What are you doing after work?

April 12, 2004

AGF Management Limited
Toronto Dominion Bank Tower
31st Floor
Toronto, Ontario M5K 1E9

Website: www.agf.com

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

and

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

**Re: Canadian Securities Administrators ("CSA") Proposed National Instrument 81-107 ("NI 81-107")** ***Independent Review Committee for Mutual Funds*** **("IRC")**

AGF Funds Inc. ("AGFFI") is pleased to provide its comments in respect of NI 81-107 and look forward to the implementation of a fair and effective rule with respect to fund governance.

We support initiatives that will provide investors with meaningful and effective protection in a practical and cost effective manner. We believe enhanced oversight by independent review coupled with harmonized product regulation would be effective toward ensuring investor protection and promoting investor confidence. We also support initiatives that are aligned with the objectives of section 2 of the *Securities Act (Ontario)*. That provision properly defines the primary means of investor protection from unfair, improper or fraudulent practices to be a balance of requirements including (a) timely, accurate and efficient disclosure of information; (b) restrictions on fraudulent and unfair market practices and procedures; and (c) maintaining high standards of fitness and business conduct to ensure honest and responsible conduct by all market participants.

The Canadian Mutual Fund Industry is a mature and well established industry, however it continues to face many difficult challenges including escalating costs, volatile markets and a general decline in investor confidence arising from the magnitude of abuses uncovered in recent years and more recently, the number of industry scandals highlighted in the United States. With increasing vigilance, investors are examining Canadian industry practices and, in doing so, have generated increased regulation with resulting increased liability to fund service providers, promoters, sponsors and managers. We note

that newer industries, for example, the hedge fund industry, continue to have limited regulation and oversight yet have been a contributor to the overall decline in investor confidence.

We have a number of outstanding concerns that we believe the CSA must consider before finalizing the proposed NI 81-107 which include:

- Scope of liability for the IRC and the Manager;
- Lack of recognition of the role played by Boards of Directors of corporate funds toward independent oversight;
- Scope of business conflicts to be referred to the IRC;
- Lack of dispute resolution mechanisms when conflicts between the IRC and the Funds or the Manager occur;
- Need for guidance on proficiency and education requirements for the IRC members;
- Definition of Independence;
- Costs of implementation and maintenance and
- Application of the Instrument across the Investment Fund Industry.

We address each of these items below.

***Scope of Liability***

In general we believe liability concerns have not been addressed adequately. Liability to IRC members remains largely undefined and creates two concerns: (i) the inability to secure adequate and appropriate insurance coverage for IRC members and (ii) the willingness of qualified applicants to accept a membership to the IRC. The question of manager liability has not been addressed at all. For example, it is not clear what liability the manager will incur if it follows the direction and advice of the IRC to the detriment of the fund and investors – will this protect the manager from a subsequent claim by investors? In contrast, how is a manager's liability affected if it does not follow the direction and advice of the IRC but no harm to the fund or investors result?

***Structure***

While the commentary to the rule indicates that the structure is purposefully flexible so that the manager may construct the IRC in the most practical and cost effective way, the rule does not recognize the existence of the Boards of corporate funds and implies that the IRC is in addition to any existing corporate fund Board of Directors.

The powers, authority and statutory requirements of corporate Boards are well understood and accepted by investors. In light of recent events in the United States, investors have increasing expectations and demands of corporate Boards and regulators here in Canada have responded by introducing new rules such as Multilateral Instrument 58 101 *Disclosure of Corporate Governance Practices* ("MI 58-101"). In the interest of meaningful and cost effective investor protection and the recognition of existing oversight and governance practices already in existence, we believe the proposal should formally recognize the existence of Boards of corporate funds. We propose that, in the

case of corporate mutual funds, the IRC should be mandated to be an independent committee of the Board or require an existing independent committee to additionally assume the IRC mandate. In this way certain liability concerns would be addressed, at least in respect of corporate funds, and the cost of oversight better managed. In the case of trust funds, the IRC must be created and liability issues adequately addressed.

***Scope of Business Conflicts***

NI 81-107 introduces some practical implementation issues relating to the proposed matters to be referred to the IRC, as well as its responsibilities. Furthermore, the types of 'conflicts of interest' to be referred to the IRC as described in section 3.1 are too broad. We submit that the scope of "business conflicts" in particular must be expressly set out and limited. We can think of many situations that would not, in our opinion, be appropriate matters to be referred to an IRC, but would, on the current drafting of NI 81-107, be required to be put before an IRC. For example, where portfolio managers that are related to the manager manage two of its funds, if one fund, with a long-term investment strategy, is long a security, yet the other fund, with a short-term investing strategy, is short the same security, then it appears this must be referred to the IRC. The IRC however, consisting of members that are not qualified registered portfolio managers, would be required to advise the portfolio managers on such matters.

In another example, the IRC would be required to review a decision of the manager to remove an arm's length portfolio manager, if that mandate was moving to a related portfolio manager. However, in the opposite scenario, the IRC would not have to review such a decision.

In many situations involving "business conflicts", we believe that the IRC is put in a position of reviewing manager decisions without necessarily having the qualifications to do so. We believe that only matters that are a true "conflict" with the best interests of the fund and unitholders be referred to the IRC and matters of business conflict remain in the hands of manager.

***Dispute Resolution and Educational Requirements***

The proposal has evolved substantially since the release of the original Concept Proposal 81-401 released March 1, 2002, particularly with regard to dispute resolution. While we agree with the current proposal to rely on disclosure and the threat of negative publicity, the proposal does not require the IRC members to meet minimum proficiency standards or to undertake initial or ongoing education. Consequently we feel that there is an exposure to the investor and manager. If a member of the IRC or the entire IRC is not acting in the best interests of the fund or investors perhaps due to lack of qualification, understanding, or negligence, there is no provision available to the manager to intervene on behalf of the investors to protect their interests. Coupled with undefined liability, there is a very serious risk that the best interest of the investors would not be safeguarded in these circumstances.

Moreover, there is potential for IRC members to have conflicting interests, particularly in the case of shared IRC members. In the absence of defined corporate governance

practices, educational requirements and effective dispute resolution mechanisms (including termination of an IRC member), opportunities for inappropriate activity present themselves. For example, if the IRC member had a professional and material interest in asset management products and services not governed by this proposal there is no deterrent to that IRC member from inappropriately disagreeing with the manager to cause negative publicity arising from differences in opinion.

In our view, the manager must have available to it, as a last measure, some method for identifying and resolving situations of inappropriate and potentially harmful actions of IRC members.

***Independence***

The requirements for independence as proposed closely parallel those in Multilateral Instrument 52 110 *Audit Committees* which we feel are excessive for the IRC's responsibilities, powers and mandate. In recognizing the existence of the Boards of corporate funds and in an effort to maintain consistency in treatment across the industry, product structures and fund complexes, we would expect independence requirements to be consistent with those in MI 58-101.

We believe the definition of "independence" should also be aligned with that of MI 58-101. We believe it is important for the IRC to have the ability to hire independent advisors. Further, we do not believe it is a conflict of interest to establish their own compensation, however, the current drafting of the NI 81-107 suggests the IRC would potentially be in a conflict situation with the fund and may be disqualified. We believe this should be clarified.

***Cost***

The aforementioned concerns and practical implementation issues (detailed in schedules A and B) have a significant cost implication that we feel the proposal has not adequately addressed. Furthermore, the liability concern represents immeasurable costs in respect of insurability and expected compensation by the IRC members. Upon inquiry, insurers have been reluctant to underwrite negligence in the absence of a clearly defined standard of care. In schedule B we provide cost calculations based on current costs associated with Audit Committees, the closest existing parallel to an IRC. These calculations however purposely exclude insurance costs since a comparable cannot be obtained. We remind the CSA that as the manager is prohibited from absorbing any of the direct costs of the IRC, the MERs of the funds will increase and depending on the fund complex size, these increases may be significant which will negatively impact fund performance.

***Application***

In the absence of mandating the proposed framework across the investment fund industry to capture all investment products and market participants, the mutual fund industry will be isolated. Moreover, only mutual fund investors will benefit from improved investor protection while other investors will be left to protect their own interests. Indeed, many non-mutual fund investments available are higher risk products, less liquid but are

available to retail investors. They too deserve the highest level of investor protection available.

In addition, we draw attention to the fact that in general, the mutual fund industry provides investment opportunities to lower to middle income investors who may otherwise not be able to participate in capital markets. To burden these investors with increased costs and reduced performance is unacceptable and in conflict with promoting efficient capital markets. This may also have negative implications for government instituted tax incentives for lower to middle income Canadians to invest locally by saving for future education and retirement income needs.

Schedule A provides further details to the above-mentioned concerns and also responds to the CSA request for commentary on specific matters. Schedule B provides further cost information based on actual costs incurred by independence committees of corporate boards that have similar objectives and mandates.

We take this opportunity to recognize the challenges faced by the CSA in arriving at a proposal for independent oversight of investment funds. Meaningful investor protection that is cost effective and practical is important to the success of the industry however, the CSA must recognize that the existing regulatory framework already contains many requirements for timely, accurate and efficient disclosure of information and restrictions on fraudulent and unfair market practices and procedures. The proposed benefits outlined in NI 81-107 risks being dwarfed by implementation costs, the creation of marketplace confusion and reduced competition. It is critical that existing regulatory requirements be thoroughly reviewed and understood prior to implementing additional independent oversight.

Yours truly,

*"Signed"*

Judy Goldring
General Counsel and Senior Vice President
AGF Management Limited

# Schedule A

| Issues for Comment | Response |
|---|---|

**Part 1 Definitions and Application**

Q. 01

Requirements should equally apply to all investment funds as they equally share conflicts of interests, self-dealing and similar operational issues. They differ largely in their objectives however they are competing products for retail investors. We believe all retail investors should be equally protected, regardless of the size of investment or product structure.

Additional comments

Significant and relevant portions of the proposed NI 81-107 are written in the form of commentary. We acknowledge that the instrument identifies these as being interpretations of the CSA and are not legally binding however, it is unclear what legal status the commentary sections have and in particular whether compliance to these form part of enforcement actions. The commentary provides very specific and relevant guidance on the application, intention and objectives of the proposed instrument. In the absence of the commentary, the proposed rule may be subject to divergent interpretations and in some instances, the requirements are so onerous that they are practically impossible to implement. For example, the commentary to sections 2.1 and 2.4 are critical in understanding the intention and application of the rule .

We recommend that NI 81-107 be drafted to ensure that relevant commentary and enforcement provisions be enshrined in the rule. The commentary should be restricted to items that need interpretation for application across varying products or industry practices. We also recommend defining terms used in the Instrument.

**Part 2 Independent Review Committee**

Q. 02

The proposed NI 81-107 does not recognize the existence of corporate fund Boards. As a result it creates the IRC outside of the existing Board structure, which makes effective cost management a challenge. Corporate Boards have existed for some time and investors have come to understand their role in protecting their interests. As of August, 2003 there were approximately $12.8 billion invested in corporate mutual funds (source: Investor Economics). In recent years, investors have challenged the responsibilities of Boards and demand more accountability. To create governance structures outside of and in addition to the Board, with very

limited powers and, to some extent, overlapping mandates would create confusion for investors.

Trust funds would need to create an independent oversight structure as existing laws to do not require it to have such governance in place. Given existing investor knowledge, understanding and acceptance of Board structures, it is important that the powers of the IRC, its responsibilities and accountability to investors be clearly articulated and be, to the extent possible, consistent aligned with existing Board standards.

We recommend the CSA formally recognize corporate fund Boards and promote consistency across investment fund structures by clearly articulating IRC responsibilities, liability, powers and accountability that are aligned with existing corporate governance standards for corporate Boards.

Q. 03 Independence definitions closely resemble those of Multilateral Instrument 52-110 *Audit Committees*. As a result, these definitions define certain authority, power, responsibility and accountability to the IRC that has not been mandated of the IRC. Independence standards should be commensurate with the authority, power, responsibilities and accountability of the IRC. High and onerous standards may be misleading to investors and create confusion in a time where building investor confidence is paramount.

We recommend the CSA adopt standards consistent with NI 58-101 *Disclosure of Corporate Governance Practices*.

Q. 04 As previously mentioned, Boards of corporate funds should be recognized and the IRC be mandated as an independent of these pre-existing and investor accepted Boards.

Current wording implies that the IRC itself would be in a material relationship with the Funds in so far as it establishes its own compensation, determines what outside counsel to engage and when and causes the funds (ultimately the investors) to pay for these charges. The prohibition of the Manager to absorb such costs may result in putting the IRC in conflict, and potentially disqualifying its members from being independent. This should be clarified.

Q. 05 The 3-year 'cooling-off' period is a deterrent to finding qualified and effective IRC members especially in Canada. Moreover, the 3-year period would effectively eliminate industry 'experts' used by most fund complexes today for advice from the time to time. Industry experts however are necessary to ensure investor protection is meaningful and

attainable, particularly in light of complex business issues and transactions involving mutual funds.

We recommend a de minimus threshold, consistent with NI 58-101 be established that allows industry 'experts' to be eligible for consideration for IRC membership in addition to the reduction of the 'cooling-off' period to 12 to 18 months.

Additional comments

There are no proficiency requirements or minimum ongoing education requirements thereby permitting individuals that do not have a good understanding of the industry to act as an IRC member. As the Manager has no recourse in the event it disagrees with the appointment of subsequent IRC members, it is possible that an IRC, in an attempt to fill vacancies, may appoint individuals who cannot adequately ensure meaningful investor protection. Moreover, as the industry and market continues to evolve and complex financial transactions become the norm, the qualifications of the IRC become critical in the pursuit of effective and meaningful investor protection.

We recommend the CSA implement education standards on the IRC not unlike existing legislation for Audit Committees where certain 'experts' are required. Furthermore, we recommend a mechanism whereby a Manager, in meeting its fiduciary responsibilities, has an effective forum to object to subsequent nominations and grounds of competency.

Q. 06/07

Commentary to section 2.8 implies exclusion of liability in the case of breach of standard of care. Insurance policies would not effectively cover negligence with this absence. Furthermore, most existing 'Directors & Officers' policies that exclude coverage for breach of fiduciary duty do not include coverage for negligence.

In the absence of proficiency requirements and ongoing education standards, negligence and breach of standard of care are of concern. Moreover, the lack of definition of liability and the likely inability to secure appropriate and adequate insurance coverage will act as a strong deterrent to qualified applicants to the IRC.

We recommend the CSA establish liability caps (for example $1million) and establish additional provisions concerning insurance coverage matters for IRC members who do not fulfill their standard of care, particularly in the case of incompetence.

**Part 3 Matters to be referred to the IRC**

Q. 08/09

Many of the items in section 3.2 would likely be more effectively handled by disclosure rather than by referring them to the IRC. Some already require shareholder approval rendering the involvement of the IRC as

inconsequential and costly. It is important to ensure that the incremental benefit toward investor protection be measured against the costs of realizing that benefit. For matters that will be directly disclosed to the security holder, the investor is empowered to make his/her own decision and is free to redeem. For matters that necessitate security holder vote, the investor is empowered to protect his/her interests. Adding the requirement of IRC review and recommendation does not provide any meaningful additional protection to the investor.

Commentary 4 to section 3.2 is not a matter for regulatory oversight. It represents a business decision of the complex and would be disclosed prior to the investor's investment. The investor chooses to make an informed investment in a fund and has received disclosure that outlines the fee schedules, including in situations where there is a change to the mutual fund. In today's industry practice, most fund complexes do not impose charges when assets are moved within a fund complex. However, if applicable, the redemption fee charged to an investor is the obligation of the investor. The investors' up-front commission has been financed on their behalf. The investor should be required to pay the obligation if the investor switches out of its investment to another fund complex.

We recommend that section 3.2 be removed entirely from the proposed NI 81-107.

Q. 10 - 13 Section 3.3 introduces many practical implementation challenges. Any matters pertaining to the portfolio trading of a fund are extremely time sensitive and require expertise, knowledge and understanding of portfolio management, taxation, securities markets and the brokerage industry.

Of most importance is time sensitivity. Qualified professionals, who have been empowered contractually and under securities legislation, to make investment decisions on behalf of clients, make all portfolio transaction decisions for the funds. Portfolio managers themselves are regulated by securities regulators and by their professional associations. To require that a portfolio manager submit to an IRC a proposal to affect an inter-fund trade does not necessarily afford an investor any additional protection. On the contrary, if the IRC is not proficient in such matters and fearful of liability issues, it may adopt conservative practices and disallow all inter-fund transfers. This may in fact be contrary to the best interest of the investor and moreover may be contrary to Best Execution principles enshrined in securities legislation.

Valuation issues for illiquid and thinly traded securities similarly are a matter for proficient and qualified individuals to address. There are industry standards and market and regulatory practices established that

are well received and understood. External auditors already have responsibilities for reviewing and reporting on such matters and in the case of corporate funds, the Audit Committee of the Board of Directors already address such matters. Referrals of such matters to the IRC do not afford investors any incremental meaningful protection.

All matters proposed in section 3.3 are time sensitive and would necessitate the availability of an IRC on a moment's notice. Practically, this is not possible unless IRC members are fulltime professionals however, this would result in their disqualification as members by virtue of the material relationship fulltime services to the funds would create. Moreover, the costs associated with pulling together the IRC, explaining the time sensitive situation & obtaining consensus (in the absence of external advice as time would prohibit it), would be prohibitive. Furthermore, the proficiency of the IRC to be able to fully understand the situation and render advice on what would effectively be immediate turn-around basis, would likely not exist. To acquire such proficiency on the IRC through its membership would also be cost prohibitive as compensation fees and liability questions would arise.

We recommend that all portfolio trading matters be replaced by the requirement of the IRC to approve all policies and business practices of the Manager and the portfolio managers as they relate to securities trading on behalf of the funds. The IRC can then obtain assurances that the Manager and portfolio managers are in compliance with those policies and practices as they see fit. For example, an internal audit function, external auditors or special independently issued reports (similar to Section 5900 reports) may be submitted to the IRC on a defined frequency. This would promote consistency with existing corporate governance practices envisaged by CEO/CFO certification, internal control reporting, and Audit Committee responsibilities. In this way, portfolio managers can perform their functions, Manager can oversee portfolio managers and the IRC can cost effectively ensure investors best interests are being considered and protected by both.

Additional Comments

Securities legislation today already provides many requirements for investment fund disclosures designed to cost effectively promote investor confidence and ensure investor protection. These include NI 81-105 *Mutual Fund Sales Practices*, NI 81-101 *Mutual Fund Prospectus Disclosure* and proposed NI 81-106 *Investment Fund Continuous Disclosure*. Furthermore, securities legislation provides other protections via Best Execution requirements of portfolio managers, the required disclosures of Statements of Policies, which include fair allocation and trading practices.

Timely and relevant disclosure to investors is a primary means of

promoting investor confidence. To add an IRC to the process does not provide additional meaningful investor protection that is commensurate with its costs. To remove disclosures in favour of an IRC puts increased accountability and responsibilities on members of the IRC rather than empowering investors. The IRC is not guaranteed to provide better investor protection than an investor could provide him/herself assuming timely and relevant disclosures.

We recommend that the responsibilities and matters to be referred to the IRC be revisited to ensure that existing regulation does not already provide adequate protections and that the IRC is the most cost effective and reliable means to investor protection.

# Schedule B

**Assumption 1**

***specific assumptions***

one IRC to cover Corporate Funds (separate IRC for Trusts and other unique products)

Fund Manager applies same policies/procedures and has similar business conflicts for all funds

compensation commensurate with an Audit Committee member

IRC meets to 'pre-approve' policies and practices & to receive some sort of attestation that such policies & practices are being adhered to

5 independent members on the committee for fund complex of 30 funds

management prepares detailed packages sent in advance of meeting similar to practices for an Audit Committee meeting

external advisors will be involved at each meeting (for example: for independent attestation or opinions on Manager's proposals)

IRC would not undertake to approve each contractual arrangement or 'event' (for example, each appointment of a sub advisor, or selection of broker for portfolio trades)

| | | | |
|---|---|---|---|
| Each IRC member shall receive compensation, by meeting, of | | **8,500** | |
| *number of IRC members* | | **5** | |
| Total IRC compensation costs per meeting | | | **42,500** |
| *External advisors average hourly rate is* | **350** | | |
| *Avg external advisor time per meeting is* | **10** | | |
| Total external advisor costs per meeting | | | **3,500** |
| Total meeting material cost (prep & distribution) | | | **1,000** |
| total out of pocket costs per meeting (travel/conference calls, etc) | | | **1,250** |
| ***estimated total meeting cost*** | | | **48,250** |
| ***minimum annual meetings required*** | | | **4** |
| ***estimated annual meeting costs*** | | | **193,000** |

**** if individual funds have materially different business conflicts & different policies and procedures applied to them, separate meetings would need to be held for those funds - for example, a pooled fund versus hedge fund versus plain vanilla mutual fund***

**Assumption 2**

***specific assumptions***

one IRC to cover Corporate Funds (separate IRC for Trusts and other unique products)

compensation commensurate with an Audit Committee member

IRC meets to 'pre-approve' each significant arrangement/agreement/event (for example: a change to approved broker list, new soft dollar agreement, each sub advisor, etc)

5 independent members on the committee

management prepares detailed packages sent in advance of meeting similar to practices for an Audit Committee meeting

external advisors will be involved at each meeting (for example: for independent attestation or opinions on Manager's proposals)

| | | | |
|---|---|---|---|
| Each IRC member shall receive compensation, by meeting, of | | 8,500 | |
| *number of IRC members* | | 5 | |
| Total IRC compensation costs per meeting | | | 42,500 |
| *External advisors average hourly rate is* | 350 | | |
| *Avg external advisor time per meeting is* | 4 | | |
| Total external advisor costs per meeting | | | 1,400 |
| Total meeting material cost (prep & distribution) | | | 1,000 |
| total out of pocket costs per meeting (travel/conference calls, etc) | | | 1,250 |
| ***estimated total meeting cost*** | | | 46,150 |
| ***minimum annual meetings required*** | | | 24 |
| ***estimated annual meeting costs*** | | | 1,107,600 |

***estimate minimum of 2 times per month**

**** if individual funds have materially different business conflicts & different policies and procedures applied to them, separate meetings would need to be held for those funds - for example, a pooled fund versus hedge fund versus plain vanilla mutual fund***