Richard W. Nesbitt
President
TSX Markets
The Exchange Tower
130 King Street West
Toronto, Canada M5X 1J2
T (416) 947-4320
F (416) 947-4295
Richard.Nesbitt@tsxmarkets.com

November 8, 2002

Denise Brousseau, Secretary
Commission des valeurs mobilières du Québec
800 Victoria Square, Stock Exchange Tower
P.O. Box 246, 22nd Floor
Montreal, Québec H4Z 1G3

Dear Ms. Brousseau,

Re: Notice of Proposed Amendments to National Instrument 81-102 "Mutual Funds" ("NI 81-102") and Related Instruments (the "Proposed Amendments")

The Toronto Stock Exchange (the "TSX") appreciates the opportunity to submit our comments regarding the Proposed Amendments to NI 81-102. Although TSX is generally supportive of reforms to the regulatory framework governing fund of fund structures, we believe that certain of the regulatory accommodations proposed by the Canadian Securities Administrators (the "CSA") should also be extended to investment by mutual funds in exchange traded funds ("ETFs") and index participation units ("IPUs").

<u>The Proposed Amendments</u>

The Proposed Amendments will provide relief from certain provisions of NI 81-102 that currently restrict investment by mutual funds in mutual funds and other investment funds. In particular, the Proposed Amendments will:

- Allow a top fund to invest a percentage of its net assets in a bottom fund or a RSP clone fund in excess of the 10 percent concentration restriction that is prescribed by subsection 2.1(1) of NI 81-102 (the "Concentration Restriction");

- Allow a top fund to purchase more than 10 percent of the securities issued by a bottom fund or a RSP clone fund in excess of the 10 percent control restriction that is prescribed by subsection 2.2(1) of NI 81-102 (the "Control Restriction"); and

- Remove the current restriction contained in subsection 2.5(1) of NI 81-102 that prohibits a mutual fund from investing more than 10 per cent of its net assets in securities of other mutual funds (the "Fund of Fund Restriction").

Despite these regulatory accommodations, the Proposed Amendments will prohibit mutual funds from investing in certain ETFs, including exchange-traded investment vehicles for which the redemption price is based on net asset value. We understand that this restriction would represent a significant change from the current rules, which permit mutual funds to invest in securities of these issuers if the Concentration and Control Restrictions are complied with. Under the Proposed Amendments, investment by mutual funds in IPUs, (as well as other closed-end funds such as most income trusts and REITS) would continue to be subject to the Concentration and Control Restrictions in NI 81-102. TSX is concerned that these proposed reforms may significantly disadvantage the development and growth of the ETF and IPU market in Canada.

ETFs

ETFs have become increasingly popular in the past few years. Currently, there are more than 90 ETFs listed on the TSX, representing a market capitalization in excess of $12 billion. As noted above, the Proposed Amendments will completely restrict mutual funds from investing in certain types of ETFs, including exchange-traded investment products for which the redemption price is based on net asset value. We believe that such restriction will constrain the ability of a portfolio manager of a mutual fund to actively manage the investments made by a mutual fund in other investment products, to the possible detriment of the unitholders or shareholders of the mutual fund. The Proposed Amendments signal a reversal in the ability of mutual funds to invest in ETFs. Although the majority of ETFs listed have been targeted to retail investors, it is probable that some institutional investors would also be interested from time to time in taking advantage of some of the unique features that these vehicles offer (much in the same way that they may be interested in investing in other mutual funds which have also been targeted to retail investors).

IPUs

Currently, there are 15 equity and two fixed income IPUs listed on TSX with a combined market capitalization of $4.3 billion. An IPU is a passively managed, exchange traded mutual fund which is similar in nature to an index mutual fund while offering investors the added benefits of lower management fees and enhanced trading flexibility.
IPUs offer mutual fund managers considerable flexibility in managing their portfolios and achieving their investment objectives while providing less liquidity and redemption risk than conventional mutual funds. For institutional investors (including mutual fund managers), IPUs are often utilized to efficiently accomplish trading strategies, which may assist managers in reaching their investment objectives.

A liquid IPU markets both complements and reinforces a viable futures market and serves to attract foreign liquidity into a marketplace. IPUs in Canada (with the exception of the i60 or XIU, based on the S&P/TSX 60 index) are still relatively small in size by international standards. These size limitations prevent large mutual funds from investing in them without contravening the current Concentration and Control Restrictions. For example, if a mutual fund with $200 million in assets wishes to allocate 5% of its portfolio in an IPU with a market capitalization of less than $100 million (10 of the 17 TSX listed IPUs have assets of less than $100 million), it will be prevented from allocating the full 5% under the current regulatory regime and the Proposed Amendments.

Under the Proposed Amendments, investments by mutual funds in other conventional mutual funds will not be subject to the Concentration and Control Restrictions. The Proposed Amendments may therefore act as a barrier to the growth of ETFs and IPUs in Canada and create an unlevel playing field vis a vis conventional mutual funds. In this regard, we do not believe that there is an appropriate policy basis to distinguish between these types of investment vehicles. Accordingly, TSX believes that the CSA should not adopt the proposed investment restrictions by mutual funds in ETFs and should consider extending relief from the Concentration and Control Restrictions with respect to investments by mutual funds in IPUs.

Thank you for the opportunity to comment on proposed NI 81-102. We hope the committee will find these comments useful. Should you wish to discuss them in more detail, I would be pleased to respond.

Sincerely,

Richard Nesbitt
President
TSX Markets