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April 10, 2008

Via Email

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

Delivered to:

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Dear Sirs/Mesdames:

Re: Proposed National Instrument 23-102 *Use of Client Brokerage Commissions as Payment for Order Execution Services or Research Services* **and Companion Policy Published for Comment on January 11, 2008**

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

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

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Our comments follow the general format of the Proposed Rule and contain more substantive comments, as well as drafting comments. We have focused more on the disclosure and interpretation portions of the Proposals, rather than on the technical aspects as to what will or will not be considered appropriate uses of client brokerage commissions.

1. Support for the CSA's General Direction

We support the goal of the CSA in finalizing the Proposals: to provide for a nationally uniform rule to regulate the use of client brokerage commissions by advisers in Canada, where the benefits of such a rule outweigh its costs. We support the work of the CSA to develop a nationally uniform rule that will replace the OSC's and the AMF's long-standing policies (rule in Quebec) and modernize the regime as it applies to use of client brokerage commissions. We also commend the CSA for their work to ensure consistency on a more global basis with the regimes applicable in this area in other countries.

We urge the CSA to move forward with the Proposals with a view to ensuring that each jurisdiction passes uniform rules, and, even more importantly, that staff in each jurisdiction administer and interpret the rules in a uniform and consistent fashion. As we have noted in past comment letters delivered to the CSA (please see our letters of June 8 and June 20, 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.

In this connection, we are troubled by the suggestion of the British Columbia Securities Commission to the effect that it might not participate in the final Proposals, since it does not feel such a rule to be necessary in light of the existing responsibilities of advisers to act honestly, in good faith and in the best interests of clients. In our view, the prolonged discussions about the appropriate use of client brokerage commissions by regulators and industry alike, not only in Canada, but also in the United States and in the United Kingdom completely demonstrate the need for clearly defined rules and regulatory guidance.

2. Need for Continued Consistency in approach amongst Canada, the U.S. and the U.K.

Although we recognize the work that the CSA has conducted to date to ensure consistency of approach amongst Canada, the US and the U.K, we urge the CSA to continue these efforts. We believe this is of utmost importance, given that many Canadian registrants operate outside of Canada and/or do business with entities registered in the United States and the United Kingdom.

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We believe that the approach suggested by the CSA in Question 3 (in the notice that accompanied the Proposals for publication) to be most appropriate and recommend that the CSA consider building in these concepts into the final Proposals.

3. Need for Consistency of National Rules that Apply to the Same Topic

The CSA notes in the Notice accompanying the Proposals, that they are reviewing the national instruments that apply to investment funds to determine what changes need to be made to provide for consistency with the Proposals. We believe that amendments should be made to National Instruments 81-101 (AIF disclosure) and NI 81-106 (financial statements, MRFP and AIF disclosure) immediately upon the finalization of the Proposals to ensure consistency in approach. Inconsistent rules lead to increased costs due to increased compliance burdens, as well as increased confusion for industry participants about the required disclosure to be provided in the various disclosure documents. Different disclosure about the same topic also will lead to increased potential for investor confusion.

4. **Comment on Subsection 3.2(2) of the Proposed Rule**

In our view, the CSA has not clarified in the Proposals, exactly what constitutes "use" of permitted goods and services by the adviser, particularly where such goods and services are received on an unsolicited basis and are bundled together with execution services. We do not find the brief statements in section 4.1(4) to be of much comfort to an adviser who has paid commissions to a broker, has received unsolicited research from that broker, which may or may not have been read by staff of the adviser. Is the adviser required to make the good faith determination as to the value of the execution services v.s. the unsolicited research received? Can an adviser attribute a nil value, even when the research is read by staff? In our view, the CSA should provide guidance on their expectations for advisers' compliance systems to track (i) receipt of unsolicited research (for example),(ii) its use by staff and (iii) its value (as required by subsection 3.2(2)(b) of the Proposed Rule. Is unsolicited research really that much of a problem, that advisers must establish systems to track it, as well as track its value? Please also see our comments below on disclosure concerning unsolicited goods and services.

5. **Comment on Section 4.1 of the Proposed Rule**

We have five substantive comments on section 4.1 of the Proposed Rule.

(a) We assume that the reference to providing disclosure to clients on "an initial basis" means that an adviser is required to give certain disclosure to each new client about the adviser's use of client brokerage commissions. We note however that the drafting of this section does not clearly articulate what disclosure must be given to *new* clients of an adviser, given that there will be no disclosure to give to a new client about paragraph (f). Also it is unclear to us what disclosure an adviser would give to a new client that would be relevant to that client in order to comply with paragraphs (c) and (g).

We recommend that the drafting of this section be broken into two sub-sections – one detailing the generic disclosure that must be given to new clients (presumably disclosure that responds to paragraphs (a), (b), (d) and (e)) and one detailing the disclosure that must be given to all clients on an annual basis (which would be a combination of the generic disclosure as well as the client-specific disclosure for the applicable annual period). We believe that it would not be relevant or possible to give new clients any non-generic disclosure.

(b) We are unclear on the CSA's intentions with respect to the required disclosure on an annual basis. Can this disclosure be generic and therefore non-customized to each individual client? Or does the disclosure have to be tailored to each client – given paragraphs (c) and (f) at a minimum, we believe this disclosure would, of necessity, have to reflect an individual client's situation. As such, we believe this disclosure obligation may be more onerous than the CSA anticipate, given that generic disclosure is easier to prepare and provide than customized information. Depending on the CSA's intentions, the compliance costs associated with this requirement may be more burdensome than presently anticipated.

(c) We are uncertain about the CSA's intentions with respect to paragraph (c) and ask the CSA to clarify whether it is intended that advisers disclose this information for each client. As we discuss above in comment (b) we believe it would be unduly cumbersome and burdensome to provide anything other than firm-wide disclosure in response to this item.

(d) Many advisers manage pooled funds and cause their clients to invest in those funds. The Proposed Rule is not clear about what an adviser would disclose in connection with those investments. We recommend that the disclosure obligation be clearly limited to disclosing the applicable information on a fund-by-fund basis. This would be consistent with the approach taken for publicly offered investment funds.

(e) Consistent with our comments on the 2004 proposals that resulted in paragraph 3.6(1)3 of NI 81-106, we urge the CSA to consider requiring disclosure of the value of only that part of client commissions that are used to acquire third party goods and services. We understand that many industry participants consider that it is simply too problematic to require valuation for client disclosure purposes of goods and services that are acquired as part of "bundled" brokerage transactions, particularly when those goods and services are acquired on a unsolicited basis (please see comment 4 with respect to unsolicited goods and services). It is open for advisers to conclude that it is impossible to attribute a value to such goods and services. In our view, among other things, different advisers will take different opinions on the value of bundled services, such that this disclosure will become meaningless and unhelpful for individual clients.

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6. **Drafting Comment on Section 6.1 of the Proposed Rule**

We note that the CSA use the term "approval date" in connection with when the Proposed Rule becomes effective. As we discuss in greater detail in comment 11 below, we suggest that the Proposed Rule become effective immediately but that appropriate transition be granted for compliance with its requirements. This would then be consistent with the approach taken with the introduction of other new CSA rules. We do not comment on whether a 6-month transition period would be sufficient time, other than to recommend that this be established as the absolute minimum transition period.

7. **Transition for OSC Policy 1.9 and AMF Rule Q-20**

In conjunction with finalizing the Proposals, we assume that the above-noted instruments will continue until the end of the transition period for the Proposed Rule? After that transition period, we assume that the OSC and the AMF will revoke these instruments to ensure consistency and unambiguous requirements.

8. Drafting Comment on Section 1.2 of the Proposed Policy

The CSA refer to the standard of care for mutual fund managers provided for in certain provincial securities statutes (for example, section 116 of the Securities Act (Ontario)). We point out that this standard of care has now been extended to all managers of publicly offered investment funds via section 2.1 of National Instrument 81-107. We recommend that section 1.2 of the Proposed Policy refer to this uniform provision of NI 81-107.

9. **Drafting Comment on Subsection 2.1(2) of the Proposed Policy**

We find the negative language used in subsection 2.1(2) with respect to advisers' entering into principal transactions to acquire securities for their clients very confusing and quite unhelpful. We agree that advisers will be subject to their fiduciary duties when they obtain goods and services other than order execution in conjunction with those trades, but we find the negative assurance that they cannot rely on the Proposed Rule to illustrate compliance to be very unhelpful. We recommend that the CSA make a more positive statement to the effect that advisers should look to the Proposals in determining how to meet their standards of care in respect of those transactions. In our view, the principles behind the Proposals can be used as guidance for advisers entering into principal transactions.

10. **Comment on Section 5.1 of the Proposed Policy**

We have two related and substantive comments on section 5.1 of the Proposed Policy.

(a) We do not understand why the CSA suggest that a fund manager/portfolio manager would make the mandated disclosure to the independent review committee for the funds. In our view, a better disclosure forum in circumstances where an adviser is also the fund manager and sponsor of publicly investment funds, would be to include this disclosure in the Annual Information Form that is prepared for each applicable fund. Although the disclosure required under National Instrument 81-101 is not

as extensive as that required under the Proposed Rule, the concept and policy rationale for the soft dollar disclosure in NI 81-101 and NI 81-106 is the same as that required under the Proposed Rule. As we recommend in our comment 3, we strongly urge the CSA to amend NI 81-101 and NI 81-106 to require similar disclosure as that mandated in the Proposed Rule in respect of advisers that are also managers of publicly offered investment funds.

(b) We question the necessity for the CSA's prescriptive suggestions that use of client brokerage commissions will generally constitute a conflict of interest matter under NI 81-107 and that accordingly, advisers that are fund managers should make the mandated disclosure to the IRC for the applicable funds. We assume, although this is not explicitly stated by the CSA, that the CSA believes that the fund manager is in a conflict of interest position when it is deciding to use the commissions generated from the portfolio trades of the funds in the manner contemplated in the Proposed Rule.

We believe that the CSA should continue to adopt their approach of not prescribing or suggesting whether a matter is or is not a conflict of interest matter necessitating a referral to an IRC. As you know, NI 81-107 is a "principles-based" rule and leaves the determination of whether an action is or is not a conflict of interest matter to the individual fund manager. In our view, a fund manager could conclude appropriately that compliance with the Proposed Rule is a compliance matter and if the fund manager follows the Proposed Rule then no conflicts of interest are raised. However, we also know that some fund managers may take the position that where it, or an affiliate is the portfolio manager for the funds, that use of brokerage commissions is a conflict of interest matter requiring IRC input.

Regardless of the position taken by individual fund managers about whether use of client brokerage commissions in the manner set out in the Proposed Rule is or is not a conflict of interest matter, we do not believe that it would be necessarily the case that the IRC would require the same level of information on a regular basis as that mandated in the Proposed Rule. What an IRC will require as a reporting matter should be left to individual fund managers and their IRCs. We recommend that section 5.1 be deleted from the Proposed Policy.

11. **Comment on Section 5.2 of the Proposed Policy**

We note that in subsection 5.2(2) of the Proposed Policy that the CSA suggest that all advisers have six months to give the mandated disclosure to each client that exists as of the effective date of the Rule. We do not believe this is required by the Proposed Rule and in any event recommend that a more appropriate transition be adopted by the CSA.

We recommend that section 6.1 of the Proposed Rule confirm that the Proposed Rule is effective immediately, but that advisers existing as of that effective date be given a

minimum of 6 months before which they must comply with the Rule. We recommend that after that date each adviser must give the requisite disclosure to *new c*lients (as per our comments 5 and 6 above) and that they must give the requisite disclosure to *all* clients within one year of the effective date of the Proposed Rule and at least annually thereafter. In our view, this transition would be more consistent with the CSA's position on transition for other national rules and would make compliance more easily available and less burdensome (not to mention less confusing).

12. **Comment on Subsection 5.3(1) of the Proposed Policy**

We question the ability of the CSA to mandate via policy statement that disclosure by advisers on the use of client brokerage commissions must include use of commissions by sub-advisers. If this is indeed the position of the CSA, we believe this should be clearly stated by rule. However, we are opposed to this interpretation or position.

We urge the CSA to consider the difficulties inherent in this position, particularly when advisers in Canada contract with sub-advisers in other countries, including the United States and the United Kingdom. It may be simply not possible for Canadian advisers to obtain the necessary information, particularly if the sub-advisers are not required by applicable laws to maintain this information. We fear that this provision would require Canadian advisers to review and renegotiate sub-advisory contracts in order to impose this reporting obligations on the sub-advisers that are not otherwise subject to the Proposals. It is not at all certain that Canadian sub-advisers would be able to make these contractual changes, particularly with non-Canadian sub-advisers that are not related to them. It is not apparent from the CSA notice that the CSA considered this point.

In this regard, it is critical, if this concept is to be retained, that the disclosure requirements of the Proposed Rule be made consistent with (identical with) the requirements of the other countries, or that the Canadian advisers be permitted to disclose only that information that a sub-adviser provides them so long as that information is the disclosure required by the laws of the sub-adviser's jurisdiction of residence (which may be NIL).

We strongly urge the CSA to re-consider this point, including the relevance of this information for clients, having regard to the Canadian adviser's duties to monitor the provision of services to their clients by service providers.

We also recommend that a longer transition period be imposed for any final rule in this area, particularly because this rule (even as modified as we suggest) would require Canadian sub-advisers to re-negotiate their contractual arrangements.

13. **Comment on Subsections 5.3(4) and (6) of the Proposed Policy**

We urge the CSA to re-consider the statements made in subsections 5.3(4) and (6) of the Proposed Policy. It is appropriate for the CSA to set minimum standards of disclosure that can be complied with by all advisers and to clarify simply that advisers are not prohibited from providing other information. However, we read these subsections as requiring, in effect, additional disclosure obligations that are in addition to the mandated disclosure set out in the Proposed Rule. The CSA appear to be *requiring* advisers to

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consider what else they *should* provide, without providing any guidance on why this might be appropriate and why they should provide this information, or what would happen if an adviser did not provide this additional information. We do not find this kind of CSA policy statement to be useful or appropriate.

We find the discussion in subsection (4) to be particularly confusing and in both sections, we believe industry participants would benefit from a better understanding of the CSA's use of the term "more granular disclosure". What would constitute more "granular" disclosure?

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We thank you for allowing us the opportunity to comment on the Proposals. Please contact Rebecca A. Cowdery in our Toronto office at 416-367-6340 and rcowdery@blgcanada.com if you have any questions on our comments or wish to discuss them with us further.

Yours truly,

"INVESTMENT MANAGEMENT PRACTICE GROUP"

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