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(Courtesy translation provided by the Québec Investment Funds Council. Please refer to the original French version for interpretation.)

Friday, December 9, 2005

Task Force to Modernize Securities Regulation in Canada
Suite 1600
121 King Street West
Toronto, Ontario
M5H 3T9

Attn: MrThomas Allen, Q.C.

Dear Sirs/Mesdames:

Re: Detailed comments regarding the Modernization of Securities Legislation in Canada

INTRODUCTION

It is our pleasure to answer your call and submit our comments for the public consultation on the Modernization of Securities Legislation in Canada. We would like to thank you for your invitation.

The Quebec Investment Funds Council (CFIQ) represents mutual fund managers and dealers of the mutual fund industry that do business in Quebec and administrate assets currently representing $75 billion. The CFIQ is the Regional Council of The Investment Funds Institute of Canada ("IFIC").

We would like to specify that our views and recommendations are to be interpreted in the mutual fund industry context in Quebec. We are aware that IFIC has previously presented to you its views on modernizing securities legislation.

The CFIQ believes that harmonization is necessary for the securities industry to improve its competitiveness. An important step has already been taken with the implementation of Rule 31-101 on a National Registration System which next phase will be to integrate some elements of the «Fair Dealing Model». We are nevertheless concerned by the fact that the Authorities are taking a perilous road which is to only consider securities and mutual funds, leaving aside all other sectors of the financial market which products are altogether comparable.

The risk, the biggest risk is to see investors turn to more « lightly » regulated products, bypassing the general provisions regulatory authorities are attempting to put in place. Inefficient regulation puts investors trust in peril, the foundation of our industry.

The financial sectors are interdependent and one can no longer think, for competitive means, that the difficulties of one product over the next are a good thing for the industry as a whole. In the consumer eye, these are all financial products and all sectors must join together to protect the investor. Regulators can no longer function with unequal parameters in a fragmented regime. One example of this situation is the Canadian Council of Insurance Regulators and the Canadian Insurance Services Regulatory Organizations which have begun a consultation process on industry practices. Their goal is to reduce the risk of conflicts of interest in the market and increase investors' confidence. In this sense, they will examine the commission structures of dealers and representatives. Isn't there some striking resemblance with the Registration Reform Project actually being considered by the CSA? Shouldn't we first consider the foundation of these unsynchronised initiatives?

Harmonisation in the context of mutual funds is two-dimensional:

1 – Fair treatment with respect to other financial products of similar nature (« level playing field »);
2 – Similar regulation between provinces to achieve greater simplification (Passport model).

These two dimensions must continually be taken into account in the analysis of any solution.

Regulation is carried by product, which brings products of similar nature to be regulated in different ways. The mutual fund industry is over-regulated when compared to other financial products of equivalent nature.

We will now answer the questions you have raised.

1. PROTECTING INDIVIDUAL INVESTORS:

a. Effective disclosure

(i) content of prospectuses and other disclosure documents – is the current prospectus useful or obsolete?

The greatest challenge of the 21st century is to deliver clear information in a sector where everything unfolds at instantaneous speed.

The simplified prospectus (for mutual funds) as we know it in its present state is obsolete. In a world where the instantaneity of information prevails, most people will not read the content of a document if it has more than two pages. France had an

effective model of concision by checkpoints, the « Notice AMF ». This past French model is similar to propositions that were made recently by British-Colombia. We do not find normal it should be so difficult to buy a diversified fund as opposed to securities of a company registered with the Stock Exchange. In the first case, the paper information are a burden where in the other case the investor has not to forget to ask for the annual report otherwise he/she will not receive it.

The simplified prospectus should only be filed with SEDAR (once completed) and on the issuer's Web site. It should not be handed systematically to each investor as only a brief summary, on two pages, should be given to him/her. The annual information form, the financial statements and other public information documents concerning the investment should also be remitted in the same fashion.

(ii) distinction between theoretical versus effective disclosure – how do investors really get their investment information in the 21st century?

The goal of the simplified prospectus, which is to provide information that is comparable and simple, is not reached for two reasons. Firstly, prospectuses are written by lawyers who use diminutive conjugations such as "can" or "could" whereas these words apply to systematic things or, even words like "in particular" or "without limiting the generality of the foregoing" which prevent to achieve the product's goal of simplicity and transparency. The prospectus is written by lawyers for lawyers and their aim is to avoid potential lawsuits and not of communicating the elements in a simple and clear way. The model imposed by National Instrument 81-101 has therefore not fully succeeded in its goal. Secondly, the prospectus is not read by the investor. Only a negligible group of mutual fund investors read the simplified prospectus.

The regulatory obligations relating to the prospectus make it impossible to give information in a simple and comprehensible wording. The investor considers the authorities role is to ensure that securities distributed in Canada are compliant with the regulatory requirements.

The investor also has a duty of due diligence. He/she must make sure with the assistance of an advisor, that the product is appropriate for him/her. This should be stated clearly in the opening documents (such as prospectus, brief summary, etc.).

Just like a car manufacturer would not consider giving to the customer a detailed document on the construction of a particular model, handing-over a document which will not be read does not make investors more sophisticated.

Should you have the idea of doing a survey – a probe of investors - to see how many really understand the financial product they buy, you may be quite surprised by the results.

The prospectus is public, intended for the public and first to the investor. Its primary goal is to help average investors understand mutual funds. It is secondly destined to the regulators and lawyers. The way the prospectus is written now does exactly the opposite. It favours lawyers and regulators to the detriment of its primary target: the investor. The regulatory authorities should stop granting the prospectus with so much virtue since it constitutes the greatest proof of the archaic nature of an obsolete and ill-adapted means of regulation.

We should go one step further and consider a standardized, simple document of a few pages that would apply to all financial product without exception (bank products, segregated funds, indexed notes, mutual funds, etc.) that would, at a glance, put into perspective the main characteristics and comparison points between products.

(iii) is there a more practical approach to communicating with retail investors?

The investor should, at the very least, have the choice of receiving the prospectus in electronic (downloadable from a Web site or request of an electronic copy) or paper format. Remittance of the prospectus should not be mandatory but the client should have the choice to elect receiving it on a voluntary basis (Section 29 of the Québec Securities Act). Moreover, continuous information should be available on the Internet site of issuers and the investor should be able to subscribe to their online broadcasting systems so that he/she is instantaneously informed of the latest developments relating to his/her investment and at the same time just like the market and medias.

(iv) what is the true role of the RR in an effective disclosure system?

The true role of a registered representative in an effective information system is the advice and knowledge of the products, the determination of the investor's profile as well as the suitability of transactions. The representative must assist the customer in his/her choices and recommend the adequate product that responds best to the client profile and that is adapted to his/her needs. The representative has the duty to put the interests of the customer in priority.

b. Sophisticated purchaser rules – who needs protection? Is wealth a proxy for sophistication? If not, is there a better definition?

Being a fortunate investor does not mean that one is automatically sophisticated, and vice versa, as some cases of litigation have proven. We could try to define the concept of "sophisticated investor" as one who owns many types of investments or that describes him/herself as such although we would need further time to consider the matter. A mix of knowledge, experience and minimum amounts seem adequate elements in this definition. We can not provide you with a definition but the concept of "sophisticated investor" as we know it from a regulatory viewpoint must be maintained.

c. Issues relating to hedge funds, as described in the recent IDA Regulatory Analysis of Hedge Funds report:

(i) application of exempt purchaser rules?

We believe that hedge funds should not be made available to the general public and that they should be subject to a minimal set of regulations. The regulatory authorities have the responsibility to provide a minimum framework in order to protect investors. Hedge funds frequently operate by overdrafts (and short positions). A note in the opening documents (such as the prospectus, brief summary, etc.) should clearly indicate, and in bold type, on the first page: "You can lose everything".

(ii) would registration be useful?

Please see previous answer.

d Should the role of technology be increasingly recognized in terms of communication, consent, privacy?

Yes, if the purpose of this technology is to simplify the communication of messages to make them more effective and to better serve the investor and the industry, making sure that there are economies of scale which are beneficial to the investors. One can think of transactions, order confirmations, statements of account and other personalized or public information memoranda. The mutual fund industry must set in place an efficient electronic system to transfer accounts which has not been done yet.

Consent must be given in an informed manner. Technology can improve understanding and be used as a gateway to the advisor according to the technological developments of market participants. The acceptance of the electronic signatures should also be considered, facilitating the communication and the processing of orders.

We think that the protection of privacy is well regulated by the *Personal Information Protection & Electronic Documents Act* (PIPEDA) **as well as provincial laws and we do not foresee the necessity to add another layer of regulation.**

e. Could a more user-friendly new account document be designed – who is responsible for deciding the risk appetite of the investor? Where does protection end and self-responsibility begin?

The risk profile of the investor should be determined by the representative, then reviewed by the compliance officer or branch manager of the dealership. The representative is responsible for those decisions although the investor is responsible for giving the correct information and for expressing his/her needs. Fund companies

have the responsibility for assessing the risk of a particular fund and for informing unitholders and its distribution channel when it is modified at a given time.

f. Should there be more robust disclosure of fees. In an era of low yields do fees represent a disproportionate % of available return to the investor? Is this simply a disclosure matter to be left to market pricing?

We believe that the administrative burden has, and will continue to have, a significant incidence on management fees. The Registration Reform Project, in the state of being presently elaborated, will have an impact on this aspect of mutual funds. The complexity of adding an element as opposed to its true usefulness for the investor must always be analysed seriously and taken into account. A greater transparency would be desirable but it should be harmonized between all financial products. The customer has the right to know what it costs him/her to hold, for instance, a guaranteed investment certificate, which is not the case at the present time.

We recommend transparency and harmonized transparency. There should be a standardized mandatory fee disclosure but not any mandatory quantitative schedules. Moreover, we question ourselves on the relevance to have management fees separate from operating expenses which may open the door to potential conflicts of interest.

All financial products (banks, insurance, mutual funds, linked notes and others) should be submitted to a standard fee disclosure (…and other "hidden" fees). Ideally, hidden fees should not exist. No one should pretend that a guaranteed investment certificate does not cost anything!

g. Should there be a periodic disclosure of investor's performance in account information?

We believe that this is a marketing and information element which should be left with the companies for these are competition and customer service matters while ensuring not to add undue pressure on the industry. On the other hand, the companies which would do it on a voluntary basis should have a standard to respect, after consultation with the industry. Harmonization must also be done in regards to the level of disclosure, and on the performance between similar products when they are comparable, such as for example between mutual funds and the segregated funds.

2. BALANCING COST AND EFFECTIVENESS OF MODERN GOVERNANCE

a. Cost benefit analysis of governance in Canadian context – can there be a Canadian context? To what extent are we in a North American market and concepts of a Canadian capital market are inappropriate?

Capital markets have become global even though the administration of regulation is, at first, local. Governance is the complement of regulation and works in parallel. Its applications must therefore be local and its source of inspiration can come from elsewhere.

Governance must remain effective and simple in order to obtain an interesting cost/benefit ratio since this cost is indirectly borne by the investor. This governance must be based on our own values and adapted to our economic and cultural context, among others. Even in this context, the governance model that is to be adopted must be inspired by internationally recognized principles.

b. Potential need for differentiated regulation, i.e., for small issuers, both in terms of an appropriate cut-off and nature of differences.

Regulation must be conceived according to the risks of conflicts of interest inherent of the organization, independently of its size. Regulation and its application must also take into account the inherent risk of the organization activities.

It is important to keep a regulatory environment that allows the thriving of free and healthy competition. The industry renews itself from innovations that come often from the small issuers. Therefore, regulation must be flexible to innovation and to small issuers.

c. Re-examination of governance requirements, in part in the light of rethinking of Sarbanes/Oxley in the US.

The mutual fund industry must give itself sound businesses and management practices which are effective, not too complex and less expensive. Fraud can not be controlled by governance.

One important aspect of governance that should be considered is to avoid the concentration of powers under one single individual. Processes must involve and spread the responsibility amongst many people at various levels. An annual reportdescribing the company processes and signed by the responsible manager would be a way to control this aspect.

The senior officer should be a person who is not the principal shareholder. This would have the consequence of putting the responsibility upon, at least, a second person's shoulders.

3. ACCESS TO CAPITAL – PROSPECTUS FILING REQUIREMENTS, INCLUDING EXEMPTION FROM THOSE REQUIREMENTS:

a. If investors gravitate to a market where liquidity is assured, what factors could be introduced or emphasised in Canada's markets to encourage investors to choose to

execute trades here rather than elsewhere (given a choice in an inter-listed stock)?

Not applicable to the mutual fund context.

b. If issuers gravitate to a market where their currency is efficiently valued, what factors could be introduced or emphasized in Canada's markets to encourage issuers either to list, or maintain their listings, in Canada?

Not applicable to the mutual fund context.

4. REGULATORY BURDEN:

The relationship between the representative and the investor is very regulated as well as the relationship between the representative and the product and the one between the issuer and the product. Strangely the relationship between the issuer and regulators are not so much regulated.

This thought is worth exploring even though it is not the responsibility of the authorities to judge of products quality. Nevertheless, the regulators are responsible for the follow-up of these products. Since market participants are unable to monitor their competitors, the authorities have that responsibility.

With the recent scandals, we have seen that the basics were not respected in off-shore investments, liquidity of assets, even the existence of those investments, and others.

We believe that legal and practical obligations of regulators would be worth considering.

a. Potentially greater role for a principle-based approach versus prescriptive rules-based regulation – in a litigious society is principle-based behaviour a pipe dream, with those asked to behave on principle increasingly seeking the safe harbour of rules? If so, and if principle-based behaviour is in fact desirable to avoid the arbitrariness of rules, what might be done to encourage principle-based behaviour?

The interpretation of principles evolves with the actions of society whereas rules are more static, controllable and with less grey areas. The spirit of the regulation must be guided by principles and its application by rules.

The present regulation, based on procedures, has created a disparity between different products, which in turn may put the representative and the dealer in possible conflicts of interest situations. This could lead to product arbitration, lower quality services, etc.

We must be clear: fraud and trust abuse will unfortunately always be. We need an efficient and simple regulation for the majority of the people who work within the system and an efficient and reactive one to detect and stop the minority that abuse the investors trust.

b. Meaningful attempt to reduce the overall paper-load for market participants, including dealers.

The National Registration Database, SEDAR and SEDI are measures that have helped to eliminate the administrative burden. Electronic commerce, as a whole, favours an important diminution of that burden and reduces paper. We should continue in this sense.

c. Regulatory burden generally, and the opportunity to adopt a more risk-based approach, especially in regard to direct regulation of market participants, the responsibility of SROs.

A risk-based approach is always adequate and has its reasons to be. This avoids imposing a large regulatory burden on the industry participants who have sound management practices.

5. ENFORCEMENT ISSUES:

Are expectations unrealistic? How could a more effective job be done? There is a direct correlation between the effectiveness of enforcement and the reputation of capital markets.

Mutual funds should have a simplified regulatory structure *vis-à-vis* other more complex products. Unfortunately, we see many of its areas where it is the opposite.

CONCLUSION:

Compared to similar products, investment funds are more, even too, regulated. There is an enormous amount of harmonization work to be done between the various financial products to create a "level playing field" in a healthy competitive market that treats the products and the investors fairly both in regards to protection and services.

There is a consensus, in Quebec and Canada, on the will to harmonize the rules between provinces. There is no unanimity, nor Quebec, neither in Canada, of a Single National Securities Commission. The CFIQ thus supports the harmonization of rules in the passport model such as it was ratified last year by the majority of the provinces.

On behalf of the board of directors,

French version signed by
Pierre Hamel
Chairman of the Board
Québec Investment Funds Council