AGF Funds Inc.
Toronto Dominion Bank Tower
66 Wellington Street West, 31st Floor
Toronto, ON M5K 1E9
Tel: 416 367-1900
Web: AGF.com

October 27, 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
19th Floor, Box 55
Toronto, Ontario M5H 3S8

c/o Anne-Marie Beaudoin
Directrice du secretariat
Authorité des marches financiers
Tour de la Bourse
800, square Victoria
C.P. 246, 22 étage
Montreal, Quebec H4Z 1G3

Dear CSA members:

Re: Canadian Securities Administrators ("CSA") Proposed National Instrument 23-102 ("Proposed NI 23-102") ***Use of Client Brokerage Commissions as Payment for Order Execution Services or Research*** **and Proposed Companion Policy 23-102 ("Proposed CP 23-102")**

AGF Funds Inc. ("AGF") is pleased to provide its comments with respect to Proposed NI 23-102 and Proposed CP 23-102 and looks forward to the implementation of a fair and effective rule respecting soft dollar arrangements that is reflective of the dual objectives of the *Securities Act* (Ontario)[1]:

[1] *Securities Act* (Ontario) (the "Act"), s. 1.1. The securities legislation in the majority of CSA-member jurisdictions contains similar statements of purpose.

1. to provide protection to investors from unfair, improper or fraudulent practices; and

2. to foster fair and efficient capital markets and confidence in capital markets.

AGF fully supports initiatives designed to meet these objectives. However, AGF has a number of outstanding concerns which we believe the CSA must address prior to the implementation of Proposed NI 23-102 and Proposed CP 23-102. These concerns include:

The CSA's Cost-Benefit Analysis is Unrealistic

As preliminary matter, AGF supports the CSA's practice of undertaking cost-benefit analyses in connection with regulatory initiatives such as Proposed NI 23-102. However, in this particular instance, the CSA's cost-benefit analysis represents a gross under-estimation of the costs that would be associated with the implementation of the proposed rule. We respectfully submit that, on a *per firm basis*, costs could range into the hundreds of thousands, if not millions, of dollars. Some of the significant potential costs not considered by the CSA in its analysis include:

- technology costs associated with modifications to existing trade order management and compliance systems necessary to monitor, track, allocate and report soft dollars in accordance with the proposed rule;

- human resource costs associated with hiring and training new compliance, investment management and back office personnel to administer the processes contemplated by the proposed rule. In addition, ensuring ongoing compliance with Proposed NI 23-102 would require the involvement of legal and compliance personnel well beyond the 8 days allocated by the CSA under the category of "one-time costs"; and

- indirect costs passed on to advisers by sub-advisers required to comply, either directly or indirectly, with Proposed NI 23-102. In order to ensure full compliance with the proposed rule, advisers will be required to ensure that any sub-advisers also implement policies and procedures consistent with both the proposed rule and the policies and procedures implemented by the adviser. In addition to the direct costs borne by the adviser associated with co-ordinating an undertaking of this nature, it is likely that sub-advisers will expect advisers to share in the sub-adviser's costs of compliance with Proposed NI 23-102, either directly or through the imposition of higher sub-advisory fees.

Accordingly, AGF submits that the "one-time costs" of implementation associated with Proposed NI 23-102 will significantly exceed the estimate of $2,800 per firm put forth by the CSA. Furthermore, the cost-benefit analysis commissioned by the CSA ignores the ongoing costs of compliance beyond the initial implementation. It is with these realities in mind that we respectfully ask the CSA, in considering the comments of AGF and other industry participants, to remain mindful of the costs associated with Proposed NI 23-102 relative to any potential gains from its implementation.

Proposed NI 23-102 Does Not Reflect the Structure of the Investment Management Industry and its Participants

The CSA's one size fits all approach to the regulation of soft dollar arrangements underlying Proposed NI 23-102 fails to reflect key distinctions in the structure of the investment management industry and its participants. In particular, Proposed NI 23-102 fails to acknowledge the differences which exist between retail and institutional client relationships.

Retail clients, primarily mutual fund investors, are typically more passive investors who may have little or no direct contact with the mutual fund managers managing their investments. To the extent that these retail clients invest primarily, if not exclusively, through investment funds subject to National Instrument 81-106 *Investment Fund Continuous Disclosure* ("NI 81-106"), these clients already receive appropriate disclosure of soft dollar arrangements as contemplated by section 2.6 to the Companion Policy to NI 81-106. Furthermore, to the extent that National Instrument 81-107 *Independent Review Committee for Investment Funds* ("NI 81-107") will eventually come to govern the majority of investment funds held by retail clients, the CSA has already taken appropriate measures to protect these clients from the conflicts of interest which the CSA has identified as being an important concern in the context of soft dollar arrangements. Accordingly, AGF respectfully suggests that the disclosure obligations contained in Proposed NI 23-102 are not necessary or appropriate in the context of investment funds governed by NI 81-106 and NI 81-107 and should therefore be expressly carved out from the application of the disclosure requirements contemplated by the proposed rule.

In contrast to the vast majority of retail clients, institutional clients – typically sophisticated financial institutions and pension funds – are generally in a position to devote considerable time and resources to both the negotiation of investment management agreements with their advisers and to the ongoing oversight of their advisers' investment activities. Given their general level of sophistication relative to a typical retail client, it is arguably more appropriate that institutional clients receive enhanced disclosure respecting the soft dollar arrangements entered into by their advisers. Indeed, investment management agreements in the institutional space often contemplate comprehensive soft dollar disclosure. In the circumstances, mandating additional disclosure for institutional clients is unnecessary. Accordingly, AGF respectfully submits that the CSA seek to formulate a definition of "institutional client" and expressly carve out such institutional clients from the application of the disclosure requirements contemplated by the proposed rule.

Proposed NI 23-102 fails to properly define the proposed rule's use of the terms "client", "account" and "portfolio". As presently drafted, Proposed NI 23-102 does not define these key terms. As a result, certain ambiguities emerge depending on the type of client relationship through which Proposed NI 23-102 is viewed. For instance, in the institutional or private client worlds, determining who a "client" is, or which "accounts" or "portfolios" are held by each client, may be a relatively uncomplicated exercise. However, who is the "client" of an adviser managing an investment fund? Is it the fund with whom the adviser has contracted to provide investment management services? Alternatively, is it the securityholders of the investment fund? Furthermore, are the terms "account" or "portfolio" even relevant in the investment fund context? These are just some of the important questions that remain unanswered by Proposed NI 23-102 and Proposed CP 23-102.

Taking our investment fund example, if we assume that the "client" of the adviser is the investment fund itself, section 4 of Proposed NI 23-102 requires disclosure to the fund. This would appear an odd result, especially in circumstances where the adviser is also the manager and/or trustee of the fund. Conversely, if we assume that the "clients" of the adviser are the securityholders of the investment fund, the disclosure contemplated by Part 4 of Proposed NI 23-102 would require tracking and reporting of soft dollar information at the individual client level. This too would appear to precipitate an odd result – mandating that investment fund managers undertake a fundamental overhaul of their client reporting systems, all for the purpose of tracking and reporting soft dollar data which, at the level of the individual securityholder, is likely to be effectively without context or meaning.

Resolving these and other latent ambiguities in Proposed NI 23-102 will be vital to the implementation of a fair and effective rule governing soft dollar arrangements. In undertaking this important task, it is imperative that the CSA take care to structure the rule and its terminology in a manner which more accurately reflects the structure of the investment management industry and the diversity of its clients.

Proposed NI 23-102 Will Provide Clients with Irrelevant and Potentially Misleading Information

In the Request for Comments accompanying Proposed NI 23-102, the CSA identifies the purpose of the proposed rule as "providing a specific framework for the *use* of client brokerage commissions by advisers [emphasis added]". Indeed, subject to the comments below, Parts 1 through 3 of Proposed NI 23-102 and Proposed CP 23-102 represent a constructive step toward establishing an effective framework governing the use of brokerage commissions to purchase goods and services.

In sharp contrast, Part 4 of Proposed NI 23-102 contemplates the imposition of disclosure obligations on advisers which do not further the CSA's stated objectives of increased transparency and accountability. Rather, the CSA has crafted a rule which is more likely to detract from these laudable objectives than further them. AGF respectfully submits that the level of detail respecting soft dollar arrangements required to be tracked and maintained by advisers and disclosed to clients is likely to leave all but the most sophisticated of clients drowning in a sea of data which they are unlikely to have the inclination to wade through, even assuming they have the analytical tools at their disposal to do so.

For example, section 4.1(1)(b) of Proposed NI 23-102 requires disclosure of the total brokerage commissions paid for each class of security (i) across all accounts or portfolios and (ii) in respect of the particular client's account or portfolio. Similarly, section 4.1(1)(d) requires disclosure of a reasonable estimate of the weighted average brokerage commissions per unit of security. However, in order to fully appreciate the resulting data, it is imperative that a client possess at least a cursory understanding of the various factors which influence the amount of brokerage commissions payable. These factors include, but are by no means limited to (i) whether the securities are equity or fixed income securities, (ii) the liquidity of the securities, (iii) the markets on which the securities were purchased or sold and (iv) the timeframe within which the adviser was required to purchase or sell the securities. What is more, the level of commissions payable in connection with a single account or portfolio may vary over time based on, amongst other things, prevailing market conditions, the interest rate environment, rebalancings and the general level of portfolio turnover. All of this is to say that, absent a firm grasp of these factors and the manner in which they interrelate, there is a very real danger that clients may misinterpret[2] the disclosure contemplated by Proposed NI 23-102. As discussed in greater detail below, the potential for misinterpretation is further enhanced by the absence from Proposed NI 23-102 of any meaningful guidance respecting the framework within which the disclosure contemplated by Proposed NI 23-102 should be presented to clients.

Furthermore, where the disclosure contemplated by Proposed NI 23-102 is not potentially misleading, it is often irrelevant. For example, it is difficult to comprehend how the identity of a dealer or third party service provider[3], or the date a permitted good or service was received[4], would be particularly relevant in the context of a client's investment decision-making process. Similarly, comprehensive descriptions of the permitted goods and services provided will not be meaningful to the vast majority of clients. Given the significant costs which will be incurred by advisers in connection with the collection and disclosure of this information, it is imperative that the CSA reconsider whether the benefits of the disclosure provisions, if any, truly outweigh the costs.

---

2 For instance, in the absence of consistent standards respecting the (i) unbundling of brokerage commissions or (ii) presentation of soft dollar disclosure, a client may assume that they are making an "apples-to-apples" comparison between two advisers. In reality, however, differences in the soft dollar data disclosed by each adviser may – as a result of the absence of consistent standards - reflect differences in the advisers' unbundling practices and/or disclosure policies rather than the advisers' actual use of permitted goods and services.

3 See sections 4.1(1)(a), 4.1(2)(b) and (c) of Proposed NI 23-102.

4 See section 4.1(d) of Proposed NI 23-102.

Proposed NI 23-102 Is Not Consistent With Soft Dollar Requirements in the U.S. and U.K.

The level of disclosure contemplated by Proposed NI 23-102 is not consistent with the corresponding U.S. requirements under section 28(e) of the *Securities Exchange Act of 1934* or FSA Policy 05/9 in the U.K. Most notably, the level of disclosure presently contemplated by Proposed NI 23-102 will put the Canadian investment industry at a relative disadvantage, primarily owing to the increased costs of compliance. Accordingly, AGF respectfully submits that the disclosure requirements contained in Part 4 of Proposed NI 23-102 should be harmonized to the fullest extent possible with the corresponding requirements in the U.S. and U.K.

Proposed NI 23-102 Does Not Provide Sufficient Guidance Respecting the Presentation of Disclosure to Clients

As articulated in section 5.3 of Proposed CP 23-102, the CSA has made the conscious decision not provide any meaningful guidance respecting the manner in which the disclosure contemplated by the proposed rule should be presented to clients. Upon implementation, this will result in potentially dramatic variances in the presentation and quality of disclosure between advisers. In turn, these variances will make "apples-to-apples" comparisons between advisers more difficult for clients to undertake. Accordingly, AGF respectfully submits that the CSA should include more guidance respecting the presentation of client disclosure. As previously noted, these requirements should be tailored to reflect the needs of each type of client as well as the nature of their relationship with their advisers.

Proposed NI 23-102 Should Require Broker-Dealers to Unbundle Their Commissions

At present, Proposed NI 23-102 contemplates that, in the absence of more reliable information, advisers will be required to formulate a "reasonable estimate" of the portion of their total brokerage commissions attributable to each of order execution and research. However, in reality, order execution and research are so intertwined as to render separating them out a difficult, if not impossible, task for an adviser to perform with any degree of precision. In contrast, the information necessary to perform the requisite unbundling should be readily available to the broker-dealers charging the commissions. However, broker-dealers are not presently required to provide this information to advisers, nor does Proposed NI 23-102 seek to impose such an obligation. Accordingly, AGF respectfully submits that the implementation of a fair and effective rule governing soft dollar arrangements necessitates a corresponding requirement obligating broker-dealers to unbundle their commissions.

Proposed NI 23-102 Excludes from the Definition of Research Certain Goods and Services Which are Undeniably of Benefit to Investors

As previously noted, AGF is of the view that Parts 1 through 3 of Proposed NI 23-102, together with Proposed CP 23-102, represent a positive step toward the formulation of a fair and effective framework for classifying permitted goods and services. However, AGF respectfully submits that the following items should be included as permitted goods and services under the category of "research":

- ***Post-Trade Analytics***. While AGF is in agreement with the CSA that post-trade analytics should not fall within the definition of order execution services, we respectfully submit that post-trade analytics may properly fall under the definition of research. Post-trade analytics add value by providing advisers with useful information and analysis respecting historical transaction costs. In particular, post-trade analytics can assist advisers in achieving best execution and managing risk.

- ***Raw Market Data***. As indicated by the U.S. Securities and Exchange Commission in its 2006 Release, raw market data is generally aggregated and, therefore, contains sufficient substantive content to be considered research. In other words, the effort expended in sorting, ordering and presenting this data in a usable format manifests the thought, knowledge and expression of reasoning necessary to elevate raw market data to the status of research. On the same basis, goods and services such as Bloomberg terminals – which are a valuable tool for advisers in the performance of their investment management activities and do not present any conflicts – should be considered permitted goods and services under Proposed NI 23-102.

- ***Proxy Voting Services***. To the extent that the proxy voting services provide advice in connection with voting on non-routine matters such as mergers, acquisitions, takeovers and proxy contests, these services are likely to contain the level of thought, knowledge and expression of reasoning necessary to elevate such analysis to the status of research.

- ***Seminars***. Seminars are simply an alternative medium by which to communicate information which may otherwise constitute research. Goods and services which otherwise manifest the content necessary to be considered research should not be *a priori* excluded from this category on the basis of the format in which the goods or services are delivered.

AGF would like to take this opportunity to recognize the many challenges faced by the CSA in formulating a rule respecting soft dollar arrangements which strikes a fair and effective balance between the objectives of investor protection and capital market efficiency. In pursuit of this balance, however, the CSA must recognize that the existing securities regulatory framework contains numerous mechanisms to ensure both that registered dealers and advisors act fairly, honestly and in good faith with their clients and that clients receive the information necessary to make fully informed investment decisions. AGF respectfully submits that the costs of implementation and ongoing compliance with Proposed NI 23-102 in its current form will dwarf the potential benefits identified by the CSA. Indeed, AGF is sceptical about whether and to what extent these proposed benefits – in particular those the CSA hopes will be generated by the proposed disclosure requirements – will actually materialize. Accordingly, we ask that the CSA carefully weigh the costs and benefits of Proposed NI 23-102 in order to ensure that the rule which is ultimately adopted is in keeping with the principles and objectives underlying Canadian securities laws and is truly of benefit to investors.

Yours truly,

AGF FUNDS INC.