May 13, 2005

British Columbia Securities Commission
Alberta Securities Commission
Manitoba Securities Commission
Ontario Securities Commission

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Dear Sirs and Madames:

Re: comments to each question on CSA Soft Dollar Concept Paper 23-402, Best Execution and Soft Dollar Arrangements.

The National Society of Compliance Professionals ("NSCP") appreciates the opportunity to submit comments on the above-referenced Concept Paper. The matter in question is of considerable interest to the NSCP and its members. NSCP is the largest organization of securities industry professionals in the United States and Canada devoted exclusively to compliance issues, effective supervision, and oversight. The principal purpose of NSCP is to enhance compliance in the securities industry, including firms' compliance efforts and programs and to further the education and professionalism of the individuals implementing those efforts. An important mission of NSCP is to instill in its members the importance of developing and implementing sound compliance programs across-the-board.

Since its founding in 1987, NSCP has grown to over 1,300 members, and the constituency from which its membership is drawn is unique. NSCP's membership is drawn principally from traditional broker-dealer firms, accounting firms, and consultants that serve them. The vast majority of NSCP members are compliance and legal personnel, and the asset management members of the NSCP span a wide spectrum of firms, including employees from the largest brokerage and investment management firms

to those operations with only a handful of employees. The diversity of our membership allows the NSCP to represent a large variety of perspectives in the financial services and asset management industry. Please note that the comments we are submitting do not cover every question in the Concept Paper.

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?

The discussion of the different responsibilities of the various parties involved in a trade in the Concept Paper is in itself a helpful educational tool for clients, as well as a reminder for registrants. Generally, we think that institutional clients are aware of their role in best execution and that the interests of retail clients in best execution would be better served by reminding registrants of their responsibilities to clients rather than by an investor education program directed at clients themselves.

Under the current regime the onus is on the registered dealer and registered advisor to pursue best execution in the performance of their difference services. The specific requirements to seek "best execution price," for example, are more clearly stated for registered dealers than registered advisers. Harmonization of terminology and requirements by different regulators or self-regulatory organizations is obviously desirable. Registered advisers might benefit from more guidance concerning their best execution responsibilities by way of policy statement or practice recommendations by way of notice given that the basis of "best execution" is the adviser's general obligation to deal fairly, honestly and in good faith with clients.

We recommend that a "safe-harbor" provision like section 28(e) of the Securities Exchange Act of 1934 be added to clarify that the best execution requirement (and the basic fiduciary obligation to the client) is not breached by a person in paying a dealer an amount of commission for a transaction in excess of the amount of commission another dealer would have charged if the person determined in good faith that the commission was reasonable in relation to the value of the brokerage and research services provided by such dealer.

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?

Dealer's obligations

• The Broker's obligations when trading OTC products such as debt securities should be further defined so that it is clear that its obligations are similar to what is stated in the Universal Market Integrity Rules for equity securities. In this manner, clients of brokers could expect Broker/Dealers to have processes in place that would result in best execution processes no matter the type of security being traded.

Adviser's obligations

• Currently, the Regulations require an investment counsel to maintain standards directed to ensuring the fairness in the allocation of investment opportunities among its clients (i.e. OSC Regulation 115(1)). This regulation requires an adviser to have processes pertaining to bunching and allocating of trades. This section does not define an explicit requirement on advisers to monitor trading costs and to ensuring that they are minimized without foregoing the necessary services from dealers. The Adviser's obligation to have processes in place to monitor for best execution should be articulated in a rule. The rule should be designed from a "principles" based approach so that each adviser for his or her applicable operations can tailor it. It would be helpful if in a Companion Policy to the rule, examples of good suggested practices were provided (similar to what is described in the OSC Capital Markets Branch, Compliance Team, Annual Reports). The Rule should focus on requiring the adviser to have a process in place and to deal with the results of the processes in an appropriate manner.

Marketplace's roles

• Given the marketplace is a player in the process of obtaining best execution for the ultimate end client, it would seem that they should also be required to establish and enforce polices and procedures that ensure that they aid in the process not hinder it.

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

While the Concept Paper provides some guidance on elements that should be considered for best execution, it does not necessarily go into the details that some of the foreign jurisdictions, particularly, the United States, provide to brokers and dealers. The safe harbor exclusions provided under Section 28(e) of the Securities and Exchange Act of 1934 provide clearer guidance on what items may be deemed soft dollar products and services. More recently, Section 28(e) and other regulatory provisions regarding soft dollars further defined best execution guidance for soft dollars. Particularly, studies such as the Securities and Exchange Commission (SEC) Soft Dollar Report Conclusions of 1998 found that overall, the vast majority of the soft dollar products and services received by advisers fall within the safe harbor. However, more than a quarter of the advisers surveyed received some non-research products without adequately disclosing the facts to their clients and approximately half of the advisers did not provide enough information to allow a client to understand the adviser's soft dollar policies and practices required under the law. Therefore, what resulted in the years ahead are increased disclosure to Investors and Fund Boards and increased transparency of execution and research costs.

Looking at the United States marketplace as a model, we see that Form N-1A provides some guidance on other factors to be considered. For example, Item 15(c) of Form N-1A requires that a Fund must disclose in its Statement of Additional Information (SAI) how it selects brokers and how it evaluates the reasonableness of commissions paid. If fund considers the receipt of research services in selecting brokers, it must identify the nature of the services. If applicable, the fund also must explain that adviser

may use research services in servicing all of the adviser's accounts, and may not use all of the services in connection with the fund. In addition, Item 15(d) of Form N-1A requires a fund adviser who directs transactions to a broker because of research services provided to state in its SAI the amount of the transactions and related commissions. In addition, the heightened disclosure that the SEC requires advisers to include within their Form ADV necessitates the firm, its portfolio managers and employees to evaluate its best execution practices. The Form ADV requires disclosure of the following information regarding soft dollar arrangements:

• A description of the products, research and services received;

• Whether clients may pay commissions higher than those obtainable from other brokers in return for those products and services;

• Whether research is used to service all of the adviser's accounts or just those accounts which pay for it (i.e., cross subsidization); and

• Any procedures the adviser used during the last fiscal year to direct client transactions to a particular broker in exchange for products and services received.

We believe that similar disclosure requirements should be required in the Canadian marketplace.

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 proposed description emphasizing process is appropriate. It has the benefit of, being inclusive of, and not limited to, the stated elements, and acknowledges that the concept is dependent on the individual client's requirements and priorities in respect of a particular trade. The fact that the specific elements of price, speed of execution, certainty of execution and total transaction cost are expressly stated adds clarity. We would recommend that any other relevant elements that are identified by consensus as material factors be included in this same way for further clarity.

6. Do you believe that there are any significant issues impacting the qualify of execution for:

(a) Listed Equities – whether Canadian-only, inter-listed or foreign-only;

(b) Unlisted equity securities;

(c) Derivatives; or

(d) Debt securities?

Other than items described in the Concept Paper, some of the issues impacting the quality of execution in Canada include the following:

• The general lack of liquidity in the Canadian market places results in additional issues for participants vs. in other market places such as the U.S.

• The Canadian Market Place has a substantial amount of Block Trading that occurs. It has been estimated that 74% of equity trading occurs through Block Trading in Canada whereas it is only 28% in the U.S. Whether this type of trading actually results in better execution has not been tested and thus is unknown at this time.

• Canada does not provide significant alternatives to trading with full-service dealers like the U.S. marketplace has with players such as Archipelago and B-Trade.

• U.S. Advisers also have significantly more Algorithmic Trading products available to them than Canadians, once again limiting the execution alternatives available to Canadians.

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

In order for Canada to monitor and measure the quality of executions received from foreign executing brokers, heightened disclosure and due diligence are required. For example, it would be prudent for Canadian advisers to make periodic evaluations of the execution performance of the foreign broker-dealers it selects for client transactions to measure varying factors considered in determining best execution. These factors may encompass obtaining the best qualitative transaction for the client (generally, this involves low commission rates for clients, placing a larger order in pieces so as to not affect the market, among other factors). Other determinates in evaluating whether the adviser has achieved best price and execution include the confidentiality provided by the broker; the promptness of execution of securities transactions; the broker-dealers' clearance and settlement capabilities; and the financial stability of the broker-dealer. Pre- and post-trade analysis may be necessary to uncover the details and hidden costs associated with execution. It may be helpful for the CSA to provide specific guidance one what analysis advisers should consider. While a "one-size-fits-all" approach is not necessary, some things to capture may include:

• Evaluation of the Volume Weighted Average Price (VWAP) - Compare the executed price coming from the broker to the stock VWAP for the date, hour or specific period of time from when the order was placed until execution was completed.

• Measurement of the Market Impact to see if the order caused any impact (price) on the specific issue during execution and after its completion.

• Comparison and analysis of the opportunity costs and delays. Evaluate when (1) there is a delay noted between the portfolio manager and the trader and (2) when there is no delay between the trader and the broker, however, a "delay" was part of our trading strategy.

• Evaluation of error(s) or partial executions. Monitor and track the error(s) in the execution process. Should an error occur, the trade is reversed, and the client is made whole.

Disclosure to the investor is imperative throughout the monitoring process. We propose that CSA adopt a similar disclosure document as the required Schedule F of Form ADV Part II for a description of the relationship between the advising firm and any third party that may provide services to the advisor. In the United Kingdom, the Financial

Services Authority's (FSA) Policy Statement 04/23 (PS 04/23) entitled Bundled brokerage and soft commission arrangements: Update on issues arising from PS 04/13 (November 2004) set forth views regarding which products and services may be paid for with commissions. To assist in disclosure efforts, PS 04/23 provides insight into the FSA's views regarding which products or services may fall within "non-permitted services," "execution," and "research." Canada may want to follow a similar approach and consider, as discussed in the FSA Policy Statement, the following proposed guidance:

• Boards of directors/trustees of fund management clients should be given clear information about the respective costs of execution and research paid for on their behalf by their manager, and the overall expenditure on these services.

• Fund managers should be encouraged to seek, and brokers to provide, clear payment and pricing mechanisms that enable individual services to be purchased separately.

• Some advisers may wish to use a valuation model designed by the UK Investment Management Association and then provide this valuation in consultation with brokers, and determine prospectively how to split commissions between execution and research.

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

We believe that the answer to this question is not a simple "yes" or "no" response. The reason for this is that internalization provides the potential of some benefits as well as some drawbacks to how securities are traded. Benefits of internalization include enhanced liquidity, faster executions and lower transaction costs. In addition, internalization may preserve anonymity. Thus, in making an overall determination of best execution, internalization provides certain elements that go into such a determination and therefore, should not be quickly dismissed.

Alternatively, internalization has been criticized by some as impeding liquidity and the price discovery process since orders are not exposed to the market. In addition, it may well be that broker-dealers engaging in this practice have little incentive to quote improved prices.

On balance, we believe that properly disclosed, internalization is one facet of the overall market dealing that should be preserved. That said, and in response to Question 20, we believe Canada should adopt rules similar to Rule 11Ac1-5 and 11Ac1-6 adopted in the United States under the Securities and Exchange Act of 1934. In doing so, broker-dealers would be required to disclose the nature of the broker-dealers' relationships with market centers that could pose a conflict of interest between them and their clients; e.g., internalization.

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)?

Requiring dealers to obtain multiple quotes for an OTC security is inherently a good idea. In describing a "best execution" transaction, the NASD has given guidance to its broker members that the term involves achieving the "price to the customer is as favorable as possible under the prevailing market conditions." This would mean that when buying a non-Nasdaq listed security, the broker-dealer would have to find at least three independent quotes from market makers to fill the customer order. We believe that a similar requirement should be adopted by the CSA. Often times the pressure possibly placed on a broker-dealer by a third party who is requiring directed brokerage for its soft dollar services is alleviated upon the showing that the broker-dealer in fact sought the best price in the situation for the customer. While a potential conflict of interest may exist, there will be less chance for abuses with the requirement of obtaining multiple quotes for OTC securities and required disclosure to clients.

Excessive mark-ups and fair prices are an increased focus of the NASD. The CSA should provide guidance on what would be deemed "excessive" and what criteria should be used to evaluate achieving a "fair price." (*See NASD Rule 2440 for additional guidance.*)

11. How does an adviser ensure that its soft dollar arrangements are consistent with its general obligations to its clients?

As described in the British Columbia Securities Commission, Capital Markets Regulation Division, 2003 Adviser Report Card, Examination Team, December 2003, various issues can arise in the usage of soft dollar arrangements. Issues identified in the report included the following:

• Some advisers failed to provide full and fair disclosure of their use of clients' brokerage

• Some advisers paid much higher brokerage fees than were necessary. This showed that the firms were not cost-conscious about trading fees. This is not in the best interest of an adviser's clients or fund unit-holders.

• Advisers failed to disclose soft dollar practices to clients

• Advisers failed to create and provide a soft dollar disclosure document to clients or failed to disclose the disclosure document was available on request

• Soft dollars were directed to related parties

• Soft dollars were used to pay for non-traditional research services

The report also identified best practices in the usage of soft dollar arrangements. The best practices identified were:

• Establish a compliance committee that has a policy and limits on soft-dollar expenditures

• Make this committee responsible for approving soft dollar arrangements and create a standard disclosure document for clients

• CFA Institute has established standards to provide guidance on soft-dollar issues; review and adopt CFAI soft dollar standards

• Be prudent and cost conscious when investing on behalf of clients.

If an adviser followed the identified best practices and avoided the issues, then they could ensure that their soft dollar arrangements were consistent with their general obligations to their clients.

13. If it is acceptable to pay for goods or services using soft dollars, which services should be included as "investment decision-making services" and "order execution services" and which services should specifically not be included?

The current description of these services in Ontario Securities Commission Policy 1.9 and AMF Policy Statement Q-20 are satisfactory.

14. Should there be additional disclosure requirements beyond those specified in OSC Policy 1.9 and AMF Policy Statement Q-20, National Instrument 81-101 and proposed in National Instrument 81-106? Should the disclosure requirements be the same for third party soft dollar payments and bundled commissions?

See our response to Question 16.

If it is feasible to "unbundle" the bundled commissions, it would be desirable to have the same disclosure requirements apply to third party soft dollar payments and unbundled commissions for better transparency.

15(a). What, if any, are the practical impediments to an adviser splitting into their component parts commission payments that compensate for both order execution and "investment decision-making services" as a result of either third party soft dollar arrangements or bundled commissions?

There is of necessity a large element of judgment associated with this exercise. The adviser will also need to obtain and rely on information from the dealer. There could be difficulty in obtaining the information from the dealer and consistent information from different dealers with whom the advisor is dealing.

16. If the split between order execution and "investment decision-making services" cannot be measured reliably, should the entire commission be accounted for as an operating expense in the financial statements? If it can be measured reliably, should the "investment decision-making services" portion of commission payments be accounted for as an operating expense in the financial statements?

We feel that the commissions should continue to be accounted for in the statement of changes in net assets. The commissions arise out of trading decisions and thus are closely tied to gains/losses on realized and unrealized investments. If the commissions were to be accounted for as an operating expense, then we would be using different accounting for different asset types (the commissions on equity trades would be included in operating expense and the imbedded commissions on debt trades would continue to be accounted in changes in net assets).

We feel that disclosure similar to what is proposed in the NASD Report to the Mutual Fund Task Force – Soft Dollars and Portfolio Transaction Costs – November 11, 2004 would be more useful.

This report recommends that disclosure concerning portfolio transaction costs should be provided to investors. The NASD Report proposes the following items to be disclosed in the funds' prospectus (any similar disclosure already included in the Annual Information Form should be removed in favor of this disclosure):

• A brief narrative description of the various types of trading costs incurred by the fund, including commissions, markups and markdowns, market impact costs, and opportunity costs.

• The manner in which the fund will select brokers to effect securities transactions.

• The manner in which the fund will evaluate the overall reasonableness of the brokerage commissions paid, including the factors that the fund will consider in making these determinations.

• The aggregate dollar amount of commissions paid.

• The percentage of the total dollar value of all transactions that were executed on a commission basis.

• The average commission paid per share.

• The total commissions paid as a percentage of total net asset value. This figure would enable investors to evaluate the amount of commissions paid based on the size of the fund and compare that cost across funds.

• The total dollar amount of commissions paid to any affiliated broker-dealer.

• The percentage of the fund's dollar amount of portfolio transactions that involve the payment of commissions that was executed through any affiliated broker-dealer.

• That the fund's performance numbers, but not the expense information, reflect these trading costs.

• The fund's portfolio turnover rate, in close proximity to other information about the costs of portfolio transactions.

17. Would it be appropriate for the MER to be based on amounts that differ from the expenses recognized in the audited financial statements? For example, should the entire commission continue to be accounted for as an acquisition/disposition cost in the financial statements but the MER calculation be adjusted either to include all commissions or to include only that portion that is estimated to relate to "investment decision-making services"?

We do not feel that MER should be based on different amounts from what is recognized in the audited financial statements. As we stated in our response to Question #16, we feel the commission should continue to be accounted for as an acquisition/disposition cost in the financial statements otherwise different asset types are being treated differently. We also feel that the additional disclosure we have proposed in our response to Question #16 will provide shareholders with more accurate information than adding estimates to the MER calculations.

18. Should directed brokerage or commission recapture arrangements be limited or prohibited?

The practices of directed brokerage and commission recapture have evolved over time. As noted in the body of this Concept Paper 23-402, National Instrument 81-105 prohibits situations where transactions of a mutual fund are directed to a dealer as inducement or reward for the dealer selling securities of the mutual fund. The U.S. Securities and Exchange Commission followed suit with a recently adopted rule effective October 14, 2004 prohibited U.S. open-end investment companies from paying for the distribution of their shares with brokerage commissions. (*See US SEC Release No. IC-26591 – dated September 2, 2004, effective date October 14, 2004, amending Rule 12b-1 of the U.S. Investment Company Act of 1940.*)

With respect to advisers using commission payments as incentives for dealers to provide some type of preferential treatment, this clearly presents a conflict of interest. Client interests may be placed behind those of the investment adviser in such circumstances. The question becomes should all such directed brokerage transactions be prohibited and how effective is disclosure at mitigating such practices. As suggested in the Concept Paper, several participants have commented that if advisers are required to disclose their top dealers and the criteria used in choosing those dealers, then the issue would be minimized. We believe that with respect to the range of directed brokerage practices which are or may become in use by advisers, that at a minimum, full and complete disclosure of such practices should be required in order to place the investor on notice of the particular practice engaged in, the incentives of the adviser for engaging in such practices and requiring the adviser to point out the material conflicts of interest which may or do exist by reason of engaging in such practices. These practices should be examined closely in the future in order to determine whether they should be prohibited, as in the case of directed brokerage to broker-dealers in exchange for the selling of fund shares.

Commission recapture programs can provide a method by which clients can help defray costs that otherwise would be imposed upon the ultimate investor. Commission recapture programs, in our view, should not be prohibited, but the emphasis on disclosure

– both by the fund administrator to the ultimate clients as well as by the investment adviser – should be enhanced. In particular, where an investment adviser is required to use one particular or a list of specified broker-dealers, it is important, to the extent not already required, to provide for various disclosures be given by the investment adviser. Those disclosures should include the fact that the adviser may not be able to batch the client's orders with those of its other clients, the latter of whom have imposed no such broker use restriction. Further, that trades for such clients directing the use of a particular broker or list of brokers may be placed at the end of the queue by the investment adviser and thus not obtain the same price as trades placed ahead of it.

19. Should disclosure be required for directed brokerage or commission recapture arrangements?

If not prohibited practices, additional disclosure about these practices or arrangements would be useful for investors and would be appropriate on the basis that there are issues analogous to soft dollars that are raised by them. The type of disclosure now required by mutual funds in Item 10.4(1)(c) of Form 81-101F2 would presumably take note of directed brokerage practices.

20. Would any of these initiatives be helpful in Canada?

We believe that a number of the initiatives set forth in the Concept Paper coming from the United States, United Kingdom and Australia should be reviewed closely for the benefits they could provide to the Canadian securities markets. It is important to note that many of the questions raised in the Concept Paper should not be read or answered in a vacuum and must be placed in some context. For example, as noted in our response to Question 8, we believe that internalization can provide some benefits, but requiring its disclosure in reports required under U.S. Securities and Exchange Act of 1934 Rule 11Ac1-6 provides some additional protections.

We support the review by Canada of a number of recent reports generated in the U.S. concerning soft dollars and the suggestions being made in respect thereof – not just those reports mentioned in the Concept Paper. For example, we believe a close reading of the following would be beneficial in "rounding out" any final position with respect to soft dollars in Canada; namely, the Investment Company Institute's Letter to the US SEC dated December 16, 2003; the Report of the Mutual Fund Directors Forum – Best Practices and Practical Guidance for Mutual Fund Directors – July 2004 – Section IV.11; NASD's Mutual Fund Task Force Report – "Soft Dollars and Portfolio Transaction Costs" (November 11, 2004) (cited in the Concept Paper); and the Independent Directors Council letter to the US SEC dated December 23, 2004.

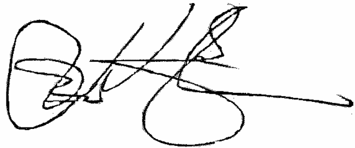
In addition, the UK Financial Services Authority issued a new consultation paper – CP05/5, proposing new soft dollar rules, which we believe has merit and should also be considered. The FSA currently anticipates making final rules in the third quarter of this year. We believe that such guidance as is contained in CP05/5 could be beneficial to the industry in terms of providing specific types of products and services that are "execution"

and “research” and therefore eligible to be paid for by commissions and those non-permitted services that must be paid for in hard dollars.

Finally, although not noted in the list of items set forth, we submit that it would be worthwhile for Canada to also consider the CFA Trade Management Guidelines. As set forth in the introductory provisions: “…the Guidelines do not prescribe how Firms should measure Best Execution. Rather, they focus on setting forth Firm-wide policies and procedures that seek to enhance a Firm’s ability to maximize the value of a client’s portfolio considering that client’s investment objectives and constraints.” The CFA guidelines are divided into three areas; namely, processes, disclosures and record keeping. We commend these guidelines to your consideration.

We hope that these comments are useful in your consideration of Best Execution and Soft Dollar Arrangements. We would be pleased to discuss our views in more detail with the Commission or the Staff.

Sincerely,
Joan Hinchman
Executive Director, President and CEO



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