IFIC
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Five Year Review Committee
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Re: IFIC Response to 5-Year Review of Securities Legislation in Ontario

The Investment Funds Institute of Canada ("IFIC") appreciates the opportunity to offer comments on behalf of its members with respect to the Five - Year Review Committee Draft Report (the "Report").

IFIC is the member association of the investment funds industry in Canada and its members currently manage assets representing almost 100% of all open-end mutual funds in the country. Membership includes mutual fund management companies, retail distributors and affiliates from the legal, accounting, and other professions.

General Comments

Prior to making our specific comments on the Report, we wish to note our concern at what we perceive to be the continued use of "single jurisdiction" initiatives that do not consider our regulatory framework as a whole. These proposals devote considerable time and expertise to detailed examinations of parts of our overall regulatory framework or develop proposals for significant regulatory reform without first having had the benefit of broad consensus from the various provincial securities commissions. The time that is taken to develop these single initiatives is paralleled by that which must be invested by interested parties in considering and responding to each paper individually while attempting to ensure that a full and accurate assessment of their collective impact on our current regime is reflected in each response.

The current process of developing proposals and issuing requests for comment continues to foster the notion of a regulatory framework that is administered by 13 separate and unrelated jurisdictions. Problems are framed and solutions are proposed in a piecemeal manner by bodies that continue to view these initiatives from the perspective of individual regulators with disparate agendas and interests. This approach

perpetuates a mindset that is one of the most significant impediments to our goal of a more unified regulatory framework.

Each provincial regulatory authority is capable of issuing interpretive guidance that can modify the spirit and substantive impact of many rules. Legislated efforts to streamline our regulatory framework may thus be of little use unless we engage the primary task of considering ourselves to be more similar than different with a common welfare and united interests. We must therefore recognize that our substantive problems are common and that the proposal and development of solutions to these problems must likewise be so.

We recognize that the initial mandate of a proposal or review may be narrow, specifically contemplating a review or the thoughts of a particular jurisdiction. However, the need for an increased coordination of efforts is driven by the multi-jurisdictional nature of the business that is conducted by firms on a daily basis.

Market participants in the Canadian investment funds industry do not and cannot afford to restrict their operations to a single jurisdiction. The majority of firms conduct business either inter-provincially or nationally, thereby becoming necessarily subject to the laws of multiple jurisdictions. It is in this context that the inefficiencies of introducing and promulgating single jurisdiction initiatives are most acutely felt. These inefficiencies cannot be avoided or ameliorated on an opt-out basis as firms that, as a matter of economic necessity, need to operate in multiple jurisdictions cannot afford to ignore the laws or proposals of any one of them.

The goals that we hope to accomplish by rationalizing and unifying our regulatory framework will need to be preceded by a significant change in the way that regulatory authorities think about and address issues confronting our industry. We note that this change, notwithstanding much talk on the subject, has yet to occur.

We wish to emphasize that the resolution of a problem depends upon how and in what spirit it is approached. We hope to provoke thought and serious reflection as to the divergence between the bold and new directions in which we hope to guide our regulatory framework and the approaches to problem solving that are currently being used to try to achieve these ends.

The Need to Streamline the Rulemaking Process

Length of Comment Period

The Report notes that Ontario prescribes a 90 day initial comment period for rules and a 60 day initial comment period for policies and in doing so provides longer periods for public comment than any other jurisdiction. The Report goes on to recommend that Ontario's 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.

We disagree with this recommendation and are of the opinion that Ontario's 90 and 60 day comment periods should be preserved.

The submission of informed and detailed comment is important at every step of the development process of a proposed regulatory initiative. This is particularly true with respect to comments that are submitted at the preliminary stages and it is only by providing informed comment from the outset that the securities industry, being most affected by the exercise of rule-making power, has a meaningful way of having its practical experience considered.

The development of submissions by industry associations and others representing groups of stakeholders is an involved and time-intensive undertaking that must incorporate a consideration of how a problem has been framed by regulators, the validity of the regulatory approach propounded and the mechanics of the proposed regulatory initiative.

To engage in this process, significant issues must be brought to light and members of the industry must be solicited and actively engaged to comment in a formal manner. As you are aware, the market participants that comprise the mutual funds industry in Canada are not a homogeneous group and vary with respect to their size, resources and market positions. We must therefore ensure that their multifaceted perspectives are given adequate and coherent expression and representation in the development of our comments.

It is already difficult to engage in this process and develop meaningful and fulsome submissions when the proposed initiatives are of significant impact. We think it inappropriate for the Ontario Securities Commission (the "Commission") to pursue expediency at the cost of a full and complete public discussion of an issue. Reducing the comment periods currently allowed would serve only to limit the time available for affected parties to engage in a complete and meaningful analysis and this would consequently relegate industry perspective to comments that are either insignificant or superficial. Ignoring or not allowing sufficient time for meaningful industry input at the preliminary stages of a regulatory initiative can lead to significant problems in its development and result in added and unnecessary transactional costs and resource inefficiencies in the industry that will ultimately be borne by Canadian mutual fund investors.

Functional Regulation

There is no continued justification for the uneven regulation of products that are functionally equivalent. This circumstance continues to prejudice mutual fund investors in Canada as it is our industry alone that is subject to the most stringent and prescriptive regulatory framework and therefore the most expensive for retail participants.

We thus generally endorse a move towards functional regulation as necessary to ameliorate the currently insupportable multiplicity of regulatory standards but note that we would require more information and detail as to the proposed scope of such initiatives and how they would be implemented.

Blanket Rulings and Orders

The Report recommends that legislation be amended to allow the Commission to issue blanket rulings and orders that provide exemptive relief only. The Report further indicates that such orders should be granted on an interim basis and subject to a sunset period of three years after which time they would automatically expire unless converted sooner into a rule.

We support these recommendations and find them to be timely suggestions that are appropriately limited in scope. Part of the Commission's mandate is to ensure and foster fair and efficient capital markets. Capital markets are by nature fluid and the mutual funds industry in Canada moves at a rapid pace. It is thus essential that the Commission have the ability to exercise its power to grant discretionary relief on a broad and general basis with respect to a class of cases that involve similar or identical facts. This would enable the Commission to expeditiously grant immediate relief to the present needs of the industry and allow it to become a more efficient and responsive regulator and not fall behind the industry that it regulates. The ability to issue blanket orders and rulings as an interim measure would allow the Commission to address industry concerns quickly while not compromising the ability of the Commission to take the appropriate time to develop and promulgate comprehensive rules.

We note in passing that the ability to grant blanket exemptive relief is one that the Commission would already seem to be vested with pursuant to section 143.2(5)(b) of the *Securities Act* (Ontario) (the "Act") (Publication – exceptions to notice requirement).

This section enables the Commission to forgo publication in its Bulletin of a notice if the proposed rule grants an exemption or removes a restriction and is not likely to have a substantial effect on the interests of persons or companies other than those who benefit under it.

The Commission could issue, without having to publish, rules generally exempting market participants from regulatory requirements. This would also obviate the need for market participants to seek separate rulings or orders on an ad hoc basis and we are of the view that having recourse to this existing ability would achieve the substantive purposes of the proposal.

Access-Equals-Delivery: Increasing Availability of Technology Should Mandate a Move Towards Greater Reliance on Provision of Information Through an Access-Based Model

Provision of information through an electronic and access-based model would by necessity, bring with it a greater degree of involvement on the part of mutual fund investors and we think this to be appropriate. Investors would have to decide what materials they wanted access to and take responsibility for accessing this information.

Investor involvement and responsibilities would increase with a move to an accessed-based model but the obligations that they would undertake are not onerous and we think it important for investors to assume a more active role in becoming informed about their mutual fund investments.

We are of the opinion that investor protection is enhanced through education that fosters investor empowerment and self-sufficiency by providing investors with the tools necessary to take a more active role in their investment affairs.

Regulation of Market Participants

Registration Requirements Related to Trading

The Report recommends that registration requirements related to trading be moved to a model requiring the person or company to be "in the business" of trading. The Report notes that this change would only be supported if it were adopted across the country.

We concur with the reasons articulated in the Report and fully endorse this recommendation. The current definition of "trade" or "trading", as set out in section 1(1) of the Act is over-broad, particularly subsection (e) that makes reference to acts "in furtherance of a trade". The Report's recommendation, in our view, would address the core difficulties brought about by the current definition of "trade". Moving to a nationally adopted registration requirement based upon being "in the business of trading" would do much to simplify regulation by removing the need for numerous exemptions for particular types of trades.

Financial Planning Activities

The advising activities undertaken by people holding themselves out as various types of "financial planners" continues to be of concern to us as individuals who are currently registered in a restricted category of dealer are adopting titles that may mislead the public as to their actual experience and expertise.

We agree with the need to impose proficiency requirements upon any registrant who chooses to adopt a title that conveys that financial planning or similar objective, comprehensive and integrated personal financial advice is offered.

To this end, we endorse and are generally supportive of the spirit underlying the enactment of the Canadian Securities Administrators Multilateral Instrument 33-107 "Proficiency Requirements for Registrants Holding Themselves Out as Providing Financial Planning and Similar Advice". We believe that all registrants must be subject to defined and appropriate standards of proficiency and qualification with respect to the particular advisory or trading activities that they undertake to provide.

Universal Registration

We support the proposed amendment of the Act to eliminate the universal registration requirements. We are of the view that any benefits to investor protection are nominal and significantly outweighed by the system's undue complexity and, more importantly, by the fact that it stands as a significant impediment to the goal of a standardized regulatory framework.

Mutual Fund Governance

Independent Governance Agencies

Please refer to the introductory remarks in the IFIC Response to CSA Mutual Fund Governance Concept Proposal 81-402 (dated June 4, 2002) which briefly canvass our general thoughts on the concept of independent governance (copy attached for your reference).

Recruiting Qualified Mutual Fund Directors

We agree that the requisite combination of experience and understanding do not necessarily inhere exclusively in senior executives at the level of chief executive officer and that there may be value in expanding the available talent pool.

The introduction of an independent governance regime for mutual funds in Canada will be a novel undertaking and the first groups of directors will have to negotiate significant challenges while having little in the way of historical precedent to guide them in the appropriate discharge of their duties. The success of this regime particularly in the early stages of its implementation will therefore depend heavily upon the stewardship and initiative of seasoned and well-experienced individuals. Directors will have to implement independent governance in a manner that is restrained so as to avoid an inappropriate intrusion into fund management activities while at the same time ensuring that the governance function fulfills a meaningful and productive role.

Regardless of the available applicant pool, we think that the prospect of unlimited liability will be a significant deterrent to the recruitment of appropriately qualified individuals and insofar as it bears upon the present discussion, we reiterate the need to adopt a cap on director liability.

Governance Agency Member Compensation

We are of the opinion that compensation paid to members of independent governance agencies should be set by the manager exclusively or at the very least jointly by both the manager and governance agency members.

Please refer to pages 11-12 of Appendix “A” of the IFIC Response to CSA Mutual Fund Governance Concept Proposal 81-402 (“ Appendix “A” ”) (Cost Consequences Arising from Unlimited Liability – Salaries of Governance Agency Members) for a further discussion of our views on governance agency member compensation (copy attached for your reference).

Access to Independent Advisors

The Report recommends that members of a governance body be given the right to retain counsel independent of counsel of the fund manager along with the right to retain other independent advisors.

From our perspective, subjecting governance agency members to the prospect of unlimited liability will render inevitable the retaining of multiple independent experts from various disciplines (i.e. accountants/lawyers) along with a reluctance to act without their prior written opinion/sign off.

In recommending that governance agency members have the ability to secure the services of independent professional advisors, sufficient cognizance has not been taken of the fact that these expenses will be significant and borne by fund investors.

Ability to Terminate the Manager

The Report recommends that the proposed independent governance body be given the right to terminate the fund manager with cause.

We strongly disagree with this recommendation and wish to note that its negative implications, including the potential ability of governance agency members to subvert investor choice, considerably outweigh any perceived advantages that might obtain by granting a governance agency the ability to terminate the fund manager.

Please refer to pages 13-14 of Appendix "A" (Power to Call for the Termination of the Manager) for further discussion of our views on this issue.

Functions of a Governance Body

Among the recommended functions of a governance body, the Report lists "ensuring compliance with investment goals and strategies".

Governance bodies will be charged with the responsibility of engaging in oversight of the fund manager and, in the exercise of this function, may set policy and hear and review reports. However, the appropriate role of any governance body is to ask, in a meaningful way, that the fund manager test itself for compliance with its own policies and procedures and in our view such testing is appropriately limited to receiving compliance reports from the manager. It is beyond the scope and purpose of a governance agency to "ensure" the conduct of the fund manager with respect to compliance with its investment goals and strategies. We think that any action on the part of the governance agency to do so would be inappropriate as micro-management of the activities of the fund manager.

Enforcement

New powers that the OSC should be given – Orders of Compensation

The Commission currently has no authority under the Act to make a restitution or compensation order. The Report notes that this is consistent with the objective of regulatory legislation in general and the Commission's public interest jurisdiction that is protective and not remedial.

We agree and think this to be an appropriate limitation to the scope of the Commission's jurisdiction.

On June 21/02 we made submissions to Scott Smith, Minister of Consumer and Corporate Affairs commenting on the amendments contained in Bill 24 – The Securities Amendment Act, that proposed conferring upon the Manitoba Securities Commission (the "MSC") the authority to order compensation for financial loss. We indicated that we believed the ability to order compensation for financial loss in civil matters to be an essentially judicial function that would be inappropriate to the MSC in its capacity as an administrative/regulatory body and outside of the jurisdiction of the province of Manitoba to delegate. In our submission we cited the decision in *Reference re: Residential Tenancies Act 1979 (Ontario)* (reaffirmed in 1996 in *Reference re Amendments to the Residential Tenancies Act (N.S.)*) as stating that powers that remain essentially judicial may not be delegated to an administrative or regulatory body as such powers falls within the exclusive jurisdiction of a section 96 federally appointed court.

We maintain our position that the ability to order compensation for financial loss in civil matters is an essentially judicial function that we believe to be outside the jurisdiction of the province of Ontario to delegate to the Commission in its capacity as an administrative/regulatory body.

Broadening Existing Powers of the Commission: Granting Ability to Order Resignation as Director or Officer; Prohibit from Becoming or Acting as Director, Officer, Mutual Fund Manager or Promoter

We endorse any steps that are taken towards greater consistency and uniformity in the treatment of all market participants and, as a consequence, have no objection to registrants and mutual fund managers being included along with officers and directors of issuers who are already subject to this authority.

However, we doubt that additional benefit would obtain by adopting this proposal as we believe it to be redundant in light of the Commission's existing ability to convene a hearing with respect to the affairs of any person or company as set out in section 8 of the Act.

We note that as a practical matter, the Commission is not required to grant receipt to a prospectus. It may refuse receipt at first instance and also has the opportunity to reconsider or render any other decision that it considers proper, pursuant to the review power set out in section 8(3) of the Act.

By this means, the Commission is already vested with the ability to withdraw its approval and thereby discipline registrants and mutual fund managers if it is of the view that a prospectus was receipted with improvidence or in a manner contrary to the public interest.

Establishment of a National Complaint Handling System

The Report recommends the establishment of a national complaint-handling system.

We are of the view that the Report's recommendations in this respect are redundant and note that the Report references the creation of National Financial Services Ombudservice, now the Centre for the Financial Services OmbudsNetwork ("CFSON").

The CFSON already has a mandate to provide more than 95% of Canada's financial services consumers with single-window access to recourse if they have concerns or complaints. Moreover, the CFSON will provide infrastructure and support to the complaints-handling process with minimal duplication of effort or resource as it will capitalize and build upon consumer redress mechanisms that are already in place and well established. We do not, as a consequence, believe that there is any necessity for the establishment of another complaint-handling system.

Publication/republication of "material" changes for comment

The rule-making authority of the Commission requires it to publish rules in draft form for comment. The Act, ss. 143.2(7)-(9) expands this primary obligation by further stipulating that draft rules must be republished if any material changes are made from a previously published version.

A determination as to what constitutes a material change is left to the exclusive discretion of the Commission and this enables the Commission to unilaterally determine whether changes in a proposed instrument merit republication for comment. We find this process to be problematic as it affords regulatory authorities the opportunity to potentially drive through controversial rule changes while limiting industry review and comment.

An assessment of materiality must be made on the basis of a comprehensive understanding of the implications of a rule change, including a review of its actual and potential cost consequences. We are of the opinion that the Commission should encourage and foster active and early industry consultation when determining the materiality of changes as exposure to the operational knowledge and practical experience that the industry has amassed will better assist the Commission in making more informed decisions.

An Illustration: National Instrument 33-102

As an example we wish to cite the process leading to the finalization and implementation of National Instrument 33-102 – Regulation of Certain Registrant Activities ("NI 33-102"), a national instrument of the Canadian Securities Administrators ("CSA") that was adopted by the various provincial jurisdictions and that became effective August 1, 2001.

The matter at issue concerned the consent that must be obtained for retail client information that may be collected and used by a registrant. The CSA were of the view that a fair reading of already published versions of NI 33-102 would lead to the conclusion that positive consent was required. The CSA maintained that additional sections explicitly requiring positive consent that were included for the first time in the final version without republication were added simply to remove any doubts with respect to the CSA's position.

The industry was of a different view and had concluded that the previous draft did not require positive consent in all circumstances. This change, in our view, was a material one that should have been republished for comment.

Without revisiting this issue in greater detail, we wish to note that it illustrates how the industry under the present system has little recourse but to raise its concerns after the fact if it disagrees with a regulatory authority and believes that an unpublished and now formalized change was material. The only other available option is resorting to an escalation of the issue to the ministerial level, which is unpalatable except in the most egregious circumstances.

The various securities commissions should determine the threshold issue of materiality of changes in conjunction with the industry. We believe that it is both timely and appropriate to address this serious problem and thereby take greater cognizance of the fact that the impact of a new rule does not end but rather only begins with its promulgation.

Transparency of Regulation in Ontario:

The Report calls for a greater need in the transparency of regulation in Ontario and urges the Commission to publish exemption orders granted from the requirements of securities rules. The Report also suggests that the Commission consider providing notice when exemptive relief applications are not granted and the reason for refusal so as to "level the information playing field among all market participants".

We endorse both of these propositions and are of the opinion that requirements to publish exemption orders/applications should apply to both the Act and Rules. We note, in addition, that these measures would go a long way in improving and disciplining the Commission's decision-making process.

Further Information

Should you wish to discuss any aspect of our submission in greater detail, please feel free to contact John Mountain, Vice-President, Regulation by telephone at (416) 363-2150 x 271 or by email at jmountain@ific.ca or Aamir Mirza, Legal Counsel at (416) 363-2150 x 295 / amirza@ific.ca.

Yours truly,

ORIGINAL SIGNED BY THOMAS A. HOCKIN

Honourable Thomas A. Hockin
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