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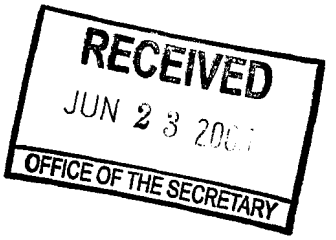

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June 22, 2005

Mr. Jonathan G. Katz
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

Re: File No. SR-NASD-2004-165; Notice of Filing of Proposed Rule Change and Amendment Nos. 1 and 2 Thereto Relating to NASD Rule 2790; Release No. 34-51735 (May 24, 2005); 70 F.R. 31554 (June 1, 2005).

Dear Mr. Katz:

On behalf of AGF Management Limited, AIM Trimark Investments, CI Mutual Funds Inc., Fidelity Investments Canada Limited, Franklin Templeton Investments Corp. and Mackenzie Financial Corporation, each of whom is an investment adviser to mutual funds, the securities of which are qualified for distribution under the laws of the provinces and territories of Canada (collectively, the "Canadian Mutual Funds"), we are submitting this letter in response to a solicitation by the Securities and Exchange Commission ("SEC" or "Commission") for comments regarding the above-referenced proposed rule change ("Proposed Rule Change") relating to NASD Rule 2790 ("Rule 2790" or "the Rule").[1]

One aspect of the Proposed Rule Change proposes to clarify when the NASD would consider the shares of a foreign investment company ("foreign mutual fund") to be "listed on a foreign exchange for sale to the public" such that the foreign mutual fund would qualify for the limited exemption granted to foreign mutual funds under that subparagraph 2790(c)(6) of the Rule (the "Foreign Mutual Fund Exemption"). The Canadian Mutual Funds are not commenting on the specific change being proposed by the NASD; instead, this letter comments on the Foreign Mutual Fund Exemption in general, and the negative and discriminatory impact of the Foreign Mutual Fund Exemption as it applies to the Canadian Mutual Funds.

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[1] Among other things, the Proposed Rule Change would amend subparagraph (i)(9) of Rule 2790 to exclude from the definition of "new issue" securities offerings of a business development company, a direct participation program, and a real estate investment trust, and would make a technical change to the exemption for foreign mutual funds in subparagraph (c)(6) to clarify the scope of the exemption as reflected in a recent staff memorandum.

Summary Comment.

The Canadian Mutual Funds submit that: (1) the Rule restricts the Canadian Mutual Funds from purchasing new issues, and otherwise creates undue burdens on the Canadian Mutual Funds, in violation of the terms of the North American Free Trade Agreement ("NAFTA") and (2) the SEC should decline to take action on the Proposed Rule Change until the NASD addresses and resolves the restrictions and undue burdens imposed on the Canadian Mutual Funds. In support of this submission, this letter discusses: (i) the burdens and the discriminatory treatment imposed on the Canadian Mutual Funds in complying with the Rule in comparison with U.S. registered mutual funds[2] as a result of the operation of the Rule; (ii) inconsistencies and misunderstandings of the facts and law that the NASD uses to justify the discriminatory treatment of the Canadian Mutual Funds; and (iii) the manner in which the Rule violates the obligations of NAFTA.

Requirements of Rule 2790.

The purpose of Rule 2790, like its predecessor, the Free-Riding and Withholding Interpretation, is to ensure that the benefit of initial public offerings ("IPOs") of securities flows to the public and not to securities industry insiders who might use their position to obtain shares in such public offerings to the exclusion or disadvantage of the general investing public. To achieve this goal, Rule 2790(a) prohibits NASD members and their associated persons from selling shares of "new issues"[3] of equity securities to accounts in which a restricted person[4] has a beneficial interest.[5] Underwriters or broker-dealers selling shares of IPOs ("selling brokers") are required to obtain a representation from purchasers that the account purchasing the IPO is eligible to purchase IPOs in compliance with the Rule.

Certain types of accounts or purchasers, such as mutual funds registered under the 1940 Act, are exempt from the prohibitions of the Rule and therefore are permitted to purchase IPOs without regard for whether any of their shareholders are restricted persons (the "U.S. Registered Mutual Fund Exemption").[6] Foreign public mutual funds, such as the Canadian Mutual Funds, on the other hand are permitted to purchase IPOs only if they identify beneficial owners who are restricted persons and determine that no restricted person owns,

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2 The term "U.S. registered mutual funds" refers to investment companies registered under the Investment Company Act of 1940, as amended (the "1940 Act").

3 The term "new issue" is "any initial public offering of an equity security," and includes IPOs made offshore in reliance on Regulation S. *See* Rule 2790(i)(9)

4 "Restricted person" includes most associated persons of a member, most owners and affiliates of a broker-dealer, and certain other classes of people. Rule 2790(i)(10). *See also* NASD Notice to Members 03-79, pp. 850-852 (December 2003) ("NTM 03-79").

5 A "beneficial interest" is any economic interest. NASD Rule 2790(i)(1). *See also* NTM 03-79, pp. 848-849.

6 *See* Rule 2790(c)(1).

individually, more than five percent of the shares of the fund.[7] Unregistered funds (e.g., hedge funds and private equity funds), *whether domestic or foreign*, are only permitted to purchase IPOs if they identify beneficial owners who are restricted and no more than ten percent of the shares in the aggregate are owned by restricted persons. Thus, with respect to their ability to purchase IPOs, only foreign public mutual funds such as the Canadian Mutual Funds are subject to disparate treatment in comparison with U.S. registered mutual funds under the Rule.

In addition, Rule 2790 requires NASD members who are managing underwriters or members of distribution syndicates to obtain agreements from non-U.S. broker-dealers who are selling shares of IPOs in foreign countries as syndicate participants or selected dealers that such non-U.S. broker-dealers will sell shares consistently with the requirements of Rule 2790.[8] Thus, any U.S. or foreign broker-dealer participating in an offering syndicate for an IPO would be required to comply with the Rule in order to sell shares of the IPO to any account, including the Canadian Mutual Funds.

Burdens and Discriminatory Treatment Imposed on the Canadian Mutual Funds.

To meet the conditions of the Foreign Mutual Fund Exemption under the current Rule, a foreign mutual fund such as the Canadian Mutual Funds must identify all of the restricted persons owning shares of the fund in order to determine if any of them own more than 5 percent of the fund's shares.[9] As applied to large foreign mutual funds such as the Canadian Mutual Funds, such an undertaking is costly, burdensome and a practical impossibility. Similarly to U.S. registered mutual funds, the Canadian Mutual Funds usually have thousands or tens of thousands of shareholders. Moreover, these shareholders may own shares directly, or indirectly through intermediaries using omnibus accounts, conduits or nominees in the same manner as shareholders in U.S. registered mutual funds. Such omnibus or nominee arrangements are established for myriad legitimate reasons including street name brokerage accounts, retirement plans, bank trust services, insurance funding vehicles, and the like. Investor questionnaires could determine restricted person status for direct-sold funds; however, in order to maintain compliance with the Rule, restricted person status information would have to be collected for subsequent additional purchases, for exchanges within fund families and for broker-sold funds. Moreover, because new purchases, additional purchases and redemptions occur continuously, changes in shareholder positions are constant and create a daunting recordkeeping problem.

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7 Rule 2790(c)(6). *See also* Memorandum Regarding the Scope of the Foreign Mutual Fund Exemption, NASD Office of General Counsel, Regulatory Policy and Oversight (August 6, 2004) (the "Memorandum"), in which NASD discussed the unavailability of the exemption for funds that are listed of a foreign exchange but not considered publicly available.

8 *See* Rule 2790(b)(2).

9 Shareholders are not limited in the number of accounts that they may hold in a Fund. Tracking and identifying all restricted persons who own shares in a fund would be required because merely tracking and identifying shareholders holding 5% of a fund's shares in any one account may not uncover a shareholder's aggregate beneficial holdings through several accounts.

The compliance burden is exacerbated by the logistics of providing representations to selling broker-dealers. Each time a broker-dealer sells IPO shares to an account such as the Canadian Mutual Funds, it must obtain a representation of compliance with the Rule from the account. Although the Rule permits a selling broker-dealer to rely on a representation that is up to 12 months old, the Rule appears to require that the person providing the representation is eligible to purchase IPOs under the Rule at the time the representation is provided to the selling broker-dealer. This "freshness" requirement requires foreign mutual funds to examine shareholder records to determine if shareholder information is current and complete each time they provide a representation, a daunting requirement because of the ever-changing pool of shareholders. Moreover, because the date that each representation is requested by a selling broker-dealer may well be different, the freshness of each representation will expire on a different date and will require the foreign mutual fund to continue to engage in a fresh examination of shareholder records each time a representation reaches its expiration date if it wishes to maintain its status as an eligible purchaser with the particular selling broker-dealer.

In addition, the cost of keeping records of restricted persons in connection with providing certifications is significant, so that if it is passed on to the fund and fund shareholders through fees, it could materially affect the fund's performance. If the cost is not passed on to the fund and fund shareholders, it could significantly affect the net income earned by the adviser or any other fund service provider who performs the recordkeeping and certification.

By comparison, for a small, private, unregistered and substantially unregulated hedge fund or private equity fund, the recordkeeping concerning restricted persons associated with providing representations to selling broker-dealers may not be unduly burdensome, even though the standard imposed on them by the Rule is tougher.[10] The task is accomplished at the time a subscription is executed by seeking information about the investor's restricted person status in the subscription documents and periodically seeking reconfirmation of the information. For a fund with a few dozen shareholders (a typical threshold for an unregistered private fund), such a task is not a significant burden, especially when one considers that interests in such funds remain relatively stable (in many cases redemptions are severely restricted or prohibited). Moreover, the likelihood that a restricted person would use a private fund as a conduit to obtain a significant interest in an IPO appears to be small, but the NASD's adoption of the restriction is at least not discriminatory among foreign and domestic hedge funds and could be justified as necessary to address NASD concerns if private funds are, in fact, creatively used or marketed as a subterfuge for avoiding the restrictions in the Rule.

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[10] Under Rule 2790, a private equity fund or hedge fund may not purchase an IPO if the beneficial interests of all restricted persons, in the aggregate, exceed 10 percent. *See* Rule 2790(c)(4). But because private equity funds are limited by the 1940 Act, or similar regulatory schemes in other countries, in the number of investors they may have, and the investment rules of such funds tend to restrict redemptions and limit shareholder turnover, the burden of identifying and tracking restricted persons is relatively less than for the Canadian Mutual Funds.

Because of the burdens of attempting to qualify for the Foreign Mutual Fund Exemption, most funds, including the Canadian Mutual Funds, conclude that it is not worth the administrative and recordkeeping cost and headache. Thus, in practice, Rule 2790 effectively precludes the Canadian Mutual Funds from purchasing IPOs, and therefore this significant class of investments that are available to U.S. registered mutual funds are not available to the Canadian Mutual Funds. By erecting barriers for Canadian Mutual Funds to purchase IPOs, the Rule inhibits the managers of the Canadian Mutual Funds from maximizing performance and diminishes the pool of capital available to the IPO market.[11]

NASD Justifications for the Discriminatory Treatment of the Canadian Mutual Funds Are Inconsistent or Based on Misunderstandings of the Facts and Law.

Numerous inconsistent positions or erroneous assumptions underlay the NASD's justification for the discriminatory treatment of foreign mutual funds. For example, the Rule's limited Foreign Mutual Fund Exemption is not imposed on similarly situated U.S. registered mutual funds,[12] yet a U.S. registered mutual fund may purchase IPOs without being subject to the burden of identifying and tracking restricted persons, or providing a representation to the selling broker, notwithstanding that a restricted person may hold more than 5% of that fund's shares. In fact, the law governing U.S. registered mutual funds clearly would permit all of the investors to be restricted persons, and the Rule would still permit the fund to purchase IPOs without restriction.

NASD staff has also said that the exemptions in the Rule reflect the NASD's general belief that sales to and purchases by entities that have numerous beneficial owners are not the type of transactions that the Rule should prohibit because there is little risk that restricted persons will attempt to use such entities as conduits for circumventing the purpose of the Rule.[13] In particular, with respect to the U.S. Registered Mutual Fund Exemption, NASD's historical statements indicate that the exemption was grounded in the belief that registered mutual funds, because of their wide availability and the comprehensive regulatory scheme in which they operate, made them unlikely candidates for restricted persons to use as a vehicle for avoiding the prohibitions of the Rule/Interpretation. Nevertheless, NASD has emphasized that it is not sufficient justification for a member or purchaser to claim an exemption for foreign mutual funds, for example, on the basis that a particular purchase or

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11 It should be noted that the Rule covers not just IPOs offered by U.S. underwriters in the United States, but any IPO, no matter where offered (e.g., Regulation S offerings) if offered by a U.S. broker-dealer, or where a U.S. broker-dealer is selling securities to a non-U.S. broker-dealer for resale. *See* Rule 2790(c)(2) and (i)(9).

12 The U.S. Registered Mutual Fund Exemption in subparagraph (c)(1) of the Rule dates back to the original adoption in 1970 of the predecessor to Rule 2790, the Free-Riding and Withholding Interpretation.

13 *See, e.g.,* Initial Public Offerings (IPOs): SEC Approves New Rule 2790 (Restrictions on the Purchase and Sale of IPOs of Equity Securities), NASD Notice to Members 03-79 (December 2003) ("NTM 03-79").

sale benefits numerous beneficial owners, few if any of whom are restricted persons.[14] The conclusion to be drawn from this apparent contradiction is that NASD continues to seek compliance from foreign mutual funds when it will not seek compliance by similarly situated U.S. registered mutual funds.

NASD also claims that the Foreign Mutual Fund Exemption is "intended to extend to foreign [mutual funds] that are similar to U.S. registered [mutual funds which are], among other things, available for sale to the public."[15] NASD went on to say, citing NASD Notice to Members 03-79, that a foreign [mutual fund] that "is limited to select investors" would not be considered as "for sale to the public."[16] NASD further explained that foreign mutual funds that are limited to high net worth individuals are not eligible for the Foreign Mutual Fund Exemption. According to NASD, "[i]nasmuch as U.S. registered [mutual funds] are not limited to sale to high net worth individuals, it would be inconsistent to permit foreign mutual funds to impose such requirements and still avail themselves of the exemption provided for foreign mutual funds under Rule 2790."[17] Notwithstanding the NASD's assertion, the securities laws, including the 1940 Act, clearly permit a U.S. registered mutual fund to be marketed to or otherwise limited to investment by certain categories of investors. For example, a U.S. registered mutual fund may limit the offering of its shares to: (1) high net worth investors or institutions;[18] (2) clients of broker-dealers and other financial institutions;[19] (3) certain eligible, qualified, or other retirement and benefit plans;[20] and (4) existing shareholders of a fund.[21] Any of these funds qualify for the U.S. Registered Fund Exemption; yet, if they were foreign mutual funds the NASD would disqualify them from the Foreign Mutual Fund Exemption because they are "limited to select investors" and would not be available "for sale to the public."

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14 *Id.*

15 *See* August 6, 2004 NASD Staff Memorandum discussing the scope of the Foreign Mutual Fund Exemption ("August 2004 Memorandum"). *See also* Proposed Rule Change, note 11 and accompanying text; and NTM 03-79.

16 *See* August 2004 Memorandum.

17 *Id.*

18 *See, e.g.,* Agilex Funds (registration statement filed with the Commission April 29, 2005) (certain of the funds offered only to certain high net worth investors as described in the prospectus).

19 *See, e.g.,* Metropolitan Series Fund II (filed with the Commission April 28, 2005) (fund shares are offered only to certain eligible qualified retirement plans; "the general public may not directly purchase shares of the fund"); the Infinity Mutual Funds, Inc. (filed with the Commission February 26, 1999) (Shares are offered only to clients of certain securities dealers that have entered into securities clearing arrangements with a service provider).

20 *See* Metropolitan Series Fund II, *supra* note 16.

21 *See, e.g.,* Brazos Mutual Funds (filed with the Commission March 3, 2004) (Small Cap Portfolio series offered only to existing investors and other limited investors "in the discretion of management").

Moreover, the NASD's narrow definition of what it means to be "for sale to the public" stands in contrast to the SEC's December 2004 release adopting its new rule to require hedge fund advisers to register with the SEC under the Investment Advisers Act of 1940 (the "Hedge Fund Release").[22] The Hedge Fund Release defines when a foreign fund would be deemed to be an "offshore publicly offered fund," thus exempting the adviser from the registration requirement. An "offshore publicly offered fund" is one that has its principal office and place of business outside the United States, makes a public offering of its securities in a country other than the United States, and is regulated as a public investment company under the laws of the country other than the United States. The Hedge Fund Release also states that the definition encompasses any type of publicly offered fund, whether in corporate, trust, contractual or other form, so long as the fund is authorized for sale in the same jurisdiction in which it is regulated as a public investment company.[23]

Finally, because the Canadian Mutual Funds are the substantial equivalent of mutual funds registered under the 1940 Act, there can be no rational justification for discrimination. They are organized under the laws of various provinces of Canada. Shares or units of the Canadian Mutual Funds are qualified for sale to the public in Canada by Canadian provincial regulatory authorities. The Canadian Mutual Funds are subject to a regulatory regime substantially comparable to the regulatory scheme governing mutual funds registered in the United States. For example, National Instrument 81-102 Mutual Funds[24] includes provisions that regulate Canadian mutual funds with respect to, *inter alia*,(i) investment restrictions, (ii) investment practices, (iii) borrowing powers, (iv) seed capital, (v) computation of net asset value, (vi) custody of portfolio securities, and (vii) sales and redemptions of fund securities. As is the case with U.S. registered mutual funds, the Canadian Mutual Funds are not required by Canadian law to identify restricted persons owning shares of the Canadian Mutual Funds. In fact, in the same manner as U.S. mutual funds, the Canadian Mutual Funds may not know the identity of some of their shareholders because some of the shares of the Canadian Mutual Funds may be held on the books of the Canadian Mutual Funds in omnibus accounts in the name of broker-dealers or other financial intermediaries on behalf of the beneficial owners of the shares. In addition, in the same manner as U.S. mutual funds, shares of the Canadian Mutual Funds are typically owned by many thousands of individual shareholders.

Non-Discrimination of Canadian Mutual Funds Under NAFTA.

The effect of NASD Rule 2790(a) is to treat the Canadian Mutual Funds differently from U.S. registered mutual funds in like circumstances, and to put the Canadian Mutual Funds at

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22 *See* Registration Under the Advisers Act of Certain Hedge Fund Advisers, Release No. IA-2333 (December 2, 2004).

23 *Id.*

24 *See* National Instrument 81-102 Mutual Funds, a national rule created by the Canadian Securities Administrators which regulates how mutual funds are managed, bought and sold, including the kinds of investments a mutual fund can make, how an investor can redeem units of the mutual fund, how the mutual fund manager can make changes to the mutual fund and how the mutual fund can advertise

a competitive disadvantage in comparison with their U.S. counterparts. This measure constitutes a violation of U.S. obligations under NAFTA.

The Financial Services Chapter of NAFTA covers (i) regulated financial institutions,[25] (ii) investments[26] in financial institutions by investors from another NAFTA country, and (iii) cross-border trade in financial services.[27] NAFTA imposes an obligation upon each country that is a signatory to the agreement ("Party") to ensure that its "measures," including any law, regulation, procedure, requirement or practice[28] adopted or maintained by a Party, conform to the general principles and standards set forth in NAFTA insofar as these measures relate to the treatment of providers of and investors in financial services from each Party.

NAFTA requires the non-discriminatory treatment of investors, financial institutions and cross-border financial services and service providers of another Party. Specifically, NAFTA provides that where a Party permits the cross-border provision of a financial service, it shall accord, with respect to that service, national treatment to the cross-border financial service providers of another Party (i.e. treatment no less favorable than it accords its own financial service providers in like circumstances).[29] NAFTA further specifies that a Party's treatment of financial institutions and cross-border financial service providers of another Party (i.e., Canada) comports with national treatment only if the treatment affords equal competitive opportunities.[30] Such treatment cannot disadvantage the financial institutions and cross-border service providers of another Party in their ability to provide financial services as compared with the ability of the Party's own institutions and providers to provide, in like circumstances, financial services.[31]

Accordingly, the United States is obliged to take into account the effects that would result from the imposition of a measure upon Canadian financial institutions and cross-border service providers. If any disadvantage results, the United States would have to make such

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25 NAFTA defines "financial institution" as any financial intermediary or other enterprise that is authorized to do business and regulated or supervised as a financial institution under the law of the country in whose territory it is located. NAFTA, Art. 1416. *See also* Gramm-Leach Bliley Act, Section 527(4)(B), Public Law No. 106-102, codified at 15 U.S.C. § 6827, which specifically includes investment companies/mutual funds as "financial institutions."

26 An "investment" includes any equity investment and any tangible or intangible property acquired for economic benefit or other business purpose. NAFTA, Art. 1416.

27 "Financial service" means a service of a financial nature, and a service incidental or auxiliary to a service of a financial nature. NAFTA, Art. 1416.

28 NAFTA, Art. 201.

29 NAFTA, Art. 1405.3.

30 NAFTA, Art. 1405.5.

31 NAFTA, Art. 1405.6.

modifications as necessary to ensure non-discriminatory treatment between U.S. and Canadian financial institutions.

The Canadian Mutual Funds provide cross-border financial services to Canadian investors for investing in securities and other financial instruments offered in U.S. financial markets. The mutual funds provide financial services to their shareholders by investing in equity securities, among other investments, for the portfolios of the mutual funds. They purchase those securities in both domestic Canadian markets as well as foreign markets. In particular, they may purchase shares of IPOs offered for sale by U.S. broker-dealers. Thus, the Canadian Mutual Funds provide a vehicle for Canadian investors to purchase IPO shares in cross-border financial services transactions. Canadian investors, through the vehicle of the Canadian Mutual Funds, also provide investment capital to the U.S. IPO market.

NASD Rule 2790(a) clearly puts the Canadian Mutual Funds at a competitive disadvantage in comparison with U.S. registered mutual funds. Without an exemption equivalent to that provided to U.S. registered mutual funds, the Canadian Mutual Funds are effectively denied access to the IPO market. It is therefore incumbent upon the United States to modify its rule to level the playing field.

Although Rule 2790(a) has been promulgated by the NASD, the private sector self-regulatory organization of America's securities industry, the NASD was established pursuant to federal legislation and by order of the Securities and Exchange Commission ("SEC").[32] Moreover, any proposed NASD rule must be reviewed and approved by the SEC through the issuance of a Commission order. The NASD rule cannot take effect unless approved by the SEC.[33] Moreover, the SEC must consult with the Secretary of the Treasury prior to approving a proposed NASD rule.[34]

Accordingly, NASD Rule 2790(a): (i) constitutes the imposition of a "measure" on a Party under NAFTA; (ii) must comply with NAFTA obligations; and (iii) in its current version, the Rule violates such obligations.

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32 15 U.S.C. § 78o-3; Section 19(a) of the Exchange Act of 1934.

33 *Id.*, § 19(b)(1).

34 *Id.*, § 19(b)(5).

The Canadian Mutual Funds appreciate the opportunity to comment on the Proposed Rule Change. If you have any questions concerning the foregoing, please contact the undersigned at 202-261-3341.

Very truly yours,

Elliott R. Curzon

cc: William H. Donaldson, Chairman, SEC

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