THE INVESTMENT FUNDS INSTITUTE OF CANADA
L'INSTITUT DES FONDS D'INVESTISSEMENT DU CANADA
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April 10, 2008

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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

In care of:
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Dear Sirs/Mesdames:

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

We are writing to provide the comments of the members of The Investment Funds Institute of Canada (IFIC) on the Notice, Proposed National Instrument 23-102 – *Use of Client Brokerage Commissions as Payment for Order Execution Services or Research Services* and the accompanying draft Companion Policy, published for public comment by the Canadian Securities Administrators (CSA) on January 11, 2008 (respectively, the "Notice", "Proposed Instrument" and "Proposed Policy").

We have previously submitted comments on the precursors to this Proposed Instrument - on June 9, 2005, on Concept Paper 23-402, *Best Execution and Soft Dollar Arrangements*, and on November 24, 2006 on the first version of Proposed National Instrument 23-102.

General Comments

We are pleased that the CSA has responded positively to the comments sent in respecting the previous version of the Instrument, and we believe that the proposed new Instrument provides for more appropriate disclosure requirements and has made significant strides towards harmonization with U.S. requirements.

Nevertheless, our members have identified a number of outstanding issues which are of particular concern to the investment fund industry, due to practical implementation issues and continuing lack of harmonization with U.S. rules. These issues are outlined below.

Quantitative Disclosure

We have very significant concerns with the proposed change to a new disclosure standard of "reasonable estimate" for client brokerage commissions, from the current "ascertainable" standard of disclosure.

For investment funds, NI 81-106 currently requires that the notes to the financial statements of a fund disclose the total commissions and other transaction costs paid or payable to dealers by the fund for its portfolio transactions during the period reported upon and, *to the extent ascertainable*, separate disclosure of the soft dollar portion of these payments, where the soft dollar portion is the amount paid or payable for goods and services other than order execution. These financial statements are available to the individual investors of each fund; fund investors and regulators are therefore currently able to obtain information about the fund's soft dollar activity.

These disclosure requirements are supplemented by NI 81-101 provisions relating to a fund's Annual Information Form. Mutual funds must provide general information on brokerage arrangements, including the method or criteria used in allocating brokerage business to dealers and firms providing research services, as well as disclosure relating to service providers, including whether those services were paid for through brokerage commissions.

Provision 4.1(g) of the revised Proposed Instrument would require disclosure of both the total client brokerage commissions paid during the period reported upon, along with the adviser's reasonable estimate of the portion of those commissions that represents the amounts paid or accumulated to pay for goods and services other than order execution during that period.

This new requirement imposes a much broader level of disclosure. We question the distinction between these two phrases - if an amount is reasonably estimated, is the amount ascertainable? The wording "reasonable estimate" will create issues as a model will need to be created that ties to accounting records and that can be supported and audited.

We believe that the proposed new standard for client brokerage commission disclosure is highly problematic. It is a subjective test that will make meaningful comparability between different

funds impossible. Moreover, costs associated with moving toward developing a new and subjective model could be significant. Accordingly, we believe that the standard set out in NI 81-106 remains the appropriate standard. In its Notice, the CSA has advised that consideration will be given to the need for harmonization between the disclosure requirements in the proposed Instrument and those in NI 81-106. We support such a harmonization effort, and urge the CSA to work with the industry to determine the most appropriate means of harmonization prior to finalization of this Instrument.

The Proposed Instrument will require companies to value the research material used in order to provide quantitative disclosure. Companies currently tracking usage of soft dollars will need to upgrade their procedures to meet the requirements of the new rules.

We also have a concern that the Proposed Instrument captures companies which have made a policy decision not to use "soft dollars" as a way of removing the soft dollar conflicts of interest entirely from their activities. In doing so, these companies have dealt with repercussions from brokerages including the loss of brokerage access, flow and market information. These companies have felt that such repercussions were acceptable to the funds given that the conflict was removed, expensive systems, policies and procedures were not necessary and brokerage commissions were bare execution only prices. The reality of this type of regime is that despite rigorous review of execution only pricing, brokers still provide unsolicited research material that is used by these companies.

These companies will now need to implement expensive systems and a number of policies and procedures to deal with the conflict of interest and the requirements of the Proposed Instrument just as if they were engaged in soft dollar arrangements (a summary of the requisite changes is provided in Appendix A).

Overall the proposed quantitative disclosure requirements will result in significant implementation and enhancement costs to the investment fund industry, none of which are captured in the CSA's Cost-Benefit Analysis that accompanies the Notice

Sub-advisers

Subsection 5.3(1) of the Companion Policy references the use of commissions by "sub-advisers", which appears to entail disclosure, and thereby tracking, by a fund manager on the use of client brokerage commissions by sub-advisers. This new proposal is very problematic from an implementation standpoint, for as we mentioned in our previous submissions, there is no obligation (other than contractual) on sub-advisers to disclose their practices. As such, we suggest the result will be inconsistent degrees of reporting to managers since the terms of disclosure by sub-advisers will depend entirely on each manager's ability to negotiate the contractual terms. Additionally, some sub-advisers may choose not to do business with Canadian managers requiring these new obligations, particularly where Canada is a small market for them. Moreover, there will be an impact on the cost of doing business for sub-advisers, thereby increasing overall costs for the fund manager. The Cost-Benefit Analysis fails to address this ongoing cost pressure.

In its Notice, the CSA requests comments on four specific questions. Question 3 asks whether the Instrument should allow an adviser the flexibility to follow the 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 Instrument. Given that the CSA acknowledges in the Notice that the proposal is not completely aligned with the rules in place or under consideration in other jurisdictions, to properly comment on this approach we would require more dialogue with you as to how "similarity" is to be determined to make this approach viable, short of the CSA identifying those jurisdictions that it considers to be similar for this purpose.

Independent Review Committees (IRCs)

Section 5.1 of the proposed Companion Policy states that for an investment fund, the recipient of the information respecting the use of client brokerage commissions is not the unitholder, but is the fund. We support this approach, as we do not believe the detailed disclosure required by the Instrument is of any value to, and thus should not be sent to, individual investors of investment funds.

We do, however, have concerns that where the adviser is the trustee and/or the manager of the investment fund or is an affiliate of the trustee and/ or the manager of the fund, the proposed Companion Policy implies that the Independent Review Committee (IRC) established under National Instrument 81-107 be the recipient of the disclosure information.

In our view, securities legislation must observe the principle in NI 81-107 that a matter is required to be brought to the IRC only if it is a conflict of interest matter. To proceed otherwise would introduce ambiguity concerning the role of the IRC and the potential liability of its members for their actions taken. NI 81-107 does not create different rules concerning conflict of interest matters depending on whether or not the manager of an investment fund also is its trustee. Determination by the manager respecting whether the disclosure information is delivered to the IRC (based on whether the manager concludes that its use of client brokerage commissions raises a conflict of interest matter) should not be embedded in another National Instrument that has a different primary purpose. We suggest the requirement in the Proposed Policy be amended to delete the reference to the IRC and NI 81-107 and state clearly that the disclosure information is required to be provided to the fund's oversight body. It will remain to the manager to decide and demonstrate that disclosure was sent to the appropriate body and (as required by NI 81-107) whether the matter need be brought before the fund's IRC.

Consistency with U.S. regarding order execution services

We appreciate that the revised Instrument has sought to achieve greater consistency with the U.S. It appears to have done so regarding research services, but has not achieved as much consistency with the U.S. regarding order execution services. One such discrepancy is that connectivity hardware / lines are permitted in the U.S. as order execution services, but are not allowed under the revised Instrument. Under Question 1 of the Notice, the CSA seeks specific comment on the temporal standard for order execution services that differs from the standard applied by the SEC (that is, a good or service categorized as research under the SEC's temporal standard might be characterized as order execution services under the proposed Instrument).

We believe that the goal of harmonization with the United States to the extent possible merits that these differences in treatment be reconciled. Discrepancies increase reporting difficulties, and add to the cost of disclosure. These discrepancies could become even more challenging in the future as new products evolve.

Obligations regarding Clients

Proposed Companion Policy 4.1(3) requires that policies and procedures be in place to ensure that all clients whose brokerage commissions were used as payment for goods and services have received "fair and reasonable benefit" from such usage. For purposes of doing this appraisal, we assume that the CSA takes the view, like the disclosure obligation under 5.1, that the "client" is the investment fund as a whole rather than the individual investor within the fund In order to more fully address these concerns, we suggest that the Companion Policy include a general statement that where an investment fund is concerned, the client generating the brokerage commissions is the fund.

Pre-trade analytics

The Summary of Comments and Responses notes the CSA's agreement with the view that to the extent pre-trade analytics are used to help determine how, where and when to place an order or effect a trade, they could be eligible as order execution services, but the CSA does not believe that additional guidance is necessary. While we recognize that it is not feasible to attempt a comprehensive list of all possible goods and services that might be considered eligible, we believe that the importance of pre-trade analytics merits its being specifically referenced in the policy to provide clarity and certainty in the future.

Futures contracts

As currently drafted, it would appear that the Instrument applies to futures contracts, not simply shares as in the U.S. and U.K. We seek clarification from the CSA as to the Instrument's intended scope and application regarding futures contracts.

Cost - Benefit Analysis

We are concerned that the costs of implementing this rule are dramatically understated in the figures estimated by the CSA. Our members advise that costs of implementation will be far greater than the estimated $2,800 cost per firm cited in Appendix B of the Notice. It is of concern, too, that the estimate is not made based on consultation with Canadian firms, but is extrapolated based on research from other jurisdictions. Furthermore we question whether the limited scope of the analysis is valid as a complete cost-benefit analysis for the Proposed Instrument as it provides the costs only of the review of current brokerage arrangements, and as noted above, does not contemplate the creation of monitoring systems, the cost of the additional required disclosures, among other necessary implementation costs to be faced by investment fund managers.

As well, the cost – benefit analysis fails to meaningfully address the benefits of the proposal. In particular, the IOSCO November 2007 report entitled *Soft Commission Arrangements for*

Collective Investment Schemes noted that no jurisdictions were able to quantify the number or probability of soft commission abuses occurring in their jurisdictions in the last three years, including Ontario, Quebec, the U.S. and the U.K.

Industry concerns with the cost/benefit inadequacy would be greatly alleviated if the recommendations on quantitative disclosure and sub-advisory issues were implemented.

Thank you for providing our members with an opportunity to comment on this important initiative. We look forward to continuing to work with the CSA to provide client brokerage commission disclosure that will be of value to investors.

Please contact the undersigned directly or Ralf Hensel, General Counsel, at 416-309-2314 or rhensel@ific.ca should you have any questions or wish to discuss these comments.

Yours truly,

THE INVESTMENT FUNDS INSTITUTE OF CANADA

By: Joanne DeLaurentiis
President & Chief Executive Officer

Appendix A

Soft Dollar Regime and Architecture

For all three types of soft dollars; Execution Services, Third Party Research and Proprietary Research, a company currently not using "soft dollars" will need to implement the following:

1. Mechanism to value research
2. System to track soft dollars (including mixed-use)
3. Procedure to report soft dollars
4. Document Operational Policies and Procedures for #1, 2 and 3
5. Document and Implement Policies and Procedures for Brokerage Allocation (this may require IRC Recommendation)
6. Document and Implement Policies and Procedures for Soft Dollar Usage (this may require IRC Recommendation)
7. P&P for oversight and reporting of Sub-Adviser soft dollars (this may require IRC Recommendation)
8. Implementation of Compliance monitoring procedures and a Soft Dollar Committee to oversee #5, 6 and 7.