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VIA e-mail:consultation-en-cours@cvmq.com

Canadian Securities Administrators

c/o Denise Brosseau, Secretary
Commission des valeurs mobilières du Québec
800 Victoria Square, Stock Exchange Tower
P.O. Box 246, 22nd Floor
Montréal, Québec H4Z 1G3

Dear M. Brosseau:

Re: Notice of Proposed Amendments to National Instrument 81-102 and Companion Policy 81 -102 CP Mutual Funds and to National Instrument 81-101 Mutual Fund Prospectus Disclosure and Form 81-101F1 Contents of Simplified Prospectus and Form 81-101F2 Contents of Annual Information Form (collectively, the "Amendments")

We are writing on behalf of PFSL Investments Canada Ltd.("PFSL") and AGF Funds Inc. ("AGF") further to your request for comments on the proposed Amendments to National Instrument 81-102 Mutual Funds and Companion Policy 81-102 CP, specifically the proposed terms under which a top fund may invest in one or more bottom funds. PFSL is the sponsor of 11 Primerica Concert funds ("top funds"). Each of the Concert funds in turn invests in a number of AGF funds ("bottom funds"), typically 5 or more bottom funds.

PFSL and AGF recognise that through the Amendment, the CSA is trying to afford flexibility for fund on fund structures and administrative ease for fund sponsors by avoiding the need for sponsors to obtain a separate exemption for each fund on fund structure through standardised criteria.

The policy objectives behind the proposed Amendments do not cause concern for PFSL or AGF, including the objective of ensuring disclosure to investors of all amounts payable as a result of the fund on fund structure. However, PFSL and AGF find that the Amendment imposes restrictions which go well beyond the policy objectives sought to be achieved and if implemented, would constitute a material change to the business relationship of PFSL and AGF.

PFSL created the Concert funds to provide added value services to its client base as discussed further below. PFSL did not create these funds to change fundamentally its relationship with AGF. PFSL is in the business of retail distribution of mutual funds to its clients. On the other hand, AGF engages only in wholesaling activities in respect of its proprietary AGF funds. When PFSL and AGF entered into their business relationship regarding the fund of funds structure, they did so in the belief that the fundamentals of their business relationship would be maintained. They find that the proposed Amendment undermines their original business premise and interferes with their ability to negotiate their bargain and to structure their relationship in a manner acceptable to both parties. The Amendment is particularly troubling for existing fund on fund relationships where the respective sponsors have already bargained in good faith and relied in good faith on the settlement of their structures through the exemption process with the securities authorities. Furthermore, the Amendment impacts not only the sponsors but third parties, such as distribution funding vehicles, with whom a sponsor has entered into a contractual arrangement based on the existing structure.

Their main concerns revolve around three of the structural restrictions in the Amendments:

(a) the requirement that there be no redemption fees or other charges paid on redemption;

(b) the requirement that no fees or charges of any sort be paid to <u>anyone</u> by the top or bottom funds, the managers, principal distributors or any of their affiliates or associates <u>in connection with the top fund's purchase, holding or redemption</u>.

(c) mutual fund fees and expenses rebated by the other mutual fund or its manager are paid or granted to the top fund.

As will be discussed in greater detail below, paragraph (a) unduly restricts the way in which distribution funding occurs. Paragraph (b) is worded very broadly and its intent seems to be to act as a form of anti-avoidance that there will be no undisclosed relationships or cash flows. It appears to have been intended to preclude the payment of any commissions by the bottom fund sponsor to the top fund sponsor or any other person. It may also catch arrangements for services required to operate the top fund. Lastly, while it appears from other statements made in connection with the publication of the proposed Amendment that it is not the case, it could even be read to prohibit management fee distributions from the bottom fund to the top fund which will be used to compensate the manager of the top fund. Paragraph (c) fails to recognise that the manner of rebating is different for corporate funds.

It is obvious that a sponsor of a top fund will not enter into an economic bargain where the sponsor knows from the start that it will lose money. The top fund sponsor is constrained in charging its management fee to the top funds by the commercial reality of the marketplace. In other words, the all-in management expense ratio ("MER") at the top fund level, including the MER of the bottom funds, must be competitive. Accordingly, the sponsor must engage in negotiations with the sponsor of the bottom funds to secure its source of income. The negotiations involve not only the explicit dollar amounts to be shared between the parties but the assumption of risks, such as those inherent in the distribution funding process.

As noted above, PFSL created the Concert funds to provide added value services to its clients. The purpose of the top fund includes for example, the ability of the small investor to get a diverse portfolio of funds with his small investment dollars. For example, a small investor investing just $1000 would only be able to buy one or two bottom funds. However, through investing in a top fund, the investor can obtain exposure to many more funds. As a result, the top fund represents in essence a bulk registration in the register of the bottom fund. What the investor is doing is investing on a pooled basis in the bottom funds through the top fund.

As noted above, PFSL is a retail sales organisation. If no top fund is introduced, a participating dealer, such as PFSL, would be entitled to receive the sales commission on a deferred sales charge (“DSC”) purchase and the trailing commission for both front end and DSC sales from AGF or other wholesale distributors on the direct purchase of the bottom fund. There is no apparent policy objective served to require PFSL to self fund the commission payments simply because it introduced a top fund. There is no duplication of sales commissions if AGF is permitted to continue to make the payments of sales commissions.

Each investment in units of the Concert funds results in investments in the underlying AGF funds. If the purchase of the units at the top fund is on a front end sales charge basis, then the securities of the AGF funds purchased at the same time are treated as a front end sales charge purchase and no commission at the time of sale is paid to PFSL. Trailing commissions on these front end purchases of the AGF funds are paid by AGF to PFSL. PFSL does not, of course, pay itself any further trailing commission such that there is no duplication.

Similarly, when there is a purchase of the top fund on a DSC basis, the securities of the AGF funds purchased with such subscription are treated as DSC sales. As a result, AGF pays to PFSL an initial sales commission and an ongoing trailing commission. PFSL does not pay itself any initial sales commission or trailing commission such that there is no duplication. If the investor in the top fund who purchased on a DSC basis redeems early such that a DSC is paid to the Concert funds, the same amount of DSC is paid by the Concert funds in respect of the redemption of the corresponding number of securities of AGF funds. No DSC is paid to PFSL. AGF or the funder receives the DSC paid in respect of the redemption of the securities of the AGF funds. All of these payments and the fact that AGF is the payer of commissions are disclosed in the Concert funds prospectus.

Other commercial relationships exist as a result of this structure. The sponsor, such as AGF, has the obligation at first instance to pay the initial commission on a DSC purchase and is entitled to receive, in addition to the management fee, any DSC paid on an early redemption. As you are aware, many sponsors will enter into distribution funding arrangements for limited periods with limited partnerships and private funders in respect of DSC purchases. In essence, the funder will fund the initial commission payable in respect of purchases on a DSC basis during a designated distribution period. As a result of providing the funding, the funder will be entitled to receive through the sponsor an amount which equals a portion of the management fee - for example, 50 basis points of the net asset value of the funded securities. In addition, the funder will be entitled to receive the DSCs payable on an early redemption. Examples of this type of funding relationship exist in the many limited partnerships which were offered by prospectus. In the case of AGF, the securities of AGF Master Limited Partnership are listed on the Toronto Stock Exchange. Securities of the AGF funds purchased by the Concert funds on a DSC basis would be included in any funding arrangement that AGF had at the time of the purchase. AGF cannot of course simply change its bargain with the funders who now have rights to these amounts.

If the Amendment were approved in its current form, neither the initial or trailing commissions could be paid to PFSL as a result of the clauses referred to above. The loss of that income (which would occur through the Amendment) is obviously not acceptable to PFSL. Based on the wording of the current Amendment, the only structure of cash flow that appears to be permitted are management fee distributions. That would mean that AGF and PFSL would have to negotiate different levels of management fee distribution payments to increase the income to PFSL. On the other hand, that is not an acceptable proposition to AGF as it has already entered into a commercial bargain with third party funders whereby it has agreed to pay a portion of its management fee and the DSC to the funder or has already self funded the sales commission on a DSC purchase.

However, this is not an issue simply for historical purchases of securities. The conversion of payments of sales commission into management fee distributions raises tax and other issues.

To maintain the same income level, the top fund sponsor would have to renegotiate the level of management fee distributions payable by the bottom fund to the top funds. PFSL would then have to increase the level of its management fee charged to the top fund so that the same dollars can be received by the top fund sponsor. It would be unfair to require the top fund manager to go to a securityholder meeting for approval of the increase in management fees when the income to PFSL is not in fact changing,

The level of fees received by PFSL is disclosed in the prospectus currently and, as noted above, was negotiated premised on the ongoing payment of sales commissions and trailing commissions by AGF. This means for example that PFSL does not have to attend to the funding of initial commissions on DSCs. The current level of PFSL management fee would provide an insufficient source of income to pay the initial commissions and trailing commissions to the sales representatives of PFSL or to pay any funder who funds the commission on a DSC purchase. Sales commissions are levied at the time of sale whereas management fees are typically a monthly fee concept premised on net asset value. This point serves to evidence how unnatural it is to convert a sales commission into a management fee when the relationship between PFSL and AGF is that of retail distributor and wholesale distributor. In addition, that re-characterization of the relationship distorts the picture to the investor. These are sales and services commissions and not management fees.

The approach of having everything flow up to the top fund before payment is made to the top fund sponsor in the form of management fees results in unnatural tax impacts. Due to tax considerations, the manager of a trust fund cannot rebate management fees directly to another party.

The manager must waive a portion of its fee and then the amount must be paid as a distribution to the investor (including the Concert fund) by the bottom funds. That distribution will likely be a taxable distribution to the top fund or if it is not, it will grind down the cost base of the top fund's investment in the bottom fund, ultimately giving rise to potentially higher capital gains. Secondly, the investors of the bottom fund are also impacted by the preferential management fee distributions to the extent that it may lower the amount of distributions available to investors generally. Furthermore, management fees are subject to GST whereas the payment of a sales commission is not.

There is one other technical issue which arises where there is in fact a management fee distribution or rebate. The structure of how a reduction in the management fee must be paid in respect of a trust fund was discussed above. If the underlying AGF fund is a corporation or a class of a corporation rather than a trust, there are not the same tax issues as there is for a trust fund in rebating a portion of the management fee. As disclosed in the prospectus, in such case AGF will rebate directly a portion of the management fee. AGF pays the management fee rebate to PFSL. The reason for doing so is simply that if the rebate was paid to the Concert funds and then used to pay the management fees to PFSL, the Concert funds would have to recognise income from the rebate even though the rebate is destined to fund the PFSL management fee. Whether the management fee reduction is in the form of a distribution or a rebate, it is still disclosed in the prospectus as a part of the management fee that PFSL is receiving. The clauses of the Amendment appears to equally preclude AGF paying the rebate directly to PFSL in respect of the AGF funds that are a corporation or a class of a corporation.

PFSL and AGF also seek to clarify that the phrase, "in connection with the top fund's purchase, holding or redemption" noted in paragraph (b) above, would not preclude the retention of the sponsor of the bottom fund or its affiliates or associates to perform services required to operate the top fund, such as administrative processing services or services as trustee for registered plans. Another commercial reality is the fact that costs charged by third parties can generally be negotiated at a lower level if there is a bundle of services obtained from the same provider. As explained above, the purchases and redemptions of units of the Concert funds are tracked against the purchases and redemptions of the AGF funds in terms of whether they constitute front end or DSC purchases. It is more efficient and less costly to use the same service providers as the bottom funds use, namely AGF and its affiliates. PFSL and AGF are arms' length parties and as a result, PFSL will have negotiated the relationship in the best interests of the Concert unitholders. This is the identical premise that underlies the existing provision of National Instrument 81-102 in not requiring securityholder approval where there is an increase in the management expense ratio due to the retention of third party service providers by the manager of a fund.

For the foregoing reasons, PFSL and AGF would seek revisions to the restrictions which would permit natural, efficient and cost effective relationships in a fund on fund structure while not undermining the policy objectives legitimately sought by securities regulators. They believe they have demonstrated through the examples above that the current terms of the Amendment are too restrictive and thereby prohibit arms' length sponsors in fund on fund relationships to negotiate their commercial bargain without any clear evidence that this structure undermines policy objectives of securities regulators.

We would suggest that in order to rectify these restrictions, a principled approach should be taken. To mandate a particular form of payment would impose unnecessary structural restrictions. The clauses of the proposed Amendment referred to above at a minimum should contain a proviso along the following lines:

"provided that payments of fees or charges as a result of the purchase, holding or redemption of securities by the top fund of the bottom fund are permitted to the extent that (i) they do not result in any duplication of commission; (ii) they are payments in respect of management fee rebates or distributions; or (iii) they relate to services required by the top fund or its securityholders provided by the managers, principal distributors or any of their affiliates or associates.".

We would be pleased to discuss further any of the foregoing comments with you. I may be contacted at 416-865-7322 or by e-mail at mdavidge@torys.com.

Yours very truly,

"Marlene Davidge"

Marlene Davidge

cc: J. Yassi, PFSL Investments Canada Ltd.
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