



November 10, 2005

**VIA EMAIL**

John Stevenson, Secretary  
Ontario Securities Commission  
20 Queen Street West  
Suite 800, Box 55  
Toronto, Ontario  
M5H 3S8

Dear Sirs/Mesdames

**Re: Ontario Securities Commission Rule 13-502 Fees - Comments of the Investment Management Group of Borden Ladner Gervais LLP**

We are pleased to provide our comments to the Ontario Securities Commission on the proposed amended and restated OSC Rule 13-502 *Fees* and its accompanying Companion Policy (collectively, the Fee Rule). We appreciate the opportunity to comment on the Fee Rule and provide our comments with a view to ensuring that the Commission levies fees on appropriate Ontario market participants and the rules are sufficiently clear to allow those market participants to comply with them.

Our comments on the Fee Rule have been compiled with input from the lawyers in BLG's Investment Management Practice Group and therefore reflect our collective views. Our comments do not necessarily reflect the opinions of, or feedback from, our investment management clients.

We view our first comment as significant. We note that we raised this comment with OSC staff earlier this year, but since the Fee Rule has not been changed to reflect our earlier submissions, we raise it again for the Commission's consideration. We also raise several technical drafting comments on the Fee Rule. We hope that our comments are considered helpful by the Commission and OSC staff.

***Application of Fee Rule to "Unregistered Investment Fund Managers"***

1. We urge the Commission to delete section 4.5 of the Companion Policy (which is new) and change the Fee Rule to clarify that participation fees are not payable by "unregistered investment fund managers" that manage investment funds that are not reporting issuers in Ontario but that are distributed in Ontario pursuant to prospectus and registration exemptions. Instead, the activity fees established by the Fee Rule would be payable in respect of those exempt distributions. In our



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view, a very simple amendment to the Fee Rule is necessary. The term “investment fund manager” as used in the Fee Rule should be narrowed for the purposes of the Fee Rule to refer only to entities that are managing investment funds that are reporting issuers. Section 4.5 of the Companion Policy should be deleted.

2. We believe that the Fee Rule should be amended in the manner set out above for three fundamental reasons:

- (a) Purely administrative services inherent in “acting as an investment fund manager” (see paragraph (b) of the definition of capital markets activities), particularly when those services are provided off-shore to off-shore investment funds arguably are not within the jurisdiction of the Ontario Securities Commission and participation fees for such services should not be levied, unless there is a much stronger connection to the Ontario capital markets. The obvious reason for unregistered investment fund managers being unregistered is because they are not required by law to be registered with the OSC to provide the services they are providing. We therefore are concerned that the Fee Rule is being interpreted to require persons, who are not required to register under the *Securities Act* (Ontario) (the Act), because they are not carrying on business regulated by the Act, to pay fees to the Commission.

Portfolio management and investment advisory services, even if given by a non-resident portfolio manager that provides its services off-shore to an off-shore investment fund, are considered by the Ontario Securities Commission to be registrable activities in Ontario where securities of the off-shore investment fund are distributed in Ontario. A person or company providing those services is required to be registered or exempt from registration under the Act or OSC Rule 35-502 *Non Resident Advisers*. If the entity is required to register and therefore becomes registered, it will pay participation fees as a registrant on its Ontario revenues from capital markets activities. If it is not required to register and does not direct the affairs of the investment fund (i.e. they provide only portfolio management services and do not fall within the definition of unregistered investment fund manager) it is not then required to pay any fees under the Fee Rule, even though it is providing (to a limited extent) registrable activities in Ontario. It is therefore an odd result that a non-resident unregistered investment fund manager that carries out *no* registrable activities in Ontario is required to pay participation fees.

- (b) For non-resident unregistered investment fund managers that manage off-shore investment funds that distribute securities in Ontario only pursuant to prospectus exemptions, the concept of “capital markets activities in Ontario” is particularly meaningless. The only capital markets activity that is carried on in Ontario in those circumstances is the distribution of securities, since the management of those funds is carried on outside of Ontario. The Act requires intermediaries to be registered (at least as a limited market dealer) and such dealer will pay its participation fees based

on the commissions it receives from Ontario residents. If all fund management and investment advisory services are provided outside of Ontario, then the entities providing such services do not receive any benefits of regulation of the Ontario capital markets or of investment funds in Ontario and should not pay participation fees to the Commission. Similarly, unregistered investment fund managers managing investment funds in Ontario that only distribute securities pursuant to prospectus and registration exemptions receive no benefits of that regulation in Ontario.

- (c) Requiring unregistered investment fund managers (whether or not these managers are off-shore) to pay participation fees in Ontario simply due to the fact that they are distributing investment funds (which may also be based off shore) in Ontario under prospectus and registration exemptions is inconsistent with the treatment of corporate finance issuers who distribute securities in Ontario on an exempt basis, but are not reporting issuers. Specifically we note that investment funds that do not have an investment fund manager (within the meaning of the Act) that are not reporting issuers, are not required to pay participation fees. These issuers do not pay participation fees, rather they pay activity fees on the private placement of their securities. Unregistered investment fund managers, particularly non-resident unregistered investment fund managers, who distribute securities of their investment funds that are not reporting issuers, should not receive unequal treatment under the Fee Rule.
3. Without our recommended change, entities falling within the definition of “unregistered investment fund manager” required to pay participation fees would include investment fund managers (within the meaning of that defined term in *Securities Act* (Ontario) (the “Act”)) of investment funds (whether public or private) distributed in Ontario, but who contract with registered advisers for portfolio management services to those investment funds. Because *unregistered* investment fund managers are not registered in any capacity in Ontario (by definition), they do not provide portfolio management services to the investment funds or if, they do, they are exempt from registration as an adviser under the explicit circumstances provided for in OSC Rule 35-502. Those unregistered fund managers may be resident in Ontario, or may be situated outside of Canada as a non-resident. Similarly the investment funds managed by those entities may be located off-shore or managed in Ontario. The concern we raise is particularly acute for non-resident unregistered investment fund managers who manage off-shore funds that distribute their securities in Ontario under applicable exemptions. However, we submit that the change we recommend should apply to all unregistered investment fund managers who manage non-reporting issuer investment funds that distribute their securities in Ontario, without regard to whether or not they conduct their activities off-shore.
4. Our recommended change will not change the requirement for any person or company (whether resident or non-resident) providing portfolio management services to an investment fund that is distributed in Ontario, to pay participation fees, if it is a registrant under the Act, based on their Ontario revenues from

capital markets activities (as defined in the Fee Rule). Those portfolio managers who are exempt from registration under OSC Rule 35-502 in the explicit circumstances of that Rule should not be required to pay fees under the Fee Rule and we agree with the Fee Rule in this respect. These entities do not pay participation fees today, either because they generally do not fall within the definition of unregistered investment fund manager or because they are only tangentially accessing the Ontario capital markets (for example, acting as a portfolio manager of a fund that is primarily distributed off-shore as contemplated in section 7.10 of OSC Rule 35-502).

5. Our suggested change is consistent with the reference in Appendix C Activity Fees to payment of activity fees “for a distribution of securities of an issuer that is an investment fund, where none of the members of the organization of the investment fund is subject to a participation fee” [see Activity Fee B 2]. In our view, this reference presupposes that there may be circumstances where an investment fund manager does not pay participation fees; with the way in which the Fee Rule is currently drafted, this reference would not ever apply.
6. Our recommended change is also consistent with the 2001 OSC Fee Rule Concept Proposal and subsequent publications of earlier versions of the Fee Rule. The 2001 OSC Fee Rule Concept Proposal suggested that *mutual fund* managers (within the meaning of NI 81-102) who were not registered under the Act would pay participation fees, given the extent that such mutual fund managers participate in the Ontario capital markets and receive the benefits of regulation of such markets and of mutual funds. No mention of non-resident fund managers or exempt investment funds was made in this Concept Proposal. Commentators on the first publication for comment of the Fee Rule noted their concerns that managers of foreign investment funds (whose securities may also be privately placed in Ontario) would be subject to the participation fee. As indicated in the summary of comments published in January 2003 one commentator noted:

... in respect of a foreign investment fund, the OSC would end up collecting multiple fees – i.e. the exempt distribution fee payable by the foreign investment fund for any private placement in Ontario; the participation fee payable by a limited market dealer on revenues generated from the private placement in Ontario; and the participation fee payable by the investment fund manager on revenues from providing investment management to the foreign investment fund.

This comment was not answered in the Summary of Responses and no change was made to the Fee Rule to take into account of the comment. The Fee Rule was only published once for comment and accordingly we have not had an opportunity to raise this comment formally before now, although as noted above, we earlier brought this matter to OSC staff’s attention.

***Participation Fees payable by Registrants of Provinces other than Ontario, but with an Ontario-only office***

7. The Fee Rule should be amended to deal with the issue raised by the application that resulted in the Order granted by the Director in March 2004 to Northwater Capital Management Inc. The Fee Rule requires registrants with a permanent establishment in Ontario to use their Ontario tax returns to determine their Ontario revenue percentage. When an adviser is registered in several provinces, but has its only office in Ontario, the Ontario tax return includes all of its Canadian income as Ontario revenue. As recognized in the Order, this is not a correct result.

***Recommended Drafting Clarifications to the Fee Rule***

8. We suggest several drafting changes to the Fee Rule to ensure clarity and ease of compliance by market participants.
- (a) *Subsection 3.1(2)*: the reference to “a fiscal year”, should be changed to “its fiscal year” to clarify that the subsection is referring to the fiscal year of an unregistered investment fund manager and not some other fiscal year.
  - (b) *Subsection 3.3 (1)(a) and 3.4(1)(a)*: the references to “the fiscal year” should be changed to “its fiscal year” to clarify that the subsections are referring to the fiscal year of the applicable registrant firm.
  - (c) *Subsection 3.4(2)(b)*: the reference to “the fiscal year” should be changed to “its previous fiscal year” to be consistent with subsection 3.4(2)(a).
  - (d) *Subsection 3.4(4)*: Although we strongly recommend that the Commission confirm that unregistered investment fund managers that only distribute investment funds on an exempt basis not be subject to the Fee Rule in respect of payment of participation fees, if the Commission does not accept this comment, we recommend that this subsection be amended to include unregistered investment fund managers, since they may have the same issues regarding audited financial statements as the other entities named in this subsection.
  - (e) *Section 3.5*: While we support the Commission for making the changes outlined in this section regarding the existing Fee Rule’s duplicative filings of Form 13-502F4 and F5, we recommend that the Commission clarify that these forms are only required to be filed in the circumstances outlined in subsection (3), perhaps by a statement to this effect in the Companion Policy.
  - (f) *Activity Fee B 2*. The second paragraph refers to the term “member of the organization” of the investment fund. This is a defined term in National Instrument 81-105, but not to our knowledge in any other rule. This is a very broadly defined term in NI 81-105 and we question whether this very



broad term is needed for the Fee Rule. For clarity we recommend that this paragraph refer to “persons or companies providing services to that investment fund that are related to the manager of the investment fund”.

- (g) *Activity Fee E 1.* We support the concept of an all-inclusive fee for an application, without a fee being payable for each head of relief applied for (although we recognize that a higher fee is paid if more than one head of relief is necessary). From a very technical perspective, we recommend you add in “or the investment fund manager”, for an applicant that is an investment fund, since investment funds do not generally pay participation fees directly.

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We hope that our comments are considered useful by the Commission. We would be pleased to discuss them with you and we are particularly interested in discussing the implications of how the Fee Rule is proposed to operate vis a vis unregistered investment fund managers. Please contact Rebecca Cowdery at 416-367-6340 ([rcowdery@blgcanada.com](mailto:rcowdery@blgcanada.com)) if you need any further information or require any additional clarification of our comments.

Yours very truly

Investment Management Group  
Borden Ladner Gervais LLP