IN THE MATTER OF
THE SECURITIES ACT, 1988, S.S. 1988, C. S-42.2

AND

IN THE MATTER OF
AGF ASSET ALLOCATION SERVICE

AND

IN THE MATTER OF
A REQUEST FOR A DETERMINATION PURSUANT TO SUBSECTION 70(4)
OF THE SECURITIES ACT, 1988

D E C I S I O N

Hearing Held April 30, 1991

Before: Marcel de la Gorgendiere,.Q.C. Chairman
Herbert Dow, Vice Chairman
Morley Meiklejohn, Commission Member
Rand Flynn, Commission Member

Appearances: James Hall, representing Commission staff
Marlene Davidge, Counsel for AGF

Decision dated May 28, 1991

DECISION

This matter was referred to the Commission at the request of the Deputy Director, Corporate Finance. It concerns an identical amendment to the prospectus and Annual Information Form filed by each of AGF Canadian Equity Fund Limited, A.G.F. Canadian Bond Fund and AGF Money Market Account. The amendment involved inserting provisions to make allowance for use of an "asset allocation service". That service would provide for investors in the above mentioned funds authorizing their dealer(s) to invest in and subsequently transfer and retransfer investments among the three funds. The service would reallocate the amount invested in accordance with recommendations generated by a computer asset allocation model developed by PaineWebber Incorporated, a U.S. investment dealer.

This service is in use in all provinces except Saskatchewan and Manitoba. It remained unavailable here pending this hearing to determine whether its use would be in the public interest as a result of concerns raised by the Deputy Director.

The attributes of the asset allocation service are:

1. Automatic switching in the amount of assets allocated to the three funds would take place when a ten (10%) percent cumulative move had been indicated by the model;

2. The assets transferred between funds would be subject to a negotiable transfer fee payable to the dealer, but there would be a cap on such transfer fees so that in any one year no more than two (2%) percent of the value of the assets allocated to the service could be charged;

3. The dealer would be advised immediately after any shift of assets was indicated, and unless he or his client indicated that they wished to discontinue the service, the allocations would be made to the funds at the end of the next day following the recommended change. This would happen automatically if the dealer was away and some would consider that an advantage.

It was further represented that the PaineWebber asset allocation model was in the public domain as any information involving its recommendations was made to all Clients, of PaineWebber Incorporated. AGF Management Limited, as the promoter, manager and distributer of the funds is a customer of PaineWebber Incorporated, but has no other connection with PaineWebber Inc. other than a non-exclusive license for use of the model and has no direction over the recommendations made in the operation of the model.

PaineWebber developed the tactical asset allocation model eighteen years ago and it is "designed to allocate resources among three classes of financial assets: stocks, bonds, and cash equivalents/money market instruments by comparing the expected rate of return of representative instruments in each asset class. The current relationships are then compared with what has been the normal relationships in the past". The percentage in any asset class can range from zero to one hundred percent and if the expected rate of return from each segment of the market was in balance, the weighting for each class would be thirty-three and a third (33 1/3%) percent. The input to the model for the fixed income sector is based on the yield on ten-year U.S. Treasury securities. For equities it is based on data generated from a survey of a large sample of institutional investors based on their forecast of earnings, dividends and growth rates, leading to an expected rate of return on stocks and the price of the equity market based on Standard and Poor's 500 Composite Stock Price Index. The money market/cash weighting is based on the return on the coupon equivalent yield on new three-month U.S. Treasury Bills.

The question referred to the Commission for determination is whether or not it is in the public interest that the use of such a service should be permitted in Saskatchewan, and if so, what conditions, if any, should be attached to the use of such a service in Saskatchewan.

The Commission, after considering the use of the asset allocation service as described, determined it was not contrary to the public interest. The Commission could understand the reluctance of the Deputy Director to approve the filing of the amendment to the prospectus and Annual Information Form based on the information before him at the time. It was necessary to consider some of the apparent significant differences between the Canadian and American economies in regard to rates of interest and the nature of the companies comprising the Standard and Poor's Index compared with that of a Canadian index such as the TSE 300.

The Commission reached its conclusion based on a consideration of two main factors. It was pointed out that to decide the relative weighting of assets within a portfolio, so as to be similar to the three generic types of investments forming part of the earnings estimates in the PaineWebber model, it was the relationship of the similarity of movement that was important rather than the particular quantitative measure. As a result, if there was a significant degree of similarity in movement in the similar sectors between Canada and the United States, the reliance on one model would be generally applicable to a similar market in Canada. Information presented at the hearing by Mr. William Cameron, Vice-President of AGF Management Limited, specifically responsible for the Asset Allocation Service, indicated a strong correlation between Canada and U.S. markets.

He came to this conclusion as a result of tests carried out by Burns Fry in regard to equities by comparing the TSE 300 to the Standard and Poor's 500 and Richardson Greenshields in regard to the interest rate markets. The closeness or degree of change of the one equity index to the other, based on movements over 20 years is 93.1%. In the case of long-term interest rates it was 97.2%; in the case of short-term interest rates it was 72.5%. Mr. Cameron was certain that a statistician would term this a significant degree of correlation. Such degree of correlation would be reliable to a significant degree for other than for a short-term investor (a matter which is adaptable to disclosure). While he admitted that such a long-term relationship could change, the investor is aware of the design of the model being based on retrospective considerations and with that disclosed the investor can decide if it is reasonable to rely on it.

The other significant consideration is that when an individual obtains advice from his dealer on how to allocate his assets among different types of investments, he does not often receive a detailed explanation of the methods used to reach a determination for that recommendation other than the general experience of the person giving the advice. The adviser may refer to an examination of assorted types and classifications of information which, while referred to, is not done so in any systematic way. Likewise, when any individual buys shares in a balanced mutual fund, the prospectus or the annual information form will give only a general description of investment aims but will not necessarily state what information in particular will be relied upon. Many funds are purchased retrospectively by investors, based on the track record of the fund, or they select a fund that operates on the basis of a fixed allocation among the three categories of investments. The Commission accepts the argument of the manager of the funds that there is enough information available about the composition of the PaineWebber model and its 18 year track record on which a dealer could determine and advise a client that the reliance on asset allocation based on such a model to the funds in question was a reasonable move for that client to make.

The Commission felt that the only alternative to its decision would be to begin extending a never-ending web of control over the reasons for recommending particular investments and there would be no more certainty that the Commission would be able to come up with better standards upon which to make an investment decision than those which were already being made. We must avoid attempting to regulate the methodology used. We do not feel it necessary to blaze a trail on regulation of methods of investment decision making. The funds in offering such a service and the adviser in advising as to its use to his client and the client in signing an application agreeing to the automatic transfers of assets within the parameters set by the service should all be aware of the criteria used to make such application. From the Commission's point of view, disclosure coupled with a lack of patent unreasonableness must be sufficient as the Commission and its staff are not responsible for the success of the investment or its failure.

However, having decided that the asset allocation service outlined may be offered in Saskatchewan, that does not mean that the Commission staff should not be concerned about the degree of disclosure of the attributes of the service. In this regard it would be appropriate for the staff to consider the adequacy of disclosure in the usual manner of individual review and consideration in conjunction with the other Securities Commissions' consideration of the same issue. This would include any general recommendation of the mutual fund committee of the Canadian Securities Administrators which the Commission will have approved.

There are some matters that the Commission would expect the staff to ensure were contained in any disclosure. The purchaser should have access to information that would show that "the service" was based upon recommendations for the United States market and depends upon the usual relationship between the Canada-USA market which is not always exactly the same and that investments made on a short-term basis and in the money market fund in particular on a short-term basis might not be wise. Fees will be disclosed for purchase, redemption, and transfer when indicated by the model. The annual management fees are claimed by the manager to be more favourable to the client compared with balanced funds on average. Their theory is that the investor is buying individual equity, long-term fixed income and money market funds, all of which have differing management rates, so on average they would be lower than the standard balanced fund. Consideration should be also given to pointing out that none of the three funds in question constitute a 100% investment at all times in the type of investments that are characteristic of the fund. There is also the possibility of lag between the investment of the funds from the time of issuance of the PaineWebber model which could lead to minor variances between the stated rate of performance based on a complete adherence to the publication dates of any model recommendations. There should also be a caution as to the advisability of a person using such a service who is dependent on constant income from his investment funds.

In the future, other matters may warrant consideration for publication as part of prospectus disclosure in what the industry and regulators accept as being essential for full, true and plain disclosure. Future undetermined changes may make the reliance upon such a model or systems unreasonable. There may have to be a subsequent determination of whether their use in fact continues to be in the public interest as a result of such changes. One must remember that it is an investment vehicle that is designed for investors who for one reason or another do not wish to undertake to engage in a detailed or ongoing review of their investments.

In light of our present knowledge, however, there appears to be no reason why such an asset allocation service cannot be used within Saskatchewan, subject to adequate disclosure preferably agreed to on a national basis.

DATED at the City of Regina, in the Province of Saskatchewan, this 28th day of May, 1991.

Marcel de la Gorgendiere, Q.C.
Chairman
Saskatchewan Securities Commission