

May 2, 2005

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Alberta Securities Commission
Manitoba Securities Commission
Ontario Securities Commission

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Re: Concept Paper 23-402 - Best Execution and Soft Dollar Arrangements

Dear Sir or Madam:

We are grateful for the opportunity to provide our comments on Concept Paper 23-402 - Best Execution and Soft Dollar Arrangements. We believe that investor confidence is the key to robust and efficient Canadian financial markets and that this concept paper provides an excellent summary of the current state of the Canadian market as well as international markets.

The following are our thoughts on some of the questions that were posed in the document:

Question 1: Are there any changes to current requirements that would be helpful in ensuring best execution? Do you think that clients are aware of their role in best execution or would some form of investor education be helpful?

We believe that the creation, application and continuous review of the UMIR have provided the necessary structure for a market in which all participants enjoy a consistent and reliable framework for best execution. We believe that clients are aware of the need to communicate clearly and directly with advisers and dealers and that the process necessary to establish the type of relationship mandated by the basic tenets of "Know

Your Client” provides sufficient opportunity for clients to establish their priorities. Having said that, the more educated investors are about the elements of best execution, the better they will be able to communicate their priorities with respect to any particular transaction.

Question 2: Should there be more prescriptive rules than those which currently exist for best execution or should the methods for meeting the best execution obligation be left to the discretion of registrants?

Best execution is a multi-faceted concept that resists narrow definition. Best execution is a qualitative measure not quantitative. As per the CFA Institute Trade Management Guidelines, “*The circumstantial and judgmental aspects involved in seeking Best Execution on a trade by trade basis generally are not quantifiable. Therefore, it is not feasible to evaluate Best Execution on a trade by trade basis.*”

We concur with the observation in the Concept Paper that “securities legislation imposes a fundamental obligation on dealers to deal fairly, honestly and in good faith with its clients”. As well, we note that section 5.1 of the UMIR provides that a dealer shall “diligently pursue the execution of each client order on the most advantageous terms for the client as expeditiously as practicable under prevailing market conditions.”

At any point in time, a client’s priority for a trade (price, certainty, market impact, etc.) may vary, the market conditions may vary, and the dealer’s ability to gauge the resulting combination may vary. It is impossible to develop prescriptive rules that will be appropriate in all situations, particularly when the effectiveness of a dealer’s compliance with such prescriptive rules can only be measured in hindsight, with information that is not available to the Participants at the time of execution.

In addition, we would like to highlight that UMIR 6.3 and 8.1 currently protect small orders to ensure their best execution, by requiring Participants to guarantee that the client receives the price or better if the order is not executed immediately or improves price if executed against a principal or non-client order.

Question 3: Do you believe that there are other elements of best execution that should be considered? If so, please describe them.

The Concept paper highlights price, speed of execution, certainty of execution and total transaction cost. Several other considerations are discussed under those subheadings, but we believe that the following list would be more descriptive of current practice, with no item being more important than any other:

1. Price
2. Speed of Execution
3. Certainty of Execution
4. Total Transaction Cost
5. Client’s instructions
6. Liquidity—market impact, willingness to act as principal
7. Order Size
8. Settlement

Question 4: If audit trail information is not in easily-accessible electronic form, how is the information used to measure execution quality? Is there other information that provides useful measurement?

Given the subjective nature of best execution, audit trail information will only ever be able to provide a partial measurement of execution quality. Free competition between Participating Organizations balances the demand for and supply of best execution. Clients who are dissatisfied with their executions can and will redirect their order flow to Participating Organizations who are providing better service, including best execution.

Question 5: Do you believe the suggested description emphasizing the process to seek the best net result for a client is appropriate and provides sufficient clarity and, if not, can you suggest an alternative description?

The Concept paper proposes that “best execution means the best net result for the client, considering the relevant elements (including price, speed of execution, certainty of execution, and total transaction cost) in light of the client’s stated investment objectives.”

As discussed above, we believe that price, speed of execution, certainty of execution, and total transaction cost do not sufficiently describe all of the competing priorities, any one of which might dominate in the course of an individual transaction. While we agree with the phrase “best net result”, we find the use of the phrase “client’s stated investment objectives” inappropriate in this context. Client investment objectives are described within the Canadian Securities Industry’s Conduct and Practices Handbook as “different combinations of safety, income and growth”, which relates to a client’s overall portfolio goals. We believe a more appropriate phrase should be used that relates to the priorities for a particular order and not a client’s portfolio.

Question 7: How should dealers in Canada monitor and measure the quality of executions received from foreign executing brokers?

Best execution is a balancing of competing priorities and is therefore impossible to measure. Dealers or Registered Representatives have a duty to their client to seek out the “best net result”. The Registered Representative handling the order should evaluate execution using the same elements described in this concept paper, in addition to client’s instructions, liquidity, size of order and ability to settle.

Question 8: Do you think that internalization of orders represents an impediment to obtaining best execution?

We agree with the observation in the Concept paper that when internalization occurs in the case of client orders being crossed, the requirements of both clients must be taken into account and they are both owed best execution. Generally, no conflict will arise.

In the case of client/principal crosses, UMIR restricts trading as principal against client orders less than 5,000 shares unless price improvement is provided. For larger orders, the dealer is required to disclose its role as principal. In that case, the client has the opportunity to rank its desire for execution certainty and market impact against the potentially competing desire for the full price discovery that might result in a better price being obtained. The price discovery mechanism may not have top priority on any single transaction. Supply and demand will drive it to dominate over the long term. Internalization will not have a long term negative impact, given the low barriers to client switching and the transparency of the listed market.

Question 9: Should there be requirements for dealers and advisers to obtain multiple quotes for OTC securities? Should there be a mark-up rule that would prohibit dealers from selling securities at an excessive mark-up from their acquisition cost (similar to National Association of Securities Dealers, Inc. (NASD) requirements dealing with fair prices)?

Unlike the NASD markets, the Canadian OTC equity market is very customized and illiquid. For some types of transactions, there often will not be 3 market makers. For equities, this market is based on a clientele of institutional and high net worth investors, who are sophisticated enough to obtain their own multiple quotes. Given the smaller, more concentrated OTC markets in Canada, the potential for market impact can negatively impact the value of obtaining competing quotes.

The customized nature of many of the products renders the requirement for a mark-up rule unnecessary; other products, such as plain vanilla swaps, are so commoditized that there is no need for a mark-up rule—market forces keep spreads in line.

Question 10: How is best execution tracked and demonstrated in a dealer market that does not have pre- or post-trade transparency such as the debt or unlisted equity market?

As discussed before, best execution cannot be quantified. While the price of a security in the marketplace at the time of the order and immediately after execution may not be ascertained without the pre- or post-trade transparency, that is only a single parameter. The best net result should be the result of the entire process, which should take into account the client's instructions, certainty of execution, speed of execution, total transaction cost, liquidity, order size and settlement.

Question 20: *Would any of these initiatives be helpful in Canada?*

We are supportive of the concept of establishing uniform guidelines around the issue of soft dollars.

Please contact us if you require any clarification with respect to the above.

Regards,

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