May 29, 2008

British Columbia Securities Commission
Alberta Securities Commission
Saskatchewan Securities Commission
Manitoba Securities Commission
Ontario Securities Commission
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

-and-

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

Dear Sirs and Madams:

Re: Response to Canadian Securities Administrators' (CSA's) Notice of Proposed National Instrument 31-103 Registration Reform ("NI 31-103), Companion Policy 31-103CP Registration Requirements ("NI 31-103CP") and Consequential Amendments.

The Investment Counsel Association of Canada ("ICAC"), through its Industry, Regulation and Tax Committee, is pleased to have the opportunity to submit the following comments regarding NI 31-103, NI31-103CP and the proposed consequential amendments to other National Instruments on behalf of its members.

As background, the Investment Counsel Association of Canada ("ICAC") represents investment management firms registered to do business in Canada as investment counsel/portfolio managers. Our members are from across Canada and are comprised of both large and small firms managing both institutional and private client portfolios. The

ICAC was established in 1952 and manages in excess of $650B assets. Our mission is to advocate the highest standards of unbiased portfolio management in the interest of the investors served by Members. Member firms are in the business of managing investments for clients in keeping with each client's needs, objectives and risk tolerances.

The ICAC wishes to again state that it is very much in support of the core objectives of NI 31-103 which we view as harmonizing and modernizing the registration and disclosure requirements across the country. We would also like to commend the CSA for responding to and/or incorporating some of the industry feedback received during the first round of comments on NI 31-103. In particular, the ICAC and its members note that many of the proposed changes contained in the ICAC's comment letter dated June 19, 2007 have been incorporated into the republished versions of NI 31-103 and the Companion Policy 31-103CP including (a) the mitigation of the litigation and privacy concerns imposed by the previous mandatory disclosures on registrants sharing information about former employees, (b) the new provisions recognizing practical market experience for existing Chief Compliance Officers, (c) the new framework of specific transition periods for certain of the new rules, and (d) the changes made to improve the international adviser and international dealer exemptions embracing the global harmonization initiatives of other senior securities regulators and enhancing the prospect of CSA registrants seeking reciprocity abroad.

The ICAC's comments on the revised draft of NI 31-103 can be categorized under two broad themes and some remaining general issues.

1. <u>The Importance of Leveling the Playing Field</u>
   (a) between the provincial and territorial securities commissions in Canada; and
   (b) between direct CSA registrants and those subject to registration by Self Regulatory Organizations (SRO)

2. <u>Finding the Appropriate Balance between Cost Effectiveness and Consumer Protection</u>
   (a) **Investment Advisers:**
      (i) Working Capital
      (ii) Insurance
      (iii) Holding Client Assets in Trust
      (iv) Assessing Beneficial Ownership of Corporate Clients
      (v) Chief Compliance Officer (CCO) Requirement – PDO Exam

   (b) **Exempt Market Dealer** – Lack of an Exemption for Advisers dealing with their own Funds with Non Discretionary Accredited Investor Clients

   (c) **Investment Fund Managers**
      (i) Jurisdiction of Registration for Investment Fund Managers
      (ii) Multiple Registrations
      (iii) Higher Working Capital Minimum
      (iv) Insurance Requirement
      (v) Investment fund Manager Chief Compliance Officer
      (vi) Financial Statement Requirements
      (vii) NAV Correction Reporting

(d) Time Limits on Examination Proficiency (Applying to All Registration Categories)
(e) Complaints and Mandatory Dispute Resolution Service
(f) Relationship Disclosure Documents

3. <u>General Issues</u>
(a) Prohibition on the provision of margin
(b) Cross trading
(c) Restrictions on International Advisers and International Dealers
(d) Transitional issues

<u>1. The Importance of Leveling the Playing Field:</u>

The ICAC supports the harmonization and streamlining of the rules and regulations within Canada.

(a) Between and Among the Provinces: The gradual harmonization of the rules within Canada continues to be a positive development serving the public and the registrant community. Where differences exist, we continue to urge the provincial and territorial regulators to be cognizant of the reality that the costs imposed by additional and unique rules and/or differences are passed on to the investing public. To that end, we wish to express disappointment pertaining to the decision by Manitoba to retain the current "trade trigger" for dealers. This will mean that firms doing business in Manitoba must continue to monitor whether they have carried out a trade in Manitoba, and if so, whether a registration exemption exists, before deciding whether they need to be registered as a dealer in Manitoba. Similarly, the decision by the regulators in Manitoba and British Columbia to provide a different Exempt Market Dealer (EMD) regime in their jurisdiction (i.e. allowing EMDs operating only in these provinces to operate without registration, provided those firms are not registered in any other province or territory) detracts from the core principles of harmonization of NI 31-103.

(b) Between and Among Direct CSA Registrants and SRO Governed Registrants: The ICAC's continues to hold the view that there is no value from perpetuating an unlevel playing field between direct CSA Registrants with those subject to a SRO. As noted in the 2007 comment letter we filed on the previous draft of NI 31-103, we recommend that section 3.3 be amended to clarify that the exemption for SRO entities apply where such SRO's have by-laws, regulations and policies dealing with the same subject matter and which are substantively similar. Furthermore, we would continue to request that the CSA members alter their existing SRO rule approval process to permit other industry groups competing with SRO entities to comment on whether the proposed rules are equivalent to the provisions which they are required to operate under.

One of the issues that still appears to be unresolved is the requirement in section 2.8 of NI 31-101 requiring an Associate Advising Representative of a registered adviser to get any advice approved by an advising representative before the advice is rendered, contrasting with a more flexible after the fact supervision for IDA member firms partaking in the same functions. We would strongly urge the CSA to take a more practical approach to supervision of Associate Advisers. For a variety of reasons, pre-approval of all advice is impractical and may have a harmful effect on clients if advising firms cannot exercise their discretionary authority to trade in a timely fashion. Advisory firms all owe a fiduciary duty toward all clients and, in most cases there is also a contractual duty of care owed to the clients. In such circumstances, the advising firm's principals are well aware of their obligations toward clients and are sensitive to preserving their most valuable asset, their reputation. In the result, if the firm's principals undertake to supervise an employee, that undertaking should suffice as the firm is responsible to ensure the advice clients are receiving is appropriate, and mandating prior approval is, in our view, onerous, impractical, and potentially harmful to clients. The exemptions in section 3.3 of SRO registrants from certain of the provisions such as relationship disclosure information, capital and suitability, etc with the justification that they have similar rules[1] also creates the potential for a non-level playing field.

2. Cost Effectiveness

The ICAC is very much in support of the efforts to reduce the administrative burden on registrants such as permanent registration process vs. annual renewal, automatic re-instatement of registrations on leave of absences, increased mobility rights for advisers servicing clients, reduced number of registration categories, etc. These efficiencies become even more important when looked at holistically against the expanding scope of regulation imposed on registrants in the securities, accounting/tax, privacy and other regulatory contexts.

The ICAC has a number of material concerns that certain provisions in the proposed National Instrument represent a significant reversal of recent positive developments in the Canadian markets and will result in detrimental consequences in the form of higher costs to the public, the impairment of existing registrant viability or product creation and/or create obstacles to new and inherently smaller prospective registrants from entering the marketplace.

(A) Investment Adviser Registration Category

(i) Adjustments to Excess Working Capital: The Proposed Instrument in section 4.18 would require advisers to calculate and maintain excess working capital using Form 33-103F1 (Calculation of Excess Working Capital). Line 9 of the calculation requires a deduction for the "market risk" of securities owned by the firm. While there were some minor changes made from the original draft of NI 31-101, (i.e. adding a new Schedule 1 to Line 9 of the Form), as the rules currently stand, an adviser that invests in its own non-prospectus qualified pooled funds would face a 100% deduction. As we noted in our original comment letter, we recommend that the deduction be 0% where an adviser invests in its own proprietary funds over which it manages and can control liquidity.

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[1] On February 21, 2008, the Investment Dealers Association of Canada (IDA) Released for a 30-day comment period its proposals for the establishment and amendment of IDA rules to implement the core principles of the Client Relationship Model. The rule proposals relate to relationship disclosure, account cost disclosure, conflicts resolution disclosure, retail client suitability and account performance reporting. The Mutual Fund Dealers Association of Canada's equivalent proposals are expected later this year.

(ii) Insurance Requirements – Adviser: While the revised NI 31-103 includes a lower mandatory insurance requirement for advisers that do not hold or have access to client assets, section 4.22 of the proposed rule includes language that would disentitle an adviser from utilizing this reduced insurance requirement merely because it may handle or redirect a client cheque. This is an unjustified result, particularly where the adviser is not the payee on a cheque, but merely acting like a letter carrier or courier forwarding the client payment instrument, without in any way altering it, to a pooled fund trust account, where an individual unitholder accounting system record is set up in the client's name. Moreover, even if an adviser went to great lengths to avoid the handling of client cheques (e.g. ensuring all flows of funds are directly to and from the client's custodian and/or a fund custodian account), there may be instances where a client inadvertently sends in a cheque to their adviser, which would seemingly disqualify the adviser from the lower capital and insurance thresholds. There could also be issues where a third party (e.g. administrator in a class action) sends in a cheque to the adviser on behalf of an account they might have been advising on for a client which could cause the adviser to be deemed to hold client assets. There are also anti money laundering (AML) provisions in the federal legislation that would require custodians to hold off accepting funds directly until a prior AML screening was done by the adviser making direct payments to trustees more difficult or imposing time holds on asset flows. Put simply, there would appear to be no increased risk from the handling of third party cheques justifying an increase to the firm's capital or insurance.

This position is fully endorsed by Chubb Insurance Company of Canada, one of the largest providers of fidelity bond and professional liability insurance in North America and the insurer for the ICAC group insurance program. Upon review of the proposed NI 31-103, Chubb noted in a communication to ICAC that

> "*We believe that it is unjustified for an Investment Advisor to be forced to significantly increase their insurance requirements simply because of the fact that they hold a client cheque made out to their Custodian. Further to this, we have consulted with our US counterparts to compare practices and they are not aware of any similar requirements in the U.S. for Investment Advisors. In fact, to the best of their knowledge, there is no specific bonding requirement for Investment Advisors south of the border at all. Many elect to carry the coverage anyway, but they are not mandated to, let alone mandated to carry such high limits as currently being contemplated in NI 31-103. Some of those who do carry it likely only carry it because they are an Investment Advisor subsidiary of a larger overall asset management organization, which does have a mandated need to carry insurance for their mutual fund operations, and while their Investment Advisor bonding coverage can't take away limits from their mutual fund arm, companies tend to cover their Investment Advisor operations as well once forced to buy it for their mutual funds. The U.S. does of course have NASD mandated insurance requirements for Broker/Dealers, similar to what we have in place for IDA members, but even that is tied to employees/locations, as opposed to Assets Under Administration (which is what the IDA does), and they're also of a much lower quantum, such that an NASD member with 300 or 400 employees & 20 locations might only be required to have a couple million of coverage. It's only the very large broker/dealers in the U.S. that tend to carry insurance in the $25M range. We agree with your comments, and that the regulations, as currently being contemplated, appear to be more onerous than those currently in place in the U.S.*" **Robert Murray** | Vice President | Chubb Specialty Insurance

The obvious solution here would be for the CSA regulators to incorporate a principled framework around what constitutes “not holding client funds” akin to the same framework utilized in other areas of NI 31-103 (e.g. Compliance policies and/or client relationship documents, etc.). Given the onerous requirements that would be triggered by being deemed to hold client assets, ICAC thinks it would be prudent for the CSA members to confirm the widely held position that merely having discretionary authority over client assets (either on a segregated basis or in a pooled fund that an adviser may be managing) does not constitute holding or having access to client assets provided such assets are held in a custodial account with a third party custodian or other applicable entity.

(iii) **Holding Client Assets in Trust**: ICAC’s interpretation of section 5.10(2) (i.e. which requires registered firms to hold cash on behalf of clients in a designated trust account with a Canadian financial institution or a Schedule III bank) is that this would only apply if a registered adviser or exempt dealer or fund manager was holding assets directly and not where such assets may be invested in a fund managed by said entity or in a segregated account established by a client where the registrant merely has trading/managing authority over the client’s assets. We would therefore request the regulators to explicitly clarify this in the National Instrument or in the Companion Policy.

If the above interpretation is not correct, this provision would create major obstacles in maintaining or developing alternative investment strategies (e.g. 120/20 or 130/30 mandates) which utilize short positions and/or leverage and where cash must generally be held by a prime broker as security. Of particular concern is that greater accommodation appears to be given to foreign advisers utilizing these same strategies in that section 5.35(c) of NI 31-103 permits non-resident registered firms to arrange for client assets to be held not only by custodians but by registered dealers who meet certain requirements. This omission to recognize that in certain circumstances assets may be held by entities other than custodians is also inconsistent with the provision in section 6.8 of National Instrument 81-102 which permits margin and/or collateral for certain derivative transactions to be held by a broker or with a counterparty.

(iv) **Assessing Beneficial Ownership of Corporate Clients:** ICAC questions the higher client identification standard being imposed on Adviser entities under section 5.3(2) (i.e. requiring registrants to establish the nature of the client’s business and the identity of any individual who is a beneficial owner, directly or indirectly, of more that 10% of the client.) than that which is currently imposed by the federal government (i.e. 25%) under the federal Proceeds of Crime (Money Laundering) and Terrorist Financing Act. It is our view that the securities requirements should be harmonized with those imposed federally.

(v) **Chief Compliance Officer Registration for Advisers** – Requirement for PDO Exam: ICAC is appreciative of the substantial revisions made to the CCO provisions from the first draft of NI 31-103. With that being said, we continue to question why section 4.13 still lists the PDO Exam as a pre-requisite condition. This “sell side” exam seemingly has little application to a buy side firm, particularly to the compliance function other than a short chapter on “ethics”. We would encourage the regulators to reconsider this requirement so as to minimize the time allocation (note: many estimate that 80-100 hours of study time is required for the PDO exam) and the costs paid to a third party group to administer this test. If it is truly the ethical chapter that the regulators believe should be prerequisite to CCO's, then they should pare this requirement down to an exam that tests this material alone.

(B) **Exempt Market Dealer – Lack of an Exemption for Advisers dealing with their own Funds with Non Discretionary Accredited Investor Clients (or alternatively for Permitted Client Category of Accredited Investors):**

Advisers typically utilize a commingled structure (prospectus or non prospectus qualified mutual fund) as an efficient investing tool to implement investment strategies on like accounts. In light of this reality, it is the ICAC's view that a corresponding exempt market dealer exemption for a portfolio adviser dealing with non-fully managed accounts with their own funds be granted as there will exist for fully discretionary client accounts. Unlike the situation that existed for years where Ontario or Newfoundland had a litany of Limited Market Dealers who had no proficiency requirements and who were not adviser entities, or alternatively, where there was a complete exemption from dealer registration if a trade in a fund was accompanied by a prospectus exemption, it seems perverse that adviser entities, already subject to the full rigors of the regulatory regime, would have to file for a separate registration status. While these registered advisers are to be granted an exemption when they are adviser deal with its own pooled funds for discretionary accounts, no such comparable exemption is granted if they are using these same pooled funds for non-discretionary accounts.

The practical reality is that in some cases, institutional clients prefer to enter a relationship with an adviser using a subscription agreement rather than an investment management agreement. In either case the accounts will be handled the same way if they are in a commingled structure, and it creates an artificial distinction for the client who enters into a subscription agreement and thereby triggers the registration requirement for the adviser. As noted in our 2007 comment letter on the previous version of NI 31-103, ICAC is also of the view that sophisticated institutional investors like the large pension plans should not be mandated to have an unnecessary local dealer on a trade where they independently source an offshore fund. As a final comment on this provision, we query whether the narrow language of the exemption being provided to "discretionary accounts that is created and managed by the adviser" would still apply where an adviser acquired a book of business from another adviser that may have "created" the original account.

(C) **Investment Fund Managers:**

(i) **Jurisdiction of Registration for Investment Fund Managers**: It is ICAC's position that the clarification that an investment fund manager only needs to be registered in one Canadian jurisdiction (if that is the only place where the mind and management of the fund is occurring) is sufficiently material that it should be contained in the NI 31-103 rather than just the NI 31-103 Companion Policy. Additionally, we think it important to include the clarification in section 2.8 of the Companion Policy (i.e. that a foreign investment fund need not register in Canada providing that the mind and management of the firm is occurring outside Canada) also be contained in the Instrument and preferably under both the Investment Fund Manager section and the section dealing with International Advisers.

(ii) **Multiple Registrations:** ICAC believes that NI31-103 should be revised to explicitly provide that an entity that would otherwise be required to register as an investment fund manager will not be required to so register if it delegates its investment fund manager obligations to a third party that is registered as an investment fund manager. This clarification is particularly important where our members may structure their investment funds as limited partnerships, each of which may have separate but affiliated general partners for each investment fund. If the general partner of these limited partnerships enter into a management agreement with a registered adviser in which they completely delegate investment advisory and management services to the registered adviser, resulting in that latter entity registering as an investment fund manager, the general partner should not also require a duplicate investment fund manager registration. As the rules are presently constituted, it would appear to require multiple registrations resulting in higher insurance, capital and general administration costs than what is truly required.

(iii) **Higher Working Capital Minimum:** ICAC continues to hold the view that there is no articulated justification for the higher working capital threshold for investment fund managers. (e.g. the minimum capital is $25,000, for an adviser, (b) $50,000, for a dealer, and (c) $100,000, for an investment fund manager). ICAC's view is that it is unfair to those advisers that may utilize prospectus or non prospectus qualified mutual funds to carry out their investment decisions for clients with similar mandates versus others that may simply use segregated accounts (or a model portfolio arrangement) to implement investment decisions for like mandates. There is also a concern that this may create a barrier to entry and/or push some advisers to avoid creating funds (optimizing investment management and mitigating account dispersion) with individual accounts (with their resulting costs) established for each client rather than one fund account. If the CSA members insist on a higher capital requirement, we would recommend as an alternative that the CSA consider a staggered capital requirement based on assets under management, with the above noted amounts as the highest amounts, to more accurately correspond to the quantum of exposure and so as not to act as a bar to new entrants or impair the business of existing firms. We would also continue to recommend that the regulators should consider a lower capital requirement for managers that outsource the key functions of the Investment Fund Manager role (e.g. NAV calculation, custody, foreign exchange, etc.) to a regulated third party service provider and who maintain robust internal controls which are often assessed by auditors in CICA 5970 Reports. If there is a perceived need for greater protection, this can be addressed through proficiency rules not arbitrary monetary requirements.

(iv) **Insurance Requirements**: ICAC is of the view that Investment Fund Managers who do not hold client assets and who have outsourced the key services in support of their Funds such as fund valuation, trustee services and unit holder recordkeeping functions to a qualified and regulated financial institution should qualify for a lower insurance requirement in the same manner that NI 31-103 prescribes a lower insurance requirement for those advisers that do not hold client assets. We do not see what additional risks would arise merely because the use of a commingled investment vehicle where a third party financial institution may be generating periodic net asset value per unit and in which audited financials and other reports are generated as compared to an adviser managing assets via segregated accounts. Furthermore, we believe in the event they do hold client assets, as noted in section 2.a) ii), we believe the recommended amounts are onerous and completely out of line with the potential risk.

(v) **Investment fund Manager Chief Compliance Officer**: We note that under section 4.15 of NI 31-103, the CSA has taken steps to address the unique skills and knowledge that an individual fulfilling such a role at an investment fund manager should have. That said, we believe that the requirement for "consecutive" years of experience is too narrow and that the experience requirement should be relaxed to be more consistent with the approach taken in section 4.13 regarding proficiency requirements for Chief Compliance Officers of portfolio management firms.

(vi) **Financial Statement Requirements**: ICAC takes the position that the filing requirement in section 4.30(2) to deliver interim financial statements within 30 days of quarter end is too onerous and inconsistent with the comparable provision in National Instrument 81-106 where 60 days are provisioned for these interim filings. ICAC also takes the position that the requirement to prepare annual and interim financial statements in accordance with GAAP as provided in section 4.32(1) is not possible as registrants currently are not qualifying enterprises for purposes of the differential reporting options under Section 1300 of the CICA Handbook, and consequently would receive an adverse audit opinion from their auditors on the annual financial statements due to non-consolidation. Furthermore compliance with International Financial Reporting Standards (IFRS) requires consolidation, where applicable, to be in accordance with IFRS. It is our view that the policy objectives with the interim filing (presumably to assess financial solvency) could be met with the filing of a balance sheet and income statement.

(vii) **NAV Correction Reporting**: The ICAC also has concerns with the administrative burdens that will be imposed by the NAV Correction Report requirement set out in section 4.30 of NI 31-103 (including the articulation of the description of all events and the calculation of dollar amounts) particularly when the reality is that this function, is generally outsourced to the three large custodians in Canada (i.e. RBC Dexia Investor Services, CIBC Mellon and State Street). Where NAV adjustments occur, it is almost invariably a result of an error in process by the outsourced custodian. In the context of advisers that operate private pooled funds to assist in the management of client accounts with similar mandates, we think it relevant to emphasize the basic principles of the fiduciary duty and the contractual standard of care that such advisers owe to all clients. As a fiduciary, the adviser (who generally will be the manager of the pooled fund as well), owes a duty to treat all clients fairly and to not prefer one client over the others. In this context, an adviser owes a duty to clients to review the NAV calculation of the calculation agent on a regular (if not daily) basis. Calculation errors occur for a variety of reasons and NAV adjustments are made to correct the errors. That said, the books and records of the advisers are open for the CSA to review on any on site audit of an adviser's business and we do not see how the reporting of every NAV discrepancy (no matter how small) will assist the regulatory authorities. Such a reporting requirement will necessarily increase administrative costs for all investment fund managers and we believe that there should be some materiality threshold (akin to IFIC's Industry Practice Rules of 50 basis points or $50) applied such that this administrative burden and costs do not become onerous.

D. **Time Limits on Examination Proficiency (Applying to All Registration Categories):**

We appreciate that the CSA recognizes that setting time limits for applying for registration after examinations or educational programs are completed imposes somewhat arbitrary limitations on qualified individuals applying for registration. This is evidenced by subsection 4.4(2) of the Proposed Instrument, which allows additional time to register once an examination or program has been completed. However, we believe this extension does not go far enough. Individuals who work in the securities industry tend to complete the Canadian Securities Exam and the Chartered Financial Analyst programs early in their careers and obtain valuable work experience afterwards. We ask the CSA to recognize this fact and consider eliminating the 36-month time limit for applying for registration entirely in situations where the individual has been employed continuously in the securities industry since completing the exam or program.

(E) **Complaints and Mandatory Dispute Resolution Service Requirement:**

The ICAC reiterates the concern noted in its prior comment letter that the revised draft of NI 31-103 does not exempt certain complaints (e.g. minor complaints and/or non-regulatory complaints relating to investment performance or client servicing) from the requirement in sections 5.27-5.32 that clients be notified about the option of referring any complaint to a dispute resolution service to mediate the alleged issue. While the revised draft provides new exemptions for Investment Fund Managers and Exempt Market Dealers dealing with Accredited Investors, the imposition of the proposed rules on Investment Advisers (as Investment Dealers are currently subject to SRO provisions with tighter controls around its application) without some practical fixes would subject these non SRO registrants to a different 'playing field' with respect to dispute resolution services and potentially add costs and barriers to entry to the marketplace.

In light of the new annual filing requirements that are also being imposed on advisers outside of Quebec (as advisers in Quebec are already subject to this semi-annual requirement disclosing the number and nature of complaints received) it is our view that the mandatory arbitration requirements present costs that outweigh any perceived benefits from the provision. The observed tendency to want to impose the "highest common standard" of regulation should be resisted without a full and fair assessment of the benefits to be obtained from this new requirement. We have heard from the regulators in the prior industry forums during 2007 that the merits of a dispute resolution service were heard from the public in earlier "Townhall Session(s)" that were held at some point in previous years. We query whether the call for mandatory arbitration was a representative comment from the broader public who will ultimately be bearing the costs. We also query whether there may be the opportunity for clients to seek to extract unreasonable concessions from advisers pertaining to smaller/less material complaints because of this proposed mandatory right.

Alternatively, to the extent that the CSA members do not agree with the ICAC's view that the status quo (no mandatory arbitration) should be maintained, we respectfully recommend that the requirement to use a dispute resolution service should (i) be clarified so that the reference to "participate" in a dispute resolution service would not automatically require registrants to pay an annual retainer to a dispute resolution service provider every year notwithstanding that no claims were made; (ii) that the obligation to use dispute resolution services would be limited to the regulatory/material complaints; (iii) that the obligation to use dispute resolution services be made mandatory for any potential claim above the deminimus threshold but under $100,000 in value with the results being binding on the parties without any opt out rights or ability to file additional actions relating to the same subject matter; and (iv) preclude a client wishing to utilize the arbitration service with a claim(s) in excess of the $100,000 limit from later opting out or commencing a civil action.

As a final matter, it is ICAC's view that for the protection of firms and for clarity of what is a complaint (as opposed to a service inquiry) triggering the dispute resolution processes, "complaints" should be in codified form (written letter or email). Section 4.12.2 currently defines a complaint as a reproach against a firm made orally or in writing.

(F) **Relationship Disclosure Records:**

As noted in our previous comment letter, the recordkeeping rules and commentary incorporated in the revised draft of NI 31-103 continues to expand the scope and requirement of client "relationship records" (which would include non material correspondence with clients) that must be preserved for 7 years after the date of termination of the client relationship. Section 5.16(4) states that "relationship records" include all communication between the registrant and its clients including "all email, regular mail, fax and other written communication to clients"[2] There is also a reference to notes of verbal communications and this potentially raises the additional burden and/or expectation of having to store all voicemail messages, particularly as they can now be stored, albeit with additional cost, electronically. We respectfully request that a materiality threshold on the relationship records that registrants should preserve and or amend the definition of "relationship records" such that it applies to matters related to the suitability of investments or material changes to the client relationship. Reference could be made to the recordkeeping standards recommended by the CFA Institute or to general principles of law. This would be consistent with the principled approach taken in other areas of NI 31-103 (e.g. the compliance controls, etc.). ICAC wishes to articulate the practical difficulties to achieve full compliance with the storage requirements without imposing on advisers a requirement to fundamentally restructure the format of how electronically data is currently preserved. The reality is that email retention software is designed to operate at a firm wide level. In short, the ability of a registrant's email administrator to purge old emails according to a firm's retention policy(s) is done against a single reference point (i.e. date of email vs. current date) and not by factoring in what could be hundreds or thousands of individual clients each with their own starting date and some with histories dating back many years or decades. The only way to seemingly accommodate the current provision would be to turn off the current retention schedules and require registrants to maintain all records indefinitely to avoid violating the 7 year

[2] "relationship record" means a document, other than an activity record, that describes the relationship between a registrant and a client of the registrant including
(a) a communication between the registrant and the client not made in respect of a purchase or sale of a security, including a record of an oral communication,
(b) an agreement entered into between the registrant and the client,
(c) a client complaint,
(d) relationship disclosure information provided to the client under section 5.4 [*Providing relationship disclosure information*].

after a client ceases to be a client rule. This proposed solution would trigger issues under applicable privacy legislation and would also therefore not be desirable.

3. **General Issues**

(A) **Prohibition on Margin**: It is ICAC's view that section 5.7 of NI31-103 (which states that a registrant "…must not lend, extend credit or provide margin to a client.") would only apply if the registered entity (adviser, exempt market dealer or fund manager) was directly lending, extending credit or providing margin to a client. Put another way, the mere fact that such registrants might be managing a pooled/mutual fund that incorporates a loan or margin facility and into which clients may invest or be managing a segregated account for a client where the client obtained their own lending/margin, would not trigger this provision. We would therefore request the regulators to explicitly clarify this in the National Instrument or in the Companion Policy.

(B) **Cross trades**: Section 6.2(2)(c) of NI31-103 prohibits cross trades, not only between investment funds managed by an adviser, but also between segregated accounts managed by an adviser, a significant change to the rule as currently expressed in section 118 of the *Securities Act* (Ontario), and comparable legislation in other jurisdictions. Funds governed by NI81-107 will be exempt from this new prohibition which indicates that a complete ban on cross trading is not deemed necessary by the CSA. However, we are unaware of the circumstances that have lead to the proposal set out in NI31-103. As previously mentioned, advisory firms all owe a fiduciary duty and a contractual duty of care toward clients. Part of this duty is obtaining best execution. If the adviser, exercises its judgment that a cross trade is in the best interests of two clients, and the clients have acknowledged contractually that the adviser may perform such cross trades between clients, we see little value being added by the proposed rule. In fact, we strongly believe that the unintended consequence of the rule will be that clients will face increased transaction costs as the refusal to allow cross trades will now expose these trades to higher commissions, market impact due to information leakage and potentially inferior pricing. The registrants will not bear this cost; it will go directly into the client portfolios.

In addition, we note that there is an inconsistency of treatment for cross-trades involving segregated accounts, reporting issuer funds and non-reporting issuer funds even though the conflicts presented by cross trades are essentially identical regardless of the investment structure. Assuming you agree with our point above and clarify that the prohibition does not apply to segregated accounts, this leaves pooled funds at a disadvantage. Relief has recently been granted to pooled funds to engage in cross trades but a condition of the relief is approval by an independent review committee. It would be extremely onerous for a pooled fund to establish an IRC only for this purpose and therefore this effectively prohibits pooled funds from engaging in cross trades. We suggest that pooled funds, which only have accredited investors as investors, should be allowed to engage in cross trades provided there are safeguards in place such as consent from the client and conducting the trades in a transparent and fair manner.

(C) **Restrictions on International Advisers and International Dealers:**

ICAC members generally have an interest in ensuring that regulatory regimes are fair to all participants local and foreign. Where this is not the case, it makes it more difficult for our member firms to justify reciprocal treatment in other markets in which we may be operating directly or through our affiliated entities. As such, we are concerned that the exemptions provided to international advisers and international dealers in sections 8.15 and 8.16 are too narrow. We would like the regulators to expand the type of securities an international adviser and International dealer could deal with to include Canadian securities when acting for permitted clients. There are many cross listed securities and it's not consistent to permit those issuers to raise money on foreign markets and trade their securities there but Canadian institutions (i.e. permitted clients) are limited to accessing financial intermediaries for trading in such securities. Often it is difficult to confirm whether an issuer is Canadian or not but the answer should not matter since the permitted client should be allowed to make a decision as to which adviser or dealer they would like to deal with. In short, the distinction between “Canadian” and “non-Canadian” securities as a basis for triggering registration requirements is not a valid one to make in the increasing globalizing markets. Furthermore, we would recommend that section 8.16(2) (d) (i.e. disentitling an international adviser from utilizing the registration exemption where it and its affiliates gross revenue from investment advisory business in Canada exceeds 10%) be deleted. In the larger spirit of reciprocity among with our international advisory colleagues, this just creates another additional trigger which is likely to change from year to year, be difficult to calculate given the extension to affiliated entities and potentially require international advisers to include revenue from affiliated entities that are Canadian registrants given the current drafting.

ICAC also believes that although the definition of "permitted client" in the NI 31-103 is based on the definition of the same term in the current OSC Rule 35-502, there are some notable differences between them in respect of the types of investment funds that are included in the two definitions. As a result of these differences, the list of “permitted clients” is more restrictive that what it was under OSC Rule 35-502. Accordingly, we would recommend, at a minimum, revising paragraph (k) of the definition of "permitted clients" under NI 31-103 to include those investment funds that distribute their securities to persons or companies who otherwise qualify as "permitted clients".

As a final matter, ICAC also believes that the language recognizing “international advisers” operating pursuant to exemptions (i.e. typically larger financial institutions) in section 8.16 also be extended to “international dealers” in the applicable definition in section 8.15.

(D) **Transitional Issues**

It is ICAC’s view that given the number and scope of the demands that will be imposed on both the industry and the regulators when NI 31-103 goes into force, and notwithstanding the new transition periods that have been incorporated in the revised rule, it would be prudent to ensure that a minimum period of 90-180 days notice be granted between the distribution of the final rule and the implementation date. This will give all parties time to gear up, allocate resources and/or set up implementation teams to ensure compliance with the new rules.

We would be pleased to discuss any of our foregoing comments further with you at your convenience. If you have any questions or concerns regarding our submission, please do not hesitate to contact Katie Walmsley at (416) 504-7018.

Yours truly;

INVESTMENT COUNSEL ASSOCIATION OF CANADA

Katie Walmsley	Tom Johnston
President, ICAC	Chair, Industry, Regulation & Tax Committee
	Executive Director, UBS

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