CARDINAL CAPITAL MANAGEMENT, INC.
Investment Counsellors

506-1780 Wellington avenue
Winnipeg, Manitoba R3H 1B3
Telephone: (204) 783-0716
Toll Free: 1-800-310-4664
Fax: (204) 783-0725
www.cardinal.ca

June 19, 2007

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

c/o **Mr. John Stevenson**
Secretary
Ontario Securities Commission
20 Queen Street West
19th Floor, Box 55
Toronto, ON
M5H 3S8

and

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

Dear Sirs,

Re: Proposed National Instrument 31-103 - *Registration Requirements*

Thank you for the opportunity to provide our comments on Proposed National Instrument 31-103 – *Registration Requirements* (the "Instrument"). Please note that as we are registered only as investment counsel and portfolio manager, our comments are intended to apply only to those aspects of the Instrument that are relevant to that category.

Section 2.6 – Individual Categories

Suggested Addition of Trader Category:

While we applaud the extensive efforts to streamline the available registration categories, we query whether the addition of a "trader" category may be appropriate for those persons whose primary role is a functional trading one within a firm. Given the continually-changing nature of trading technology, products and regulatory requirements, it may be prudent to develop a category that creates specific educational requirements for persons in this role (who are not otherwise registered to carry out portfolio management services), which would presumably be different than the educational requirements of an advising representative or an associate advising representative; that is, an operational and technical regulatory compliance focus would be appropriate. Given the importance of this role within a firm, we suggest that regulatory approval and oversight of such persons is not inappropriate.

Section 4.10 – Associate Advising Representative

Currently, persons registered as Associate Advising Representatives with the Manitoba Securities Commission as their principal regulator will have typically satisfied these educational requirements: completion of the Canadian Securities Course, and enrolment in either Investment Management Techniques or CFA Level I. Any such registrant must act under the supervision of an advising officer of the firm, but no experience requirements are prescribed – which is appropriate in our view given that this is an apprentice category. Under NRS, satisfaction of these requirements will, in our experience, result in approval of the registration in all other Canadian jurisdictions, with terms and conditions attached where the associate or "junior" categories are not available.

Under the Instrument, Associate Advising Representatives may be granted registration upon completion of a requirement, or any part of a requirement, set out in section 4.9 [*portfolio manager – advising representative*]. Section 4.9 prescribes two tracts of educational and experience requirements for Advising Representatives, with actual experience ranging from 12 to 48 months. In the commentary to the Instrument, reference is made to the understanding that the CFA tract is generally appropriate for portfolio managers who act for institutional clients, and the CIM tract is generally appropriate for portfolio managers who act for retail clients (presumably via an IDA platform).

There are two issues upon which we provide comment. First, it is unclear how these new requirements for Associate Advising Representatives will impact on the renewal of currently registered individuals who do not meet either the suggested experience requirements or a sufficient "part" of the prescribed educational requirements. With respect to experience requirements, the Companion Policy provides examples of relevant experience:

- at least two years performing financial or investment research
- at least two years employment as a registered dealing representative with a registered dealer firm
- at least two years under the supervision of:
    - an unregistered investment manager of a Canadian financial institution
    - an adviser that is registered in another Canadian jurisdiction or a foreign jurisdiction, or
    - an adviser that is not required to be registered under the laws of the jurisdiction or foreign jurisdiction in which the adviser carries on business

With respect to educational requirements, the Companion Policy indicates that the regulator will consider granting an exemption from any of the prescribed proficiency requirements if the regulator is satisfied that an individual has qualifications or relevant experience that are equivalent to, or more appropriate in the circumstances than, the prescribed proficiency requirements.

While we would assume that automatic renewal of current registrants in this category would be the most likely intention of the regulators, it would provide comfort to registrants if this was actually set forth in the transitional provisions of the Instrument or in the Companion Policy. Absent such statements, a registrant may not know if his or her registration will be renewed at all or with new terms and conditions that may impact the person's ability to perform their job function. In particular, our view is that if this is truly an apprentice category, no experience requirements should be prescribed, as it would be very difficult to provide an opportunity for experience when a person is unable to perform the activities in question.

The second issue follows from the above. The Instrument uses one category of registration for what the commentary acknowledges are two very different roles within a firm, that is, the commentary suggests that the Associate Advising Representative category will be appropriate for both apprentice portfolio managers and client services professionals who do not manage portfolios. Given the fact that there appears to be significant discretion in determining what qualifies as proficiency and experience in this category, we query whether a more formal distinction is appropriate in order to avoid confusion as to what a registrant in this category is authorized to do. This could be clarified by: (a) formalizing what the Quebec Securities Commission now imposes on client services staff in this category, being a condition on registration that all activities be restricted to client services and the registrant have no involvement in the portfolio management function, (b) adding distinguishing descriptive terms to the category titles, or (c) creating an entirely separate category for client services staff who have no portfolio management responsibilities.

Section 4.17 – Insurance – Adviser

Section 4.17(1) requires that an adviser that does not "handle, hold, or have access to" client cash or assets must maintain a financial institution bond for $50,000. Where an adviser does "handle, hold or have access to" client cash or assets, the bonding requirement increases in a material way – from a minimum of $200,000 (which would apply only to those advisors having less than $20 million in assets under management) to up to $25 million in bonding. If an advisor is found to fall within section 4.17(2), the financial impact of the new bonding requirement to which it will become subject is unknown but likely highly material to its operating budget. In our firm's case, our bonding requirement would rise from the current $200,000 to $10 million. An enquiry made to our insurance broker (Sinclair Cockburn) led them to contact the insurer, American Home Assurance Company. The insurer advised that until they have certainty of the regulatory requirement, they would not be attempting to develop a premium schedule given the significant impact of the change on customers – which in our firm's case would be an instant 5,000% increase in mandatory coverage levels.

In our view, use of the phrase "handle, hold, or have access to" without a clear definition or guidance in the commentary as to what it encompasses is not appropriate, given that it could be interpreted to capture many activities that an adviser carries out but which do not provide actual or regular access to client cash or assets, such as receipt of a third party cheque, inadvertent receipt of security certificates, etc. In our view, these significant levels of mandatory bonding should be directed at those advisors who actually have custody of client cash or assets in their business, where the risk of fraud is far more likely as compared to advisors who require that client cash and assets be held by a third party custodian or broker-dealer.

We respectfully suggest two alternatives. First, at a minimum, we suggest that the CSA consider adopting use of a term such as "custody" as used by the US Securities and Exchange Commission ("SEC"). This is defined in Rule 206(4)-2 of the Investment Advisor's Act of 1940 as follows:

> "Custody" means holding, directly or indirectly, client funds or securities, or having any authority to obtain possession of them. Custody includes --
>
> (i) Possession of client funds or securities, (but not of checks drawn by clients and made payable to third parties,) unless you receive them inadvertently and you return them to the sender promptly but in any case within three business days of receiving them;
>
> (ii) Any arrangement (including a general power of attorney) under which you are authorized or permitted to withdraw client funds or securities maintained with a custodian upon your instruction to the custodian; and

> (iii) Any capacity (such as general partner of a limited partnership, managing member of a limited liability company or a comparable position for another type of pooled investment vehicle, or trustee of a trust) that gives you or your supervised person legal ownership of or access to client funds or securities.

We believe that this definition provides sufficient clarity such that advisors will be better able to determine which bonding requirement is applicable.

As a better alternative, we suggest that the CSA consider adopting a rule similar in nature to that imposed by the SEC on registered investment advisors, being a requirement that client assets be held by an institutional custodian or a registered broker-dealer, which removes the risk of fraud perpetrated by an advisor with direct custody of client cash and assets. The fact that a custodian provides quarterly account reporting to the ultimate client builds in a protection whereby the client is able to verify their account on a regular basis from documentation provided by a third party. An acceptable custodian provides financial stability and protection to clients; a Canadian broker-dealer, in addition to being a registered entity, will be a participant in CIPF. A further alternative could be to specifically exclude from "custody" those assets and cash that are held by a custodian or a broker-dealer.

As general support for this point, we refer to section 5.35 of the Instrument, which requires a non-resident registrant to have client assets held directly by the client, by an acceptable custodian or by registered dealer that is a member of an SRO that is a member of CIPF or comparable fund. We believe that this model is the most appropriate system to apply to advisors generally, and by its application makes the proposed new bonding levels prescribed in Part 4 unnecessary.

We specifically refer you to Securities and Exchange Commission 17 CFR Part 275 and 279 [Release No. IA-2176; File S7-28-02] RIN 3235-AH-26, *Custody of Funds or Securities of Clients by Investment Advisors,* issued September 25, 2003, for a more extensive discussion of the amended SEC Rule and the related SEC staff commentary, which we believe provides relevant discussion of the SEC approach.

As a secondary issue, we suggest that Part 5, Division 3 (*Client Assets*) be modified appropriately to use the same terminology as Section 4.17 (whether modified or not). As it stands, sections 5.13(1) and (2) refer to a firm that "holds" securities or cash, which suggests that the phrase "handle, hold, or have access to" as used in section 4.17 has a more expansive meaning.

Sections 5.3, 5.5 – Conduct Rules

While an investment fund manager will be a registrant upon imposition of the Instrument, and mutual fund sub-advisory agreements are entered between an advisor and the investment fund manager, it is not clear if the exception provided by section 5.5 is broad enough to exclude the relationship with the

mutual fund (being the ultimate client) from the requirements of Part 5. We believe clarification of this point is necessary.

Section 6.1 – Conflicts

Section 6.1(1)(d) places a positive requirement on a registered firm to identify both potential and actual conflicts of interest between clients. We believe that the application of section 6.1(3), which requires the registrant to disclose the identified conflict to the applicable clients, forces the registrant to breach Canadian privacy laws as well as the CFA Institute Code of Ethics, which requires that the identity of clients be kept confidential. In our view, a firm ought to have in place procedures that identify conflicts of interest between clients, and have in place policies to reduce or negate the impact of conflicts between clients. In theory, every client is in conflict with each other when the firm is buying or selling securities because of price changes, and it is left to the registrant to develop and implement appropriate policies and procedures to manage the conflict. We believe that the same philosophy should apply to any and all conflicts, and that specific disclosure is both unnecessary and improper.

Section 6.3 – Registrant Relationships

Section 6.3(2), which prohibits a dealing, advising or associate advising representative of a registered firm from acting as an officer, partner or director of a non-affiliated registered firm, is a stark change from the existing regulatory landscape exemplified by Ontario Securities Commission Rule 31-501 (*Registrant Relationships*). Under OSC Rule 31-501, where a principal shareholder, officer, partner or director of a registered firm is a principal shareholder, officer, partner or director of another registered firm:

a) the fact must be disclosed to the OSC, including the business reasons for the relationship;
b) the registered firm must adopt policies and procedures to minimize the potential for conflicts of interest resulting from the relationship; and
c) the details of the relationship, and the policies and procedures adopted to minimize the potential for conflicts of interest, must be disclosed to clients.

We believe that this combination of disclosure and polices and procedures deals appropriately with these types of situations, and permits firms (in particular smaller firms) to develop a variety of business relationships with other registrants that are mutually beneficial. We believe that imposing the prohibition under the Instrument on existing business relationships made in accordance with OSC Rule 31-501 will have a material adverse impact on such firms. We also fail to understand the public policy rationale behind the prohibition given the prior acceptability of the OSC Rule 31-501 procedures. Moreover, by exempting affiliated entities from the prohibition (being typically subsidiaries within large financial institution organizations), the CSA is penalizing smaller firms.

While we can appreciate the application of the prohibition on firms within the same registration category, we do not support the blanket prohibition provided by the Instrument.

Part 8 – Information Sharing

We express our concern that compliance with section 8.1(1) could constitute a breach of privacy laws, could constitute defamation or trigger another cause of action, and could place a firm in a position where it must choose between non-compliance with the Instrument and breaching the confidentiality terms of a settlement agreement or other agreement entered in connection with a termination. Our view is that the current disclosure mandated by the Uniform Termination Notice should be all that is required of a firm, and, as in any other industry, it should be left to the hiring firm to perform whatever due diligence they feel is appropriate.

If a registrant has been the subject of an investigation or other action by a member of the CSA, we suggest that the onus of making disclosure about a prospective employee should fall to the CSA. Disclosure to the new firm could be made during the registration process, including through a pre-hire review process the CSA could establish.

***

We appreciate the opportunity to provide comment.

Yours truly,

CARDINAL CAPITAL MANAGEMENT, INC.
Per:

Steven M. London
Vice-President, General Counsel & Chief Compliance Officer