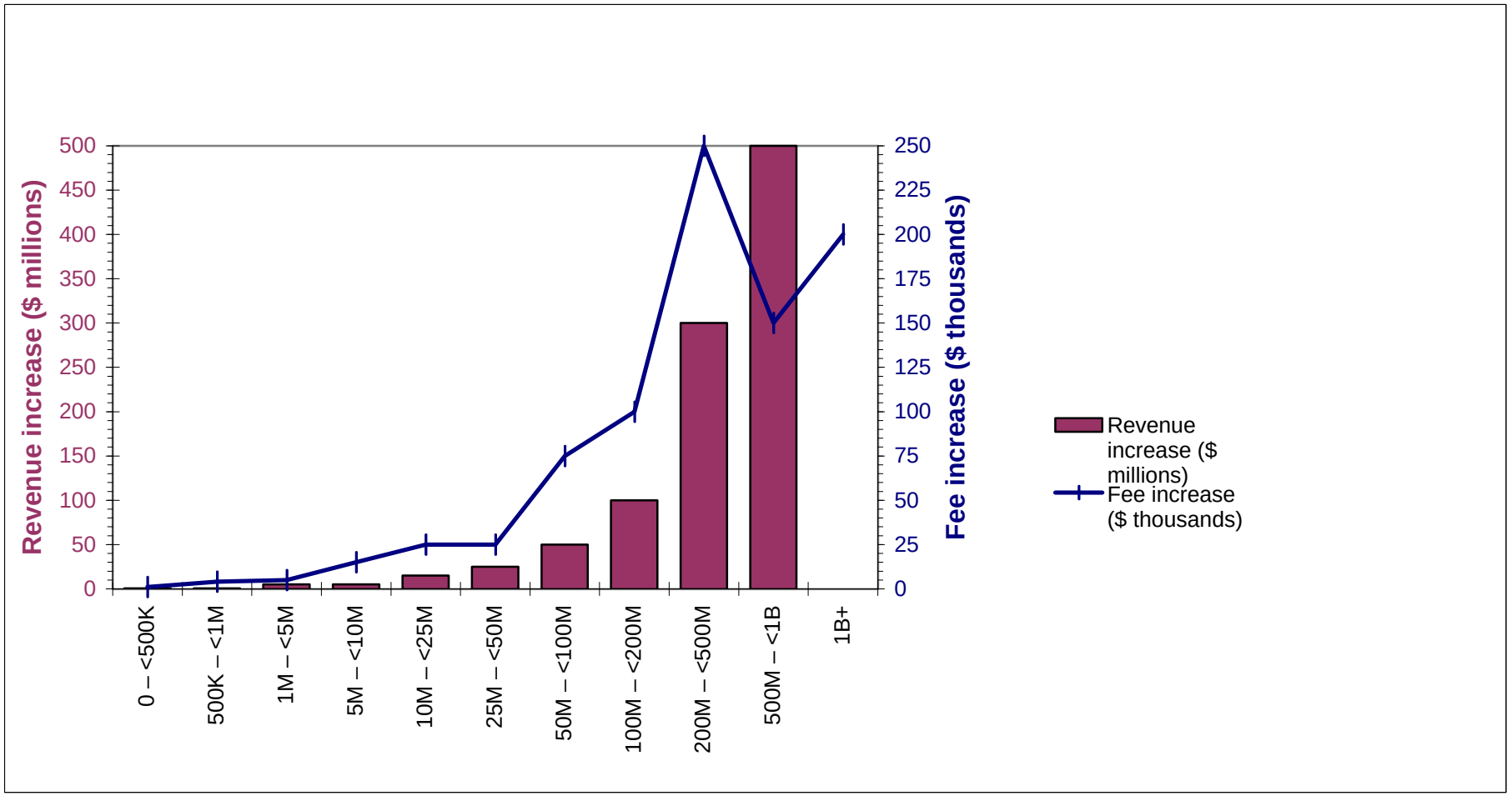
500K – <1M
1M – <5M
5M – <10M
10M – <25M
25M – <50M
50M – <100M
100M – <200M
200M – <500M
500M – <1B
1B+
Actual revenue ($ millions)
Actual fee ($ thousands)

Exhibit "B"


Revenue increase ($ millions)
500
450
400
350
300
250
200
150
100
50
0
Fee increase ($ thousands)
250
225
200
175
150
125
100
75
50
25
0
0 – <500K
500K – <1M
1M – <5M
5M – <10M
10M – <25M
25M – <50M
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Revenue increase ($ millions)
Fee increase ($ thousands)