Borden Ladner Gervais LLP
Lawyers • Patent & Trade-mark Agents
Scotia Plaza, 40 King Street West
Toronto, Ontario, Canada M5H 3Y4
tel.: (416) 367-6000 fax: (416) 367-6749
www.blgcanada.com

BORDEN
LADNER
GERVAIS

June 20, 2007

Via Email

British Columbia Securities Commission
Alberta Securities Commission
Saskatchewan Financial Services 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

Delivered to:

John Stevenson
Secretary
Ontario Securities Commission
20 Queen Street West
19th Floor, Box 55
Toronto, ON M5H 3S8
jstevenson@osc.gov.on.ca

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
consultations-en-cours@lauthorite.qc.ca

Dear Sirs/Mesdames:

Re: Proposed National Instrument 31-103 *Registration Requirements*, Companion Policy and Related Forms Published for Comment on February 27, 2007

We are pleased to provide the members of the Canadian securities administrators (CSA) with comments on the above-noted proposed instruments (the Proposed Rule, the Proposed Policy and collectively, the Proposals).

These comments are those of lawyers in BLG's Securities and Capital Markets practice group and do not necessarily represent the views of the firm or our clients, although we have incorporated feedback received to date from our clients into this letter. Our

BORDEN
LADNER
GERVAIS

comments follow the general format of the Proposed Rule and contain more substantive comments, as well as drafting comments.

1. Support for the CSA's General Direction

We fully support the goal of the CSA with the overall Registration Reform Project: to harmonize, streamline and modernize the registration regime across Canada and to create a flexible and administratively efficient regime with reduced regulatory burden.

To the extent that the Proposals will create a nationally-uniform set of rules that would govern the "fit and proper" requirements and conduct rules for registrants, as well as any applicable exemptions for specified industry participants, we believe that the Proposals are a very positive regulatory development. Today, in order to properly advise our clients, we must keep track of not only differing rules in the various provinces that apply to the same activity or registrant, but even more troubling, different interpretations and methods of administering regulations, rules and legislation that may be substantively the same in each province. Today's regulatory regime creates inefficiencies, regulatory burdens and increased costs for our clients that are unjustified in the context of the Canadian capital markets.

We urge the CSA to move forward with the Proposals with a view to ensuring that each jurisdiction passes uniform legislation and rules, and, even more importantly, that staff in each jurisdiction administer and interpret the legislation and rules in a uniform and consistent fashion.

As we noted in our comment letter delivered to the CSA on the proposed Passport System (please see our letter of June 8, 2007), most securities industry participants in Canada are not "local" market participants, given that for the most part, securities are sold to all Canadians in every province and territory and industry participants often participate in the markets in many of those jurisdictions. To the extent industry participants today distribute securities or advise on securities in a limited number of provinces or territories, they generally do so to avoid having to deal with all regulators and all laws in all provinces and territories. We see no need for *any* local rules or regulation and, particularly, no need for any differing interpretations or administrative positions (particularly unwritten administrative positions) by different regulators.

2. Lack of Complete Legislative Context for the Proposals

The Proposals are predicated on amendments to existing securities legislation in each province and territory being passed since, among other things, current legislation is based upon registration requirements for "trading" in securities and does not address being in the business of being an investment fund manager. Although we recognize that the OSC described generally the features of the legislative amendments necessary in Ontario with the Notice published on the OSC's website, we are concerned that we are being asked to comment on the Proposals without a complete understanding of their context in the overall legislative scheme applicable to registrants in each province and territory.

BORDEN
LADNER
GERVAIS

We know that the BCSC has published a draft rule that outlines how it proposes to handle the concept of a "business trigger" for dealing in securities, but we were unable to locate the base requirement to be registered as an investment fund manager.

We are also aware that Bill 21 *Securities Amendment Act, 2007* has received royal assent in Alberta. Bill 21 takes a different approach from the BCSC draft rule, and contains definitions of *adviser, advising in securities*, *dealer*, *dealing in securities* and a requirement to register if an entity is a dealer, adviser or an investment fund manager. In all cases, the "business trigger" is part of the definitions.

There has not been any public information about the status of legislative changes in any other province or territory. As we noted in our Passport System comment letter, we are strongly in favour of *uniform* approaches by the members of the CSA and do not understand the necessity for one or more provinces to go a different route, simply because of philosophical differences. For example, we understand from public presentations by BCSC staff on the Proposals that the BCSC believes that it has good reasons for its rule-based approach, but these reasons are nowhere explained in writing on a more public basis. We fear that these reasons will be lost as time moves on and industry participants will soon be back at today's situation of having to analyse why differences exist between different provinces' regulation and whether they have any practical bearing or implications. Even if we are able to conclude at the end of that analysis that there are no practical implications, the mere fact that we were forced to do that analysis because of different approaches increases regulatory costs to our clients and industry participants.

We urge the CSA to publish, ideally for comment, a more complete description of the legislative implementation approaches being taken in each province and territory, together with a description of the mechanisms proposed to ensure uniform approaches and harmonized implementation dates. We urge those members of the CSA who are today in the minority in approaching how to implement the Proposals (from a legislative perspective) to agree with the majority of CSA members so that a uniform approach will result.

3. Lack of Complete Context for the Proposals for SRO Members

We understand from public presentations that the two SROs for dealers in Canada, the Investment Dealers Association of Canada and the Mutual Fund Dealers Association of Canada, will be publishing proposed rules that will supplement or add to the Proposals later this year or early next year We urge the CSA to publish an explanation of what those new rules will cover and how they will fit with the Proposals. The lack of common understanding of what else is being worked on, other than the Proposals, has led to misunderstanding and confusion on the part of our clients, as well as our lawyers, as we work to comment on the Proposals.

4. Support for Careful Transitioned Implementation of the Proposals

We recognize that the CSA has been actively discussing the Proposals with selected industry participants since 2004. We were pleased to assist in the CSA's deliberations through our lawyers' participation in focus groups organized by the OSC. However, we

BORDEN
LADNER
GERVAIS

urge the CSA to move thoughtfully, carefully and with adequate transition periods in working to implement the Proposals, keeping in mind that the publication of the Proposals was the first opportunity that industry participants have had to publicly comment on the proposed new registration regime. While we recognize that the CSA published a couple of papers outlining its thinking on certain aspects of the Registration Reform Project, these papers were not widely disseminated (one had to know about the separate Web site) and they were not published for public comment.

We recommend that the CSA consider implementing the changes in stages – that is, implement beneficial amendments to today's regulation where there is complete uniformity and general industry support first, and wait to implement other provisions until after industry participants have had the opportunity to review and comment on the legislative context for the Proposals (as discussed above) and a second version of the Proposals that incorporate the changes recommended through this comment period. We believe that the suggested target date of "mid-2008" for implementation of the Proposals is too ambitious and we fear that it will not lead to a thoughtful, careful implementation of the Proposals and consideration of industry commentary and feedback.

We note that the Notice accompanying the Proposals did not address transition to the new rules (other than to say that transition will be worked out). We recommend a healthy transition period of up to 3 years for new categories of registration and new proficiency requirements. Given the uncertainty about the expectations of the CSA around which "exams" will be necessary to illustrate adequate proficiency, individuals who are registered today will need additional time to ensure that they meet that proficiency. In addition, some industry participants will want to consider how to restructure their businesses to better meet the new requirements.

5. **Registration of Firms and Representatives "In the Business of Dealing in Securities" – Multiple Registration Categories**

It is not completely clear to us what the CSA intend with the different registration categories, notwithstanding the discussion found in section 2.8 of the Proposed Policy.

We assume that a firm registered as an investment dealer, and a representative registered with that firm, can deal in any security – whether exchange-traded or not - of any issuer, including mutual funds, scholarship plans, non-redeemable investment funds and corporations or whether being distributed or traded on an exempt basis (i.e. without a prospectus) or not.

We know that a mutual fund dealer, and a representative registered with that firm, can deal in public mutual funds that are being distributed under a simplified prospectus and annual information form. We urge the CSA to clarify that a mutual fund dealer, and its representatives, can also deal in securities of an issuer that falls within the definition of "mutual fund" in applicable securities legislation, whether or not that mutual fund is being distributed under a prospectus, as has been the case in many CSA jurisdictions in the past. In our view, the regulatory oversight of mutual fund dealers, and the proficiency required of mutual fund dealer representatives, are sufficient to cover such securities and no additional registration or proficiency is necessary.

In the event that the CSA do not accept this view, then the CSA must seriously consider what they expect mutual fund dealers and their representatives to do with all of their clients who hold pooled funds in their accounts To require these representatives and firms to have those clients divest those positions solely to stay onside with registration requirements seems imprudent, given that the clients may suffer tax consequences and additional transaction costs when the investments are otherwise suitable for them.

We support the CSA's apparent decision to permit dealer firms and representatives of those firms, to seek to be registered in more than one category. We anticipate that some firms will wish to be registered in more than one category of registration. For example, a firm may wish to be registered as an exempt market dealer and also as a mutual fund dealer, or as a mutual fund dealer and a scholarship plan dealer. We understand that any representative who is "dealing" in the applicable securities would need to have the proficiency proposed for representatives dealing in the applicable securities.

6. Registration of Exempt Market Dealers

(a) If the definition of "dealing in securities" is as broad as the proposed definition published by the British Columbia Securities Commission (which includes the "act in furtherance" concept we currently have in the "trade" definition), persons with very limited involvement in exempt transactions (for example, as the referring party in a referral arrangement or as a "finder") but that are not involved with respect to the execution of any resulting trade may be considered to be "dealing in securities" and if they are in the "business of" dealing in securities be required to obtain registration. In our view, the Proposed Rule or the Proposed Policy must provide some certainty and/or guidance regarding the circumstances in which persons involved in exempt transactions (again for example, as the referring party in a referral arrangement or as a "finder") will require registration. In addition, it may be appropriate for the CSA to consider a blanket exemption from the registration requirements for persons with certain types of limited involvement in exempt transactions. See our related comments below under "Referral Arrangements".

(b) We understand the position of the CSA in proposing "fit and proper" requirements on exempt market dealers and their representatives. However, we are concerned about the notion that a representative would need to pass the Canadian Securities Examination regardless of the nature of the exempt market security being dealt in and regardless of the proficiency associated with his or her other registrations. It also is not clear to us why a dealing representative of an exempt market dealer must take the Conduct and Practices Handbook Exam or the Partners, Directors and Senior Officers Exam. Why are these course relevant to the type of dealing these representatives will undertake?

(c) We have received comments from a number of parties involved in the exempt market regarding the proposed exempt market dealer registration category. Many find it difficult to apply certain of the conduct requirements to their business given the nature of their activities. In our

experience, the roles of parties involved in the exempt market are often very different from those typically associated with dealers, in particular where their involvement is very limited. For example, we understand that many do not regard the investors they deal with as their "clients" and similarly, many investors do not regard themselves as "clients" of the persons they deal with. We suggest that the CSA consider the proposed conduct rules to ensure that they are appropriate and practical for persons involved in the exempt market and where appropriate either provide related guidance regarding the application of these rules to such persons or provide exemptions from these rules. Examples of issues to consider include:

(i) whether it is it appropriate or otherwise necessary for a person whose involvement in an exempt transaction is that of a "finder" to "maintain account opening documentation" for persons that they refer to other parties (presumably, at a minimum something other than typical "account opening documentation" is contemplated but guidance would be useful)?

(ii) should there be an exemption from the leverage disclosure requirements for persons that qualify as "accredited investors"?

(iii) how will the confirmation of trade requirements in section 5.21 or statement of account and portfolio requirements in section 5.25, apply to a person who is not involved in the execution of trades for an investor?

7. Restricted Dealer Category of Registration

We note that the CSA indicates (in section 2.2 of the Proposed Policy) that they intend to use the restricted dealer category rarely. The example given is an odd example and we urge the CSA to more completely explain their intentions with respect to this category, particularly given the broad categories of investment dealer, mutual fund dealer and exempt market dealer. What else is left? What will it be used for? We are concerned that one of the CSA members will, in the future, use this category, and carve out of the broader categories a particular security that might be of particular concern in that time period (PPNs, for instance) and indicate that any one wishing to deal in those securities must be also registered in this restricted dealer category. This category and its lack of definition provides considerable uncertainty, which is inconsistent with the goals of the CSA for the Proposals and the Passport System.

8. Proficiency for Mutual Fund Dealer Representatives

(a) The implications of the proposed requirements for registration as exempt market dealers, and the associated proficiency requirements for representatives will be that many mutual fund dealer representatives will not be in a position to deal in securities on an exempt basis, even if their firm has become registered as an exempt market dealer. We recommend that representatives of mutual fund dealers be permitted to deal in

securities pursuant to available prospectus exemptions, given their demonstrated proficiency to deal in mutual fund securities and the higher level of oversight represented by the firm and the representative's membership in the MFDA.

(b) It is not clear to us whether the CSA is moving to ensure that the SROs adopt the CSA's Exam-based approach. The last sentence of section 4.2 of the Proposed Policy will cause considerable uncertainty and is inappropriate[1] – either a representative meets defined proficiency requirements, which are set by the SROs since the CSA does not so regulate, or he or she does not. Regulation must provide certain defined thresholds–and not leave those thresholds up to unwritten administrative practice of individual CSA members.

9. **Comment on Proficiency Rules - General**

(a) Certain of our clients have expressed to us their view that a Chartered Financial Analyst designation should suffice as appropriate proficiency for all categories of representatives.

(b) In addition, many of our clients have expressed frustration with the current requirements that an individual may not be registered in a category unless the individual passed the required examination or successfully completed a particular program required for a specific category of registration within 36 months of the date of applying for registration. Our clients feel that this provision, which is proposed to continue under section 4.2 of the Proposed Rule, is unfair since it imposes an arbitrary time limit on exams and programs. Information and experience obtained in certain exams and specific programs, particularly the CFA, does not change over time and individuals should not be penalized for having completed these exams and programs outside of the 36 month period. Furthermore, professional degrees do not have an expiry date and neither should the exams and courses required for these registration categories.

10. Exemption From Dealer Registration by Pooled Fund Managers

(a) Section 2.2(2) of the Proposed Rule should be deleted and the reference to "pooled fund" in subsection 2.2(1) clarified. Pooled fund is an undefined term under securities regulation, although it is commonly used as meaning a mutual fund that is distributed under prospectus exemptions. We ask the CSA to clarify that the fact that the term "pooled fund" (singular) is used does not mean that the exemption is not available when the portfolio manager has more than one pooled fund. What is intended by the reference to "its own" pooled fund? If it manages the assets? If it acts as investment manager of the pooled fund, but engages a sub-adviser? In our

[1] "We note, however, that whether an applicant for registration as an investment dealer or mutual fund dealer representative satisfies the minimum proficiency requirements by the IDA or MFD SRO, as applicable, is a **relevant consideration** towards **whether** the applicant is suitable for registration pursuant to securities legislation." [emphasis added]

view, this exemption should be as flexible as possible to recognize the realities of the portfolio management industry.

(b) We do not agree with the CSA's requirement that portfolio managers have only "bona fide" managed accounts as referred to in section 2.3 of the Proposed Policy.

If a registered portfolio manager chooses to manage its clients' money more efficiently in pooled funds (mutual funds) and has as clients individuals who are accredited investors or who purchase amounts above the minimum thresholds and hence a prospectus exemption is available, we see no reason why the portfolio manager needs to obtain another registration (with the applicable regulatory burden associated with this registration), merely so it can fulfil its primary function of managing client assets. We believe that this should be the case whether the client buys the pooled fund by subscription outside of a managed account, within a managed account as the sole investment or within a managed account as one of many investments.

Whether or not the client is a discretionary or non-discretionary client of the portfolio manager, the portfolio manager has full K-Y-C and fiduciary duties. Pooled funds merely package the advice into a product format, but do not change the fact that the client is purchasing, and the registered portfolio manager is providing, essentially advisory services.

Section 2.3 of the Proposed Policy is based, in our view, on a misguided understanding of the portfolio management business and the reasons why a portfolio manager may wish to set up pooled funds, rather than manage each client's account in a separately managed account. Managing the pooled funds in this instance is synonymous with managing the managed accounts.

(c) Portfolio managers who manage mutual funds that are distributed pursuant to prospectus exemptions should also be exempt from dealer registration if they distribute their pooled funds to institutions, such as insurance companies, pension funds, foundations etc. To require these highly regulated firms to obtain another registration (exempt market dealer) in order to distribute their pooled funds to institutional investors would be regulatory overkill and the imposition of a real regulatory burden that is not justified.

11. **Associate Advising Representatives (section 4.10 of the Proposed Rule)**

(a) In recent years, we have noted that portfolio managers are structuring themselves with a centralized advising team of qualified individuals who actually manage client's assets. These individuals rarely meet one-on-one with clients – they focus on managing client accounts according to prescribed investment authority or objectives. The client relationships are managed by individuals with different skill sets (marketing, client-service

focus, people skills, securities/economic/finance understanding), but who do not have the proficiency required for registration as advising representatives. In many cases these individuals do not provide services vis-a-vis the client that would bring them into the realm of "advising". However, in other cases, they potentially do and we experience a great deal of difficulty in (i) advising our clients whether we believe their services will require them to be registered and (ii) actually getting these individuals registered in an advising capacity since they have different skill sets than individuals who qualify as advising representatives and often do not possess the mandatory educational requirements.

It is unclear to us what is intended under section 4.10 of the Proposed Rule. Since these client relationship managers do meet with clients to go over their objectives and assist them to complete account opening documentation for accounts with the firm, they likely do not fall under the exemption in section 9.12 of the Proposed Rule (the generic advice exemption), since they are potentially discussing "advice" that is tailored to the client. More troublesome to us is the reference to client relationship managers in section 2.5 of the Proposed Policy, where the CSA indicate that CRMs can be registered under the associate advising representative category of registration.

As noted above, it is often difficult to shoehorn these individuals' unique skills and experience into the associate advising representative category. In any event they are often not really providing "advice" in the *classical* sense, since they do not manage a portfolio and really do provide "relationship management" only.

We recommend that the CSA acknowledge that these individuals exist (this is increasingly a favoured business structure) and provide more clarity around the activities that can be conducted by these individuals without registration, or alternatively, provide for a specific relationship manager category of registration, with tailored and appropriate "fit and proper" requirements.

(b) In this regard, we appreciate that an associate advising representative can be registered as such if they demonstrate that they have completed "a requirement or any part of a requirement" for full advisers (section 4.10 of the Proposed Rule). We are unclear about what this really means, keeping in mind the CSA's explanation around the expectations for what would fall within "investment management experience" for associate advising representatives provided in section 4.4 of the Proposed Policy. In our view, section 4.4 of the Proposed Policy is more mandatory than "policy". We believe the Proposed Rule must set out the minimum required to be registered as an associate advising representative. Is a CFA designation or the Exam enough? Or is two years' experience (as stated in section 4.4 of the Proposed Policy) and no courses? Or some sort of combination to be decided at the discretion of the individual registration officer? In our view, the latter is not an acceptable option and section 4.10 of the

Proposed Rule is simply too vague and/or provides the regulator with too much discretion.

(c) We also wish to comment on recent OSC administrative positions regarding associate advising representatives. In recent portfolio manager registration applications, our clients have been advised by the OSC that the individuals would not qualify as full advisers in three years if they did not obtain experience doing research and analysis on equity investments (as opposed to fixed-income investments). In our view, which is shared by our clients, experience doing research and analysis on fixed-income investments should be given the same weight as research and analysis on equity investments since it involves the same amount of time, evaluation and skill sets.

12. Registration of Investment Fund Managers

(a) The CSA must clarify that the scope of being in the business of "investment fund manager" is not to be interpreted so broadly as to require trustees of investment funds to be registered simply because of the trustee's powers over and responsibilities towards a fund, where a separate entity acts as fund manager and actually carries out the functions. Similarly, for funds structured as limited partnerships, the general partner should not be required to register as an investment fund manager where it has delegated management of the limited partnership to a separate management company. We strongly recommend this be clarified, given the discussion in section 1.4 of the Proposed Policy as it relates to general partners of limited partnerships.

(b) We also recommend that the CSA confirm that an investment fund manager need only be registered in the province or territory from which it actually administers and manages the investment funds. In the case of many mutual fund managers operating in Canada, this would mean that their fund administrators would be registered as investment fund managers only in Ontario, with other fund managers being registered only in British Columbia, only in Alberta, only in Manitoba and only in Quebec. This is consistent with the current approach taken to registration of portfolio managers to investment funds.

(c) We urge the CSA to provide for a substantial transition period of at least 3 years from the coming into force of the Proposed Rule and the investment fund manager registration requirements to permit fund industry participants to arrange their corporate affairs sufficiently to ensure that an appropriate entity is available to act as the "investment fund manager" of the various investment funds, to meet all applicable fit and proper requirements and to seek to become so registered. In addition, several of our clients are concerned that these new requirements will require them to inform other regulators (including those located in other countries) about the new registration and any new corporate restructuring and it may be necessary to seek regulatory permission from some of those regulators.

(d) We note that there are IDA member firms who manage investment portfolios through discretionary authority that also act as investment fund managers under their registration with the IDA. Just as these IDA members are exempt from the adviser registration requirements, they should also be exempt from investment fund manager registration requirement, in a similar manner as provided for in section 2.5 of the Proposed Rule.

(e) We strongly recommend that the CSA clarify what kind of marketing and dealing activities that investment fund managers can carry out without triggering a dealer registration requirement (whether mutual fund dealer or exempt market dealer).

In our view, the CSA should acknowledge the description of the activities that could be carried out without dealer registration, or with an exemption from registration, by investment fund managers (and the attendant necessity of becoming a member of the MFDA) that was set out in the letter from staff of the OSC in their letter to The Investment Funds Institute of Canada and the Investment Counsel Association of Canada dated December 6, 2000[2]. We attach the letter for ease of reference.

We recommend that the CSA definitively state that these activities do not mean that the investment fund manager is "in the business of dealing in securities". We also add to the description of activities in that letter the following activity: causing top funds to invest in underlying mutual funds (whether managed by the same manager or not). This latter point is an integral part of many fund managers' activities as registered portfolio managers for their funds and should not mean that the fund managers are "in the business of dealing in securities" and hence required to register as a dealer.

13. **Concept of International Investment Fund Manager and International Portfolio Manager for Non-Canadian Funds (section 9.15 and 9.16 of the Proposed Rule)**

Given our view that an investment fund manager and any portfolio manager of that fund need only be registered where it is actually carrying out the management of the funds, we do not understand the CSA's proposal to provide for an exemption for international investment fund managers and international portfolio managers "privately placing securities primarily offered abroad" – sections 9.15 and 9.16. Why are these entities even caught by the registration requirements? And which registration requirements are they being exempted from? On what regulatory theory is the CSA relying: a concept of a "look-through" regulatory concept that was behind OSC Rule 35-502; that is if a fund is being distributed in Canada even though management and advice is being provided outside of Canada, then the fund manager and portfolio manager must be registered in the applicable province(s)? If so, in which provinces will they be deemed to be providing

[2] Published with the Notice of Minister of Finance Request for Further Consideration of OSC Rule 31-506 SRO Membership – Mutual Fund Dealers dated December 22, 2000.

such services in? We had understood that the OSC was reconsidering this interpretation as over-reaching and unsupportable from a regulatory perspective. We had also understood that the OSC was the only Canadian regulator who took this position. We recommend that further thought be put into this concept and the proposed exemptions.

In this regard, we repeat our comments made in our letter dated November 10, 2005 to the OSC on its proposed rule to charge regulatory participation fees to unregistered international fund managers. We attach our earlier comment letter on OSC Rule 13-502 *Fees* to this letter. Given our views contained in that letter and as outlined in this comment letter, we again strongly recommend that the OSC amend the Fees Rule to remove the requirements for payment of participation fees by international fund managers.

14. **Elimination of International Adviser Registration Category and Exemptions Available for International Portfolio Managers (section 9.14 of the Proposed Rule)**

Many Canadian institutions, including investment fund managers, engage international investment advisers (i.e. located in non-Canadian jurisdictions) to provide investment management expertise regarding non-Canadian securities, whether it be directly as a portfolio adviser to the funds or indirectly as sub-advisers to the portfolio manager. Similarly, many international portfolio managers wish to enter the Canadian marketplace to manage Canadian clients' money.

Many of the international investment advisers choose to register in Canada under the OSC's current registration category of "international adviser". This category is a restricted category of adviser registration designed specifically to allow international advisers to register without the full regulatory burden of domestic adviser registration on the policy basis that such advisers are already highly regulated in their home jurisdictions and would only be advising a list of sophisticated clients in Canada on non-Canadian securities.

However, with the proposed elimination of the "international adviser" registration category, such international advisers would need to become full domestic advisers (now "portfolio managers") and bear the full regulatory burden (including proficiency of individual advising representatives), notwithstanding that they are registrants with other recognized regulators globally, their Canadian clients are primarily institutional (including mutual funds) and high net-worth individuals and their focus is on non-Canadian securities.

We believe that this regulatory change will affect Canadians' access to such global investment management expertise by making the registration process a barrier to entry for these international participants.

We note that the international portfolio manager registration exemption (section 9.14 of the Proposed Rule) proposed by the Proposals will not permit many international participants to take advantage of it. The proposed conditions attached to such exemption, including the prohibition on solicitation and the very narrow list of permitted clients, which does not include an investment fund or individuals and is much more restricted

that the OSC's current list of international adviser permitted clients, render the exemption of little use to most international advisers.

We strongly encourage the CSA to establish a nationally harmonized category of registration for international advisers which would mirror the current Ontario international adviser registration category contained in OSC Rule 35-502.

Without this accommodation, previously-negotiated and long-standing relationships and Canadians access to international investment expertise will be put into jeopardy.

We also note that many Canadian institutional investors prefer, or are required only to engage, entities that are registered in Canada. We know that many international advisers became registered in this category in order to meet the preferences and/or requirements of Canadian institutional investors.

15. **Exemptions for Sub-Advisers to Registered Advisers**

We recognize that section 9.17 of the Proposed Rule codifies exemptive relief that has been regularly provided by the CSA in recent times, although this relief has not been required in Ontario or Quebec. We strongly object to the continued "opt-out" from the Manitoba Securities Commission provided for in subsection 9.17 (f). We see absolutely no regulatory rationale for the MSC continuing to insist on this condition, which is particularly burdensome, embarrassing (to Canadians) and surprising given the CSA's (including the Chair of the MSC) efforts to inform the Canadian marketplace about the benefits of the Passport System.

16. **Mobility Exemptions for Dealers and Advisers (Division 2 – Mobility Exemptions of the Proposed Rule)**

In our view, the proposed mobility exemptions for dealers and advisers do not reflect the realities of a more mobile Canadian population or the efforts of the CSA to implement a Passport System and will not significantly reduce the regulatory burdens of having to become registered in multiple provinces where clients reside.

In our view the restrictions on the availability of this exemption, particularly for mid-to-large registrants are patently too onerous and without any degree of reasonable practicality. For a dealer registrant with over a hundred sales representatives to consider that the exemption would only apply if 10 or fewer clients move to a particular province, is not meaningful. And a successful sales representative to be capped at five clients moving to a particular province, is also not realistic or meaningful.

We also urge the CSA to review the complexities proposed that are associated with using this exemption. Are all of the filings, forms, and notices really necessary in light of (i) the Passport System and (ii) a more mobile Canadian population?

In our view, the same rationale should apply to U.S. registered investment advisers who happen to be advising a U.S. client who moves to Canada. The same conditions can be said to apply to this U.S. registered investment adviser, which will permit the former U.S. resident to enjoy continuity of service while living in Canada, and at the same time,

reduce the regulatory burden on that investment adviser. Investor protection will not be compromised. We fully understand that this point raises issues of reciprocity for Canadian registrants into the United States.

17. Compliance Systems For Registrants (section 5.26 of the Proposed Rule)

In our view, section 5.26 of the Proposed Rule, while positive in the sense that it sets out broad principles for registrants, has a fundamental flaw. It goes beyond the scope of the CSA's regulatory powers in that it attempts to require registrants to set up a compliance system that "manages the risk associated with its business in conformity with prudent business practices". We understand the concept of a registrant setting up a compliance system (and the CSA's authority to so regulate) so as to achieve compliance with securities legislation, but submit that the second leg of the compliance test is over-broad and uncertain, in addition to being in excess of the CSA's regulatory powers.

Generally we urge the CSA to revise the requirements so as to be more consistent with the U.S. SEC's Compliance Plan Rule adopted for U.S. investment advisers and investment companies several years ago. In our view, the SEC's Rule is a clearer, more practical and effective rule since it (among other things):

(a) Requires compliance policies and procedures that are "reasonably" designed to prevent violations of securities laws and rules

(b) Requires the designation of a CCO who is responsible for administering the same and recognizes that the CCO is a risk manager and strategist

(c) Requires an annual review and testing of policies and procedures and improvements of any weaknesses discovered through the annual review and testing.

We recommend that the CSA leverage off the experience of industry participants in the U.S. with the Compliance Plan Rule rather than attempting to regulate a different "made-in-Canada" system.

18. The UDP and CCO of Registrants (sections 2.8 and 2.9 of the Proposed Rule)

(a) The description of the UDP and the CCO contained in sections 2.8 and 2.9 of the Proposed Rule appear to be reversed from the actual status, in fact, of these individuals. In our view, it is the UDP that should be "responsible for discharging the registered firm's obligations under securities laws" and the CCO that should be responsible for ensuring that the registered firm develops and implements policies and procedures for the discharge of those obligations. This formulation is consistent with the SEC's Compliance Plan rule.

(b) The CCO of an investment fund manager must be (via section 4.13, which refers back to section 4.11) an individual that either

(i) was previously registered as an advising representative of a portfolio manager (this will likely not often apply to any CCO of an investment fund manager)

(ii) is a lawyer or a chartered accountant with the requisite Exams and experience, including being employed by a registered dealer or registered adviser or

(iii) has passed the requisite Exams and been employed for the requisite period by a registered dealer or adviser in the applicable capacity.

We believe that these tests will not necessarily permit all existing well-qualified and professional CCOs of investment fund managers to become registered and we urge the CSA to permit transition periods or alternative experience requirements tailored to recognize experience gained in the investment fund management industry to allow these highly qualified individuals to continue in their CCO capacity. For example, the CSA might consider compliance skills acquired in other industries as appropriate experience and proficiency. This will be essential in our view to ensure that enough individuals with appropriate qualifications will be available to implement the requirements discussed above with regards to compliance systems.

(c) We urge the CSA to clearly indicate that a CCO of one registered firm can act as the CCO of another registered firm, particularly if those firms are affiliated with each-other.

(d) We recommend that section 2.8 of the Proposed Rule include the same provision as section 2.9(2)(b) dealing with sole proprietorships.

19. **Capital and Insurance Requirements for Investment Fund Managers (sections 4.14 and 4.18 of the Proposed Rule)**

(a) We urge the CSA to explain how they arrived at the particular capital and insurance requirements. Understanding the regulatory rationale and principles behind a significant new rule is essential for a proper discussion and, when it comes into force, appropriate implementation.

(b) Some of our clients have discussed the new insurance requirements with us and have indicated that they believe that the proposed requirements are unduly onerous and the cost of such insurance will likely be prohibitive.

(c) We recommend that portfolio managers and investment fund managers be permitted to include the seed capital that they have in their proprietary investment funds for the purposes of computing capital adequacy.

(d) Our clients have discussed with us the need for Item 9 – Less Market Risk proposed in proposed Form 31-103F1 – Calculation of Excess Working Capital to be removed as this line item provides that for all securities

owned by the firm, IDA margin rules must be applied as set out in the IDA Rule Book. Our clients assert that the IDA margin rules do not necessarily provide an accurate assessment of market risk.

20. **Division 3 – Financial records**

(a) Submitting unconsolidated financial statements for advisers and dealers (non-SRO) may prove difficult for many offshore registrants. We recommend that the Proposed Rule allow consolidated statements to be provided, together with the unaudited financial statements of the relevant operating registrant that have been reviewed by auditors.

(b) We do not see any regulatory principle behind the specific and different regulatory filings and requirements that apply only to investment fund managers in light of the other regulation that applies to investment funds and their managers, including:

(i) the NAV adjustment report

(ii) quarterly financial statements.

21. **Account Opening and K-Y-C**

(a) Why does a mutual fund dealer or scholarship plan dealer have to "ascertain whether a client is an insider of a reporting issuer", given the nature of the securities these dealers distribute?

(b) It is very unclear to us, exactly what the CSA expects a registrant to do to keep K-Y-C information current – and exactly why this rule (subsection 5.3(2) of the Proposed Rule) is important, particularly in the context of a client who does not carry out trades on a regular basis. In our view, the requirement to update K-Y-C information should be done at the time of any subsequent trade or other positive action taken by the client, which is our understanding of the historical position taken by the CSA on this issue. At the very least, the rules should be clear – perhaps MFDA Rule 2.24(b) could be used a guide (annual notification to clients).

(c) Subsection 5.4(1) of the Proposed Rule will require a registrant to take reasonable steps to ensure that a proposed purchase or sale is suitable for the client with reference to the client's circumstances. We recommend that the Proposed Rule be conformed to MFDA Rule 2.2.1, and in particular, the concept outlined in paragraph (d) of that Rule be introduced into the Proposed Rule.

22. **Relationship Disclosure**

In our view, disclosure to investors at the point of sale must be viewed in the context of the entire account opening package that investors receive, which can be particularly voluminous in certain instances, depending on the securities being acquired and whether the investor is entering into a RRSP or other registered account. Any new disclosure

form, such as the proposed RDD, must be flexible enough to not overlap with existing requirements, not overwhelm the investor, and provide important information that is not duplicated elsewhere. We are concerned that the proposed RDD will not meet this objective and we recommend additional flexibility to permit registrants to develop their own document that is tailored to the particular characteristics of their services to clients.

In addition, the SRO members should be subject to the same requirements as non-SRO members so as to ensure uniformity of approach by the SROs and to ensure appropriate and consistent investor experience and protection. In addition, any mandatory RDD must be made consistent with any proposals for reform of the point of sale disclosure system for mutual funds.

We also urge the CSA to consider how the RDD fits with the equity disclosure requirements presently provided for in National Instrument 81-105. We recommend that the RDD take the place of these disclosure and consent requirements, given the technical difficulties experienced by many in the industry with NI 81-105, particularly with keeping up with changes in share structures and obtaining client consent prior to putting through a trade.

23. **Record-Keeping**

Paragraph 5.20(4)(b) imposes a requirement to maintain documentation for seven years from the date a client "ceases" to be a client. Dealers who operate in client name will find this concept difficult and will benefit from a definition of when a "client" ceases to be a client. The definition should be based on activity or contact between the dealer/representative and the client and not on receipt of compensation (i.e trailer fees) from the fund managers.

We urge the CSA to provide guidance around record-keeping in respect of electronic mail and other recent technological forms of communication. We understand this is currently being clarified in the United States by the SEC.

24. **Confirmation of Trades**

We urge the CSA to codify the exemptions granted in recent years to dealers, who act as portfolio managers and hence manage managed accounts, from having to give confirmations of trades to clients who hold those managed accounts, on the conditions set out in those decision documents. There have been many such decision documents, including *In the matter of BMO Nesbitt Burns Inc.*, a decision document granted in September 2005.

We strongly recommend that the CSA clarify that it is acceptable for the registered dealer to set up other arrangements with sub-advisers of managed accounts, such that the dealer does not have to send the sub-adviser a confirmation of all trades. Sub-advisers are the entities recommending the trade and have processes in place with dealers to ensure that those trades are carried out and appropriate records of such trades maintained.

BORDEN
LADNER
GERVAIS

25. **Part 6 –Conflicts – Application to Investment Fund Managers**

Given the existence of National Instrument 81-107, it is confusing and inappropriate for the Proposals to regulate the same areas, for example, conflicts management by investment fund managers. Much of Part 6 should be deleted as it applies to investment fund managers, since NI 81-107 has already mandated a regulatory scheme to address conflicts of interest experienced by investment fund managers in managing their funds.

For reasons that also apply to mutual funds sponsored and affiliated with registered dealers, scholarship plans should also be referenced in subsection 6.5(c). We note that, strictly speaking, as with mutual funds, scholarship plans cannot be said to be "affiliated" with the dealer – it is their managers and administrators that are so affiliated. Perhaps "promoted" or "sponsored by" would be a better choice of words for both mutual funds and scholarship plans.

26. **Application of Section 6.2 of the Proposed Rule**

Section 6.2 of the Proposed Rule appears to be a version of section 118 of the Ontario Securities Act and the equivalent provision in other securities legislation. However there are differences between the two pieces of regulation.

It is very confusing to us (and we expect that this confusion is shared by other industry participants) to have a duplicate rule contained in a regulatory instrument, that is slightly differently drafted or even the same as a legislative provision. As a matter of law, we believe that industry participants must look to the legislation as primary regulation, over a rule of the CSA. We do not understand the rationale behind including section 6.2 in the Proposed Rule.

We note several flaws with section 6.2:

(i) Paragraph 6.2(1)(d) is substantially different from section 118 as in section 118, affiliates and associates of the adviser are only considered to be responsible persons if they fall within the criteria set out in (e) (i) and (ii)

(ii) The overall section is unclear as to its scope. We urge the CSA to reconsider the comments of OSC staff made in a 1995 paper outlining technical issues with Part XXI of the OSA that deal with section 118, particularly as it relates to mutual funds.

(iii) Subsection 6.2(2)(b) is substantially different from subsection 118(2)(b). Is this intended?

(iv) Investment fund managers and mutual funds are not exempted from its scope as applicable, in ways dealt with in National Instrument 81-107. Does this mean that if an investment fund manager and/or a fund has an exemption under NI 81-107 from securities regulation that it must again apply for an exemption under section 6.2 of the Proposed Rule?

BORDEN
LADNER
GERVAIS

(v) Similarly, if a registrant has already been exempted from section 118 (or equivalent section in other applicable legislation) in respect of a continuing activity, will it have to re-apply for an exemption from section 6.2? If this section is retained, we urge the CSA to provide blanket relief from this section to any registrant who has relief from the equivalent provisions of securities legislation.

As noted in the 1995 Conflicts paper referred to above, it has always been unclear the extent to which 118(2)(b) captures "inter-fund" trading and "cross-trades" (trades made by a portfolio manager of securities between two of its funds, where those trades are placed with a registered dealer who carries out those trades on an exchange). This is a very significant issue for the investment fund and portfolio management industry, given the staff position that two funds managed by the same manager are considered to be "associates" and therefore are associates of each-other and of the manager. Is it intended that section 6.2 cover inter-fund trading? What about cross-trades? If so, why? And if so, how? The inter-relationship of section 6.2 with NI 81-107 is of critical importance here. We strongly recommend that the CSA conduct additional consultation with the investment management industry on inter-fund trading and cross-trading before formulating a final rule in this area. We would be pleased to provide the CSA with further feedback, including our clients' experience with NI 81-107 and the inter-fund trading rules contained in that instrument.

27. **Section 6.4 of the Proposed Rule**

We are aware that certain portfolio managers, because of their style of investing, regularly invest in issuers that, over time, become "related" issuers to them within the meaning of securities regulation. While section 6.4 of the Proposed Rule is an improvement over existing regulations, to the extent that the CSA have deleted the requirements for these managers to obtain advance client consent, section 6.4 still does not address the practical compliance issues faced by these managers, arising from the changing nature of investments and hence their relationships.

We strongly recommend that section 6.4 be redrafted to provide the following:

(i) Account opening documents must clearly disclose the possibility of a portfolio manager causing a client to invest in a "related issuer" and outlining the general reasons why an issuer may become a related issuer to the portfolio manager.

(ii) Clients will consent to the portfolio manager causing them to invest in related issuers as part of their general discretion given to portfolio managers at account opening.

(iii) Clients will receive a list of related issuers when they enter into an account, and a revised, updated list of related issuers on an annual basis.

It is simply impractical and costly to require portfolio managers to send a notice describing a new related issuer every time this relationship threshold is tripped or

BORDEN
LADNER
GERVAIS

materially changed, before being able to invest client's assets in that related issuer. In any event, we expect that clients will not appreciate, or know what to do with, the regular paper flow of information proposed to be mandated in section 6.4.

28. Referral Arrangements

We urge the CSA to provide guidance regarding the circumstances in which persons involved in referral arrangements will require registration. If the definition of "dealing in securities" is as broad as the proposed definition published by the British Columbia Securities Commission (which includes the "act in furtherance" concept we currently have in the "trade" definition), persons who simply refer a potential investor to a registrant but have no other involvement in any resulting trade may be considered to be "dealing in securities" and if they are in the "business of" dealing in securities, be required to obtain registration. In our view, it would be appropriate for the CSA to consider a blanket exemption from the registration requirement for persons involved in these types of limited activities.

29. **Complaints Handling – Division 7 (sections 5.29-5.32)**

The requirement that all registrants are to treat complaints in an effective and fair manner is commendable. However, we recommend changes to this Division.

In our view, if, for an investment fund manager, the independent review committee of the funds managed by that manager, has considered the complaint handling policy of the fund manager (pursuant to NI 81-107), and considers regular reports of the fund manager on complaints and their resolution, then, that investment fund manager should be exempt from this provision. We understand that certain industry participants could take the position that complaint handing is a conflict of interest matter contemplated under NI 81-107.

We expect that questions will arise as to when a complaint arises and when it can be said to be resolved. For example, if a registrant concludes that there is no wrongdoing on its part and informs a client of its conclusion, is this complaint resolved? Absent a client taking a positive action to indicate agreement with the conclusion - something that we see as unlikely - how will a registrant know if there is resolution? We believe that once a registrant has come to some conclusion which does not entail the acceptance of a client's position and has informed the client of that conclusion, that should be seen as "resolution" unless the client advises in writing within a specific time period of his or her intention to take further action or steps with regard to the complaint.

We are very concerned about section 5.30 of the Proposed Rule. For non-SRO members, what dispute resolution service does the CSA expect registrants to "participate in"? This is a very vague, unexplained proposed rule that will have far-reaching implications. In our view, considerable additional consultation is required before implementation of this proposed rule.

What will the regulators do with the complaint handling reports sent in (presumably in paper form) to each regulator where the registrant is registered? This question should be answered by the CSA in the interests of transparent rule-making.

30. **Part 8 – Information Sharing**

We and our clients have serious concerns about this Part, as it increases the regulatory burden on registered firms and significantly increases the risk of being found liable under privacy, employment and/or defamation laws otherwise applicable to the relationships. In our view, if the CSA proceed with this section, we strongly recommend that the CSA provide protection to registered firms who make disclosure as required by this section.

The requirement to share information under Part 8 raises concerns regarding lawsuits relating to defamation, breach of privacy, confidentiality, etc. Clearly, a statutory "good faith" defence must be delineated in the Rule, regardless of its availability under common law or any statute. Registrants often may not be aware of common law or statutory defences, and therefore may hesitate to disclose information in an open and complete fashion for fear of lawsuits or challenges by privacy regulators. Registrants must be in a position to provide information in good faith without feeling the need to obtain legal advice as to whether there has been a change in a common law defence.

31. CSA Views on Principal – Agent Relationships

We urge the CSA to acknowledge the accepted principal-agent structure for **all registrants** and not just mutual fund dealers, with a reference to this issue (which is a broader industry issue, not restricted to mutual fund dealers or other dealers). We believe that a consistent regulatory approach must be taken and we support the approach taken by the Mutual Fund Dealers Association of Canada in permitting, for many years, Approved Persons to be in a principal-agent relationship with their dealer-firms, and to be able to direct that commissions be paid to personal service corporations. We believe that an ideal approach would be for the CSA to recognize the efficiencies for industry participants and continued investor protection that would be inherent in permitting representatives to provide their services to their firm through corporations.

32. **Comments on Proposed Form 33-109FI and Proposed Form 33-109F4**

We reviewed Proposed Forms 33-109F1 and 33-109F4 to ensure that they are consistent with reasonable practice and the other aspects of the Proposed Rule (as we have commented on it).

We note that the term "national registration database" used in both Forms should be capitalized to "National Registration Database".

Our comments on Proposed Form 33-109F1 are:

1. *Part E – Further Details (Form 33-109F1):* In our view, completion of the "Further Details" section should not be required unless an individual was dismissed or resigned <u>for cause</u>. Where an individual has resigned or was dismissed without cause (i.e. – simply moved on to another job or was downsized), the litany of checkboxes that are required to be filled out by the sponsoring firm are intrusive and unnecessary. We also believe many of the questions are vague and subjective and hence will be very difficult to answer. We note that there are consequences for providing incomplete or erroneous

information in regulatory forms and therefore, in our view, the questions must be completely clear and understandable and capable of a definitive answer.

2. *Part E – Section 4:* In addition to the more general comment above, we note that section 4 of this Part asks whether any investors allege that they lost money because the individual acted inappropriately and provides that such allegations include written complaints, civil actions and arbitration notices. We recommend that this section either be removed entirely or the reference to written complaints be clarified, since not all written complaints can be substantiated and would merit a positive response to this questions.

3. *Part E – Section 8:* Again, in addition to the more general comment above, we believe the concept of "demonstrating a pattern of failing to follow compliance policies and procedures" is particularly vague and confusing and, in our view, will be very difficult to answer.

Our comments on Proposed Form 33-109F4 are:

1. *Item 1, #3 – Business Names*: We recommend that this section would be better found in the Current and/or Former Employment sections. It is confusing to have questions regarding carrying business under any other business names on a form that is for the registration of individuals.

2. *Item 2 – Residential Address:* We recommend the addition of a new sentence stating "We require a complete residential address history for the past 10 years" in the instructions after "If you have resided at this address for less than 10 years…".

3. *Item 13 – Regulatory Disclosure:* We recommend amending the definition of "derivatives" in the opening paragraph of Item 13 to mean "financial instruments such as commodity futures contracts, exchange contracts and swaps whose market price…". We recommend removing the word "options" from this definition, as an "option" is already included in the definition of "security" in the *Securities Act* (Ontario). It would therefore be redundant in Item 13(1)(a) to ask whether an individual has been registered or licensed to trade in or advise on securities (including options) or derivatives (including options).

4. *Item 16 – Financial Disclosure:* In question #2 – Debt Obligations, we recommend clarifying the threshold level for disclosing the failure of a firm ("of which you were an officer, partner or director") to meet a financial obligation. That is, does the question ask whether you, or any firm of which you were an officer, partner or director, has ever failed to meet a financial obligation of $5,000 or more; or does the question ask whether you have ever failed to meet a financial obligation of $5,000 or more, or has any firm of which you were an officer, partner or director ever failed to meet *any* financial obligation (i.e. – even an obligation for, say, $10)?

5. *Schedule "A":* With respect to the "business names" that are required to be provided, please see our comment #2, above.

BORDEN
LADNER
GERVAIS

6. *Schedule "C":*

- Firstly, we recommend that the entire Schedule be broken into three distinct sections – one for non-SRO firms, one for IDA firms with the additional IDA information; and one for MFDA firms and any categories unique to that registration.

- We recommend that the categories and checkboxes under the "Supervisory Roles" heading be moved to that new IDA section referenced above.

- We also recommend that the categories and checkboxes under the "Traders" heading be similarly moved to the new IDA section referenced above.

- Under the "Registration by Jurisdiction" heading, is the individual supposed to check off each box next to a particular province that applies to the category for which they applying? That is, if I were applying as a Trading Representative in Alberta, would I check off the first box next to Alberta? We recommend that these boxes be made larger, or preferably separated into three distinct columns and order alphabetically–labelled "Advising Representative", "Associate Advising Representative" and "Trading Representative".

- Under the heading of "Relationship with Sponsoring Firm, we recommend clarification on what a "Representative – Non Employee" is. This does not appear to be a category of registration under the Proposals.

****

We thank you for allowing us the opportunity to comment on the Proposals. Please contact the following lawyers in our Toronto, Vancouver and Montreal offices if the CSA members would like further elaboration of our comments. We would be pleased to meet with you at your convenience.

- Prema K.R. Thiele (Toronto office) at 416-367-6082 and pthiele@blgcanada.com

- Rebecca A. Cowdery (Toronto office) at 416-367-6340 and rcowdery@blgcanada.com

- Jason J. Brooks (Vancouver office) at 604-640-4102 and jbrooks@blgcanada.com

- Scott McEvoy (Vancouver office) at 604-640-4170 and smcevoy@blgcanada.com

- Fred Enns (Montreal office) at 514-954-2536 and fenns@blgcanada.com

BORDEN
LADNER
GERVAIS

Again, we commend the CSA on the work done to date and urge the CSA to complete the registration reform initiative in ways that achieve complete national uniformity of applicable rules and that recognize the national scope of most Canadian capital markets industry participants.

Yours truly,

"SECURITIES AND CAPITAL MARKETS PRACTICE GROUP"

Securities and Capital Markets Practice Group
Borden Ladner Gervais LLP

Letter Sent to The Investment Funds Institute of Canada and the Investment Counsel Association of Canada:

December 6, 2000

The Investment Funds Institute of Canada
151 Yonge Street
5th Floor
Toronto, ON
M5C 2W7

Attention: Honourable Thomas A. Hockin

Investment Counsel Association of Canada
61 Shaw Street
Toronto, ON
M6J 2W3

Attention:Colin Haddock

Dear Sirs:

RE: Firms registered as Mutual Fund Dealers who are also Mutual Fund Managers and/or Portfolio Managers

As you know, provincial securities regulators considering recognition of the Mutual Fund Dealers Association of Canada are at various stages of making rules requiring mutual fund dealers to join a self regulatory organization for mutual fund dealers (collectively, "Membership Rules"). Staff in these jurisdictions have received inquiries from registrants whose registration as mutual fund dealer is used to carry on what they perceive as an incidental or secondary part of their business. These registrants submit that mandatory membership in a SRO is not appropriate due to the nature of their business. These registrants carry on a primary business that falls into two broad categories:

(1)Mutual fund managers who do not sell their sponsored mutual funds directly to the public but are registered as mutual fund dealers to enable them to carry on incidental sales and marketing activities.

(2)Portfolio managers conducting a money management business and who are also registered as mutual fund dealers to enable them to sell their mutual funds (pooled funds) to their discretionary account clients or directly to the public.

Mutual Fund Managers

Staff understand that mutual fund managers not carrying on a direct mutual fund distribution business are nonetheless registered as mutual fund dealers for several reasons:

a)they are concerned that their marketing and wholesaling activities vis a vis their mutual funds subject

them to the registration requirement;

b)they believe that they require this registration to fulfil their role as principal distributor of their funds;

c)they became registered when the provincial securities regulators required an underwriter certificate for mutual fund prospectuses and have maintained that registration;

d)they take purchase and redemption orders, including switch requests, directly from clients who hold mutual fund units in "client name", particularly when the client's original dealer does not consider the client an active client; or

e)they believe that this registration is necessary to service house accounts of employees and family membersof employees and various service providers to the manager.

Mutual fund managers carrying on the activities listed in paragraphs (a), (b) or (c) should consider whether they wish to continue their registration or apply for an exemption from registration. Staff have concluded that it may be appropriate to exempt mutual fund managers carrying on the activities listed in paragraphs (a), (b), and (c) from the requirement to obtain registration as a mutual fund dealer.

In addition, provided the activities are limited and incidental to their primary activity of managing mutual funds, mutual fund managers who accept purchase and switch
orders in the circumstances described in (d), or who carry out the activities described in (e) may wish to apply for an exemption from the Membership Rules. Mutual fund managers should also review existing exemptions from registration in relevant provinces to determine if any are applicable to their businesses. Registrants making an application for exemption should explain the reasons why they are registered as mutual fund dealers and describe the full extent of their trading activities. Applications will be considered on a case-by-case basis by the applicable regulator. Staff will likely recommend relief from the Membership Rules in circumstances where staff agree that the registrable activities are limited and incidental to an applicant's business. Registrants who are exempted from the Membership Rules must continue to maintain their registration as a mutual fund dealer and comply with applicable securities legislation and rules.

Portfolio Managers

Firms registered as advisers in the category of portfolio manager act on behalf of both institutional and private high net worth clients pursuant to investment management agreements. Registration as a portfolio manager permits registrants to manage the investment portfolio of clients through discretionary authority granted by one or more clients giving discretion to the portfolio manager to manage assets. According to the comments received during the MFDA recognition comment process, the reasons that a portfolio manager would seek registration as a mutual fund dealer are:

a)it has prospectus-qualified its pooled funds to enable it to manage all of a client's assets, including those which might not meet a given jurisdiction's exemption thresholds for investing in securities without a prospectus; or

b)it sells these mutual funds directly to the public.

Some portfolio managers have commented that if required to become a member of the MFDA, the rules of the MFDA would make it difficult or impossible to comply with the terms of the account management agreements they have with their clients. Most notably:

a)the assets under administration fee model adopted by the MFDA would assess fees based on all relevant assets of a given portfolio manager rather than being limited to those assets related to sales for which mutual fund dealer registration is required; and

b)the draft rules of the MFDA prohibit discretionary trading by members.

Portfolio managers have suggested that the regulators should consider providing an exemption from the Membership Rules or exemptions from certain of the MFDA rules.

Staff are of the view that, to the extent that a portfolio manager is selling its pooled funds (whether or not prospectus qualified) to clients for whom they have fully managed accounts governed by the terms of an investment management agreement, it may be appropriate for the portfolio manager to be granted an exemption from the requirement to obtain registration as a mutual fund dealer. A portfolio manager exempted from registration would not be required to become a member of the MFDA.

Registrants making such an application should explain the reasons why they are registered as mutual fund dealers and describe the full extent of their trading activities. Applications will be considered on a case-by-case basis by the applicable regulator. Staff will likely recommend relief from the registration requirements in circumstances where the portfolio manager confirms the nature of their trading activities is such that all clients receiving such fund securities do so pursuant to a discretionary account agreement with the portfolio manager. Staff would likely recommend a condition that such relief expire after a specified limited period after the coming into force of a rule related to pooled funds managed by portfolio managers.

Fund Managers and Portfolio Managers Selling Directly to the Public

Where a fund manager or a portfolio manager is selling mutual funds pursuant to a prospectus directly to the public, it is appropriate for that registrant to be registered as a mutual fund dealer and to be subject to the Membership Rules.

With respect to exemptions from certain MFDA rules, MFDA staff have noted the difficulties inherent in attempting to regulate only a portion of the assets administered by a member and therefore exemptions from the relevant MFDA rules may not be feasible. As a result, registrants concerned about the impact of MFDA rules upon their business may wish to consider the advice of the Ontario Securities Commission noted in the Notice of Rule 31-506 SRO Membership -Mutual Fund Dealers at (2000) 23 OSCB 7015 - namely, changing their business structure by creating a subsidiary to carry on their mutual fund distribution business, surrender their existing registration as mutual fund dealers and register the subsidiary instead. The subsidiary would then be required to be a member of the MFDA and subject to all of its rules.

Please note that I am writing this letter on behalf of staff in British Columbia, Alberta, Saskatchewan, Manitoba and Ontario. Questions on a registrant's individual status in a particular jurisdiction should be directed to the relevant jurisdiction as follows:

Ross McLennan
Director, Registration
British Columbia Securities Commission
(604) 899-6685

Ken Parker
Director, Capital Markets
Alberta Securities Commission
(403) 297-3251

Barbara Shourounis
Director
Saskatchewan Securities Commission
(306) 787-5842

Bob Bouchard
Director, Capital Markets
Manitoba Securities Commission
(204) 945-2555

Tamara Hauerstock
Legal Counsel, Investment Funds
Capital Markets
Ontario Securities Commission
(416) 595-8915

Please let me know if you have any additional questions or concerns about the matters outlined in this letter. We ask that you distribute a copy of this letter to your members. We may also publish this letter in our respective Commission bulletins.

Yours very truly,

Rebecca Cowdery
Manager, Investment Funds
Capital Markets
(416) 593-8129

cc: CSA staff noted and MFDA working group
John Mountain (IFIC)
Larry Waite (MFDA)
Mark Gordon (MFDA)

Borden Ladner Gervais LLP
Lawyers • Patent & Trade-mark Agents
Scotia Plaza, 40 King Street West
Toronto, Ontario, Canada M5H 3Y4
tel.: (416) 367-6000 fax: (416) 367-6749
www.blgcanada.com

BORDEN
LADNER
GERVAIS

November 10, 2005

VIA EMAIL

John Stevenson, Secretary
Ontario Securities Commission
20 Queen Street West
Suite 800, Box 55
Toronto, Ontario
M5H 3S8

Dear Sirs/Mesdames

Re: Ontario Securities Commission Rule 13-502 *Fees* - Comments of the Investment Management Group of Borden Ladner Gervais LLP

We are pleased to provide our comments to the Ontario Securities Commission on the proposed amended and restated OSC Rule 13-502 *Fees* and its accompanying Companion Policy (collectively, the Fee Rule). We appreciate the opportunity to comment on the Fee Rule and provide our comments with a view to ensuring that the Commission levies fees on appropriate Ontario market participants and the rules are sufficiently clear to allow those market participants to comply with them.

Our comments on the Fee Rule have been compiled with input from the lawyers in BLG's Investment Management Practice Group and therefore reflect our collective views. Our comments do not necessarily reflect the opinions of, or feedback from, our investment management clients.

We view our first comment as significant. We note that we raised this comment with OSC staff earlier this year, but since the Fee Rule has not been changed to reflect our earlier submissions, we raise it again for the Commission's consideration. We also raise several technical drafting comments on the Fee Rule. We hope that our comments are considered helpful by the Commission and OSC staff.

Application of Fee Rule to "Unregistered Investment Fund Managers"

1. We urge the Commission to delete section 4.5 of the Companion Policy (which is new) and change the Fee Rule to clarify that participation fees are not payable by "unregistered investment fund managers" that manage investment funds that are not reporting issuers in Ontario but that are distributed in Ontario pursuant to prospectus and registration exemptions. Instead, the activity fees established by the Fee Rule would be payable in respect of those exempt distributions. In our

BORDEN
LADNER
GERVAIS

view, a very simple amendment to the Fee Rule is necessary. The term "investment fund manager" as used in the Fee Rule should be narrowed for the purposes of the Fee Rule to refer only to entities that are managing investment funds that are reporting issuers. Section 4.5 of the Companion Policy should be deleted.

2. We believe that the Fee Rule should be amended in the manner set out above for three fundamental reasons:

(a) Purely administrative services inherent in "acting as an investment fund manager" (see paragraph (b) of the definition of capital markets activities), particularly when those services are provided off-shore to off-shore investment funds arguably are not within the jurisdiction of the Ontario Securities Commission and participation fees for such services should not be levied, unless there is a much stronger connection to the Ontario capital markets. The obvious reason for unregistered investment fund managers being unregistered is because they are not required by law to be registered with the OSC to provide the services they are providing. We therefore are concerned that the Fee Rule is being interpreted to require persons, who are not required to register under the *Securities Act* (Ontario) (the Act), because they are not carrying on business regulated by the Act, to pay fees to the Commission.

Portfolio management and investment advisory services, even if given by a non-resident portfolio manager that provides its services off-shore to an off-shore investment fund, are considered by the Ontario Securities Commission to be registrable activities in Ontario where securities of the off-shore investment fund are distributed in Ontario. A person or company providing those services is required to be registered or exempt from registration under the Act or OSC Rule 35-502 *Non Resident Advisers*. If the entity is required to register and therefore becomes registered, it will pay participation fees as a registrant on its Ontario revenues from capital markets activities. If it is not required to register and does not direct the affairs of the investment fund (i.e. they provide only portfolio management services and do not fall within the definition of unregistered investment fund manager) it is not then required to pay any fees under the Fee Rule, even though it is providing (to a limited extent) registrable activities in Ontario. It is therefore an odd result that a non-resident unregistered investment fund manager that carries out *no* registrable activities in Ontario is required to pay participation fees.

(b) For non-resident unregistered investment fund managers that manage off-shore investment funds that distribute securities in Ontario only pursuant to prospectus exemptions, the concept of "capital markets activities in Ontario" is particularly meaningless. The only capital markets activity that is carried on in Ontario in those circumstances is the distribution of securities, since the management of those funds is carried on outside of Ontario. The Act requires intermediaries to be registered (at least as a limited market dealer) and such dealer will pay its participation fees based

BORDEN
LADNER
GERVAIS

on the commissions it receives from Ontario residents. If all fund management and investment advisory services are provided outside of Ontario, then the entities providing such services do not receive **any** benefits of regulation of the Ontario capital markets or of investment funds in Ontario and should not pay participation fees to the Commission. Similarly, unregistered investment fund managers managing investment funds in Ontario that only distribute securities pursuant to prospectus and registration exemptions receive no benefits of that regulation in Ontario.

(c) Requiring unregistered investment fund managers (whether or not these managers are off-shore) to pay participation fees in Ontario simply due to the fact that they are distributing investment funds (which may also be based off shore) in Ontario under prospectus and registration exemptions is inconsistent with the treatment of corporate finance issuers who distribute securities in Ontario on an exempt basis, but are not reporting issuers. Specifically we note that investment funds that do not have an investment fund manager (within the meaning of the Act) that are not reporting issuers, are not required to pay participation fees. These issuers do not pay participation fees, rather they pay activity fees on the private placement of their securities. Unregistered investment fund managers, particularly non-resident unregistered investment fund managers, who distribute securities of their investment funds that are not reporting issuers, should not receive unequal treatment under the Fee Rule.

3. Without our recommended change, entities falling within the definition of "unregistered investment fund manager" required to pay participation fees would include investment fund managers (within the meaning of that defined term in *Securities Act* (Ontario) (the "Act")) of investment funds (whether public or private) distributed in Ontario, but who contract with registered advisers for portfolio management services to those investment funds. Because *unregistered* investment fund managers are not registered in any capacity in Ontario (by definition), they do not provide portfolio management services to the investment funds or if, they do, they are exempt from registration as an adviser under the explicit circumstances provided for in OSC Rule 35-502. Those unregistered fund managers may be resident in Ontario, or may be situated outside of Canada as a non-resident. Similarly the investment funds managed by those entities may be located off-shore or managed in Ontario. The concern we raise is particularly acute for non-resident unregistered investment fund managers who manage off-shore funds that distribute their securities in Ontario under applicable exemptions. However, we submit that the change we recommend should apply to all unregistered investment fund managers who manage non-reporting issuer investment funds that distribute their securities in Ontario, without regard to whether or not they conduct their activities off-shore.

4. Our recommended change will not change the requirement for any person or company (whether resident or non-resident) providing portfolio management services to an investment fund that is distributed in Ontario, to pay participation fees, if it is a registrant under the Act, based on their Ontario revenues from

capital markets activities (as defined in the Fee Rule). Those portfolio managers who are exempt from registration under OSC Rule 35-502 in the explicit circumstances of that Rule should not be required to pay fees under the Fee Rule and we agree with the Fee Rule in this respect. These entities do not pay participation fees today, either because they generally do not fall within the definition of unregistered investment fund manager or because they are only tangentially accessing the Ontario capital markets (for example, acting as a portfolio manager of a fund that is primarily distributed off-shore as contemplated in section 7.10 of OSC Rule 35-502).

5. Our suggested change is consistent with the reference in Appendix C Activity Fees to payment of activity fees "for a distribution of securities of an issuer that is an investment fund, where none of the members of the organization of the investment fund is subject to a participation fee" [see Activity Fee B 2]. In our view, this reference presupposes that there may be circumstances where an investment fund manager does not pay participation fees; with the way in which the Fee Rule is currently drafted, this reference would not ever apply.

6. Our recommended change is also consistent with the 2001 OSC Fee Rule Concept Proposal and subsequent publications of earlier versions of the Fee Rule. The 2001 OSC Fee Rule Concept Proposal suggested that *mutual fund* managers (within the meaning of NI 81-102) who were not registered under the Act would pay participation fees, given the extent that such mutual fund managers participate in the Ontario capital markets and receive the benefits of regulation of such markets and of mutual funds. No mention of non-resident fund managers or exempt investment funds was made in this Concept Proposal. Commentators on the first publication for comment of the Fee Rule noted their concerns that managers of foreign investment funds (whose securities may also be privately placed in Ontario) would be subject to the participation fee. As indicated in the summary of comments published in January 2003 one commentator noted:

> ... in respect of a foreign investment fund, the OSC would end up collecting multiple fees – i.e. the exempt distribution fee payable by the foreign investment fund for any private placement in Ontario; the participation fee payable by a limited market dealer on revenues generated from the private placement in Ontario; and the participation fee payable by the investment fund manager on revenues from providing investment management to the foreign investment fund.

This comment was not answered in the Summary of Responses and no change was made to the Fee Rule to take into account of the comment. The Fee Rule was only published once for comment and accordingly we have not had an opportunity to raise this comment formally before now, although as noted above, we earlier brought this matter to OSC staff's attention.

BORDEN
LADNER
GERVAIS

Participation Fees payable by Registrants of Provinces other than Ontario, but with an Ontario-only office

7. The Fee Rule should be amended to deal with the issue raised by the application that resulted in the Order granted by the Director in March 2004 to Northwater Capital Management Inc. The Fee Rule requires registrants with a permanent establishment in Ontario to use their Ontario tax returns to determine their Ontario revenue percentage. When an adviser is registered in several provinces, but has its only office in Ontario, the Ontario tax return includes all of its Canadian income as Ontario revenue. As recognized in the Order, this is not a correct result.

Recommended Drafting Clarifications to the Fee Rule

8. We suggest several drafting changes to the Fee Rule to ensure clarity and ease of compliance by market participants.

   (a) *Subsection 3.1(2)*: the reference to "a fiscal year", should be changed to "its fiscal year" to clarify that the subsection is referring to the fiscal year of an unregistered investment fund manager and not some other fiscal year.

   (b) *Subsection 3.3 (1)(a) and 3.4(1)(a)*: the references to "the fiscal year" should be changed to "its fiscal year" to clarify that the subsections are referring to the fiscal year of the applicable registrant firm.

   (c) *Subsection 3.4(2)(b):* the reference to "the fiscal year" should be changed to "its previous fiscal year" to be consistent with subsection 3.4(2)(a).

   (d) *Subsection 3.4(4)*: Although we strongly recommend that the Commission confirm that unregistered investment fund managers that only distribute investment funds on an exempt basis not be subject to the Fee Rule in respect of payment of participation fees, if the Commission does not accept this comment, we recommend that this subsection be amended to include unregistered investment fund managers, since they may have the same issues regarding audited financial statements as the other entities named in this subsection.

   (e) *Section 3.5*: While we support the Commission for making the changes outlined in this section regarding the existing Fee Rule's duplicative filings of Form 13-502F4 and F5, we recommend that the Commission clarify that these forms are only required to be filed in the circumstances outlined in subsection (3), perhaps by a statement to this effect in the Companion Policy.

   (f) *Activity Fee B 2.* The second paragraph refers to the term "member of the organization" of the investment fund. This is a defined term in National Instrument 81-105, but not to our knowledge in any other rule. This is a very broadly defined term in NI 81-105 and we question whether this very

BORDEN
LADNER
GERVAIS

broad term is needed for the Fee Rule. For clarity we recommend that this paragraph refer to "persons or companies providing services to that investment fund that are related to the manager of the investment fund".

(g) *Activity Fee E 1.* We support the concept of an all-inclusive fee for an application, without a fee being payable for each head of relief applied for (although we recognize that a higher fee is paid if more than one head of relief is necessary). From a very technical perspective, we recommend you add in "or the investment fund manager", for an applicant that is an investment fund, since investment funds do not generally pay participation fees directly.

We hope that our comments are considered useful by the Commission. We would be pleased to discuss them with you and we are particularly interested in discussing the implications of how the Fee Rule is proposed to operate vis a vis unregistered investment fund managers. Please contact Rebecca Cowdery at 416-367-6340 (rcowdery@blgcanada.com) if you need any further information or require any additional clarification of our comments.

Yours very truly

Investment Management Group
Borden Ladner Gervais LLP