October 30, 2006

British Columbia Securities Commission
Alberta Securities Commission
Saskatchewan Securities Commission
Manitoba Securities Commission
Ontario Securities Commission
New Brunswick Securities Commission
Securities Office, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
Registrar of Securities, Northwest Territories
Registrar of Securities, Nunavut
Registrar of Securities, Yukon Territory

c/o John Stevenson, Secretary
Ontario Securities Commission
20 Queen Street West
Suite 1903, Box 55
Toronto, Ontario M5H 3S8

-and-

Madame Anne Marie Beaudoin
Directrice du sécretariat
Autorité des marchés financiers
800, square Victoria, 22e étage
C.P. 246, Tour de la Bourse
Montréal (Québec) H4Z 1G3

Mr. Stevenson and Mme Beaudoin:

Re: Response to Canadian Securities Administrators' (CSA's) Request for Comments on Proposed National Instrument 23-102 – Use of Client Brokerage Commissions as Payment for Order Execution Services or Research

The Investment Counsel Association of Canada (ICAC), through its Industry Regulation and Tax Committee is submitting comments on behalf of its members.

ICAC is the representative organization for investment counsel and portfolio managers in Canada. ICAC was established in 1952 and its current members are responsible for managing in excess of over $500 billion of client assets. Member firms are only in the business of managing investments for clients in keeping with each client's needs, objectives and risk tolerances.

ICAC concedes that while there is an illustrative value in prescribing categorizations of what goods and services can be acquired using soft dollar commissions, effective regulation should ultimately be usage based, focusing on how the good or service is utilized by the particular manager in devising or executing trades or in its research processes. This is consistent with the guidance released by the CFA Institute to its members regarding best practices related to the use of client commissions.

Given the current discussions and developments on the issue of soft dollars both at an industry-level and internationally, the ICAC commends the CSA for revisiting and updating its rules in this regard.

The following are the ICAC's general comments on the Proposed Instrument and the impact it will have on our members. Attached, as Appendix A, are our responses to the specific questions that the CSA included in its Request for Comments.

1. **USE BASED:** The rules should be used to restrict abuses and not to prescribe actions. The ICAC agrees that it is important for investors to clearly understand what goods and services can be "purchased" by their advisers when using client commissions. Yet, we also argue that looking at the actual use of the good or service is more important than classifications that may have no bearing on the actual use of these goods or services. The CFA Institute also encourages a "use"-based definition in its guidance on the use of client commissions. It is important to focus on how the goods and/or services are actually used, rather than what they are. This, together with an appropriate disclosure system, would enable the CSA to achieve its goals.

2. **INCREASED COSTS:** The proposals, if left unchanged, will increase costs to advisers and to the service providers (who will require modifications to their current reports/processes) which will ultimately be passed on to clients by way of higher transaction costs and/or management fees.

   Additionally, the increasing costs (i.e. the narrowing in the definition of what constitutes research will transfer more costs to investment managers and raise fixed costs) may impose entry barriers or have other detrimental impact on smaller investment management firms seeking to compete with larger firms.

   Furthermore, where registrants are operating in multiple jurisdictions/markets (some of our members are registered both in Canada and with the SEC), there will be significant operational and compliance issues where the Canadian standards are materially different from those of other jurisdictions, without a substantial reason for such divergence.

3. **GLOBAL COMPETITIVENESS:** While we commend the CSA for its initiative to harmonize the rules regarding soft dollars, ensuring that there is a level and competitive playing field for all participants in the Canadian market, the lack of uniformity with

recent initiatives in the U.S.A. and U.K. is concerning (e.g. the Canadian rules are more restrictive in defining permitted services than the U.S. rules), particularly where there appears to be no clear and substantial justification for this regulatory deviation. This has the potential to detrimentally impact the competitive status and/or long term growth prospects of the industry in Canada (e.g. Canadian firms might have to (i) increase fees, thus becoming less competitive to registrants in other markets; (ii) decide not to utilize additional goods or services to the detriment of their investment processes or clients; or (iii) may choose to relocate abroad so as to avoid the potential events in (i) or (ii)). The differential treatment of goods and services brings with it a real probability of decreasing the ability of Canadian advisers to compete for business, particularly large institutional mandates. If an American adviser, for example, is able to utilize commissions to pay for a service which a Canadian adviser is not, then the Canadian adviser must either absorb the cost of such services as a fixed cost reducing its profit margin or increase its fees. Either scenario impairs the Canadian adviser's ability to compete with non-resident managers. An example of one such difference is the restrictions on raw market data that will have a direct and detrimental impact on quantitative and momentum investors that require this data in the generation and evaluation of their investment models.

4. **DISCLOSURE DEFICIENCIES:** The disclosure to investors in the Proposed Instrument is overly subjective and potentially confusing in the requirement to estimate expenses on a client by client basis. Effective disclosure should ensure that managers are exercising their fiduciary duties to allocate commissions in the best interest of clients. While the concept of individualized reporting has an inherent appeal, the reality of how money is typically managed diminishes greatly the benefit in this type of report. It is a simple fact, and a by-product of the regulatory obligation, that advisers will generally aggregate "like-account" trades to ensure fairness in allocating investment opportunities for "like-accounts" and to ensure best execution. Moreover, the engagement of research services is done at a macro level. Any unbundling of the transaction and research services on a client-by-client basis will involve assumptions and/or estimates on allocations of cost. Beyond the credibility of this data, there is also the additional cost associated with this type of reporting.

   We urge regulators to ensure that the accountability and disclosure standards targeting research and brokerage expenditures treat all research, whether bundled or independent, equally as part of the commissions spend. The proposed NI 23-102 will not do this as long as it requires a specific breakdown in s. 4.1(c)(iii) of independent/non-bundled research in a separate reporting bucket with seemingly little justification for this separation in treatment.. Regulatory discrimination in requiring more disclosure for independent research seriously impairs the competitive position of independent research providers, (estimated to be $61 million of the $300 million Canadian soft dollar commission in 2004 by Greenwich Associates and IDA data).

5. **LACK OF A TRANSITION PERIOD:** While it is not one of the specific questions posed to the industry by the CSA, the ICAC's view is that the absence of a planned transition period for this new rule may trigger serious issues within the certain segments in the industry. The extensive disclosure requirements alone merit a longer implementation period. It is uncertain whether some of the broker dealers and/or data suppliers will be able to make the necessary adjustments in their systems to enable the

advisers to adhere to the reporting requirements in time. This is particularly relevant with respect to mixed use goods and services. The experience in the U.S.A, which the CSA should be scrutinizing, has revealed that some suppliers are scrambling to re-engineer their billing processes to accommodate what is and what is not a permissible use. If the Canadian rules are different from the US rules in this regard (e.g. raw data, exclusion of industry seminars, etc.) it will require a separate tailoring of processes again for Canadian clients. It is simply unreasonable to expect that these processes will be available right away as the suppliers will not even know exactly what needs to change until the publication of the final rule.

Notwithstanding our use of the term in this letter and the attached Appendix A, the ICAC is also of the view that the CSA should cease to use the term “soft dollars” because the term is confusing and has taken on a negative connotation.

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We would be pleased to discuss our comments with you. If you have any questions regarding our submission, please do not hesitate to contact the undersigned or the Chair of our Industry, Regulation and Taxation Committee, Tom Johnston #416-681-5120.

Yours truly,

INVESTMENT COUNSEL ASSOCIATION OF CANADA

Katie A. Walmsley, BComm, CHRP, CIP
President

APPENDIX A

Comments on Specific Questions

Question 1 – Should the application of the Proposed Instrument be restricted to transactions where there is an independent pricing mechanism (e.g. exchange-traded securities) or should it extend to principal trading in OTC markets? If it should be extended, how would the dollar amount of services in addition to order execution be calculated?

The ICAC believes that the Proposed National Instrument should only apply where there is a clear and objective disclosure to the amount of commissions charged by the broker-dealer on a trade-by-trade basis.

As a result, the Proposed Instrument should not apply to principal trading/transactions given the difficulty of calculating the service levy from the actual security bought or sold. NI 23-102 should also attempt to take into consideration that the soft dollar rules in the US explicitly carve out any security where there is not an explicit commission and in doing so, do not apply to principal transactions unless they are riskless and do not apply to fixed income trades, except where done on an agency basis. The U.K. rules, as noted by the CSA in its Request for Comment Paper are even narrower in their application (i.e. applying to shares, options and warrants only). The question the CSA must address is whether there is a compelling reason to deviate from the approach taken by the aforementioned regulators. On a practical note, it will be particularly difficult to obtain the necessary breakdowns on commissions in principal transactions with respect to foreign fixed income securities where this requirement is not imposed on the dealers in these markets. Moreover, where commissions are not explicitly delineated by the dealer and where advisers will be required to estimate them, this will result in different advisers coming up with different amounts to allocate as commissions and therefore there will be inconsistency in the resulting disclosures.

Question 2 – What circumstances make it difficult for an adviser to determine that the amount of commissions paid is reasonable in relation to the goods and services received?

It is difficult to determine value when the goods and services are bundled, as is often the situation with a full service broker. It is possible to ascribe fair value for trading execution and some forms of research within the context of competitive offerings, but when these are bundled with sales coverage, access to new issue product and other such proprietary resources, the split becomes very subjective and the valuation difficult. Where commissions have not been conveyed in a generally accepted and quantifiable method or where they have not been communicated to the adviser, such a determination would be almost impossible.

On a more practical level, it will be particularly difficult to obtain the necessary breakdowns on commissions in principal transactions with respect to fixed income trades where this requirement is not imposed on the dealers in these markets.

This is really a subjective evaluation by each adviser taking into account the facts pertinent to the transaction(s). All that can be reasonably expected in this area is that advisers make consistent, good faith determinations.

Question 3 – What are the current uses of order management systems? Do they offer functions that could be considered to be order execution services? If so, please describe these functions and explain why they should – or should not – be considered "order execution services"?

Order management systems (OMS) generally assist investment advisers in facilitating trading in an expeditious and organized fashion. Traditionally, an OMS was used to keep track of outstanding orders, original order size, current balances, fills, dealers, etc. In the increasing electronic world, investment advisers now have the ability to send orders directly from their desktops to the marketplace.

There are proprietary and broker-sponsored algorithms embedded in most OMS today, all to give the buy-side institution a much more rapid response time to changing market activity. Some broker dealers offer market access via their algorithm formulas from an adviser's own desktop directly, by-passing the traditional program desks of the various dealers, so that the investment adviser is now responsible for determining the parameters of the trade. This is all done for the purpose of best execution, in an attempt to capture all of the correct ingredients in a expeditious fashion, thus allowing for successful trading. What was once considered two separate functions, is now becoming a blend of OMS and DMA arrangements from the adviser's desktop application. (Note that most OMS have compliance and guideline restrictions built into their systems.)

As noted in our general comments above we do not feel it is advisable to pronounce whether a particular system or approach is acceptable for soft dollar usage. The systems are becoming increasingly complex and are often used in very different ways by various advisers. It should be left to the adviser to make a reasonable and good faith determination as to if a particular service fits within an accepted branch of soft dollars.

Question 4 – Should post-trade analytics be considered order execution services? If so, why?

We suggest that both pre- and post-trade analytics should be available for payment with soft dollars, provided they are being utilized in the investment decision making process or are sufficiently linked to order execution. Pre-trade analysis considers factors that are likely to be based on a previous trade's "post-trade analytics". Post-trade analytics also play a key role in a manager's ability to optimize its execution to achieve best execution and to lower the total costs of trading. Post-trade is easier to capture in an auditable report, and this can be very important in an adviser meeting its best execution mandate. Input from this data can be used to research appropriate stock selections, as stocks which are difficult to trade due to historically poor trading volume or volatile responses to added pressure may often be excluded from portfolio construction.

As an example, the quantitative group of one of our members uses post-trade analytics as an important part of the team's research and part of the investment process. Trades are analyzed on both a trade-by-trade basis and in the aggregate and trading costs are an input into the team's portfolio model.

Question 5 – What difficulties, if any, would Canadian market participants face in the event of differential treatment of goods and services such as market data in Canada versus the U.S. or the U.K.?

It is an important issue in the investment industry to strive to achieve regulation that addresses principles, while also recognizing that Canadian registrants live in a competitive marketplace with registrants in other jurisdictions. It is simply not good policy to impose regulations materially different from the other senior regulators without a clear and substantial justification for doing so.

Also consider that a firm that has clients in Canada and the US would be required to conduct different analyses for those clients even though the inputs into the service provided were identical. This will lead to confusing analysis and inefficient use of resources without material benefit to either client group.

The asset management business can be considered fairly transportable, and so any long term decline in profitability has the potential to encourage Canadian advisers to move services to other jurisdictions where the regulatory approach is more efficient but still helpful to investors.

Furthermore, the Proposed Instrument would give certain U.S. advisers (e.g. those utilizing a lot of raw market data or industry seminar/publications) a competitive edge over Canadian advisers utilizing the same tools. If the Canadian rules do not recognize the benefit afforded to U.S. quantitative managers, these Canadian registrants will have a cost disadvantage vis-à-vis their foreign competitors.

To the extent that harmonization can be achieved with the policies of other jurisdictions this would be commended by our members.

Question 6 – Should raw market data be considered research under the Proposed Instrument? If so, what characteristics and uses of raw market data would support this conclusion?

Raw data permits advisers to shape their opinions and investment ideas from verifiable and dynamic data. It is our view that the proposed policy will allow such data (e.g. price feeds, trade volumes, etc.) if it assists in the trade process, as it should qualify as permitted brokerage services in the trade execution category, as is the case in the U.S. However, we also believe that there is a need to expand the proposed rule to allow for the purchasing of raw data in the category of research. Raw market data should be considered research as long as it can be shown by the adviser that it is part of, or an input to, the investment decision making process and adds value.

While raw data is not manipulated and/or analyzed with specific conclusions akin to typical research, the information is necessary for quantitative advisers for model building and back testing. The analysis that allows the manager to establish a mandate or to periodically review a mandate is based on back testing large quantities of data and using statistical tools such as regression and time series analysis. Original thought or the expression of reasoning or knowledge is only as sound as the research on which it is predicated. The data that is analyze and manipulated is the separate “reasoning” from the supporting data on which it is based.

The Proposed Instrument as it stands could create the following scenario: if a quantitative based adviser purchases data directly in order to construct its models, for example, it will not qualify for commission dollars; however, if an independent research provider buys the data and then sells it to the quantitative adviser, it could qualify for commission dollars. This means that the regulatory regime encourages the use of an intermediary, with a likely increase in the ultimate costs to the investor.

Question 7 – Do advisers currently use client brokerage commissions to pay for proxy-voting services? If so, what characteristics or functions of proxy-voting services could be considered research? Is further guidance needed in this area?

In general, ICAC members do not use commission dollars to pay for proxy-voting services.

However we believe that in certain circumstances some proxy-voting services could qualify as research. Some providers of proxy-voting services offer data from their proxy-voting databases on trends in corporate governance as reflected by shareholder voting. Some research studies in the industry have indicated correlations between corporate governance and share prices. We believe that such data should be considered part of research as it could be an important input to investment decision making models.

As stated previously, we believe that the definition of what constitutes research should be driven by basic principles rather than prescriptive detail. We propose that costs should qualify for commission dollars as long as the adviser can demonstrate the relationship to investment decisions.

Question 8 – To what extent do advisers currently use brokerage commissions as partial payment for mixed-use goods and services? When mixed–use goods and services are received, what circumstances, if any, make it difficult for an adviser to make reasonable allocations between the portion of mixed-use goods and services that are permissible and non-permissible (for example, for post-trade analytics, order management systems, or proxy-voting services)?

Mixed-use services are not uncommon and can arise where there is a good or service that provides value to other components of an adviser’s business beyond the investment process: e.g. client service reporting or compliance.

The ICAC is comfortable with the existing requirement for registrants to separate and estimate the component and costs unrelated to the investment process and to pay for those directly. As we understand it, a number of licenses to different participants, log-on rights and usage are all monitored and are helpful in this exercise.

Question 9 – Should mass-marketed or publicly-available information or publications be considered research? If so, what is the rationale?

The ICAC would agree with the SEC that certain financial newsletters and trade journals intended to serve the interests of a narrow audience should be considered research, as they can provide invaluable information and insight into industries which, while publicly-available, is not in broad circulation. This type of information, from trusted sources, can provide an important foundation for unique and independent research.

We do not agree with a blanket exclusion of mass market or publicly available information. Again, it is important to note the use of this information – for example, industry seminars should be afforded research status provided that the given seminar relates to a research function.

Question 10 – Should other goods and services be included in the definitions of order execution services and research? Should any of those currently included be excluded?

Consistent with our approach on other issues, the ICAC believes that the correct approach to ensuring the appropriate use of commission dollars is to establish key principles, based on use, to govern what goods and services can be purchased with them and to ensure adequate disclosure to investors of the usage of such dollars by the adviser.

Question 11 – Should the form of disclosure be prescribed? If prescribed, which form would be most appropriate?

The ICAC's view is that to ensure clarity and uniformity on the usage of soft dollars to the market, it is important that the form of disclosure be prescribed. To avoid unnecessary costs and mailings to clients, the prescribed form of disclosure should be capable of being integrated into existing client reporting processes. Disclosure pursuant to the Proposed Instrument should be provided on an annual basis.

Question 12 and 14 – Are the proposed disclosure requirements adequate and do they help ensure that meaningful information is provided to an adviser's clients? Is there any other additional disclosure that may be useful for clients?

What difficulties, if any, would an adviser face in making the disclosure under Part 4 of the Proposed Instrument?

The proposed disclosure requirements will result in a considerable amount of unnecessary administrative costs to buy side firms while resulting in inconsistent disclosures resulting from subjective inputs. The granular disclosures suggested will give the appearance of precision but mask the inexact nature of the decisions necessary to make such disclosures.

While we support efforts to ensure uniform and meaningful disclosure of commission dollars and the services obtained from them, there are some issues which we have with the proposed disclosure requirements in section 4.1.

(a) *Timing of Trades and Payments:*

Trades on behalf of clients and the payments made for goods and services do not always happen at the same time. Subsections 4.1(b) through (d) propose that advisers are required to separate trades into many categories based on whether the clients received only order execution, trades where they received bundled services, trades where part of the commission was paid directly to third parties, and so on. At the time that a trade is executed it is not always clear where the soft dollar allocation will ultimately be paid. “Reasonable estimates” by advisers would be highly subjective and would undermine the goals of transparency and accountability.

(b) *Appropriateness of Reporting Inputs:*
The requirement in section 4.1(b) that commissions be broken down and reported for each “class of security” may not be meaningful where an adviser manages multiple investment strategies (e.g. fundamental GARP, quantitative, deep value, growth, etc.) within a single class of security. These strategies would involve different securities, different trading strategies and different clients and so any report commingling them would seem to add little value.

At a minimum, we would propose replacing and/or clarifying the proposed rules to address the fact that comparisons should be completed across accounts that have a similar investment strategy/mandate. If the comparison is made across different types of mandates, the comparison will be confusing to the client or, at worst, misleading. While this recommendation would improve the current provision, it really does not result in any value being provided to an investor: what is the value to an investor in aggregated reporting by investment strategy?

We would also recommend a refining of the reporting process to provide a more meaningful and simplistic disclosure such that only the reporting required in section 4.1(a) and 4.2 would be required.

(c) *Costs of Disclosure:*
It is difficult to appreciate the perceived value behind the reporting required in sections 4.1(c) and 4.1(d) of the Proposed Instrument. Given the advent of technology, the efficiency of the markets and the competitive nature of the industry, trading commissions are a very small percentage of client accounts.

Requiring registrants to break down these commissions will result in a considerable amount of administrative costs to firm, costs which ultimately will be charged back to clients. The utilization of “reasonable estimates” in providing this data, and the potential inability to obtain the commission component, particularly on foreign principal transactions also undermines the purported value in this disclosure.

To further our response to Question #5, above, it is troubling that the Canadian rules would deviate from the disclosure approach by the SEC and FSA, which permit bundled and third party research to be grouped together.

The requirement for this disclosure involves tremendous time and expense on the part of the adviser to log phone calls, emails, report reception and the like. We question the relevance of this information to investors and fail to see how investors would or could use this very costly information.

In summary, while we agree that transparency and accountability are important goals of the Proposed Instrument, subsection 4.1(b) through (d) will place a large administrative on advisers without increasing the quality or utility of information to clients. This burden will have a disproportionate impact on small investment counselors and in its most extreme outcome could lead to more consolidation by larger firms and fewer choices for individual investors.

(d) *Compliance for Firms with Varying Client Types:*
Firms which hold assets for their clients on a segregated basis will necessarily have a higher cost of compliance. This will serve to further increase the fee gap between segregated and pooled products. In addition, mutual fund managers will have to disclose this commission usage in publicly available disclosure documents. The high level of disclosure required may have an impact on a mutual fund manager’s use of such broker commissions.

Furthermore, one of our members with a national presence across Canada, has commented that neither institutional nor private clients have shown any interest in receiving this level of extremely detailed disclosure. In fact, this company receives approximately five (5) requests per year for information on client specific commission usage. None of these requests has ever been from private clients. They have recommended that detailed disclosures be provided to a client upon request by the client, rather than inundate all clients with information that may not find useful.

Question 13 – Should periodic disclosure be required on a more frequent basis than annually?

The ICAC’s view is that an annual disclosure is adequate. Accounts and mandates, as well as soft dollar budgets, often change on an annual basis and requiring disclosure for less than annual periods could result in a false sense of volatility.

Question 15 – Should there be specific disclosure for trades done on a “net” basis? If so, should the disclosure be limited to the percentage of total trading conducted on the basis (similar to the IMA’s approach)? Alternatively, should the transaction fees embedded in the price be allocated to the disclosure categories set out in sub-section 4.1(c) of the Proposed Instrument, to the extent they can be reasonable estimated?

The ICAC’s views on the shortcomings of estimated allocations has been articulated throughout out submission letter. In this light, the reporting of data using estimations should be discouraged or at least supplemented with further guidance on what is and what is not reasonable.