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British Columbia Securities Commission
Alberta Securities Commission
Saskatchewan Securities Commission
Manitoba Securities Commission
Ontario Securities Commission
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, Nunavut
Registrar of Securities, Yukon Territory

c/o John Stevenson, Secretary
Ontario Securities Commission
20 Queen Street West
Suite 1903, Box 55
Toronto, Ontario, M5H 3S8

Madame Anne-Marie Beaudoin
Directrice du secrétariat
Autorité des marchés financiers
Tour de la Bourse
800, square Victoria
C.P. 246, 22 étage
Montreal, Québec
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Via email

Dear Commission Members:

We are writing to you on the topic of Regulatory Reform of Proposed National Instrument 31-103.

We think the Canadian Securities Administrators (CSA) are heading in the right direction with the thrust of their proposals. We applaud the direction of disclosure, increased capital levels, proficiency requirements and investor protection. Both this year and last year we participated in a few discussions with the Investment Counsel Association of Canada (ICAC) including sessions with two representatives from the OSC hosted by the law firm Fasken Martineau in 2007 and 2008. There are a handful of areas that we are tackling independently of the ICAC because we think the CSA can improve its efforts even further with these amendments.

Specific recommendations and comments:

1. *Cross trades.* Section 6.2(2)(c) prohibits cross trades. We agree strongly with the ICAC comments on this and the articulation of fiduciary duty, duty of care and best execution. In our OSC review audit, the auditors reviewed our cross trades and in each case the clients faced lower commission and/or market impact costs on these trades. We support this ability to do cross trades enough that we requested a special exemption to do this for our two small pooled funds which was granted by the CSA with ample disclosure requirements. Implementing this would simply cost clients more money with no obvious benefit to anyone.

2. *Insurance Requirements - Adviser.* The ICAC suggestions on the need to differentiate holding or having access to client assets to exclude handling cheques where the adviser is not the payee on any cheque are common sense. They should be adhered to because it would be impossible to think of any adviser not handling cheques payable to custodians at least occasionally.

3. *Insurance Requirements – Investment Fund Manager.* **This is our most significant objection.** We would hope that the CSA will make changes this time and have several helpful suggestions. To paraphrase our insurance broker, the proposed requirements are a completely unnecessary level of insurance coverage and would simply add cost without any meaningful benefit to clients of investment counselors. He noted that the proposals are following the formula for investment dealers, which are significantly higher risk, and applying it to the investment counselor model (you acknowledge this distinction with your investment advisor category). Unlike investment dealers, investment counselors which normally keep assets segregated with a custodian or clearing broker, do not accept cash or securities and usually have trading authority but not power of attorney. In his view, which we share, investment counselors including those with pooled funds are at low risk for misappropriation of funds and/or improper activities. Our broker is one of the most experienced in the industry and would personally gain from higher levels of insurance coverage (insurance commissions are directly linked to premium levels), but says the proposed insurance levels are overkill for investment counselors though reasonable for investment dealers. In our view, the higher risk areas of the industry are the stockbroker world where assets are essentially custodied in-house and where there is more potential for abuse.

Investment funds with proper custodians and independent net asset valuation calculations should have the liability with the custodians, fund accountants and auditors and are only marginally riskier than pure investment counselors. Investment counselors with small pooled funds would only be modestly higher risk than the pure investment counsel model. In our case, we have $17 million of client funds (out of $250 million in total funds) in two small pooled funds which offer diversification for clients with specific requirements at costs far lower than available in the mutual fund industry. Our FI bond requirements grow from $50,000 to $2.6 million because of being in the investment fund manager category due to these two small pooled funds. The incremental insurance costs are eligible costs for being paid by pooled funds and mutual funds – **hence the full amount of the incremental and unnecessary cost will be paid by investors not investment counselor firms.** Canada's fund management industry has already been critiqued for being high cost and this proposal would only compound the problem. We have three alternate suggested changes to section 4.23(1):

i) Amending section 4.23 (1) for the single loss limit to read: "1% of ***investment fund*** assets under management, as … records, ***plus $50,000,*** or $25,000,000..." [This would make the investment fund manager have the $50,000 FI Bond plus 1% of the amount in their investment fund rather than 1% of the total assets]; or

ii) Excluding the investment fund category for all ICPMs who use only independent, external service providers for the functions of custodian and fund accountant and keep them under the umbrella of section 4.22; or

iii) Amending section 4.23 (1) (a) to read: "***0.25%*** of assets under management". [This is probably the least appealing because of the discrepancy between 4.22 (2) and 4.23 (1)].

4. *Excess Working Capital levels*. We applaud the CSA for raising the bar here and for being more explicit in their calculation methodology. We are leery of the impact of lessening competition and hurting entrepreneurship but with some tweaking this negative impact can be reduced to an acceptable minimum.

i) We do not think that registered Investment Counselor/Portfolio Managers who have small pooled funds on the side should be captured in the investment fund manager category. Those who use independent, external service providers for the functions of custodian and fund accountant and whose investment fund assets are below 25% of total assets should be measured the same way as an investment adviser, i.e. a minimum capital of $25,000.

ii) The calculation methodology wins points for clarity but by copying the investment dealer model when investments dealers have significantly higher risks, is excessive. Investment dealers use their assets as collateral for loans as a normal part of their business. Investment counselors use liquidity for true working capital or for investments beyond their normal operations. Fund managers should be encouraged to invest in their own funds or in the same securities they purchase for their clients to align their interests further. Amendments that we recommend are as follows:

a) Investments in investment counsel pooled funds which can be readily accessible for liquidity purposes should have the same treatment as All Other Mutual Funds (rather than the 100% exclusion under IDA rules).
b) We think investments in publicly traded stocks (over $2) or All Other Mutual Funds (or pooled funds as per recommendation a) above) should have a simple 25% haircut for inclusion in the calculations (rather than the 50% haircut under IDA rules).

Unlike in the investment dealer world, requirements for this cash would be rare, and with stocks and pooled and mutual funds usually settling for cash in a few days, a 25% haircut should more than adequately cover market risk. At the very least, pooled funds should be treated on par with All Other Mutual Funds.

5. *Delivering financial information – investment fund manager.*

i) We don't think 4.30 (2) is necessary. Quarterly statements are excessive. This is particularly true where investment funds are less than 25% of firm assets in which case the investment fund manager should be treated the same an investment adviser under section 4.10 (1). The ICAC comments re. GAAP are sensible.

ii) 4.30 (1) (c) [and 4.30 (2)(c) should our recommendation of abolition be ignored] should insert the word "material" before "net asset value adjustment".

6. *Referral arrangements*. While many in the investment industry object to the disclosure requirements and the principle, we strongly applaud the CSA moves here. In fact, our objection is that it is too generous. We think referral arrangements should only be allowed between firms and/or individuals who are regulated by the Securities Commissions or the Investment Dealer Association or its equivalent. Marketing firms for money managers should be required to get a special exemption. Otherwise, there could be enormous potential for abuse by people generating a lucrative sideline business and potential growth in fraud. In addition, it would result in investment money flowing to the big payers of referral fees rather than the most independent managers which we have seen in the world of mutual funds where even the original puritan firms are paying trailer fees to full service and discount brokers. This helps boost costs for investors and Canada's mutual fund and investment advisory fee are already among the highest in the world.

7. *Dispute resolution service*. We do not think that this is necessary for investment counselors where disputes are rare and where clients, by virtue of being accredited investors and having assets above minimum asset threshold levels, have the financial capacity to take any disputes to the courts. Since we acknowledge the slow pace of the legal system, we would suggest making a dispute resolution mandatory in the investment management agreement contracts of investment counsel firms, but only for regulatory or material disputes, with two important distinctions. First, investment counselors would not have to pay an annual fee for a service that they would most likely never use but would only pay a portion of the costs if a dispute actually occurred ("pay as you go" rather than pay wasteful retainers). Secondly, minor discussions over investment or service performance could be triggered for disputes without a narrowing of the scope to regulatory or material disputes.

With the adjustments suggested above, we think that the Regulatory Reform proposals would improve the regulatory framework for the investing public. We continue to support the CSA in its efforts to regulate the capital markets and to strive towards best practices in ethics and providing financial services to Canadian investors.

Sincerely,

Richard M. Tattersall, CFA
Vice-President & Compliance Officer