

MEMO# 14613

April 8, 2002

CANADIAN REGULATORS PROPOSE NEW FRAMEWORK FOR THE REGULATION OF MUTUAL FUNDS IN CANADA

ACTION REQUESTED [14613] April 8, 2002 TO: INTERNATIONAL COMMITTEE No. 27-02 RE: CANADIAN REGULATORS PROPOSE NEW FRAMEWORK FOR THE REGULATION OF MUTUAL FUNDS IN CANADA Last month, the Canadian securities regulators (CSA) published a concept proposal on a new framework for regulating the Canadian mutual fund industry.¹ The concept proposal, a copy of which is attached,² focuses on five areas: (1) registration of mutual fund managers; (2) mutual fund governance; (3) product regulation; (4) disclosure and investor rights; and (5) regulatory presence. Each of these elements is briefly summarized below. The Institute is considering whether to comment on this concept release. Comments must be submitted by June 7, 2002. If there are issues that you would like us to consider addressing in a comment letter, or would like to be included in any discussions with members about the proposals in the concept release, please contact me (202-371-5430; rcg@ici.org) before Friday, May 10, 2002.

Registration of Mutual Fund Managers The concept release proposes the creation of a new registration category specifically for mutual fund managers. The conditions of registration would impose new minimum standards on mutual fund managers, including minimum proficiency standards for senior executives and minimum capital and insurance requirements for the firm. The CSA has requested comment on all of these standards, including whether minimum capital requirements should be imposed on fund managers and, if so, in what amounts. Under current law, mutual fund managers are only registered with securities commissions if they trade in fund securities (acting as dealers) or manage the assets of 1 Concept Proposal 81-402, "Striking a New Balance: A Framework for Regulating Mutual Funds and their Managers" (March 1, 2002). The concept proposal was issued by the Canadian Securities Administrators, an umbrella organization comprised of the thirteen provincial and territorial securities regulators in Canada. 2 The release also is available on the Internet. See http://www.osc.gov.on.ca/en/Regulation/Rulemaking/Notices/conceptpro/cpro_81-402_20020301_proposal.pdf.

2 individual funds (acting as advisers or portfolio managers). Some mutual fund managers are not registered at all because they do not themselves carry on these activities. Under the concept release's proposal, a fund manager would not have to separately register as a dealer or adviser. The conditions of registration for fund managers would include standards applicable to those fund managers acting as dealers or advisers.

Mutual Fund Governance The concept release proposes a new fund governance regime designed to ensure independent oversight of mutual fund managers and minimize conflicts of interest. The CSA called this proposal the "centerpiece" of the proposed regulatory framework. The proposal would require a "governance agency" to oversee the fund manager. It would not require that each mutual

fund that is sponsored or advised by the manager have a separate governance agency. The governance agency would have to be comprised of at least three individuals, with a majority being independent of the fund manager. In general, the governance agency would have a minimum set of prescribed duties and responsibilities, with the flexibility to develop other responsibilities and procedures.³ The existence of the governance agency would not affect the fund manager's duty of care – fund managers would continue to be bound by a standard of care that requires them to act in the best interests of the mutual fund, and would continue to be responsible for the actions of service providers. The concept release describes eighteen specific areas with respect to governance on which comment is requested, including the appropriate number, independence, responsibilities, liabilities, election, compensation, and training of governance agency members. In addition, the concept release acknowledges that this governance proposal is not the only way to protect the interests of fund investors, and specifically seeks comment on effective alternatives, including: (1) requiring the industry to develop best practice guidelines for fund governance; (2) creating enhanced duties for auditors or an enhanced role for regulators; and (3) requiring funds to adopt a governance regime but letting fund managers determine the appropriate structure of that regime.⁴

Product Regulation The product-level regulation of Canadian mutual funds would not significantly change under the new proposal. Instead, the concept release proposes to evaluate the detailed rules currently applicable to funds, and, where warranted, eliminate them or replace them with broader regulatory principles or guidelines.⁵ Each fund manager's governance agency would be required to monitor how these broad regulatory principles or guidelines are met by the fund manager.

³ See pages 21-23 of the concept release. ⁴ See pages 12-13 of the concept release. ⁵ See National Instrument 81-102 (Mutual Funds), which sets out detailed rules on investment restrictions and practices, seed capital, custody, sales and redemption procedures, and calculation of net asset values.

3 Disclosure and Investor Rights The concept release does not propose to change the disclosure regime currently applicable to mutual funds in Canada, although territorial and provincial regulators are presently considering changes designed to modernize the disclosure required of funds. The release notes, however, that as fund regulation is simplified, "disclosure to investors on the specifics of their investments becomes even more crucial." As in the US, investors in Canadian funds must approve certain fundamental changes with respect to the fund. The concept release proposes to re-examine the types of changes that would require shareholder approval and consider the possibility of substituting the approval of a regulator or the governance agency in some cases, such as the change of a manager resulting from indirect changes in control, or the change of a fund's auditor (both of which currently require shareholder approval).

Regulatory Presence The concept release proposes an "enhanced regulatory presence" by the territorial and provincial regulators, particularly through increased on-site examinations of mutual fund managers. Regulators would continue to review prospectuses and other disclosure documents and sales material.

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Attachment Attachment (in .pdf format)