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ASSOCIATION FOR
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AND RESEARCH®

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6 April 2004

John Stevenson, Secretary
Ontario Securities Commission
20 Queen Street West
19th Floor, Box 55
Toronto, ON M5H 3S8

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

Re: Request for Comment – Proposed National Instrument 81-107 – Independent Review Committee for Mutual Funds

Dear Sir and Mesdame:

The Canadian Advocacy Committee (CAC) of the Association for Investment Management and Research® (AIMR®)[1] is pleased to respond to the request for comments on the Canadian Securities Administrators' (CSA) proposed National Instrument 81-107, Independent Review Committee for Mutual Funds. The CAC represents members of AIMR and its 12 Member Societies and Chapters across Canada. The CAC membership includes portfolio managers and other investment professionals in Canada who review regulatory, legislative, and standard setting developments affecting investors, investment professionals, and the capital markets in Canada.

[1] With headquarters in Charlottesville, VA, and regional offices in Hong Kong and London, the Association for Investment Management and Research is a non-profit professional association of more than 69,500 financial analysts, portfolio managers, and other investment professionals in 116 countries of which more than 56,800 are holders of the Chartered Financial Analysts® (CFA) designation. AIMR's membership also includes 127 Member Societies and Chapters in 46 countries.

Summary Position

We support the CSA proposal that mutual funds be required to establish an independent review committee (IRC) to address conflicts of interest inherent in the typical mutual fund/investment manager relationship. While an IRC may not provide a complete solution to the full range of conflicts of interest, we believe that it can be an important means of achieving objectivity and will help a mutual fund manage these conflicts. In itself, an IRC should provide a measured deterrent to both individuals and entities that seek to circumvent their fiduciary duties to their investing clients.

While we generally support the proposal as drafted, we do not support the approach suggested in Section 2.10 that would require a fund only to disclose when the manager ignores a recommendation of the IRC. We believe that implementation of the recommendation, not disclosure, is required. We also suggest revisions to certain other provisions of the proposal, including the intended scope. We provide further discussion on these aspects of the proposal below.

Discussion

AIMR has long promulgated the fundamental principle that investing clients' interests must come first. Yet, events over the recent past have clearly shown that the inherent conflicts of interest that exist in mutual fund relationships threaten this principle. Therefore, we welcome the CSA proposal because it seeks to provide a separate, independent mechanism for addressing these conflicts. We believe that, overall, an independent review committee will be a significant step in increasing investor protections at mutual funds and will enhance market integrity generally.

We particularly support the proposed principles-based approach that views conflicts of interest not just as related-party transactions but in a wider context. We believe that too often rules are too prescriptive and provide a "roadmap" for those seeking to avoid the strict letter of a regulation. We believe that the CSA has proposed a realistic approach to addressing the range of conflicts that are inherent in the manager-mutual fund relationship.

We strongly support the proposal's emphasis on a manager's fiduciary duty to fund shareholders as an underlying and fundamental principle. In addition, the CSA's expressed intent of creating a single standard across Canada is consistent with our desire for more harmonization in securities regulations, and ultimately our call for a single securities regulator, in Canada. We also appreciate that the CSA has given fund managers some flexibility, within certain guidelines, to structure an IRC that works best for the funds that it manages rather than mandating a one-size-fits-all structure. Finally, the CSA's commitment to provide this proposal in plain language gives much-needed clarity.

However, while we think that the underlying objectives and approach are sound, we recommend that the CSA revisit several provisions, particularly those that address which investment vehicles require an IRC, the scope of the IRC's authority, and the time limits for individuals serving on an IRC.

1.2 Mutual Funds Subject to the Instrument

We are concerned about the scope of the proposed requirement that an IRC will apply only to conventional mutual funds, with certain funds specifically excluded from coverage. We urge the CSA to extend this requirement to all investment vehicles that are offered through registered offerings and that are subject to a public registration statement.

2.3 Composition, Term of Office and Vacancies

The proposal recommends that the term of a member of the IRC must be not less than two years and not more than five years. We question this approach.

We fully agree that two years is a reasonable minimum term of service for ensuring that individuals become sufficiently familiar with the fund to provide value to the IRC. However, we disagree that the term should be limited to five years. We understand that complacency might accompany longer-terms, but we believe that a five-year limit is too low. If the CSA concludes that a term limit is appropriate, we suggest that members be permitted to serve at least seven years, rather than the proposed five.

We agree that the IRC should be permitted to reappoint members. However, we suggest that an individual who has served the maximum allowable term not be eligible for reappointment until two years have elapsed.

Finally, we also agree that staggered terms will ensure continuity. However, the proposal does not address how initial terms should be structured so as to achieve this effect. We suggest that the final rule clarify that at the formation of the IRC, members should be appointed for set terms on a one-time basis (e.g., seven -, five -, and three-year terms) so as to set the staggered terms in motion.

2.4 Independence

As defined, a person would not be deemed "independent" and thus able to serve on the IRC if s/he is an "associate" of certain people, e.g., a person whose immediate family member has been an employee within the last three years of an entity related to the fund manager. However, we believe that without a definition of "associate," this restriction could be understood to be overly broad, and not meaningfully related to the intended prohibition. We recommend that the CSA better clarify what is mean by an "associate" for use in this context.

2.5 Standard of Care

As we understand it, a central principle in the proposed rule is the need to address those conflicts in the manager/mutual fund relationship that are detrimental to interests of mutual fund shareholders. However, the standard of care provision speaks to an IRC member's duty to "act in the best interests of the mutual fund" rather than its shareholders Presumably the best interests of a mutual fund would benefit its shareholders, but we can envision instances where a

mutual fund might stand to benefit from transactions that do not directly benefit the shareholder. We believe that, to avoid any confusion, it would be better if the final rule state unequivocally that IRC members have a duty to act in the best interests of mutual fund shareholders.

2.7 Authority

We agree that IRC members should be compensated with fund assets, and that the fund managers should not directly or indirectly provide such compensation. The latter situation could serve to seriously undermine the needed independence of the IRC members from the fund manager. However, we do question the proposal that IRC members themselves set their own compensation.

We believe that this may present a serious conflict of interest and suggest that the CSA consider use of the full board or another body to approve the IRC's recommendation for compensation. Alternatively, we ask that the CSA provide some guidance regarding the method by which compensation scales should be determined. In any event, we believe that the fund should disclose to shareholders and investors, clearly and prominently, what compensation is being paid to the IRC members and how it is determined in the funds' Annual Financial Statement, so that there is full transparency about this expense. For those IRC members overseeing more than one fund, we suggest that applicable expenses be reflected on a pro-rata basis.

2.8 Liability

We agree that IRC members should be afforded limited liability based on a reasonable person standard. We believe that without this approach it will be difficult to find highly-qualified individuals willing to fill IRC positions. We would like to see mutual funds in a strong position to attract the best people for this important function.

2.9 Proceedings

As proposed, the IRC would be required, at a minimum, to maintain a written record of its charter, minutes of meetings, and its reports and recommendations. We believe that transparency is important to this process. Thus, for the IRC to be fully effective, not only must it maintain adequate records, but must also make them available to the public. While we do not think that there is a need to require routine circulation of the Committee's reports and recommendations, we do believe that investors should know that they will be made available upon request.

2.10 Disclosure

Under the current proposal, if a mutual fund chooses not to implement an IRC recommendation, it would need to disclose that fact, the general nature of the recommendation, and the reasons for not following it. We cannot support this approach. We do not believe that a mutual fund should be able to avoid implementing a recommendation of its IRC. To be effective, an IRC must have the authority to direct the fund to act in the best interests of shareholders.

3.2 Changes to the Mutual Fund

As proposed, before a mutual fund could proceed with certain changes, it must allow shareholders, free of charge, to redeem fund shares and purchase shares in another fund managed by the fund manager. We agree that the final rule should require transfers free of charge in the situations noted. However, in some situations, simply waiving fees, including the associated sales charges, may not be enough.

In particular, we are concerned about situations where transferring into another fund (even though managed by that manager) may not be an altogether satisfactory option, depending on the funds available and the investor's investment objectives. Moreover, in other situations where the investor simply wants to leave that fund due to a material change (not limited to, but including, changes such as a departure of a fund manager), we believe that applicable back end sales charges should not be assessed. Instead, there should be a limited period of time during which the investor can leave the fund without penalty. We urge the CSA to provide in its final rule a provision to this effect.

3.3 Inter-fund Trades

The proposal provides a fair amount of detail about inter-fund trades, particularly with respect to pricing issues. While these issues appear to fall within the IRC's mandate, we do not think that the detail into which the proposal addresses pricing issues is necessary. Instead, we suggest that decisions regarding the specifics of pricing should not be mandated by rule, but should be left to the Committee. We do however, support full disclosure of the pricing policy itself. We therefore urge the CSA to eliminate the pricing detail from the final rule while retaining the IRC's authority over the area of inter-fund trades.

Closing Remarks

We appreciate the opportunity to comment on the CSA proposal for an Independent Review Committee for Mutual Funds. As discussed above, we fully support the concept of an IRC as a way to minimize conflicts of interests between the fund shareholders and the fund manager. However, we recommend that an IRC have real authority to effect changes at a mutual fund and that mutual fund managers not be permitted to reject an IRC recommendation. If you have any questions or seek elaboration of our views, please do not hesitate to contact Linda L. Rittenhouse at 1.434.951.5333 or linda.rittenhouse@aimr.org.

Sincerely,

/s/ David L. Yu
David L. Yu, CFA
Canadian Advocacy Committee Co-Chair

/s/ Linda L. Rittenhouse
Linda L. Rittenhouse
Associate, Advocacy