October 19, 2006

British Columbia Securities Commission
Alberta Securities Commission
Saskatchewan Financial Services Commission
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Nova Scotia Securities Commission
Prince Edward Island Securities Office
Securities Commission of Newfoundland and Labrador
Registrar of Securities, Department of Justice, Government of the Northwest Territories
Registrar of Securities, Legal Registries Division, Department of Justice, Government of Nunavut
Registrar of Securities, Government of Yukon

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

- and -

c/o Anne Marie Beaudoin
Directrice du secrétariat
Autorité des marchés financiers
Tour de la Bourse
800 square Victoria
C.P. 246, 22e étage
Montréal, Québec
H4Z 1G3

Dear Sirs/Mesdames:

Re: AIMA Canada's Comments on Proposed National Instrument 23-102 *Use of Client Brokerage Commissions as Payment for Order Execution Services or Research ("Soft Dollar" Arrangements)*

This letter is being written on behalf of the Canadian chapter of the Alternative Investment Management Association ("AIMA") and its Members to provide our comments to you on proposed National Instrument No. 23-102 *Use of Client Brokerage Commissions as Payment for Order Execution Services or Research ("Soft Dollar" Arrangements)* ("NI 23-102").

AIMA was established in 1990 as a direct result of the growing importance of alternative investments in global investment management. AIMA is a not-for-profit educational and research body that specifically represents practitioners in hedge fund, futures fund and currency fund management – whether managing money, providing a service such as prime brokerage, administration, legal or accounting. AIMA's global membership comprises over 1,000 corporate members, throughout 46 countries, including many of the leading investment managers, professional advisers and institutional investors. AIMA's Canadian chapter, established in 2003, now has over 70 corporate members.

One of the objectives of AIMA is to ensure the representation and integration of skill-based investments into mainstream investment management. AIMA works closely with regulators and interested parties in order to better promote and control the use of alternative investments.

This comment letter has been prepared by a working group of the Canadian members of AIMA, comprised of hedge funds, fund of funds and accountancy and law firms with practices focused on the alternative investments sector.

Organization

This letter outlines our general thoughts and major points with respect to NI 23-102. Our comments with respect to the specific questions posed by the CSA for which responses were requested are outlined on Attachment A.

General Comments

We support this CSA initiative to update the Ontario Securities Commission (OSC) Policy 1.9 and the Autorite des marches financiers (AMF) Policy Statement Q-20 in light of industry and international developments and to ensure a consistent application of principles across Canada.

AIMA is in support of the stated goals of this policy initiative:

1. To provide investors with more information about their adviser's use of soft dollar commissions.
2. To harmonize the rules for goods and services that can be purchased with client commission across the CSA and take into account international developments.
3. To clarify which goods and services can be acquired by advisers with client commissions and to assess their true management expense.
4. To increase confidence that commissions are ultimately benefiting those that pay them.

However, we believe that in order to achieve these goals the following changes are required to the proposal:

1. **An explicit goal that any proposals should not <u>increase</u> costs borne by investors, either directly, or indirectly through increased costs to the adviser which could increase fees.**

2. **Disclosure to investors on how the commission dollars have been used should be consistent, informative and meaningful, balanced against the maintenance of each firm's proprietary competitive advantage.**

Alternative Investment Management Association

Canada Chapter

3. **Harmonization should ensure that there is a level and competitive playing field for all participants in the Canadian market, and that the rules are consistent to allow for a level playing field, particularly with U.S.-based advisers.**

4. **The determination of which goods and services can be acquired using commission dollars should be usage-based and recognize that order execution and research are integrated processes.**

5. **Recognition that market processes (e.g. increasing levels of due diligence by clients requirements of professional standards) and regulatory processes (e.g. enhanced disclosure and regulators' adviser audit programs) serve to ensure that the use of commissions is appropriate.**

6. **Inclusion of a transition period for implementation of the final rule, similar to previous CSA practice and consistent with the approach in other jurisdictions.**

Our comments below and in Attachment A are made with reference to these above-stated goals and suggested modifications. The comments fall into three major areas: Competitiveness, Permitted Goods and Services, and Transparency and Disclosure.

Competitiveness

AIMA supports the goal to harmonize requirements across the CSA, taking into account international developments. However, in our opinion the proposals as drafted could harm the development, growth and competitiveness of the Canadian industry.

We believe that it is very important to recognize that the asset management industry is extremely competitive globally. It is a very portable type of business that in most cases can be conducted wherever the cost and regulatory structure is most advantageous. Very few worldwide industries have their results measured as frequently and publicly as asset management does. Investors have a wide range of choices when they select an asset manager.

In light of this competitiveness, any arrangement that increases client expenses negatively affects performance, thereby reducing the adviser's ability to raise more assets and reducing adviser compensation. For this reason, advisers are incented to minimize any cost to the investment portfolio and to ensure that any expense that is incurred has been incurred by necessity or in order to ultimately help improve performance. This ensures that the interests of an adviser are aligned with its clients.

Market and regulatory disciplines are also increasing and are acting to enhance disclosure and ensure that commissions are only used appropriately. Institutional investors in particular are conducting an increasing amount of due diligence research on advisers, which includes how the adviser utilizes commission dollars. In fact, AIMA has been a world leader in developing suggested Due Diligence Questionnaires for use by investors, which include this topic. From a regulatory perspective advisers are also subject to audit by the various regulators in which the usage of commission dollars is regularly reviewed.

Given this state of the industry AIMA believes that regulatory concerns that commission dollar arrangements create potential conflicts of interest, including an "incentive to direct trades to dealers for goods and services that benefit the

advisers, and not the clients", are driven more by perception than by reality. The necessity to impose more onerous or prescriptive regulations is not as high as may be believed given the behaviour of the market.

Canadian advisers must compete on a global basis, working from a relatively small base, so it is important that any regulatory regime not impose obstacles to their ability to compete effectively. The Canadian market is a small proportion of international activity, with the U.S. and the UK/EU constituting the bulk of such activity. Any national instrument should attempt to be consistent with the primary international proposals from the Securities and Exchange Commission (SEC) in the United States and the Financial Services Authority (FSA) in the United Kingdom. Given that the proposals from both the SEC and the FSA are inconsistent in some respects, in our opinion the CSA should harmonize with the aspects of each that are most relevant to the Canadian market.

Effective harmonization must also ensure that Canadian advisers are not disadvantaged through the imposition of a higher level of costs in order to meet regulatory requirements versus competitors in other countries. This could occur any time that goods or services are eligible for payment by commission dollars in a foreign jurisdiction but not in Canada. Creation of a higher Canadian cost structure will inevitably increase investor costs and reduce investor returns.

Given that the majority of Canadian economic activity is conducted with the U.S., and that the primary competition for Canadian money managers comes from the U.S., in our opinion the draft instrument should be harmonized as much as possible with the SEC proposals, particularly with respect to what goods and services qualify for payment with commission dollars. As a general principle we believe that regulation should be as neutral as possible so that it is the market that decides on the provision of services.

This harmonization would ensure that there is a level competitive playing field between Canadian and U.S. advisers. For example, as the proposal stands a U.S. based adviser would be able to utilize commission dollars to purchase various research services such as raw data and publications while a Canadian adviser would not. The result is that the Canadian adviser would either be uncompetitive as it may not purchase such services, thereby potentially not providing the best possible service to investors, or would be forced to raise its fees to cover such costs, thereby becoming uncompetitive. In the former case investors are deprived of the best possible service, in the latter case investor costs are increased. Alternatively the Canadian adviser might leave Canada and set up business elsewhere, resulting in a loss to the Canadian economy. The net result is that money management mandates could end up leaving Canada and reduce the size of the Canadian advisory industry.

The key area in which harmonization with the SEC is required is with respect to definitions of research and other permitted services (please see our comments below on this topic).

In addition, within Canada we believe that the CSA proposal, through its definitions, serves to favour certain investment styles and could potentially discourage new and competitive entrants to the industry.

For example, by excluding the purchase of raw data from the list of permissible items the proposal disadvantages quantitative and momentum investors that need this data in order to build and test their investment models. Only raw data can be used for this type of research. This point is expanded upon below and in Attachment A (see question #6), but the key point is that the regulatory regime should not advantage one type of business or investment approach over another, thereby restricting the products and choices available to investors.

The competitiveness of the Canadian industry could also be hurt if restrictions on the permitted goods and services discourage new entrants. Allowing commissions to pay for a range of goods and services on a variable cost basis (as a function of transactions and asset volume) versus a fixed cost basis (out of a profit margin or increased fees) if some goods and services are excluded enhances the ability of new players to enter the market, increasing innovation and competition. In our view the rules governing permissible goods and services should be more usage-based than prescriptive. Market processes and the general rules governing the industry (including regulatory inspections) should serve to restrict abuses.

As stated by the U.S. Security Traders Association in an October 2004 letter to the SEC "To assist in the investment decision making process, asset managers must rely on in-house research, in-house research enhanced by outside research, or outside research only. *Soft dollar arrangements allow fund managers to acquire research necessary for the creation of innovative investments, strategies and products, thus better enabling mutual funds to compete not only on the basis of price, but also on product differentiation.* Small managers, since they lack economies of scale, often prefer to pay for their research services through soft dollar arrangements to reduce their costs, enabling them to compete with larger managers. *The increased competition allows investors more choice between mutual funds and among products.*" *(emphasis added)*

In summary, in order to support the stated goals of the proposal, AIMA recommends that:

a) The national instrument recognize that market and regulatory processes serve to ensure conflicts of interest are reduced and that the use of commissions is appropriate.

b) Key requirements of the national instrument ensure that there is a level, competitive playing field between Canadian money managers and their major competitors in the U.S. so that the adviser's jurisdiction of residence does not impact the provision of services.

c) The draft regulations be amended to ensure that specific types of investment styles are not advantaged over others and that barriers to entry are not created. Maximum choice should be available as determined by the market.

Permitted Goods & Services

AIMA fully supports the stated goal of ensuring that there is clarity for investors with respect to which goods and services can be acquired by advisers utilizing client commission dollars.

However, we believe that this is best achieved through utilizing a "use"-based definition, as promulgated globally by The CFA Institute as part of its guidance on the use of client brokerage or commissions. This is a more principles-based approach to defining allowable expenses that focuses on how the goods and services are actually used by the adviser. This approach, coupled with a robust and meaningful disclosure regime, would meet the goals of the CSA as outlined above. This approach by The CFA Institute governs the professional and ethical duties of many of our members.

Under this approach research is defined as "Services and/or products provided by a Broker, the primary use of which must directly assist the investment manager in its Investment Decision-Making Process and not in the management of the investment firm." The Investment Decision Making Process is defined as "..the quantitative and qualitative process

and the related tools used by the investment manager in rendering investment advice to clients, including financial analysis, trading and risk analysis, securities selection, broker selection, asset allocation and suitability analysis."

We submit that the definitions of "order execution services" and "research" in the proposed standard generally meet the above definitions, but they must be expanded along the lines of the above to allow for the inclusion of additional items, such as raw market data, that are part of the process. These points have also been commented upon above and in Attachment A.

As pointed out the by The CFA Institute in its May 2005 comment letter to the FSA with respect to soft commissions, we believe that a content-based definition of research as outlined in the proposed standard is too narrow and could potentially eliminate many products and services that advisers legitimately use as research to benefit their clients. The proposed requirement that research include original thought or the expression of reasoning or knowledge ignores the fact that raw data can be an input to an adviser in order to form its own independent strategy or analysis. In our view it is inconsistent to implicitly state that such reasoning performed by a third party is superior to that performed by the adviser itself. Such an approach will increase research costs paid by investors. Investment decision-making is a process and all components and inputs to that process should be allowable for payment by commission dollars.

We fully support the SEC's view on research and the arguments put forth on July 18, 2006 in Release No. 34-54165; Commission Guidance Regarding Client Commission Practices Under Section 28(e) of the Securities Exchange Act of 1934, section III. C. 3. Market Research and 4. Data that includes the following observation on the eligibility of raw data as research: "In our view, this approach will promote innovation by money managers who use raw data to create their own research analytics, thereby leveling the playing field with those money managers who buy finished research, which incorporates raw data, from others."

Once the definitions for permitted goods and services have been finalized it is important that a transition period be allowed for advisers to review their usage and amend systems, supplier billing processes and other relevant policies and procedures.

In summary, in order to support the stated goals of the proposal, AIMA recommends that:

a) A usage-based approach to defining permitted goods and services be employed.

b) The regulations ensure that the adviser is able to obtain such goods and services at the lowest possible price and not favour one type of supplier over another.

c) The regulations set a transition period to allow a reasonable timeframe for implementation.

Transparency and Disclosure

We agree that adequate disclosure to investors and clients of an adviser's use of commissions is important to ensure that such amounts are used effectively for the benefit of the client and in accordance with the adviser's fiduciary duty to act fairly, honestly and in good faith. This clearly aligns with the goals above.

While this objective is not in dispute, our view is that such disclosure must be consistent with other disclosures, meaningful, easily understood by the investor and capable of being provided by the adviser in a cost effective manner. It

is important to note that disclosure has costs attached, both in monetary terms and in time requirements, the latter not only on the part of the adviser but also on the part of the client to understand the disclosure. There must be an effective balance between costs and benefits. The costs of providing such disclosure, which AIMA believes are not insignificant, will ultimately be borne by the investor.

In our view the proposed level of disclosure, particularly the requirement to drive it down to the individual client level, is more than is required to achieve the stated goals. Given how trading and such costs are generally managed in the industry, any such level of detail can only be achieved through a cost allocation process that would have to be developed by each adviser to reflect their business. Any such methodology will only be as good as the assumptions used to allocate the costs, which will differ from firm to firm and are subject to discretion and judgement. Thus any attempt at comparability between advisers becomes questionable and clients are likely to assume that there is a greater level of accuracy than actually exists.

In addition to the above, we do not believe that the proposed requirement to break out the commissions by supplier, and then for each supplier by type of instrument, with further subdivisions between order execution, research (both direct and bundled) and third party services would add significantly to investor understanding of costs. In our view it is also inappropriate to require a greater level of disclosure with respect to goods and services obtained from third parties, where a further breakdown is proposed, than for bundled services. It is AIMA's belief that distinguishing research by source rather than content does not increase investor understanding.

In our opinion the total commission costs, segregated between order execution and research, with a general description of the type of goods and services purchased, along with the ratio of the costs to the assets managed, would be sufficient information for most investors. This would have the benefit of consistency with the determination of the Management Expense Ratio or MER and allow comparability between advisers versus results, giving investors additional input into their choice of adviser.

Please note that this form of disclosure would be consistent with National Instrument 81-106 Investment Fund Continuous Disclosure ("NI 81-106") that requires the disclosure of total commissions or other transaction costs paid to dealers and the soft dollar portion of such costs paid to obtain goods and services other than order execution. NI 81-106 also requires the disclosure of the Trading Expense Ratio, determined as outlined above. In our view the type of disclosures made to investors should be consistent, irrespective of whether the adviser is managing the funds directly or in an investment fund. AIMA also believes that this sort of ratio disclosure is more meaningful to an investor.

We submit that the proposed requirement to disclose the specific suppliers of such goods and services would violate accepted norms of business confidentiality by forcing the disclosure of proprietary information. The vetting and development of supplier relationships can be a large part of an adviser's competitive advantage. Disclosure of such detail places the adviser at a competitive disadvantage, particularly with respect to foreign competition that does not have a comparable disclosure requirement.

The record keeping requirement as proposed is also potentially extremely onerous. While maintaining records for items which are subject to an invoice is obviously possible, in our view the proposal would incur significant costs in tracking and recording the receipt of other services. We do not think that maintaining records of the date for each good and service is meaningful data for an investor. The general regulatory requirement to maintain adequate books and records is sufficient.

The Alternative Investment Management Association – Canada Chapter
P.O. Box 786, Station "A", Toronto, ON, M5W 1G3
Tel. 416-453-0111 **Fax**. 416-322-9074 **Email**: briant@aima-canada.org **Internet**: www.aima-canada.org

As mentioned above it is important that the regulations allow a transition period for implementation. This is important given that the requirements are potentially an entirely new disclosure system for advisers.

In summary, with respect to transparency and disclosure, to provide meaningful information to investors as to how commissions are used we recommend that:

a) Disclosure be required only at the total or adviser level.

b) Costs only be broken out between order execution and research, with a description of the goods and services obtained, along with the ratio of such costs to assets managed being provided. The names of specific suppliers should not be required disclosure.

c) Record keeping requirements be in accordance with the general requirement to maintain adequate books and records to support business activities.

d) The regulations set a transition period to allow a reasonable timeframe for implementation.

(Please also see our specific comments on Attachment A for questions 11 to 15.)

Conclusion

AIMA fully supports the efforts of the CSA to achieve the policy goals of this initiative. We believe however that change is required to the draft proposal in order to:

1. **Explicitly set a goal that any proposals should not <u>increase</u> costs borne by investors either directly, or indirectly through increased costs to the adviser which could increase fees;**

2. **Ensure that disclosure to investors on how the commission dollars have been used is consistent, informative and meaningful, while recognizing the importance of the maintenance of each firm's proprietary competitive advantage;**

3. **Ensure that there is a level and competitive playing field for <u>all</u> participants in the Canadian market;**

4. **Utilize a usage-based approach to determine which goods and services can be acquired using commission dollars, recognizing that order execution and research are integrated processes;**

5. **Recognize that market and regulatory processes serve to ensure that the use of commissions is appropriate; and**

6. **Include a transition period for implementation of the final rule.**

We appreciate the opportunity to provide the CSA with our views on this proposal. Please do not hesitate to contact the following members of the working group with any comments or questions that you might have. We would appreciate the opportunity to meet with you in order to discuss our comments:

Ian Pember, Hillsdale Investment Management Inc. (416) 913-3920 ipember@hillsdaleinv.com
Co-Chair, Legal & Finance Committee, AIMA Canada

Ron Kosonic, Borden Ladner Gervais LLP (416) 367-6621 rkosonic@blgcanada.com
Co-Chair, Legal & Finance Committee, AIMA Canada

Phil Schmitt, Summerhill Holdings Inc. (416) 961-0891 pschmitt@summerhill-holdings.com
Chair, AIMA Canada

Yours truly,

ALTERNATIVE INVESTMENT MANAGEMENT ASSOCIATION

By: By:

By:

ATTACHMENT A
PROPOSED NATIONAL INSTRUMENT 23-102
AIMA CANADA COMMENTS RE 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 for services in addition to order execution be calculated?

In our opinion the proposed instrument should apply to any transaction where a demonstrable transaction based fee can be determined or reasonably estimated. This could be achieved by monitoring the bid/ask spreads and assessing the services provided by a broker or dealer in relation to the volume of trading with it and commissions charged on other types of transactions.

Question 2:

What circumstances, if any, make it difficult for an adviser to determine that the amount of commissions paid is reasonable in relation to the value of goods and services received?

It could be more difficult to determine if commissions are reasonable for the value received if an adviser tends to execute transactions with one dealer, either exclusively or in a majority of transactions, particularly if the adviser is small or just starting up. However, we believe that given the highly competitive nature of the Canadian and North American markets this risk is minimal and any adviser should be able to easily demonstrate that commissions paid are reasonable with respect to those paid, or that would be paid, to other dealers. This would be particularly important when such goods and services are obtained from non arms length parties.

It is also difficult to determine reasonableness when services are bundled with order execution and are not separately priced.

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 are generally used to handle an order from the time an investment decision has been made until it settles, including order entry and routing, messaging, execution tracking and pre- and post-trade analytics. Such systems are generally put in place in order to streamline the execution components of the investment process, allowing for its continuous review and improvement in order to reduce the overall costs of trading. In our opinion any component of an OMS that facilitates the placement and settlement of an investment

order and allows for improvement and monitoring of the process should be eligible for payment by commission dollars. Please note our comments below on question #4 with respect to post trade analytics.

Question 4:

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

We believe that post-trade analytics should be considered order execution services. In our view they are a key part of how an adviser reviews the order execution process and determines ways to make it better for the benefit of the investor. Similar to any process in the business world, undertaking an activity is a continuum of: Plan (make the investment decision); Do (execute the decision); Review/Check (analyze the process and its effectiveness); and Act/React (amend the process to incorporate improvements). Post-trade analytics are part of the Review/Check stage of the process. In our view excluding post-trade analytics would be analogous to not considering feedback from a teacher to be part of the education process.

In summary, post-trade analytics must be included as part of the feedback to allow the achievement of best execution and to lower the total costs of trading. It is all part of one continuous process.

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.?

The key difficulty arising from a differential treatment of goods and services would be a potential decrease in the ability of Canadian advisers to compete for business, particularly large institutional mandates. If a foreign adviser, e.g. in the U.S., is able to utilize commissions to pay for a service while 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 ability to compete with non-resident managers.

Besides this impairment, 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 to other jurisdictions where the regulatory regime enhances, or does not hurt, their ability to compete.

In summary AIMA believes that definitions should be conformed to ensure a level, competitive playing field, particularly with the U.S. as Canada's largest trading partner.

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 market data should be considered research under the proposed instrument. If this data is excluded from the definition of research the regulatory regime is in the position of discriminating against quantitative and momentum money management approaches, both of which utilize such data to construct their models and to conduct back testing. This would mean that the regulators are in the position of influencing what is available to

the investor in the market, rather than letting the market determine. We submit that this is not an appropriate role for a regulator to play. Please note that the proposal would give U.S. advisers a competitive edge over Canadian advisers utilizing the same sort of investment management approach.

The proposed instrument defines research to include "analyses or reports concerning securities, portfolio strategy, issuers, industries, or economic or political factors and trends," and goes on to require that such analyses or reports add value to investment or trading decisions. In our view such a definition and requirements are reasonable.

However, we disagree with the additional statement that in order to add value such analyses must contain the expression of reasoning or knowledge and contain original thought, including the analysis or manipulation of data to arrive at meaningful conclusions. The proposal states therefore that raw data would not constitute research.

We believe that the market has already indicated that the provision of raw data has great value. This is evidenced by the fact that various providers, such as Reuters and its many competitors, spend a great deal of money collecting, scrubbing, aggregating and distributing data from markets all over the world to arm's length customers who are willing to pay significant sums for such a service. There is great value to the end investor in the efficiency gains to the adviser in being able to obtain such data to support the process of formulating investment recommendations. Such services certainly result in lower costs than if the adviser attempted to obtain and aggregate such data itself.

The proposal as it stands could lead to the situation that if a quantitative-based adviser purchases raw data directly in order to construct its models it does not qualify for commission dollars. However, if an independent research provider buys the data, tweaks it in some fashion and then sells it to the quantitative adviser, it presumably could qualify for commission dollars. This means that the regulatory regime encourages the interposition of a middleman into the process, with a likely increase in the ultimate costs to the investor. In our opinion research is research, irrespective of whether the original thought and expression of reasoning and knowledge is conducted by a third party or by the adviser utilizing raw data to draw its own conclusions.

We would also point out an inconsistency in the proposed approach in that Section 3.2 of the Companion Policy specifically states that algorithmic trading software, if it assists in order execution, would qualify for commission dollars. However, algorithmic software functions based on the inflow of raw market data. This functional requirement is increasing with the development, for example, of neural networks and fuzzy logic to determine what investments will be made. We believe that if such systems are used for order execution and investment-decision making as part of an integrated process, then all components should be eligible for payment by commission dollars, subject to the adviser being able to demonstrate that such systems are utilized for the benefit of the client.

In summary, AIMA is of the opinion that 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. Similar to our comments above with respect to question #4, research is a process and all of its components should be permissible goods and services.

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 we understand that AIMA members do not use commission dollars to pay for proxy voting services.

However, in some circumstances, proxy voting services could qualify as research. Some providers of such services, such as Institutional Shareholder Services (ISS), offer data from their proxy voting databases on trends in corporate governance as reflected by shareholder voting. Research studies in the industry have indicated correlations between corporate governance and share prices, and so such data could be an 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. Therefore such costs could qualify for commission dollars as long as the adviser can demonstrate the relationship to the 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)?

The experience of AIMA members is that mixed use goods and services form an important part of purchases with commission dollars. When there are mixed use goods and services it can be difficult to make an allocation of costs when the item consists of a tightly integrated system where one element is not easily separable from another. The first step is generally to talk to the external supplier, if there is one, to attempt to get some idea of the relative cost components. If that is not possible the adviser will make its best guess and document the rationale accordingly, as the proposal indicates.

We believe that this is the only reasonable approach. However we would note that as long as such an approach can be shown to have been done in good faith and is reviewed regularly it should not be subject to second guessing upon review by another party.

As part of this issue we would like to point out that the lack of a transition period for implementation of the National Instrument could create problems. Both the FSA and SEC have allowed for a transition or implementation time period for advisers to implement or modify their systems as necessary. This could be particularly important with respect to mixed use goods or services. We are aware of several instances in the U.S. where suppliers are working on segregating their billings between permissible and non permissible services. This work cannot be done however until the final rules are known. We do not believe that it is reasonable to expect advisers to have done all the necessary work in order to be compliant with the National

Instrument from the date it becomes effective, since the final rules only become known at the date of publication.

In our opinion the proposal should include a transition period for implementation by advisers, similar to how other National Instruments have been implemented previously.

Question 9:

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

We believe that such information should be considered research. The fact that it is mass marketed and/or lower cost is reflective of the efficiency of the market, not whether it has value to an adviser. In our opinion it is better for an investor, due to lower costs, if an adviser can obtain market and corporate information from such publications versus paying more to a dealer via commissions to obtain the same information.

Similarly, industry publications and conferences or seminars can be an integral part of the research process and can deliver large value for cost. For example, is it better (and cheaper) for an adviser to attend a conference and have access to 10 analysts for discussions or to obtain access to the 10 analysts by paying a higher level of commissions to their 10 firms? In some cases industry leaders will only address the adviser community through public seminars where everyone has equal access.

Research should also include specialized publications marketed to a generally restricted audience, usually with a higher subscription or other costs, such as industry or trade journals. Such material can provide insight and thought to an advisers research process.

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?

As indicated by our general overview and responses to other specific questions, AIMA 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.

We believe that, following this approach, various items (see our responses to questions 4, 6, 7 & 9) should be included. In our opinion permitted goods and services should also include, for example, hardware and communication lines as long as the adviser can demonstrate dedicated usage by the order execution or research processes.

We do not see any items currently proposed for inclusion that should be excluded.

Question 11:

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

We do not believe that the form of disclosure should be prescribed but rather that the adviser and its clients should determine what is reasonable. However we believe that it is important, when specific data is required to be disclosed by any National Instrument, for the CSA to provide a suggested format that it believes would meet the requirements, while making clear that it is not mandatory. This would provide some guidance from which advisers could determine their own form of disclosure.

Question 12:

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?

We believe that the level of proposed disclosure is too detailed and would be confusing to most investors. In our view it is very difficult to lay out in an understandable manner (see our comments in Question #11 above) and we would appreciate the opportunity to discuss this with the CSA before the National Instrument is finalized.

Some specific comments with respect to the proposed disclosure are:

a) We do not believe that disclosure to the individual client level is meaningful. In our view disclosure for the adviser in total is sufficient; in the belief that when an investor selects an adviser they are interested primarily in how the business is run overall and whether the adviser will manage the money effectively. Please also refer to our comments below for question #14.

b) Disclosure by name of the dealers and suppliers utilized by the adviser violates business confidentiality by forcing the disclosure of potentially competitive data. Providing a general description of the goods and services received would be sufficient for most investors.

c) Breaking out the commissions by security class does not provide meaningful information to the investor. We believe that investor focus is on total costs.

d) Similar to (b), we do not believe that the provision of the weighted average cost per unit of security class is meaningful to the average investor. If the focus is on total costs then the ratio of the total cost of client commissions to assets under management is more easily understood and aligns with the determination of the Management Expense Ratio or MER. As mentioned previously, such disclosure would also be consistent with what is required of investment funds under NI 81-106.

e) The requirement to distinguish between bundled and unbundled services does not provide a meaningful distinction in our view. We believe that it is inappropriate to require a greater level of disclosure with respect to goods and services obtained from third parties, where a further breakdown is proposed, than for bundled services. What is received is what is important, not whether it is received as part of a package or independently. For example, research is part of both categories. Segregating the source or

how it is received is not meaningful for an investor, only the fact that research was purchased is important. Consequently we recommend that this distinction be removed and that the only breakdown be between order execution and research, with the latter broken down between what is retained by the executing broker and what is paid to third parties. This would be consistent with the categories in the instrument, and is consistent with the recommendations developed in the United Kingdom by the Investment Management Association and the National Association of Pension Funds.

Question 13:

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

We believe that annual disclosure is sufficient for investors.

Question 14:

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

The main difficulty with the proposed disclosure is the requirement to allocate the commission dollar analysis to the level of the individual client. It would likely only be rare instances where commissions and their usage could be tracked to a specific client. We believe that, given how the trading activity is conducted by most of our members at an aggregate level for multiple clients at once, providing data to the individual client level would become a large and burdensome cost allocation exercise, driven by whatever assumptions and allocation methodologies that the adviser considers reasonable. Any such allocation processes would likely require development by the adviser in-house, increasing costs significantly to develop and maintain. These costs would ultimately be borne by the investor. Given the range of businesses and allocation methodologies employed in the business world any such result is only a “best guess”. In our opinion investors would perceive the level of accuracy to be greater than is actually the case.

We believe that disclosure at the adviser level of the totals involved provides sufficient information to investors so that they can understand how the adviser uses commissions and that they are being used for the benefit of investors, which are two of the stated goals of the initiative.

We also submit that the proposed requirement to disclose the specific suppliers of such goods and services would violate accepted norms of business confidentiality by forcing the disclosure of proprietary information. The vetting and development of supplier relationships can be a large part of an adviser’s competitive advantage. Disclosure of such detail places the adviser at a competitive disadvantage, particularly with respect to foreign competition that does not have a comparable disclosure requirement.

In addition to the proposed disclosure, we believe that the specific books and records requirements are onerous and of questionable benefit. The requirements have the potential to necessitate the creation of a tracking and documentation system, especially with respect to items that are obtained other than through invoices or through more informal processes. In our opinion the general requirement on all advisers to maintain adequate books and records to support the business is sufficient. The proposed national instrument does not have to contain additional requirements.

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 this 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 reasonably estimated?

We define trades done on a "net" basis to be trades done with no commission paid where the broker is remunerated by the bid/ask spread, or trades done on a principal basis.

In our opinion such trades should be disclosed in a fashion similar to the UK IMA's approach. If transaction fees can be reasonably estimated (see our response to question #1) then they should be allocated.

The Alternative Investment Management Association – Canada Chapter
P.O. Box 786, Station "A", Toronto, ON, M5W 1G3
Tel. 416-453-0111 Fax. 416-322-9074 Email: briant@aima-canada.org Internet: www.aima-canada.org