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VIA ELECTRONIC MAIL

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Dear Mr. Stevenson and Ms. Brousseau:

Re: Proposed National Instrument 81-107

I am pleased to have the opportunity to comment on the above referenced proposed national instrument.

Generally, it is my opinion that the authority that 81-107 bestows on the Independent Review Committee (IRC) seemingly lacks the type of powers that would be characteristic of a regime that further protects mutual fund securityholders. The lack of an IRC's power is troubling in that it effectively loosens the rules and regulations in many ways. 81-107 does not appear to offer any potential improvement in regulation or investor protection.

In the spirit of full and clear disclosure, the following comment on specific sections of, and requests for comment on 81-107 is prefaced by a summary of my business interests.

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Summary of business segments

Dan Hallett and Associates Inc. (DH&A) is licensed as Investment Counsel in the province of Ontario. DH&A's three business segments are: a) consulting to mutual fund sponsors, product manufacturers, and related entities, b) the production and sale of research content to licensed salespersons, and c) investment counsel for retail clients. Hence, DH&A is in the unique position of generating roughly equal amounts of revenue from the mutual fund industry and individual retail investors.

Section 1.2 – Mutual funds subject to Instrument

In my opinion, proposed NI 81-107 appropriately applies to mutual fund trusts and corporations that are governed by NI 81-102, but it should not be restricted to such funds. 81-107 should also apply to segregated funds, which are also sold to retail investors. In my opinion, however, products sold via an offering memorandum, labour sponsored investment funds, and any other pooled product or investment fund with an existing board of directors should be exempt from 81-107.

Section 1.3 – Multiple class mutual funds

I agree that each 'class' of what is commonly referred to as a 'corporate tax class' mutual fund corporation should be treated as a separate mutual fund for the purposes of 81-107. While the legal structure is such that all of the classes comprise a single corporate structure, each 'class' typically has a unique mandate that often mirrors that of an existing mutual fund trust.

Section 2.1 – Independent review committee for a mutual fund

I agree with a principles based approach to defining independence, but disagree with moving so abruptly from a rules-based system. Critics of the current regime point to a number of scandals that have occurred under a rules-based system. However, the CSA has offered no material evidence of the superiority of a principles-based system. Nor am I aware of any such evidence. Hence, it stands to reason that if the effectiveness of making such a drastic shift is highly uncertain (as it appears to be), that a more gradual shift should occur. In other words, moving first to a hybrid regime – incorporating a mix of principles and rules – seems like the next logical step. 81-107 does not strike that balance.

Section 2.1 – Independent review committee for a mutual fund

In addition to each committee member's workload, members should have demonstrated knowledge of capital markets and the mutual fund industry in particular.

Section 2.4 – Independence

The definition of independence in subsections 2.4(2) and (3) and the categories of precluded persons are both incomplete. While difficult to verify at times, a personal friendship with a manager should preclude a person's appointment to an IRC. Many have suggested that the potential pool of candidates is very limited in Canada. If true, such a shortage is not a sufficient justification for 'watering down' a good definition of independence – as has been suggested in some other submissions. Doing so will simply undermine the very protection this proposed NI attempts to achieve.

With respect to subsection section 4 of the commentary under this section, 81-107 refers to the time gap between a person's compensatory relationship with a fund and his/her eligibility as an independent IRC member ("cooling off period"). In my opinion, a cooling off period of one calendar year is sufficient.

Section 2.8 – Liability

There is seemingly a great deal of uncertainty surrounding the issue of personal liability for IRC members. I disagree with the lack of authority and decision-making power of the IRC. However, the fact that the fund manager has final decision-making power under proposed 81-107 would seemingly place the most of the liability on the manager and his/her employer. The existence of such uncertainty will strongly deter qualified individuals from sitting on an IRC. Further, if IRC members have liability risk, appropriate and adequate insurance coverage must be available and purchased on the members' behalf.

Section 2.10 – Ceasing to be a member

Since a change in 'manager' can effectively trigger the termination of an IRC member, it is critical for 81-107 to clarify the meaning of the word 'manager' for the purposes of the instrument. Subsection 1(1) of the Ontario Securities Act defines the terms "*investment fund manager*" and "*management company*" as follows:

> "investment fund manager" means a person or company who has the power and exercises the responsibility to direct the affairs of an investment fund; ("gestionnaire de fonds d'investissement");
>
> "management company" means a person or company who provides investment advice, under a management contract; ("compagnie de gestion").

Notice that both definitions include a "person". Hence, there is clearly the potential for abuse of this section's intent. Suppose a fund sponsor wishes to terminate the entire IRC. Conceivably, the sponsor could change the individual lead manager to immediately end the term of all IRC members. According to 81-107 – and considering the aforementioned

definitions – an investment management firm or fund sponsor could do so (since the individual manager will have changed) while making no change to the company managing the fund.

Section 2.11 – Disclosure

Paragraph 2(b) of this section states that a fund's prospectus must disclose the nature of any instance where a manager did not follow its IRC's recommendations – and the reasons for not following such recommendations. However, I fail to see how such measures will help investors or improve existing regulations.

The current size of a mutual fund prospectus is a barrier of intimidation for the typical mutual fund investor. Simply burying additional disclosures within an already lengthy and intimidating document does not effectively accomplish what I see as 81-107's intended purpose. Further, with the Joint Forum still working toward a policy of giving investors a prospectus only upon request makes the disclosure in this section egregious.

The solution, in my view, is to simply give the IRC more power.

Section 3.2 – Changes to the mutual fund

Paragraph 3.2(1)(2) states that a proposed change in the manager of the mutual fund must not be referred to its IRC if the new manager is affiliated with the existing manager. There are two reasons why this is clearly inconsistent with 81-107's mandate of improved investor protection.

First, my above comments with respect to section 2.10 should make clear why a change in manager – particularly if both the existing and new managers are related – presents a clear conflict of interest.

Second, the very exception described in this section represents a business conflict. The proliferation of mergers among fund sponsors has resulted in many questionable manager changes in favour of related managers. I state this opinion as a recognized expert in the area of fund research and manager evaluation. It is clearly a conflict of interest where a fund sponsor effectively chooses to realize higher operating margins by firing an external portfolio manager and hiring in its place a related manager. Hence, an independent body – such as an IRC – should represent mutual fund securityholders' interests in such instances or any time a fund sponsor wishes to effect a change in management in favour of a related entity.

Investor protection will be further diluted if, as proposed, this section replaces paragraphs (b), and (d) through (g) of section 5.1 of NI 81-102. The proposed measures do not offer an equivalent level of investor protection. Hence, securityholders should retain the right to vote on such fundamental changes to their funds.

Finally, when switching between funds sponsored by the same firm, all dealers have the option of charging a 'switch fee' of up to 2% of the transaction value. It is industry practice to process such switches without any fee. However, in instances where clients wish to switch as a result of some fundamental change, it makes good sense to mandate the permission to switch out free of charge.

Section 3.3 – Inter-fund Trades

Inter-fund trades and the motivations behind such transactions can be complex and are fraught with potential conflicts. The large Canadian chartered banks are prime examples of how intertwined and conflicted their dealings may be. Take the common instance where a bank is both a lender of capital to, and a mutual fund manager holding equity in a particular public company. If the public company's business takes an extended downturn, the bank's lending department will be at direct odds with its mutual fund management arm. Add in some investment banking relationship with the same firm and the scenario becomes even more tangled. Hence, potential business conflicts could exist far beyond the expected scope of the IRC.

Since NI 21-101 and NI 23-101 were specifically designed, in part, to deal with such situations, it would be imprudent for this section to include an exemption from these NIs with respect to the issues addressed within this section.

Closing Comments

I fully support the intent and spirit of proposed NI 81-107. The introduction to 81-107 states that it is designed to, "*…promote investor protection in mutual funds while fostering market efficiency*". However, for reasons highlighted above, I fail to see how proposed NI 81-107 achieves this mandate. It is my hope that the draft version of 81-107 is not approved as proposed since it would represent an effective deregulation in my opinion.

Further, I fear that proposed 81-107 will simply add a layer of additional costs to securityholders (particularly those in smaller fund complexes) while realizing insufficient benefits in the form of improved governance. I would be pleased to further discuss these issues with you to help further the CSA's efforts to improve mutual fund governance and market efficiency.

Sincerely,

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