OGILVY RENAULT

Direct Dial: (416) 216-4053
Direct Fax: (416) 216-3930
csinger@ogilvyrenault.com

125 1879 - 2004

Sent by E-Mail

Toronto, March 12, 2004

Ms. Rhonda Goldberg
Senior Legal Counsel, Investment Funds
Ontario Securities Commission
20 Queen Street West, Suite 1903
Toronto, Ontario M5H 3S8

Dear Rhonda:

Request for Comments –
Proposed Rule 48-501 – *Trading during Distributions, Formal Bids and Share Exchange Transactions*

I appreciate Staff having asked, given my recent involvement with certain applications (the "**Applications**") seeking relief for mutual funds from the conflict of interest provisions in National Instrument 81-102 – *Mutual Funds* ("**NI 81-102**"), if I have any comments from the mutual fund perspective on the proposals contained in Proposed Rule 48-501 – *Trading during Distributions, Formal Bids and Share Exchange Transactions* (the "**Proposed Rule**"). I apologize for having taken this long to respond but, as I had mentioned, I had not directly considered the Proposed Rule from a mutual fund perspective in the context of the Applications. Having said that, I have since focused on the Proposed Rule from that perspective, and my comments are below.

As I see it, the issue as it pertains to mutual funds is the same as applies more generally to other "related entities" of a "participating dealer". Accordingly, mutual funds should be provided the same treatment as other related entities under the Proposed Rule.

A "**dealer-restricted person**" is defined in the Proposed Rule to include the dealer involved in the distribution (the "**participating dealer**") and "a related entity of the dealer … or an investment fund or account managed" by any of the above. A "**related entity**" is defined, in respect of a participating dealer, as "an affiliated entity of the [participating] dealer which carries on business in Canada and is registered as a dealer or adviser in accordance with applicable securities legislation". The terms "related entity" and "affiliate" and derivative terms are used interchangeably herein.

The effect of this very broad definition of dealer-restricted person in the Proposed Rule is to

capture, among others, portfolio management companies that are related to the participating dealer and any of the investment funds or accounts managed by them, and to thereby require all of those entities to abide by the general trading prohibition in the Proposed Rule for so long as the participating dealer must abide by them.

This restrictive approach taken in the Proposed Rule, with respect to related entities (including mutual funds), is a departure from the current approaches taken in Paragraph 26 of Ontario Securities Commission Policy 5.1 (the "**Policy**") and is also more restrictive than the approach taken in the Securities and Exchange Commission's Regulation M ("**Reg M**"), the parallel regulation of trading during a distribution in the United States. The approaches taken in the Policy and in Reg M are outlined below.

Paragraph 26(b)(ix) of the Policy contains an exemption from the general trading prohibition for affiliates of participating dealers provided the affiliates meet certain conditions. A trade made by an affiliate of the participating dealer, or an attempt by such affiliate to induce or cause a trade by another person or company, is exempt from the general trading prohibition provided that:

- the affiliate is a separate and distinct organizational entity from the participating dealer, with no common officers or employees (other than those who are not engaged in securities activities);

- the affiliate has employee compensation arrangements with respect to those persons who are actively involved in securities activities that are not affected by the performance or profitability of the participating dealer; and

- the trade by the affiliate is made in the ordinary course of its business and is not made jointly or in concert with or for the account of the participating dealer or any others involved in the distribution.

Paragraph 26(b)(viii) of the Policy specifically exempts mutual funds from the general trading prohibition, with a footnote that states that trades in mutual fund securities are regulated by the *Securities Act* (Ontario) and NI 81-102. In providing the exemption in Paragraph 26(b)(viii), it may have been thought that mutual funds need not be restricted under the Policy as Section 4.1 of NI 81-102 restricts public mutual funds from trading in securities that are the subject of a distribution during the distribution period and for 60 days thereafter. The commencement of a distribution period is not defined in NI 81-102 and it would be my guess that, currently, the distribution period in Section 4.1 is not interpreted along the lines provided for in the Policy, but rather as commencing at some later point in the prospectus preparation process. As well, there are likely differing practices. In any event, Section 4.1 will be repealed in due course when Proposed Rule 81-107, *Independent Review Committee for Mutual Funds*, becomes effective, leaving such determinations to an independent review committee. It would therefore be useful to bring some clarity, certainty and uniformity to the issue. In this respect, it might be instructive to consider the approach taken in Reg M, which provides an exemption for affiliates (including mutual funds) that meet certain conditions (which are similar to the conditions under which affiliates are currently exempted from the general trading prohibition under the Policy, except

that under the Policy mutual funds are not included as affiliates as they are treated separately under paragraph 26(b)(ix)).

In my understanding of Reg M, a mutual fund would be considered as an affiliate of a participating dealer, and an affiliate (which may be a separately identifiable department or division of the participating dealer), that regularly purchases securities for its own account or for the account of others, or that recommends or exercises investment discretion with respect to the sale of securities, is exempted from the general trading prohibition provided that:

- the dealer (i) maintains and enforces written policies and procedures reasonably designed to prevent the flow of information between the participating dealer and its affiliate that might result in a violation of the applicable rules, and (ii) obtains an annual independent assessment of the operation of such policies and procedures;

- the affiliate has no officers or employees (other than clerical, ministerial or support staff) in common with the participating dealer that direct, effect, or recommend transactions in securities; and

- the affiliate does not, during the applicable restricted period, act as a market maker, or engage, as a broker or a dealer, in solicited transactions or proprietary trading, in covered securities.

The exemption for affiliates in the Policy is very similar to the affiliate exemption in Reg M. Both exemptions are based on the affiliates operating independently of one another with policies and procedures in place to ensure a restricted flow of information.

It has been recognized in connection with the early warning requirements in National Instrument 62-103 - *The Early Warning System and Related Takeover Bid and Insider Reporting Issues*, that affiliated entities can operate independently from each other, enabling disaggregation of securities positions for early warning reporting requirements. There would not seem to be any reason why the same logic should not apply in regulating trading during a distribution. In fact, it would seem counter-intuitive to have related entities recognized as separate entities for purposes of the early warning requirements based on their independence from one another and yet require greater communication between the entities in order to enable the related entity of a participating dealer to be able to comply with the restrictions in the Proposed Rule.

To the extent that related entities of a participating dealer, such as a portfolio manager managing mutual funds and the mutual funds themselves, are required to abide by the general trading prohibition in the Proposed Rule, this would require that additional steps be taken and costs incurred to ensure that there are appropriate compliance systems in place, resulting in increased cross communication between the compliance branches of the different entities and increased restrictions on the related entities' trading abilities, all of which is unnecessary when organizations do in fact operate independently of each other and of little practical value in terms of protecting the investing public.

The direction being taken in the Proposed Rule for related entities, including mutual funds, is inconsistent with the current approaches taken in the Policy and in Reg M, and the Notice and Request for Comments accompanying the Proposed Rule does not address the reason for doing so.

Absent some compelling reason that the drafters of the Proposed Rule may have for not carrying forward into the Proposed Rule the exemption currently contained in Paragraph 26(b)(ix) of the Policy, it would seem that such exemption should be carried forward into the Proposed Rule to exempt related entities (such as related portfolio management companies) and further expanded to also exempt the mutual funds managed by such related entities.

Please do not hesitate to call me if you have any questions or comments.

Yours truly,

"Cathy Singer"

Cathy Singer

CS/mll