INVESTMENT COUNSEL ASSOCIATION OF CANADA

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August 28, 2002

Mr. Purdy Crawford, Chair
Osler, Hoskin & Harcourt LLP
Barristers & Solicitors
Box 50, 1 First Canadian Place
Toronto, ON
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Dear Mr. Crawford:

Re: Five Year Review Committee Draft Report

The Investment Counsel Association of Canada ("ICAC") is pleased to respond to the request for comment on the Five Year Review Committee Draft Report. This submission is made by the Industry Regulation and Taxation Committee of the ICAC. The ICAC is a representative association for portfolio management firms in Canada, all of which are registered as advisers in the categories of Investment Counsel/Portfolio Manager or the equivalent thereof. Seventy-one firms actively support the ICAC and collectively are responsible for the management of over $450 billion of assets on behalf of high net worth and institutional investors.

We have organized our comments to correspond with the recommendations number in the Executive Summary.

If you have any questions or require any clarification, please feel free to contact the undersigned at (416) 932-6337 or e-mail m_gibson@beutel-can.com.

Yours truly,

INVESTMENT COUNSEL ASSOCIATION
OF CANADA

By: Michael J. Gibson
Chair, Industry Regulation and Taxation Committee

Five Year Review Committee Draft Report

Part 1 – Role of the Commission in Capital Markets Regulation

Recommendations

1. **Provinces, territories and federal government work towards creation of a single securities regulator responsible for capital markets across Canada.**

2. **In the meantime, securities regulators continue to harmonize securities regulation across Canada.**

   Securities regulators be given the authority to delegate any power, duty, function or responsibility conferred on them to another securities regulatory authority within Canada.

   Securities legislation across the country be amended to provide for "mutual recognition" – that a securities regulator may deem that compliance by a market participant with securities laws in another specified Canadian jurisdiction constitutes compliance with securities laws in the regulator's own jurisdiction.

ICAC Comments

ICAC has long advocated a single national securities regulator. The current overlapping of regulators is inefficient and costly. In addition, it reduces investment opportunities for Canadians because financings are raised elsewhere and foreign investment managers are discouraged from operating in Canada because of the complexities.

We are also fully supportive of the delegation authority and mutual recognition proposals which would make the current system easier to deal with as would the continued harmonization initiative. These measures should only be viewed as interim solutions because costs and inefficiencies still remain in dealing with 13 regulators.

The real and only solution is a national securities regulator.

Recommendations

3. Foreign and Canadian companies should be permitted to prepare their financial statements in accordance with U.S. GAAP. During a transition period, issuers who prepare financial statements under U.S. GAAP should be required to reconcile the statements to Canadian GAAP.

4. Canadian regulators and standard setters should move to International Accounting Standards.

ICAC Comments

ICAC agrees that financial statements of Canadian and foreign companies be prepared under U.S. GAAP and agrees with a move to International Accounting standards. However, such directions should be coordinated with Canadian and U.S. standard setters – the Canadian Institute of Chartered Accountants and Financial Accounting Standards Board, respectively.

Recommendation

5. The Commission and the CSA should continue developing securities transfer legislation modeled on the Uniform Commercial Code revised Article 8 in the United States, and governments across Canada should ensure such legislation is adopted on a uniform basis.

ICAC Comments

ICAC agrees with the recommendation that there is a need for national and global harmony among regulators to oversee the holding, transferring and pledging of securities. Without it, clearing and settlement of securities will be inefficient and Straight Through Processing will not be achievable.

Recommendation

6. The Commission should continue its participation in the International Order of Securities Commissions ("IOSCO") initiatives and the Commission should adopt, in a timely fashion, changes to its rules to implement the standards emanating from IOSCO.

ICAC Comments

ICAC is in favour of collaboration and co-operation among securities regulators in different countries, however, IOSCO standard changes should not be implemented in Canada without consideration of domestic practicalities.

International standards are important in developing Canadian regulations in a global marketplace.

Recommendation

7. The CSA, provincial and territorial governments and the federal government move to adopt a system of harmonized functional regulation across Canada, whereby capital market activities, products and conduct, are regulated by a single market conduct regulator and fiscal solvency matters are regulated by a single prudential regulator.

ICAC Comments

ICAC does not believe harmonized functional regulation can be achieved until a single national securities regulator is established. Creating a harmonized functional regulatory system among thirteen regulators would only add to the complexities of our business. Conceptually, functional regulation has potential but implementation must be in the proper framework.

Part 2 – Flexible Regulation

Recommendation

11. We recommend that the Commission be given "basket" rulemaking authority that is substantially identical to that conferred on the Lieutenant Governor in Council pursuant to clause 143(2)(b) of the Act. The Commission should be given the authority to make rules respecting any matter that, in the opinion of the Commission, is "necessary or advisable for carrying out the purposes of the Act."

ICAC Comments

The ICAC agrees with the recommendation that there is a need for the Commission to be given the authority to make rules respecting any matter that, in the opinion of the

Commission, is "necessary or advisable for carrying out the purposes of the Act." As discussed in the Draft Report, in other provinces (British Columbia and Alberta) the commissions enjoy such rule-making authority and, as stated earlier, the ICAC is supportive of any effort to enhance the harmonization of the rules between the various securities regulatory authorities. Such a change would be consistent with the concept of allowing the Commission to be flexible and proactive in its approach to securities regulation.

Recommendation

12. We recommend that the minimum initial comment period for rules be reduced from 90 to 60 days and that the minimum initial comment period for policies be reduced from 60 to 30 days.

ICAC Comments

While the ICAC does support the attempt to streamline the rule and policy making processes as embodied by this recommendation, the ICAC does note that in the context of complex or substantial changes to rules or policies, that the Commission must continue to ensure that ample time for input from industry and market participants. If sufficient time for comment is not provided, the effectiveness of the comment process (and consequently the rule and policy making process as a whole) may suffer.

Recommendation

17. We recommend that the legislation be amended to allow the Commission to issue blanket rulings and orders that provide exemptive relief only. We further recommend that blanket rulings and orders be used only as an interim measure. Therefore, they should be subject to a sunset period under which any blanket ruling or order issued by the Commission will automatically expire in three years unless converted sooner into a rule.

ICAC Comments

The ICAC believes that allowing the Commission to issue blanket orders and ruling to provide for exemptive relief is an effective tool in order to allow the Commission to act in an expedient manner to handle specific issues or concerns. This is particularly important where it is not an effective alternative to wait for the complete rule drafting and comment process prior to resolving an issue. The ICAC agrees that a “sunset” provision in all such blanket orders would be an effective way of ensuring that if a topic is of sufficient importance, the Commission will have ample opportunity to prepare a draft rule on the issue.

Recommendation

18. We recommend that the Commission publish exemption orders granted from the requirements of securities rules. We also urge the Commission to consider whether there should be some notice when exemptive relief applications are not granted, and of the reason for the refusal.

ICAC Comments

The ICAC supports any initiative to enhance the transparency of the exemption process as all industry and market participants will benefit from the publication of such information.

Recommendation

20. The Committee recommends that the CSA consider whether NP 11-201 and NP 47-201 conflict with provincial legislation such as the ECA. The Committee believes that the CSA should ensure that the guidance provided by it continues to be operative.

ICAC Comments

The ICAC believes that consistency between the above-mentioned National Polices and other legislation is an important objective in order to avoid any confusion in the marketplace. Given the importance of electronic commerce in today's society, the ICAC agrees that any inconsistencies between the *Electronic Commerce Act, 2000* and the CSA's National Policies must be reviewed and resolved.

Part 5 – Enhancing Fundamental Shareholder Rights

Recommendation

52. We support the reforms to the CBCA relating to proxy solicitation. We believe that Part XIX of the Act should be similarly amended to ensure that shareholders are able to communicate with each other in **prescribed circumstances without having to file an information circular. We believe that the Commission should co-ordinate with the provincial government so as to ensure that amendments adopted under the OBCA and the Act are uniform. We further recommend that the Commission consider whether it has the authority to incorporate by reference the requirements of another Canadian**

statute such as the OBCA or CBCA with regard to proxy solicitation, rather than stating the rules explicitly in the Act.

ICAC Comments

The ICAC would support these reforms as additional continuing communication and are in the best interests of shareholders. The reforms require management of a reporting issuer to send information circular information with any proxy sent to shareholders. This allows for full information disclosure that would otherwise only be given at the meeting itself. In essence, they are consistent with the rules adopted by the SEC ten years ago.

Recommendation

53. We recommend that the Commission, together with the CSA, undertake further study to determine whether amendments to securities law are necessary with regard to communications with and among shareholders in the context of a take-over bid.

ICAC Comments

In 2000, the SEC adopted revisions to proxy solicitation rules in the context of take-over bids. The recommendation for further study as to whether Ontario should follow suit is only postponing the inevitable, but would be of little concern to the ICAC either way.

Recommendation

55. Nothing has come to our attention that would support the need to regulate arrangements and take- over bids in an identical fashion. We believe that, as a matter of public policy, parties to commercial transactions should have the freedom to structure transactions to achieve their business purposes so long as these transactions, and the legislation that governs these transactions, are fair to all interested parties. The Committee notes that it is especially important to harmonize take-over bid regulation across the country and encourages the CSA to adopt a harmonized approach with respect to these issues.

ICAC Comments

The issue here is the structure the bid takes often dictate to whom the acquirer deals with in the transaction. If it is an amalgamation, they deal with the B of D and seek shareholder approval after vs dealing directly with shareholders in a take-over situation. They are not regulated the same. The ICAC would agree with the recommendation.

Recommendation

55. The Commission should consider preparing a policy statement setting out guidance as to when in a take-over bid a poison pill must be terminated.

ICAC Comments

The issues are often required to be reviewed in the context of the specifics of the case and often end up in the courts. The recommendation is to leave the issue to be reviewed under the current common law and regulatory environment but would invite further comments. In regard to "poison pill" defensive tactics, the recommendation is to inform all reporting issuers and management of the guidelines and existing standards the commission uses today. The ICAC would agree.

Recommendation

56. Commission and the CSA should introduce a requirement for all publicly offered mutual funds to establish and maintain an independent governance body. This body should have the right to terminate the mutual fund manager when, in the reasonable opinion of the independent directors, there is cause, including poor performance of the fund, or where the manager has placed its interests ahead of those of unitholders of a mutual fund through self-dealing, conflict of interest transactions or breach of its fiduciary obligations.

ICAC Comments

The committee has done extensive review of the conflicts they see as inherent in the Manager and the Fund structure in the fund industry. They reviewed the Report of the Canadian Committee on Mutual Funds and Investment Contracts (1969), the Stromberg Report, The IFIC Steering Group and the recent CSA report and Concept Proposal. They also reviewed the extensive submissions on the matter, which were generally supportive. They cite that most major jurisdictions other than Canada have some form of mutual fund governance. One of the big issues they reviewed was whether the Board should have the right to terminate the Manager, knowing that they founded, organized and sponsored the fund. The recommendation was to allow the Board this power where there is (i) cause (including poor performance) or (ii) when the interests of the manager have been placed ahead of the interests of unitholders through self-dealing, conflict of interest transactions or breach of fiduciary obligations.

ICAC is concerned that the CSA may move forward with the fund governance requirement before it is ready to implement changes to the existing prescriptive regulatory regime, specifically 81-102. Such an additional laying of regulatory cost would be entirely inappropriate and unjustified. The primary problem with many of the existing prescriptive rules, as acknowledged by the CSA in their Proposal, is not that they don't in fact address the policy issues that they were designed to address but simply that they are too inflexible. As a result, imposing a fund governance regime that would address many of these same policy issues prior to eliminating the relevant prescriptive rules would be inappropriate. It is essential that if the Regulators intend to move forward with the fund governance regime, the committee needs to push the CSA to expedite its work on the product regulation pillar so that the two may be implemented contemporaneously. The outstanding issue is whether the same policy needs to be implemented for non-prospectus pooled funds which today fall outside the regulatory regime.

Recommendation

57. We recommend that the process by which potential directors of mutual fund governance bodies are identified and nominated be expanded so as to include a broader range of potential directors. We further recommend that the majority of directors be independent of the management company.

ICAC Comments

The ICAC feels that it would be extremely difficult to recruit qualified members for a governance agency at a reasonable cost. The degree of difficulty will be contingent upon the exact roles expected of these members. With no cap on the liability that the member will be assuming, it is likely to become extremely expensive to recruit qualified people. The Committee is silent on this issue. It is our opinion that corporate directors are generally subject to unlimited liability and see no reason why the same should not be the case for fund governance agency members. We would note however that the "business judgment rule" which has been developed by courts over the years offers very clear guidance to corporate directors on the steps they must take to ensure they have satisfied their duty of care. Fund governance agency members however are being asked to assume a fiduciary duty in respect of which there is absolutely no judicial or other precedent to which they can look for guidance. Also, the availability of adequate directors' and officers' insurance and errors and omissions insurance and the cost for those types of coverage and at what cost is an issue that should be dealt with before any proposed changes to any existing regulations. Limiting the liability of these governors would help reduce the overall cost and help to obtain the proper insurance coverage that would be required but it would still not dramatically increase the pool of qualified people.

With respect to training courses to help increase the pool of qualified people, we do not feel that this is necessarily a viable option. Depending on the overall responsibilities of the governors outlined, we consider training to review the investment performance of investment managers a challenging one as portfolio managers themselves spend years being educated and trained to perform this function. This is recognized in the proficiency requirements that must be satisfied by individuals wishing to register as advisers. Members may be ultimately required to rely on the opinions of experts which would also add to the overall costs of maintaining a governance agency.

Recommendation

59. We believe that it is important to identify certain fundamental responsibilities of the mutual fund governance body. We believe these responsibilities should include, at a minimum, overseeing the establishment and implementation of policies related to conflict of interest issues; monitoring fund performance, fees, expenses and their allocation; ensuring compliance with investment goals and strategies; reviewing the appointment of the auditor; and approving changes to investment goals and strategies and approval of material contracts

ICAC Comments

The ICAC cannot determine whether the benefits of the recommendations will outweigh the cost because we believe that the costs have not been clearly and accurately considered. The cost of the Governance Board will be born either by the individual investors or by the fund managers. The CSA Proposal estimates the average cost will be about 16 bps, however, it is felt that these numbers could be low. We do not know what the cost of insurance would be. We do not know the availability of qualified people to participate on these governance agencies and as a result the type of remuneration that would have to be paid.

There are many fund managers who absorb a significant portion of the expense of running their funds because adding all costs to the MERs would negatively impact the managers ability to attract new money into their fund. Even if the 16 bps estimate is accurate, the ICAC expects the result of forcing a governance agency upon small mutual fund groups may be to undermine the viability of their businesses. Small managers should therefore be given the option of remaining subject to the existing prescriptive regime or adopting a fund governance agency if the additional flexibility that should accompany the adoption of a governance agency makes it viable from a cost perspective for them to do so. There is a real possibility that forcing a governance agency upon some small managers could result in the piling on of additional costs which could severely impair their ability to compete within the marketplace. Also, increasing the MER's of existing funds could have a large negative impact on current unitholders. Unitholders who are quite happy with their fund managers will not perceive any additional benefit to them by this change in regulatory structure and will only see the negative side of it which would be the increase in expenses.

Any change in current regulatory structure should be done within a framework of reducing expenses by simplifying the regulatory regime and harmonizing it, not by adding new layers that will increase costs.

Part 6 – Enforcement

Recommendation

62. The Commission be given the ability to impose an administrative fine of up to $1 million per contravention.

The Commission be given the power to order the disgorgement of profits made by a respondent as a result of contravention of Ontario securities laws.

In the case of an administrative fine or disgorged profits, the money will paid into the Consolidated Revenue Fund, unless designated for allocation to or for the benefit of third parties in furtherance of the purposes of the Act.

ICAC Comments

ICAC generally supports the expansion of the Commission's powers to impose an appropriate remedy in all enforcement situations. Accordingly, we are in favour of the Commission's ability to impose an administrative fine (consistent with the powers of the securities regulators in British Columbia, Alberta, Saskatchewan, Manitoba, Quebec and Nova Scotia, as well as in the United States and the United Kingdom) and to order the disgorgement of profits. We agree with the recommendations relating to the application of monies paid as an administrative fine or disgorged profits

Recommendation

65. The Commission monitor the exercise by the Financial Services Authority in the United Kingdom of its new ability to order restitution to determine the practicality of giving such a power to the Commission.

ICAC Comments

ICAC supports the monitoring of the Financial Services Authority's ability to order restitution with a view to revisiting whether a similar power would be an appropriate remedy for the Commission

Recommendations

67. A national complaint-handling system should be established in which participation by financial services providers is mandatory. The system should be independent of government and industry, provide information and general guidance on the process and have a centralized system for handling calls and compiling and recording statistics. There should be an

Ombudsman with authority to make binding decisions on the financial services provider but not the investor.

68. A similar national system for dispute resolution should be established.

Transparency is encouraged in connection with such programs as well as the publication of statistics relating to the use of the programs and particulars concerning the outcomes of cases or the resolutions of complaints.

SROs should be required to have their members participate in and agree to be bound by any national complaint-handling system as well as any industry-sponsored dispute resolution program which may be applicable.

ICAC Comments

ICAC is in favour of an independent, national complaint-handling/dispute resolution system and agrees that the National Financial Services OmbudService will meet the Committee's criteria, so long as there is co-ordination between such OmbudService and any other Ombudsman's office that our member firms may be subject. We believe that the reference to inclusion of an Ombudsman as a part of the national complaint-handling system may more properly belong in the national dispute resolution system.

We would suggest that the recommendations relating to publication of statistics and particulars concerning the programs be subject to compliance with federal and provincial privacy laws.

Recommendations

72. The Commission be given the authority to order

- **a person resign not only his/her position as director or officer of an issuer but also as director or officer of a registrant or as a manager of a mutual fund,**
- **a person be prohibited from becoming or acting as director or officer of an issuer, registrant or manager of a mutual fund,**
- **a person or company be prohibited from becoming or acting as manager of a mutual fund or as a promoter, and**
- **a person or company be prohibited from engaging in touting of securities or promotional activities relating to the purchase or sale of an issuer's securities.**
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73. The Act be amended to include a definition of touting of securities or promotional activities, similar to the definition of "investor relations activities" in the *Securities Act* (British Columbia).

ICAC Comments

ICAC supports broadening the Commission's powers to authorize ordering a person/company to resign as officer or director of a registrant or as manager of a mutual fund, or be prohibited from becoming or acting as officer or director of a registrant or manager of a mutual fund or acting as manager of a mutual fund or as a promoter. We are also supportive of the recommendation that the Act be amended to include a definition of touting of securities or promotional activities and that the Commission be authorized to order that a person or company be prohibited from engaging in such activities.

Recommendation

76. The courts should be allowed to increase the maximum fine to $5 million and to increase the maximum term of imprisonment to five years less one day.

ICAC Comments

As noted above, ICAC generally supports the expansion of the Commission's powers to impose appropriate enforcement remedies. We are in favour of the proposed increase in maximum fine and term of imprisonment, which is reflective of developments in the marketplace since the last changes to the general penalty provision in 1987.

Recommendation

80. The Act be amended to expressly prohibit market manipulation and fraudulent activity.

ICAC Comments

ICAC agrees that market manipulation and fraudulent activity should be expressly prohibited in the Act

Recommendation

81. The Act be amended to prohibit a person or company from making a statement, written or oral, that the person or company knows or reasonably ought to know is a misrepresentation. Consideration should be given to whether it is appropriate to limit this prohibition to statements made "with the intent of effecting a trade" in a security.

ICAC Comments

We agree with the recommendation to prohibit the making of an oral or written statement that is known or reasonably ought to be known to be a misrepresentation.

Recommendations

84. The CSA reduce the time periods for reporting trades by insiders from the current 10 days from the date of the trade once SEDI is fully operational.

85. Ontario securities laws be amended to require insiders to report any effective change in, or disposition of, their economic interest in an issuer.

ICAC Comments

ICAC also supports the reduction of time periods for reporting trades by insiders and the requirement for insiders to report any effective change in, or disposition of, their economic interest in an issuer.