August 24, 2005

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 the revised version of proposed National Instrument 81-107 Independent Review Committee for Mutual Funds (the "Proposed Rule"). In 2004 we provided written comments on the initial version of the Proposed Rule.

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 approximately 30 mutual funds to Canadian retail investors. Currently SEI manages more than $ 6 billion for Canadian investors.

We continue to have serious concerns about the Proposed Rule. We strongly object to this new regulatory burden which will not benefit our clients and will adversely affect our business operations.

Although a certain small number of investment fund managers with publicly traded affiliates or significant related dealer operations may support the Proposed Rule, primarily because it will codify relief from conflict of interest prohibitions, we believe it imposes unnecessary regulation at great cost on the majority of investment fund managers. It is unwarranted and serves no benefit to investors.

Our objections to the Proposed Rule are a consequence of the following erroneous premises, assumptions and conclusions which are explicitly and implicitly reflected in the Proposed Rule:

1. that Canadian investment fund managers cannot be trusted to treat their customers fairly and ethically; or, more generally, that no company can be expected to deal with its customers with integrity;

2. that the relationship between Canadian investment fund managers and their customers is one of conflict;

3. that governance is currently inadequate, or does not exist;

4. that IRC members will not be "conflicted" in seeking to protect themselves from potential liability or criticism;

5. that the Proposed Rule will make the Canadian investment fund industry more efficient.

Inherent conflicts

The CSA insists that "conflicts of interest are inherent in the management of all investment funds" (from Summary of Comments, CSA response regarding cost and small investment funds). We object most strongly to this assertion.

The reality is that fund managers are in the business of providing investment solutions for their customers. Although the CSA reference the "commercial bargain" between investors and an investment fund and acknowledge that the fund manager is fundamental to that bargain (response to section 2.11 in Summary of Comments), little thought appears to have been given to what this means. Investors choose, and put their trust in, funds and fund managers. The regulators are telling Canadians that the managers they have chosen to manage their investments cannot be trusted.

Customers must be protected because investment fund managers cannot be trusted to assess whether they are acting in a manner that will lead to "a fair and reasonable result for the investment fund" (ss. 5.2 and 5.3). A policing function is necessary. Rather than have the securities regulators continue their traditional oversight role, a new requirement (akin to a self-regulatory organization) must be imposed on the entire investment fund industry.

This line of thinking is insulting to Canadian investment fund managers. The Canadian investment fund industry is extremely competitive. No manager will have a future if it does not consistently strive to provide the best possible service to its clients.

The CSA has reached an incorrect conclusion or just an unsupported assumption that is being used to justify an unnecessary and costly new regulatory burden on all investment funds.

What is a "conflict of interest"?

The CSA has assumed that fund managers are in conflict with their customers. This conclusion is erroneous and unfounded.

In the CSA notice it is stated that the Proposed Rule addresses two types of conflicts of interest:

1. Business or operational conflicts

The CSA state that these are not specifically regulated except through the general duties of loyalty and care imposed on the fund manager. Examples given are decisions to charge fees to the fund, using affiliates in the operation of the fund and allocating securities amongst other

funds in the fund family.

This definition is seriously flawed. Offering to provide someone with a service in exchange for money is not a self-dealing transaction. It is an exchange based on the free will of the contracting parties and is the cornerstone of Canada's economic system.

A fund manager is in the business of providing services to clients. In order to survive fund managers must provide a consistently high level of service to their customers. Acting against the interest of clients (i.e. in conflict to their interests) will inevitably damage a fund manager's business. Consequently, there is no long term incentive to engage in such conduct. The relatively few cases when self-dealing has occurred have been addressed adequately through the current regulatory regime of statutory duties and standards of care enforced by provincial securities regulators.

2. Structural conflicts

These are described as conflicts resulting from proposed transactions by the manager with related parties. Examples include decisions to purchase securities of a related issuer or inter-fund trading.

This type of conflict does not apply to SEI and would not apply in the future as we do not intend to engage in related party transactions. Although it is an issue for dealer managed funds, such as those offered by the major banks, it is not an issue for companies such as SEI. Therefore, an IRC should not be mandated for all investment funds because of this issue. It should be voluntary for those managers who wish to benefit from the relaxation of the conflict of interest prohibitions.

What is "governance"?

The CSA state that the Proposed Rule will impose a "minimum, consistent standard of governance for publicly offered investment funds." The implied, if not stated, assertion is that good governance, or perhaps governance itself, requires a board or similar body.

The same standard of care that is currently imposed on fund managers will be imposed on the proposed independent review committees (IRCs). It is not at all clear why the CSA has concluded that IRC members would be more likely to meet that standard of care. We submit that unless there is clear evidence that a significant number of fund managers are breaching the current standard of care, there is no need for mandatory IRCs. There is no evidence to support the apparent conclusion of the CSA that fund managers present a risk to their customers.

Recent events in the corporate world clearly demonstrate that a board of directors is not a guarantee of good governance. Canadian investment funds are well governed. The CSA has not demonstrated that these additional requirements are necessary or that the additional costs are justified.

Shift in responsibility

The CSA state that the Proposed Rule "still ensures that ultimate responsibility and accountability for the investment fund remains with the fund manager". That is not correct. Ultimate responsibility, and the final say on so-called "conflict" matters now will rest with the IRC.

Ironically, if one uses the implicit reasoning of the CSA with respect to human nature and the tendency to act in one's own interest, the proposed rule will create a new "conflict". IRC members, whether they admit it or not, will have as their primary goal the avoidance of personal liability. To extent that they pursue that goal they will be acting in their own best interests. Who will monitor and review the IRC?

It is understandable and to be expected that IRC members will attempt to protect themselves. However, fund operating costs will increase as IRC members retain independent counsel or other consultants to assist them in dealing with matters that are brought to them for review. Investors will pay more. The Canadian investment fund industry will become less efficient. These results have been confirmed to us by representatives of our U.S. affiliate who have told us of the costs and inefficiencies related to mutual fund boards in that country.

Risk can be defined as the cost or consequences of something going wrong. If something goes wrong with an investment fund that has millions, if not hundreds of millions of dollars in assets, the potential liability for an IRC member could be staggering. Although the CSA has attempted to prove that the exposure of IRC members to potential liability is limited, it does not appear to have recognized the risks associated with the amount of money administered by investment funds. For many investment funds, even a relatively small error could lead to millions of dollars in loses. Potential claims to recover or account for such losses could expose IRC members to huge financial risks. As a result of this reality, we expect IRC members will generally do everything they can to insulate themselves from such risk. Inevitably, this will cost investment funds and investors money.

More efficient Canadian capital markets

Ultimately, all of the additional costs imposed by NI 81-107 will be borne by investors. Many of these costs will be fixed and outside the control of the fund manager. SEI has always worked to control overall costs. We set limits on our MERs which are exceptionally low by industry standards. NI 81-107 would hamper our ability to minimize and control costs by imposing new and unpredictable costs on our funds and investors.

Comments have been requested about the impact of the Proposed Rule on "smaller investment funds". The focus seems to be on cost. The CSA does not define what is a "small investment fund" but insists that costs would not be an issue regardless of size. They estimate the cost of an IRC at $50,000 to $250,000. This is not an insignificant amount for any size of fund.

We acknowledge that some mutual funds could benefit from relaxed conflict of interest rules (e.g. dealer managed mutual funds) that would be facilitated by an IRC. However, there is no justification for imposing the cost of such a structure on funds which could not (or would not wish) to benefit from such relaxed rules.

OUR RECOMMENDATION - Restrict application/by exception—i.e. opt-in

If the CSA insist on introducing IRCs, we strongly urge you to apply the requirement much more narrowly. IRCs should only be required for those fund managers 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. There is no evidence that such a costly structure is needed for investor protection. Existing rules relating to conflicts of interest, including disclosure, mandated standard of care and oversight by provincial regulators, have served Canadian mutual fund investors well in the past and can continue to do so into the future.

We do not object if those investment fund managers who have issues with the current conflict of interest regime wish to rely on the IRC model to avoid conflict of interest prohibitions.

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

Conclusion

We hope our strong objection to NI 81-107 and our recommendation for a more limited introduction of IRCs (i.e. to those funds wishing to benefit from relaxed conflict of interest regulation) will be given serious consideration by the CSA.

Sincerely,

Patrick Walsh
Chief Executive Officer
SEI Investments Canada Company

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