NSCP
NATIONAL SOCIETY OF COMPLIANCE PROFESSIONALS INC.

April 10, 2008

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Dear Mr. Stevenson and Madame Beaudoin:

Re: Proposed National Instrument 23-102 *Use of Client Brokerage Commissions as Payment for Order Execution Services or Research* Services

The National Society of Compliance Professionals ("NSCP")[1] appreciates the opportunity to comment on the revised versions of proposed National Instrument 23-102 ("proposed instrument") and Companion Policy 23-102 ("companion policy") recently published by the Canadian Securities Administrators ("CSA"). The proposed instrument and companion policy are of considerable interest to the NSCP and its members. The NSCP is the largest organization of securities industry professionals devoted exclusively to compliance issues, effective

1 Headquartered in Cornwall Bridge, CT, NSCP is a nonprofit, membership organization dedicated to serving and supporting compliance officials in the securities industry. Since its founding in 1987, NSCP has grown to over 1,500 members, and includes securities industry participants from the various Canadian provinces, the US and internationally. The constituency from which its membership is drawn is unique. NSCP's membership is drawn principally from investment advisers, traditional broker-dealer firms, accounting firms, and consultants that serve them. The vast majority of NSCP members are compliance and legal personnel spanning a wide spectrum of firms including employees from the largest brokerage and investment management firms to those operations with only a handful of employees. The diversity of our membership allows NSCP to represent a large variety of perspectives in the asset management industry.

supervision and oversight. The principal purpose of the NSCP is to enhance compliance in the securities industry, including firms' compliance efforts and programs and to further the education and professionalism of the individuals implementing those efforts. An important mission of the NSCP is to instill in its members the importance of developing and implementing sound compliance programs across-the-board.

The NSCP is encouraged that many of the industry concerns and comments were adopted in the revised documents and continues to support the CSA's efforts to further clarify and provide guidance concerning the use of client commissions for research and order execution services. Nevertheless, the NSCP still has concerns with certain aspects of the original proposal and does not believe that the revised documents fully address the challenges that this new regulation poses for both the dealer and adviser communities. Where the CSA is seeking commentary, we have provided our collective views; however the NSCP is concerned that the four questions are not the only remaining issues to be resolved. In consultation with some of our Canadian members we have provided commentary with respect to several specific issues that continue to be of concern to the NSCP.

I. Specific Issues of Concern to NSCP

The following are a few remaining issues of concern and matters that NSCP believes require clarification in the proposed instrument and companion policy:

- The expectations relating to the responsibility of the registered dealer in assessing the eligibility of the client brokerage commission payment and the extent to which due diligence must be conducted should be clarified. As a general matter, the CSA have acknowledged that the eligibility of a particular service is dependent on the use of the services by the adviser. In most cases, the dealer will not be in a position to know the extent and manner of use of a service by the adviser. More specifically, in the case of payments made to third parties at the direction of advisers, it should be recognized that in many cases the dealer will never see the end product provided by the service provider to the adviser. As such, it is not appropriate that dealers be subject to the same level of responsibility as the adviser for evaluating the eligibility of the services. The consumer of the service is, in most cases, the only person that can provide a meaningful evaluation. For example, many providers of third party research services require a subscriber to log in to view their sites so dealers may be unable to evaluate their services, and therefore may have no way to determine if these services are eligible. We suggest that registered dealers should only be required to exercise due diligence in respect of services that are proposed, sponsored or offered by a registered dealer to the adviser. In all other cases, dealers should only be responsible for ineligible uses or payments if the dealer had actual or constructive knowledge or ought to have known of the ineligibility.

- While recognizing that the CSA has attempted to address concerns of commenters with respect to unsolicited goods and services, the NSCP believes that the proposed rule will continue to present problems for dealers and their adviser clients in relation to "free" services offered by dealers

to their clients. Having the flexibility to provide free services to clients is important to dealers who use free service offerings to compete for and attract business. However, many of these free services are not easily categorized as eligible or ineligible within the context of the proposed rule, and requiring advisers to do so is impractical and unwieldy. For instance, adding additional tools to an Order Management System may help Compliance or Finance with bookkeeping or other administrative requirements without subjecting the adviser to additional cost. Requiring the adviser to track the use of these types of free services and to include such free services in its assessment of value received in relation to commission paid may be viewed by the adviser as a burden and thereby undermine the dealer's entire service offering. Given the myriad of services that a dealer may offer its clients for free, it is not practical for advisers to track all of these services, value the ones they wish to use, and then restrict their organizations from using the services they are not valuing and/or paying for. For example, a dealer's corporate website may provide a variety of free information, including "third party" research, charting, news, watch lists etc. for all of its customers as part of its marketing efforts. Requiring advisers to identify, value and perhaps restrict the use of all of these various types of free services is unworkable. Accordingly, we suggest that an adviser should not be required to identify, allocate cost to, and/or pay with its own funds for, any unsolicited services provided by the dealer, whether or not used by the adviser, as long as the dealer is providing such services to all of its clients on the same basis regardless of the commission rates paid by such clients.

- It should be recognized that market data feeds that are part of electronic trading systems should not be considered a “billable” service. They are an essential component of such trading systems and have not historically been charged or otherwise treated as a client brokerage commission expense. For the same reason, retail discount traders do not pay discrete fees to dealers for the trading technology they use (which could include pre-trade analysis, charting, live level 2 quotes, portfolio analysis tools etc.). Institutional clients should not be required to track these services separately.

II. Responses to CSA Questions

We have the following responses to the specific questions posed by the CSA:

Question 1:

What difficulties might be caused by a temporal standard for order execution services that might differ from the standard applied by the SEC, especially in the absence of any detailed disclosure requirements in the U.S.? In the event difficulties might result, do these outweigh any benefit from having a temporal standard that results in consistent classification of goods and services based on use?

The NSCP agrees with the CSA on the proposed temporal standard and supports the broader interpretation that would include many services that have become essential to the investment process and best execution. The one area that needs to be expanded further is where a product or service is so integrated with the technology and delivery of orders that it cannot be separated from the execution of

the order. For instance, many execution management systems require direct quote feeds for order entry and trade monitoring. With the introduction of multiple markets and the vast amount of data being aggregated and delivered to the buyside desk, the bandwidth requirements have increased to require dedicated connections. These single purpose connections appear to be labelled by the CSA under the category of overhead costs similar to computer hardware and therefore not eligible. The industry has historically viewed these connections as an integral part of the execution management system where the dealer specifies the types of communication networks to be used and sponsors the portion of the network from the adviser's door to the dealer. The NSCP does however support the position that the networks, computers and other hardware used by the adviser are part of the adviser's infrastructure and therefore should be excluded from client brokerage commission arrangements.

Question 2:

What difficulties might be encountered by requiring the estimate of the aggregated commissions to be split between order execution and goods and services other than order execution? What difficulties might be encountered if instead the requirement was for the aggregate commissions to be split between research services and order execution services?

The proposed rules would create a requirement for advisers to unbundle for disclosure purposes while dealers, the providers of these bundled services, would have no requirement to provide transparency of the costs associated with the services provided. Even with the most basic offerings by discount brokers, they often compete on maximizing the services they offer while maintaining very low per trade commissions. The actual cost of execution of a trade has so many variables that it is practically impossible to individually value them on a per trade basis. Therefore, both dealers and advisers view the costs of trading as relationship pricing where services are often offered as part of an overall package and value is very subjective. Many advisers have developed complex internal surveys (broker voting) to help establish guidelines for commission allocation; however this may only be practical for the larger asset managers.

The NSCP suggests that for the purposes of disclosure, advisers should be grouped into three categories: the first group would be for advisers that only use bundled services and would require such advisers to disclose their analysis for selecting brokers and the aggregated commissions paid but would not require them to unbundle the commissions; the second group would be for advisers that have decided to take the approach that they will unbundle and use commissions to pay for services not provided by the execution broker, such as third party research. The second group would likely be able to comply with the rules as proposed but they should be able to use them as guiding principles instead of prescriptive rules. The final group is a hybrid of the first two categories, for advisers that use bundled services and also arrange to use commissions to pay for third party services. The last group would provide disclosure of the separate commission arrangements and be required to detail the decision on how the commissions are allocated between the two categories.

The NSCP believes that the current proposal is unworkable for small firms from a documentation point of view and that even the larger firms would find it extremely difficult to accurately allocate commissions

as proposed by the CSA unless the whole industry was completely unbundled. Moreover, the experience in the UK has shown that even the most sophisticated investors are not using the disclosure provided. In the US there is a movement to refocus on what questions should be asked instead of prescribing standard industry disclosure.

Question 3:

As order execution services and research services are increasingly offered in a cross-border environment, should the Proposed Instrument allow an adviser the flexibility to follow the disclosure requirements of another regulatory jurisdiction in place of the proposed disclosure requirements, so long as the adviser can demonstrate that the requirements in that other jurisdiction are, at a minimum, similar to the requirements in the Proposed Instrument? If so, should this flexibility be solely limited to quantitative disclosure given that the issues associated with differences in quantitative disclosure requirements between regulatory jurisdictions are likely greater than the problems associated with differences in narrative disclosure requirements? In addition, should there be limitations on which regulatory jurisdictions an adviser may look to for purposes of identifying suitable alternative disclosure requirements and, if so, which jurisdictions should be considered eligible and why?

The NSCP supports the view that Canadian investors should enjoy the same protections whether they are dealing with domestic or foreign advisers. We believe however that it may not be practical for a foreign adviser to comply with both their local requirements and the Canadian requirements if for some reason their local requirements conflict with the Canadian requirements. The foreign advisers and their regulators may also have a different perspective on commission arrangements and therefore foreign advisers should have the option to comply with their local requirements provided that they make disclosure to potential investors that they adhere to their local requirements client brokerage commission arrangements. We note that the proposed National Registration Rule contains a similar requirement that foreign advisers disclose their use of an exemption from the Canadian rules to their Canadian clients.

The NSCP also believes that the application of the proposed instrument to non-Canadian registered dealers also requires clarification. Specifically, it is unclear whether the proposed instrument would apply to non-Canadian dealers that are registered in one or more Canadian jurisdictions, particularly as it relates to these dealers' client brokerage commission arrangements with non-Canadian advisers who may be providing services to both Canadian and non-Canadian clients. The NSCP respectfully requests that the CSA clarify this uncertainty by providing interpretive guidance in the companion policy to the effect that the proposed instrument only applies to goods and services provided to Canadian advisers. This is a reasonable approach in the circumstances given that the non-Canadian dealer would not ordinarily be in a position to know whether any goods or services provided to the non-Canadian adviser involve the use of commissions generated from trades executed for Canadian clients, even though the adviser may also be registered in Canada or is managing some Canadian accounts pursuant to an adviser registration exemption.

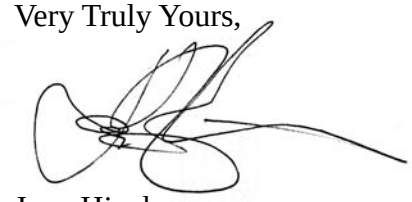
Question 4:

Should a separate and longer transition period be applied to the disclosure requirements to allow time for implementation and consideration of any future developments in the U.S.? If so, how long should this separate transition period be?

The proposed 6 month transition period will not permit advisers to avoid the added costs of making interim period disclosure to deal solely with commission arrangements. The advisers should be given a transition period that runs until their next regularly scheduled annual information statement (or that runs until the following year if the next annual information statement is required to be issued within six months of the rule coming into force).

We thank the CSA for the opportunity to comment on the revisions to the proposed instrument and companion policy and we hope that you find these comments useful in preparing the final release. We would be pleased to discuss our views further with the CSA. Please feel free to contact Joan Hinchman at the NSCP at (860) 672-0843 with any questions or comments.

Very Truly Yours,



Joan Hinchman
Executive Director, President and CEO

cc: British Columbia Securities Commission
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