CARDINAL CAPITAL MANAGEMENT, INC.
Investment Counsellors

May 29, 2008

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

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

and

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

Dear Sirs,

Re: Proposed National Instrument 31-103; *Registration Requirements* (the "Instrument")

Thank you for the opportunity to provide further comment on the Instrument.

<u>Section 4.22 – Insurance – Adviser</u>

We reconfirm our concern of the material business impact that is expected to result from the implementation of this provision. Section 4.22(1) requires that an adviser that does not "handle, hold, or have access to" client cash or assets, including cheques, must maintain a financial institution bond in the amount of $50,000. Where an adviser does "handle, hold or have access to" client cash or assets, including cheques, the bonding requirement increases in a material way – from a minimum of $200,000 (which would apply only to those advisors having less than $20 million in assets under management) to up to $25 million in bonding. If an advisor is found to fall within section 4.22(2), the financial impact of the new bonding requirement to which it will become subject is still unknown but likely highly material to its operating budget. In our firm's case, our bonding requirement would rise from the current $200,000 to $10 million. An enquiry made to our insurance broker (Sinclair Cockburn) led them to contact the insurer, American Home Assurance Company. The insurer advised that until they have certainty of the regulatory requirement, they would not be attempting to develop a premium schedule given the significant impact of the change on customers – which in our firm's case would be an instant 5,000% increase in mandatory coverage levels. Our follow up enquiries indicate that no further detail is available.

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

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

> "Custody" means holding, directly or indirectly, client funds or securities, or having any authority to obtain possession of them. Custody includes --
> (i) Possession of client funds or securities, (but not of checks drawn by clients and made payable to third parties,) unless you receive them inadvertently and you return them to the sender promptly but in any case within three business days of receiving them;
> (ii) Any arrangement (including a general power of attorney) under which you are authorized or permitted to withdraw client funds or securities maintained with a custodian upon your instruction to the custodian; and
> (iii) Any capacity (such as general partner of a limited partnership, managing member of a limited liability company or a comparable position for another type of pooled investment vehicle, or trustee of a trust) that gives you or your supervised person legal ownership of or access to client funds or securities.

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

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

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

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

Section 6.2(2)(c) – Prohibition on Certain Managed Account Transactions

We express very serious concern over this new provision, which is a material change to the previous draft rule and which, we note, was not highlighted in the CSA commentary as a "Key Change".

The proposed rule prohibits an advisor from causing an investment portfolio managed by it from purchasing a security from another portfolio managed by the advisor, including an investment fund for which the advisor acts as an advisor. If the intention is to only capture securities owned by the investment fund, but specifically excluding securities issued by the investment fund, then the language in the rule must be clarified. As it stands, this will prohibit a portfolio manager from investing a client account in any mutual fund that the manager sub-advises. In the case of our firm, the investment fund manager that manages the funds which we sub-advise has qualified "Cardinal Series Units" under the funds' prospectus, which units are only available for purchase by us on behalf of our firm's private clients (i.e., on behalf of fully-managed accounts). This proposed provision appears to make this impossible, which would have a material, adverse impact on our firm.

As this is a significant change from the prior draft, I query whether this is intentional. If it is not intended to have this impact, then clarification is required.

Section 6.3 – Registrant Relationships

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

a) the fact must be disclosed to the OSC, including the business reasons for the relationship;

b) the registered firm must adopt policies and procedures to minimize the potential for conflicts of interest resulting from the relationship; and

c) the details of the relationship, and the policies and procedures adopted to minimize the potential for conflicts of interest, must be disclosed to clients.

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

While we can appreciate the application of the prohibition on firms within the same registration category, we do not support the blanket prohibition provided by the Instrument. As an accommodation, perhaps the CSA can consider removing those who only serve as directors from the prohibition, given that their role would be less involved than an officer or partner.

In conclusion, we believe that these three provisions will have material adverse impact on our firm and other advisors, and that their impact will substantially outweigh the perceived public benefits.

Yours truly,

CARDINAL CAPITAL MANAGEMENT, INC.
Per:

Steven London
Vice-President, General Counsel and Chief Compliance Officer