INVESTMENT INDUSTRY ASSOCIATION OF CANADA
ASSOCIATION CANADIENNE DU COMMERCE DES VALEURS MOBILIÈRES

Ian C.W. Russell FCSI
President & Chief Executive Officer

November 22, 2006

Mr. Joseph J. Oliver
President & CEO
Investment Dealers Association of Canada
121 King Street West
Suite 1600
Toronto, Ontario
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Dear Mr. Oliver:

RE: Rules - Client Relationship Model

We are writing on behalf of our membership to express serious concerns about the process by which draft rules have been prepared by the Investment Dealers Association of Canada (IDA) in response to the rules for the Client Relationship Model (CRM) (the Draft CRM Rules). Industry consultations in the rule-making process in respect of Draft CRM Rules have not been sufficiently comprehensive to ensure the Rules will be effective, cost-efficient, practical, avoid unintended consequences and promote an innovative and competitive marketplace. Industry professionals and the IDA working group on the CRM project are concerned that the decision to bring Rules to the IDA Board of Directors meeting in January 2007 for approval does not give sufficient time for adequate consultation and the design of appropriate Rules. The Investment Industry Association of Canada (IIAC), on behalf of these industry professionals, recommends the IDA delay Board approval until Draft CRM Rules can be properly designed.

The IIAC members support the principles that underpin the Draft CRM Rules, as well as the proposed direction and focus of these Rules. However, a broad segment of industry professionals, including the IDA working group, recognize the design of practical and cost-effective CRM Rules is a complex and difficult process. Despite much discussion about broad concepts in connection with the broker-client relationship, the actual rule-making process has just begun. The consultations that have taken place so far have been largely briefing sessions rather than constructive give-and-take on the structure and content of the proposed Rules. The IDA must demonstrate flexibility and responsiveness to the industry's position in the rule-making process to ensure at the end of the day the

rules are practical and meet the public interest. If the process is truncated to meet the January 2007 deadline, IDA firms will be left with uncertainty about appropriate compliance, risk serious unintended market consequences, and fail to meet the public interest objectives of the Client Relationship Model.

The initial round of consultations held in late summer (the August 16 Advisor Consultation), based on a preliminary framework of the proposed Rules, provided extensive feedback from participating IDA member firm professionals. These industry comments have an important bearing on the rule-making process to evaluate concerns about proposed Rules and stimulate further discussion to design efficient Rules. These industry comments have not been distributed to industry participants, including the IDA working group. The IIAC recommends the IDA distribute the industry commentary to all interested firms to promote vigorous debate and consultation on these issues. Further, we suggest the Rules, as presently drafted, be distributed broadly to industry participants.

Cost Benefit Analysis and Client Survey

The IDA has committed to a comprehensive cost-benefit analysis and a client survey as a precondition to developing new Rules. We fully support both these initiatives and believe they are integral to the rule-making process. In this regard, the cost-benefit analysis and client survey should be undertaken once the Draft CRM Rules are in a formative stage of development. Whether or not IDA staff judges the current state of the draft Rules of sufficient specificity to conduct a cost-benefit study and client survey, the Rules should not proceed to the Board of Directors for approval until these two initiatives have been completed.

It is important that the regulators ascertain that the benefits to the investing public of the CRM Rules exceed the direct and indirect compliance costs. It is our view that competitive pressures from market forces respond effectively to client needs and wants. However, a comprehensive client survey could determine whether Rule requirements in terms of services, mandated information and client disclosure requirements, are congruent with client needs and wants. Both initiatives are therefore important to the CRM rule-making process and integral to the final structure and framework of these rules.

Specific Comments on the Draft CRM Rules

1) Relationship Disclosure Documents (RDDs)

The RDDs have been presented to certain committees for comment. However, many relevant concerns raised by IDA member firms have not been properly addressed. We re-iterate these concerns below:

- We support the objective of providing consumers with a clear and concise description of key aspects of the relationship. However, the RDDs are overly prescriptive and they require individual customization, depending on the type of account and type of client. As we understand it, the intention of the customization was to assist clients to understand the relationship. However, the intricacy

demanded involves an incredible amount of advisor and client time and effort, which will not result in client clarity on the relationship.

Currently, clients receive excessive quantities of material in the course of establishing and maintaining their relationship with a firm and advisor. This volume detracts from the concept of disclosure as clients are unable to assimilate all such materials and it is often disregarded or discarded. Furthermore, over the years, increased regulatory client disclosure has been mandated from increased general disclosure in mutual fund prospectuses to general disclosure relating to leverage notwithstanding the fact that a client may not employ a leverage strategy to increased general disclosure related to potential conflicts. Our members have advised us that clients have already responded negatively to increased disclosure raising concern about the volume and complexity of required regulatory disclosure with the result that clients do not review such disclosure in detail or at all. An additional layer of increased disclosure will increase the complexity for the retail investor, particularly smaller investors, to open an account and invest. The RDD proposal as currently constructed adds to that volume and there is a very real risk that it will be viewed as an additional administrative burden and disregarded by clients.

We believe that the CRM would benefit from greater focus on principle-based regulation, an approach the IDA has publicly endorsed. The IDA should conduct a comprehensive assessment of all written materials and disclosures currently provided in the course of a relationship, with the objective of more streamlined documentation.

The IIAC supports the creation of a single neutral document, with simplified disclosures and information in plain language. This document could be provided to all clients, regardless of the type of client or the type of account. A layered disclosure format that permits clients to obtain additional information could be used as it leaves the level of details in the hands of the client. As the layers unfold so does the amount of detail and complexity which allows clients to determine the depth of disclosure with which they are comfortable and which they wish to receive.

- There is also a newly introduced requirement for an ongoing suitability review. Firms had requested clarification as to what exactly this obligation will entail. Without that clarification, it is our understanding that the requirement may only be onerous for the firms, and will require a great deal more supervision and follow up to ensure that this is taking place on an ongoing basis. It has not been demonstrated that the resources required to supervise this process are proportionate to the benefit to clients.

- There appears to be a requirement on the RDDs for a client signature or acknowledgment. Clients often refuse or forget to sign documents or forget to return signed documents to the firm. No direction has been offered as to what a firm should do in any of these situations. We do not believe that restricting client

accounts for lack of acknowledgment of receipt of additional general disclosure is in the best interest of clients.

2) Performance Reporting

While the IIAC supports the concept of performance reporting, the Draft CRM Rules leave many unanswered questions as to how the information can be presented in a standardized and consistent format between dealers which will not be misleading to clients. We also believe that there is significant administrative and operational complexity associated with the proposals and these implications have not been fully identified and addressed. The overall result may be a significant cost burden which will translate into higher costs to consumers and, potentially, more limited access to investment product and services for clients with limited assets as the economics of servicing that segment of the market are altered.

Performance reporting is an area where we also believe that less than adequate consideration has been given to existing services and practices in the current market. Many firms currently provide or make available such information. The overall effect of new regulation, in the absence of a clearly defined market deficiency, may have the unintended effect of adversely impacting what may in fact be a consumer demand which is currently being satisfactorily met.

Our members have a number of real concerns that have not been addressed and include:

- How is a client's rate of return to be compared between firms or even between accounts belonging to the same client when each firm and each holding or account may have different methods by which to calculate that return even when using the same performance calculation standard (such as gross or net of fees, gross or net of withholding tax).

- How will the correct cost base be determined when securities have been acquired in one account at one firm and transferred to another account at another firm? The cost base of the original transactions do not transfer from one firm to another and as such using the original cost for some securities and market at the date of transfer for others results in client confusion.

- How are unsolicited trades, flow through shares and DSC mutual funds to be valued when calculating performance information?

- How can firms be required to include all positions in respect of which revenue is received in the calculation of performance, when such positions may not be permitted to be reflected on the clients' account statement. Client name positions would be an example.

Other major concerns with the Draft CRM Rules arise from the benchmarking requirements. A focus on a benchmark does not mean that the investments selected are not meeting the client's objectives. For instance, while high risk products may achieve the goal of beating the benchmark, those same securities may not meet the client's

objective of capital preservation, particularly in a down market. The difficulties in terms of technology, costs, disclosure and client confusion connected with choosing a benchmark appropriate for comparison purposes with a particular client's portfolio outweighs any benefits that may be derived from including a benchmark. We do not believe that chasing a benchmark promotes an appropriate approach for clients.

While transparency is welcomed, meaningful information must be provided to clients and a benchmark requirement does not achieve that objective.

3) Costs, Conflicts and Compensation

We understand that the Draft CRM Rules do not yet include specific requirements with respect to costs, conflicts and compensation, the third fundamental tenet of the CRM, other than general conflicts disclosure requirements as part of the RDDs. For consistency and clarity, it is important that the Rules be developed, to allow fulsome discussion and understanding of all of the changes that will affect the industry.

We look to you for further information on the cost, conflicts and compensation Draft CRM Rules.

Consistent Application of CRM Rules

The CRM Rules applies to both investment dealers and mutual fund dealers but it is our understanding that the Draft CRM Rules are applicable to the IDA members alone. We understand that there is significant discrepancy between the IDA and MFDA with respect to a number of fundamental issues, resulting in less onerous rules for MFDA members. For instance, we understand that the MFDA is comfortable not including client name positions when determining performance figures, whereas the IDA plans to include all positions for which the firm receives compensation notwithstanding the current regulatory prohibition of inclusion of certain of these positions on client account statements.

It is imperative that the self-regulatory organizations, the IDA and MFDA, reach agreement on the content of the Draft CRM Rules and the implementation process, to ensure clients dealing with MFDA firms receive the same protections in terms of mandated services and disclosure as the clients of IDA firms. If the MFDA staff have fundamental disagreements on the content of the IDA Rules or the timing of implementation, these differences must be resolved before the CRM Rules are promulgated.

The CSA could play a useful role in promoting uniformity and standardization in the MFDA and IDA Rules related to the Client Relationship Model. Moreover, the lack of uniformity in the CRM Rules and differences in the timing of implementation create an unfair playing field between MFDA and IDA member firms. The regulators have an obligation to ensure the equity of regulatory treatment among investment dealer and mutual fund dealer registrants, given the substantial burden of regulatory compliance.

As clearly detailed above, the CRM will have a tremendous impact on firms, advisors and clients. We recommend that the Draft CRM Rules not be brought forward for approval at your forthcoming January Board of Directors meeting. The first step is to conduct an extensive consultation with the industry, followed by a cost-benefit analysis and a survey to determine the wants and needs of clients to ensure a positive result for the Canadian capital markets as a whole.

Yours sincerely,

cc: Louis Arki, Director of Securities, Government of Nunavut
Douglas Hyndman, Chair, British Columbia Securities Commission
Ronald Lloyd, Chair Investment Dealers Association of Canada
Gary MacDougall, Registrar of Securities, Department of Justice, Government of Northwest Territories
Winston Morris, Administrator, Consumer & Commercial Affairs Branch, Securities Commission of Newfoundland and Labrador
Don Murray, Chair, Manitoba Securities Commission
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William Rice, Chair, Alberta Securities Commission
Richard Roberts, Registrar of Securities, Yukon Securities Commission
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