March 31, 2004

Ontario Securities Commission
20 Queen Street West
19th floor, Box 55
Toronto, ON, M5H 3S8

Attention: John Stevenson, Secretary

Dear Sirs:

Comment Letter: Proposed National Instrument 81-107 Independent Review Committee for Mutual Funds

We are writing in response to your request for comments on proposed National Instrument 81-107 Independent Review Committee for Mutual Funds.

SEI Investments Canada Company is a significant participant in the Canadian investment management industry. It is a trusted advisor to many of Canada's largest institutional investors and offers more than 30 mutual funds to Canadian retail investors. Currently SEI manages more than $ 4.5 billion for Canadian investors.

We have serious concerns about proposed National Instrument 81-107 and we object to the imposition of its requirements on our business operations.

In summary, our objection is based on the following concerns:

1. The proposed National Instrument appears to be the result of an improper perception of the nature of the mutual fund industry.

2.The proposed National Instrument will not promote investor protection or foster market efficiency.

3. Given the broad way that the CSA interprets "conflict of interest", over time the role of independent review committees may evolve and expand into matters that should be left to fund managers.

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4. The proposed National Instrument is an inappropriate attempt to impose on mutual funds a governance model that traditionally applies to operating companies.

5. Given the narrow way that the CSA interprets "independence", it will be difficult to recruit competent IRC members.

We will explain these concerns in more detail.

1. The nature of the mutual fund industry

NI 81-107 appears to be the result of misguided intentions and an improper perception of the nature of the mutual fund industry.

The CSA refer to the "inherent conflict" of mutual fund managers, implying that they cannot act independently in the best interests of investors i.e. their customers.

A fundamental issue is how to define a conflict of interest that requires a regulatory response.

From reading NI 81-107 it appears that the CSA believe that the mere receipt of compensation or economic benefit by a mutual fund manager necessarily results in a conflict of interest. Are mutual fund managers any more "conflicted" than anyone else selling a service in a market economy?

We are particularly concerned about your description of "business conflicts" in Commentary 4 under section 3.1. Since we are in the business of managing mutual funds, this commentary indicates that we would be in a perpetual conflict of interest. As a result, an IRC would be required to continuously review every inch of our business.

You claim that charging fees to the mutual fund in addition to charging a management fee would be a "business conflict". However, the prospectus explains all fees and charges. If we charge fees that are disclosed to investors before they invest in the mutual fund, is that a conflict of interest? No. It is a consensual commercial transaction. If investors do not want to pay our fees, they do not invest in our mutual funds. The same can be said about other examples you provide: charging incentive fees, providing discounts to large investors, and providing incentives to distributors. All these activities are disclosed as required by securities law and conducted in accordance with any conditions or restrictions imposed by securities law.

The CSA have provided no evidence of widespread conflicts of interest adversely affecting investors. To the contrary, the industry has an exemplary record of client service. Mutual fund managers already have legal, ethical and economic reasons for acting in the best interests of their customers. We do not believe that imposing NI 81-107 on the industry is justified.

2. Investor protection and market efficiency

The stated purposed of proposed NI 81-107 is "to promote investor protection in mutual funds while fostering market efficiency". We do not believe that either of these objectives will be achieved by imposing NI 81-107 on all mutual fund managers.

The Canadian Securities Administrators (the "CSA") has provided no credible evidence that the proposed changes will result in better investor protection. In fact, the CSA has not demonstrated that the current regulatory approach to conflicts of interest has failed Canadian investors. To the contrary, recent events in the United States support the conclusion that the existence of oversight boards does not guarantee good governance. The current rules have served Canadian investors well. Additional costly requirements are not necessary.

By mandating an independent review committee for all mutual funds, the CSA will be making the mutual fund industry more inefficient. This is because an IRC will not be useful for all mutual funds. It will impose costs without benefits for numerous funds, including SEI's. The CSA's summary of its own cost/benefit analysis states that the proposed rule will be a net negative for those managers who will not benefit from related party relief. NI 81-107 will also add to market inefficiencies by imposing another regulatory cost on mutual funds that does not apply to competitive products: segregated funds, LSIFs, and exchange traded funds (ETFs). It is not at all clear to us why NI 81-107 does not apply to ETFs. They are significant competitors targeting the same investors.

As a result of industry comments, NI 81-107 is significantly narrower in scope than what was set out in the concept proposal published in 2002. The CSA has decided to focus on "conflicts of interest". However, the proposed rule primarily addresses concerns about dealer-managed mutual funds and funds related to large, publicly traded financial institutions. The imposition of an IRC on all mutual fund managers appears to be "window dressing" intended to play down the fact that the CSA is primarily addressing regulatory issues raised by consolidation and concentration in the Canadian financial services industry. The CSA's assertion that all funds must have an IRC to ensure "consistent industry-wide standards" has not been adequately explained or justified.

Ultimately, all of the additional costs imposed by NI 81-107 will be borne by investors. As a result of the fixed costs of maintaining an IRC, smaller funds will be at a distinct cost disadvantage. Furthermore, the costs of an IRC will be outside the control of the fund manager. SEI has always worked to control overall costs. We set limits on our MERs which are very low by industry standards. NI 81-107 would hamper our ability to minimize and control costs by imposing new unpredictable, and uncontrollable costs on our funds and investors.

Inefficiencies will also result from the process for dealing with disagreements between a fund manager and an IRC. The idea is that disagreements be disclosed to investors. We question how this would work. It could lead to a significant amount of information being sent to investors so that they can fully understand the issues. Remember, the fund manager may be right. NI 81-107 seems to assume that the IRC will always be right and that disclosure, or the threat of disclosure, will force fund managers to follow IRC recommendations. We think this process will be confusing for investors as well as costly and unproductive. It highlights that an IRC would be a duplicate layer of management established for the purpose of second-guessing the fund manager. Such a structure will not benefit investors.

The CSA has requested comment on whether NI 81-107 should apply more broadly or narrowly. If you insist on proceeding with NI 81-107, we strongly urge you to apply it much more narrowly. It should only apply to those fund managers unlike SEI, who want to take advantage of a more relaxed conflict regime. It should not be imposed on those who do not need such relief and for whom NI 81-107 will have a negative impact.

The proposed NI codifies conflict of interest relief that has already been given, by way of exemption orders, to any market participants that wish to receive it. The CSA should let those market participants rely on such relief without imposing IRCs on fund managers who do not want or need the relief.

3 The role of IRCs over time

We strongly believe that if IRCs are mandated across the industry, their role will inexorably evolve and expand into matters that should be left to fund managers.

This expanded role could result from actions taken by IRCs themselves as they try to justify their existence and cost. It may also result from a desire by IRC members to protect themselves from potential liability at the hands of investors and regulators, by asserting greater authority to monitor fund management. Regulators might also expand the role of IRCs by imposing additional responsibilities on them. IRCs could be seen as a convenient tool to quickly implement a "regulatory response" to questions raised by the media or investors (e.g. late trading or market timing).

The Request for Comment notice foreshadows such an evolution in a section entitled "Our long-term vision for fund governance". The CSA "strongly" encourage consideration of a "broader mandate" for IRCs. The CSA also state that they expect fund governance to "evolve with time" and that IRCs provide "a flexible platform for future regulatory reform" with respect to product regulation. Perhaps you should share the full 'long term vision' with the industry.

4. Mutual funds are not operating companies

Proposed NI 81-107 is an inappropriate attempt to impose on mutual funds a governance model that traditionally applies to operating companies.

Good governance involves more than having a board of directors. Recent press reports clearly demonstrate that the traditional corporate board model is not a panacea.

The theoretical rationale for boards in the context of an operating company does not exist in a mutual fund context. In an operating company, the board of directors is intended to bridge the gap created by the division of ownership and management. Such a gap does not exist in a mutual fund. A mutual fund is a vehicle for providing investment management services. Mutual fund investors do not "own" a mutual fund in the way that shareholders of any operating company own a piece of the business. The Summary of Comments section of the Request for Comments notes that the CSA was told this during the comment period.

5. Difficulty of recruiting

The CSA seem to assume that there is a large pool of potential IRC members. We disagree.

First, you interpret "independence" very narrowly. For example, you impose a 3 year cooling off period for anyone who was an officer, director or employee of the mutual fund complex. This exceeds the cooling off periods applicable to members of the public service which are often no more than one year. You then narrow the definition even further by excluding any associates of such persons.

Furthermore, in order for an IRC to be of value, its members must have some understanding (or ability to quickly understand) the workings of the financial services industry in general and mutual funds in particular. "Independence" is not the only criteria. Industry knowledge and business competence are just as important.

NI 81-107 gives IRC members the authority to retain advisers and pay them out of fund assets. The less competent and experienced IRC members are, the more likely they will be to seek out professional advisors. This tendency will be encouraged by the lack of limited liability for members and the CSA's statement in commentary 2 under section 2.8 that it expects insurance not to cover "any liability resulting from members of the independent review committee not fulfilling their responsibilities and standard of care". This makes no sense. The purpose of liability insurance is to provide compensation in the event that someone makes a mistake or is found to have made a mistake. Furthermore, this approach to insurance is even more restrictive than the orders which granted conflict of interest relief to fund managers such as Mackenzie Financial Corporation. In those orders, the restriction is only that the mutual funds not indemnify independent committee members or pay the cost of liability insurance.

Without limited liability, or at least the ability to obtain sufficient insurance, it will be difficult to recruit knowledgeable members. Those who are not deterred by the possible liability will likely seek protection through the advice of advisors hired at the expense of the mutual fund.

Conclusion

We strongly object to NI 81-107 because it will impose immediate costs on our funds and investors with no offsetting benefits. It also has the potential for increasing costs further and making fund management more inefficient in the future.

At a minimum, mutual funds which will not benefit from the imposition of NI 81-107, (such as those managed by SEI), should be allowed to continue to operate under the existing rules relating to conflicts of interest. Those rules have served Canadian mutual fund investors well in the past and can continue to do so into the future.

Those mutual fund managers who have issues with the current conflict of interest regime can request that the CSA address their specific concerns. The CSA have clearly demonstrated that they are willing and able to respond in this fashion.

A "one size fits all" response is neither necessary nor desirable.

NI 81-107 will impose unnecessary, unpredictable and uncontrollable additional costs on our investors. We strongly believe that many aspects of NI 81-107 are implausible and unworkable in practice. We expect to face serious difficulties recruiting qualified and suitable candidates especially because of the restrictive way you have defined "independence". Unfortunately, the imposition of NI 81-107 would force us to re-assess the continuance of our mutual fund operations which we believe are already operated with the highest integrity and practice standards and in compliance with responsible and practical regulatory requirements.

Sincerely,

Patrick Walsh
Chief Executive Officer
SEI Investments Canada Company