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January 6, 2009

VIA EMAIL

John Stevenson, Secretary
Ontario Securities Commission
20 Queen Street West
Suite 1900, Box 55
Toronto, Ontario
M5H 3S8

Dear Sirs/Mesdames

Re: Proposed Revocation and Replacement of OSC Rule 13-502 Fees and Companion Policy 13-502CP Fees

We are pleased to provide the Ontario Securities Commission (OSC) with comments on the above-noted proposed replacement instruments (collectively, the Proposals).

These comments are those of lawyers in BLG's Securities and Capital Markets practice group and do not necessarily represent the views of individual lawyers, the firm or our clients.

We have three comments on the changes proposed by the OSC in the Proposals. We also wish to provide the OSC with additional feedback on an issue that we brought to the attention of the OSC in 2005 when OSC Rule 13-502 was last published for comment.

1. Use of Historical Data for Participation Fee Calculations

We urge the OSC to re-consider its proposal to require reporting issuers and registrants to calculate participation fees based on historical data[1] at this time. We understand the reasoning behind the OSC's proposal for this change, but we believe that this change will require reporting issuers and registrants to calculate participation fees until at least April 1, 2011 based on record high capitalization and revenues, which will be particularly inappropriate having regard to the market downturn experienced during the latter part of 2008. This proposed change, coupled with the decision to revert back to the stated minimum participation fees for each tier, can be expected to continue the OSC's practice of earning fee surpluses, which then must be returned to reporting issuers and registrants. We

[1] Being capitalization and revenues (as the case may be) for each market participant's financial year ended prior to January 1, 2008.

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point out that these changes will represent a fee increase for virtually all capital markets participants.

2. **Lack of Transparency in OSC's Budgeting Process**

We believe that it would be appropriate for the OSC to publish a detailed accounting of its budgetary process, including how it determines returns of surpluses to capital markets participants. The need for this transparency and accountability is enhanced by the fact that the OSC has indicated that it has again experienced a surplus in its fee revenue, yet is proposing to increase both participation and certain activity fees. It has never been clear to us, nor to our clients, exactly how the OSC determines which reporting issuers and which registrants are entitled to a refund, nor how the OSC determines how to allocate the surplus between reporting issuers and registrants. We believe that this issue will become more acute if the OSC moves to a historical data basis for calculating participation fees.

3. **Support for the Two-Year Cycle of Fee Review**

We support the OSC's plan to review Rule 13-502 every two years, rather than every three years.

4. **Participation Fees of Unregistered Fund Managers**

We commented in 2005 on the reference in section 4.6 of the Companion Policy to the necessity for non-resident "unregistered fund managers" distributing units of investment funds in Ontario on a prospectus exempt basis, to pay participation fees. We provided a detailed explanation in our comment letter dated November 10, 2005 of why we felt this change was inappropriate. Our earlier comments did not distinguish between Canadian and non-Canadian unregistered investment fund managers whose only activity in Canada was distributing securities of investment funds on an exempt basis.

We urge the OSC to consider our comments again. Given the expectation that under proposed National Instrument 31-103, an investment fund manager that is based in Canada and that manages investment funds that have been established in Canada will be required to register as an "investment fund manager" (and therefore will be required to pay participation fees as a registrant), we are only commenting in this letter on the apparent requirement in Rule 13-502 that *non-Canadian* "unregistered investment fund managers" that distribute investment funds *not established in Canada* must pay participation fees under the rule.

Non-Canadian unregistered fund managers not otherwise operating in Canada and whose only connection with Canada is the distribution of investment funds *that have not been established in Canada* on an exempt basis do not expect to pay participation fees. They generally pay the activity fees payable for the filing of Forms 45-106F1 or 45-501F1 in connection with private placements as required by Rule 13-502, which is consistent with fee requirements in the other provinces. We believe that the interpretation of Rule 13-502 provided for in section 4.6 of

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the Companion Policy is not correct from a policy perspective or from a plain reading of the Rule, although the Rule is ambiguously drafted.

We urge the Commission to delete section 4.6 of the Companion Policy and change Rule 13-502 to clarify that participation fees are not payable by non-Canadian "unregistered investment fund managers" that manage investment funds not established in Canada, in circumstances where those funds are distributed in Ontario pursuant to prospectus and registration exemptions. Instead, the activity fees established by Item B of Appendix C to Rule 13-502 would be payable in respect of those exempt distributions.

We believe that Rule 13-502 should be amended in this manner 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) when those services are provided offshore to offshore investment funds, arguably are not within the jurisdiction of the OSC 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 Rule 13-502 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 OSC. We understand that this status for non-resident investment fund managers managing offshore funds will continue under proposed National Instrument 31-103.

Currently, portfolio management and investment advisory services, even if given by a non-resident portfolio manager that provides its services offshore to an offshore investment fund, are considered by the OSC to be registrable activities in Ontario when securities of the offshore 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 Rule 13-502, even though it is providing (to a limited extent) registrable activities in Ontario[2]. It is therefore a very odd result that a non-resident unregistered investment

[2] We note that the registration exemptions provided for portfolio managers distributing investment funds in Ontario are predicated on the existence of a registered dealer through whom the securities are distributed. These dealers pay participation fees to the OSC on their revenues generated from the distribution of such securities.

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fund manager that carries out *no* registrable activities in Ontario is required to pay participation fees.

(b) For non-resident unregistered investment fund managers managing offshore investment funds that distribute securities in Ontario only pursuant to prospectus exemptions, the concept of "capital markets activities in Ontario" is rather 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 Ontario. The Act requires intermediaries to be registered and those dealers will pay participation fees based on the commissions received from Ontario residents. If all fund management and investment advisory services are provided outside 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.

(c) Requiring non-resident unregistered investment fund managers to pay participation fees in Ontario simply due to the fact that they are distributing investment funds that are not established or managed 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 exempt investment funds that do not have an investment fund manager within the meaning of the Act are not required to pay participation fees. These issuers instead pay activity fees on the private placement of their securities. Non-resident unregistered investment fund managers that distribute securities of their investment funds that are not reporting issuers should not receive unequal treatment under Rule 13-502.

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, unless the investment fund has an investment fund manager that 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 Rule 13-502 is currently interpreted, this reference would never apply.

Our recommended change is also consistent with the 2001 OSC Fee Rule Concept Proposal and subsequent publications of earlier versions of Rule 13-502. 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 Rule 13-502 noted their concerns that managers of foreign investment funds (whose securities may also be privately

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placed in Ontario) could 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 clearly answered in the Summary of Responses, although as we noted above, Appendix C was clarified to ensure that there would be no double payment of activity fees for the private placement and also participation fees.

Finally, we point out that the OSC really has no way of determining which non-resident unregistered fund managers are or are not complying with the apparent requirement to pay participation fees, which we believe makes it impossible to enforce the apparent rule. In addition to the apparent rule being difficult to enforce, it also imposes compliance obligations on non-resident fund managers by requiring them to complete the required form, determine how much of their revenues are derived from activities in Ontario and pay the applicable participation fees. Given our submissions described above, we believe this is an inappropriate result.

We hope that our comments are considered useful by the OSC. We would be pleased to discuss them with you. Again, we are particularly interested in discussing the implications of how Rule 13-502 operates vis a vis non-resident unregistered investment fund managers. Please contact Rebecca Cowdery at 416-367-6340 (rcowdery@blgcanada.com) if you need any further information or require any additional clarification of our comments.

Yours very truly

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