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Autorité des marches financiers
New Brunswick Securities Commission
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Nova Scotia Securities Commission
Superintendent of Securities, Newfoundland and Labrador
Registrar of Securities, Northwest Territories
Superintendent of Securities, Yukon Territory
Registrar of Securities, Nunavut

January 13, 2011

Dear Sirs/Mesdames

Comment on Notice of Request for Comment on Proposed Amendments to National Instrument 31-103 *Registration Requirements and Exemptions* (NI 31-103) Registration of International and Certain Domestic Investment Fund Managers

We make the following comments on the proposed amendments to NI 31-103 as they relate to non-resident domestic investment fund managers.

1. The proposed requirement (proposed requirement) for non-resident domestic investment fund managers to register in jurisdictions other than the one in which their head office is located is beyond the scope of current securities legislation.
2. The proposed requirement is unduly burdensome and unnecessary.

3. The proposed requirement is not the appropriate solution to the risks identified.

The proposed requirement is beyond the scope of current securities legislation

The definition of "investment fund manager" in the Securities Acts of the various provinces and territories differs very little. Apart from Manitoba, where the word "manages" is used, an investment fund manager is generally defined in the legislation as a person or company that directs the business, operations and/or affairs of an investment fund.

The word "direct" does not appear to have been legally defined or judicially considered in Canada. The definition in the Oxford dictionary is: control the operations of; manage or govern. "Director" is defined in provincial and federal corporate legislation, but not in a way that is meaningful in the context of this comment. Duhaime's Legal Dictionary defines a director as a person selected by the shareholders to manage the affairs of a corporation.

In any case, the clear implication is that "directing" involves activities that are more of a strategic, authoritative nature, rather than administrative. As such, directing, whether it be of a corporation or an investment fund manager, would normally take place from an entity's head office, although in the case of a conglomerate, there may be more than one place from which directing happens. It certainly does not take place where an entity does not have a physical presence. Except for Manitoba, the definition of an investment fund manager in the securities legislation of the jurisdictions does not refer to management. Even so, "managing", while an administrative task, implies activity of a supervisory nature. Supervision also cannot take place where there is no physical presence.

An investment fund manager "directs [and/or manages] the business, operations or affairs of a fund" from its head office and should be registered in the jurisdiction in which its head office is located. We submit that the definition of investment fund manager in the various Securities Acts does not contemplate an investment fund manager registering in any jurisdiction other than the one in which its head office is located.

The CSA seems to recognise the difficulty they face in trying to expand the registration requirement for non-resident investment fund managers, because they have found it necessary to add criteria to trigger a registration requirement. Thus, the exemption in proposed section 8.29.2 will only apply if none of the following is met:

- The investment fund manager conducts activities from a physical place of business in the local jurisdiction.
- The investment fund manager is incorporated, formed or created under the laws of the local jurisdiction.

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- The investment fund is incorporated, formed or created under the laws of the local jurisdiction.
- The investment fund is a reporting issuer.
- The investment fund manager or the investment fund actively solicits residents of the local jurisdiction.

None of those criteria refers to directing. An administrative body cannot assume powers beyond the power and authority of its founding legislation. Adding criteria to require registration for investment fund managers to register in jurisdictions other than where they direct the business of the investment fund (that is, their head office) is, we submit, beyond the authority of the regulators.

The reference to the business trigger is irrelevant because directing the business of a fund is not a single action or series of actions. It is an ongoing process that may ebb and flow as events or situations require, but it does not have a finite timeline. The business trigger may have been relevant for dealer registration, but trading can take place anywhere with each trade being a disparate activity, while directing the business, operations or affairs of a fund happens in one place and is a continuous process.

Active solicitation is a marketing or selling activity and, therefore, an administrative function. Even if an investment fund manager actively solicits residents in a jurisdiction in which it is not registered, that active solicitation is not a "directing" function.

The proposed requirement is unduly burdensome and unnecessary

Requiring investment fund managers to register in jurisdictions other than where their head office is located is unduly burdensome, because of the costs involved. It is also unnecessary, because registration will provide no real value to investors.

Costs

Requiring investment fund managers to register in multiple jurisdictions will put additional strain on their financial and time resources. Having to register in additional jurisdictions will make it extremely difficult, if not nearly impossible, for smaller firms to continue to keep investors in those jurisdictions in the investment funds in which they have invested. And it will reduce the availability of different funds to those investors, leaving them to choose only local funds or those funds whose investment fund managers can afford additional registration. This is patently unfair.

No real value to investors

The CSA explains that the investment fund manager category is intended to ensure that investment fund managers have sufficient proficiency, integrity and solvency to adequately carry

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out their functions. We agree. But the regulator in the jurisdiction in which the investment fund manager is registered already has the responsibility to ensure that the investment fund manager continues to comply with proficiency, integrity and solvency requirements. Indeed, securities legislation contains the necessary requirements to ensure that is the case. Investment fund managers must act honestly and in good faith and in the best interests of the fund. They must also exercise the degree of care, diligence and skill that a reasonably prudent person would (see, for example, section 125 of the *Securities Act* (BC)). The investment fund manager must meet registration and continuing reporting requirements and its securities regulator is authorised to examine its books and records, and to take action as it sees fit.

Furthermore, the investment fund must comply with registration and prospectus requirements in the jurisdictions in which its securities trade. Those requirements afford investors the protections they rightfully deserve, and are the appropriate protections.

The proposed requirements are not the appropriate solution

The CSA has identified the following specific risks:

- Incorrect or untimely calculation of net asset value
- Incorrect or untimely preparation of financial statements and reports
- Incorrect or untimely provision of transfer agency or record-keeping services
- Conflicts of interest between the fund manager and fund investors

The proposed registration requirement is not a solution, as it does not mitigate those risks, and there are already other measures in place that do mitigate those risks.

The CSA has already dealt with the first two areas of risk by requiring an investment fund manager to deliver interim and annual financial statements to its regulator, including a description of any net asset value adjustment to a fund that it manages. The description of the adjustment must explain the effect of the adjustment on individual units and corrections of purchase and sale transactions that affect the fund or its security holders. Non-compliance with these requirements will lead to action by the regulator.

In practice, most investment fund managers rely on their fund administrators to calculate the net asset value of the fund, although they must satisfy themselves that the fund administrator has done its calculation correctly. This practice means there is a double check, and errors would be found and corrected in a timely way. The risk of incorrect or untimely transfer agency or record-keeping services is a function of organization. If fund managers outsource those services to third parties, they must ensure the third parties are capable and competent. We understand from our clients that in practice, there are few instances of fund securities being recorded incorrectly. We

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suggest the risk of investors suffering irreparable harm as a result of this type of error is small. In any case, we do not see how the proposed requirement would forestall or mitigate this risk.

There is an inherent conflict of interest between the investment fund manager and fund investors, because the fund manager's primary obligation is to its client, the fund. However, the investment fund manager cannot carry out its responsibilities to the fund without taking care of the fund's investors. The appropriate way for the investment fund manager to deal with this risk is to disclose the conflict to investors and potential investors in the fund. There is already a requirement for the investment fund manager to do so under section 13.4 of NI 31-103.

The conflict of interest more likely to arise is when a portfolio manager that is also an investment fund manager manages individual client accounts as well as the funds. That conflict arises in the firm's role as portfolio manager, and not as investment fund manager, but the requirement in section 13.4 of NI 31-103 to identify and respond to conflicts of interest applies equally to portfolio managers as it does to investment fund managers. We submit that the appropriate measures are already in place and the proposed requirement would not lead to any improvements.

Specific comment on the requirement for notice to clients

We think it is appropriate for non-resident investment fund managers to notify investors of their non-resident status.

Conclusion

The proposed registration requirement for non-resident domestic investment fund managers is not appropriate for the following reasons:

1. It goes beyond the scope of authority of the regulators.
2. It is unduly burdensome to investment fund managers and does not have a corresponding benefit to investors.
3. It is not an appropriate solution to the identified risks.

We request that the CSA not proceed with the proposed requirements.

Yours truly

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