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

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

October 30, 2006

Mr. John Stevenson, Secretary
Ontario Securities Commission
20 Queen Street West
Suite 1903, Box 55
Toronto Ontario M5H 3S8

Dear Mr. Stevenson:

Re: Proposed National Instrument 23-102 *Use of Client Brokerage Commissions as Payment for Order Execution Services or Research ("Soft Dollar" Arrangements)*

Further to the CSA request for comments dated July 21, 2006 on the above noted issue, the Investment Industry Association of Canada ("IIAC") makes the following submission, based on input from our members.

The IIAC is the professional association representing over 200 investment dealers which employ 39,000 Canadians. Our mandate is to promote efficient, fair and competitive capital markets for Canada and assist our member firms across the country.

The IIAC is generally supportive of the intention of the proposed National Instrument. Our members have indicated that the restrictions on services to be purchased by soft dollars as well as the proposed disclosure rules will likely considerably reduce the level of conflict inherent in these types of transactions, and in fact, will likely result in a significant reduction on the number of soft dollar transactions. While we acknowledge the argument that a reduced number of soft dollar transactions may reduce the amount of independent research that is available through third parties, our members are of the view that independent providers of quality research will continue to be in demand.

Although the objective of increased transparency inherent in the National Instrument is welcomed, the costs and the ability to achieve meaningful transparency must also be considered. The requirements to provide a detailed breakdown of soft dollar services by type of client, and a mechanism to ensure and demonstrate the direct correspondence between soft dollar expenditure and specific client benefit make this part of the proposed National Instrument difficult, if not impossible to comply with. The difficulty with the proposed disclosure criteria increases with the number of clients. We believe a disclosure regime can be developed that accommodates clients' need for information without imposing unworkable requirements that result in arbitrary and likely inaccurate reporting.

Specific Requests for Comments

Question 1:

Should the application of the Proposed Instrument be restricted to transactions where there is an independent pricing mechanism (e.g., exchange-traded securities) or should it extend to principal trading in OTC markets? If it should be extended, how would the dollar amount for services in addition to order execution be calculated?

Where there is no independent pricing mechanism, the problem of measuring best execution is compounded. As such, the proposed rules should only cover transactions in exchange traded securities or transactions where a commission is not only charged but can be easily broken out from the total transaction cost. Determining the dollar amount attributable to services in addition to order execution may become subjective without a transparency mechanism. If, however, the application of the proposed National Instrument is extended beyond exchange traded securities with an independent pricing mechanism, a transparency mechanism must be established.

Question 2:

What circumstances, if any, make it difficult for an adviser to determine that the amount of commissions paid is reasonable in relation to the value of goods and services received?

Where a trade happens for a pool of clients it is difficult to break down and allocate the costs and benefits of only those clients that are paying for and receiving the benefits of services procured using soft dollars. In addition, clients holding differing amount of investments may not trade in the same volumes, and as such will pay different amounts of commissions. They may still, however, benefit from the same services procured through soft dollars. This makes it very difficult to determine "reasonableness" on a client by client basis.

Question 3:

What are the current uses of order management systems? Do they offer functions that could be considered to be order execution services? If so, please describe these functions and explain why they should, or should not, be considered "order execution services".

This is not a clear cut issue, as an argument could be made that order management systems should be included due to their link to clearing and settlement. However it is our view that the fact that order management systems have an intellectual component that is paid for in hard dollars must be considered. Order management services provide a strategic advantage to firms that use them, and as such their cost should be allocated explicitly and not included as a permitted service in a soft dollar arrangement.

Question 4:

Should post-trade analytics be considered order execution services? If so, why?

Post trade analytics, as well as pre-trade analytics should be considered order execution services as they influence how and where one decides to trade. It also is a component in proving best execution. In addition, post trade analytics may also be considered research in some circumstances.

Question 5:

What difficulties, if any, would Canadian market participants face in the event of differential treatment of goods and services such as market data in Canada versus the U.S. or the U.K.?

Given the expanding importance of global markets in the financial services industry, it is extremely important to be aware of, and minimize differences in the operational environment between Canada and other significant global participants. Differential treatment of goods and services will only increase friction points in the system, increasing costs and impeding the flow of capital. In addition, from a competitive standpoint, harmonization of standards is generally preferable. Imposing standards that are more stringent or more lax than the prevailing global market standards will have a negative effect. More stringent standards may cause capital to flow to jurisdictions where business is more easily conducted; however, a perception of lax standards may attract criticism and lead to questions about the integrity of the Canadian market. It may also have the unintended consequence reducing execution quality by directing order flow to jurisdictions with lower standards.

Question 6:

Should raw market data be considered research under the Proposed Instrument? If so, what characteristics and uses of raw market data would support this conclusion?

Given that there is no value added component to raw market data, this should generally not be considered to be research. However, there are cases where market data is used directly in conjunction with modeling applications that provide analysis of the markets, sectors, or specific securities that are subsequently used to drive investment decisions. In the cases where market data is used directly as part of this type of analytical modeling, it may be appropriate to consider these eligible for soft dollars. It could be argued that there is a clear investment decision benefit in this regard.

Question 7:

Do advisers currently use client brokerage commissions to pay for proxy-voting services? If so, what characteristics or functions of proxy-voting services could be considered research? Is further guidance needed in this area?

There does not appear to be a value added component for proxy voting services that would justify putting it in the category of research. Our members have indicated that they are not aware of any current industry practice that would categorize proxy voting services as research.

Question 8:

To what extent do advisers currently use brokerage commissions as partial payment for mixed-use goods and services? When mixed-use goods and services are received, what circumstances, if any, make it difficult for an adviser to make reasonable allocations between the portion of mixed-use goods and services that are permissible and non-permissible (for example, for post-trade analytics, order management systems, or proxy-voting services)?

Advisors do use "soft" mixed-use goods and services as noted above. Without prescriptive rules on what is permissible and non-permissible, it's difficult for advisors to make allocations since it's an entirely subjective exercise. Because flexibility exists in the interpretation and the inherent subjectivity of it, there is potential for divergence among dealers in the industry on eligible items.

Question 9:

Should mass-marketed or publicly-available information or publications be considered research? If so, what is the rationale?

In general, the mass marketed type of information does not have a value added component that would qualify it as research. However, certain publications which are trade, industry, sector, or investment specific may, in fact, be used to further investment decisions. As such, they could be considered "research" regardless of availability or method of distribution. The value of such information in making an investment decision is not necessarily related in any way to its method of distribution. An example of this would be where an advisor of a fund comprised of stocks in a specific sector would benefit in his/her investment decision making from a sector-specific publication. This of course, would not be true of a general or a mixed-use publication which would not likely qualify.

Question 10:

Should other goods and services be included in the definitions of order execution services and research? Should any of those currently included be excluded?

As noted above, we are of the view that pre and post trade analytics should be included in the definition of order execution services. Nothing in the proposed definition should be excluded.

Question 11:

Should the form of disclosure be prescribed? If prescribed, which form would be most appropriate?

A form of prescribed disclosure should be developed. It is important to create a consistent industry standard that clients can understand and compare. Such a form should make it clear to clients how the services obtained using soft dollars fit into the categories of allowable uses. This plain disclosure would also likely have the positive effect of reducing the use of soft dollar arrangements for non legitimate services. We note that the FSA is using an industry led solution as a model for disclosure. In developing prescribed disclosure, guidelines and templates would assist the industry in compliance.

Question 12:

Are the proposed disclosure requirements adequate and do they help ensure that meaningful information is provided to an adviser's clients? Is there any other additional disclosure that may be useful for clients?

The proposed disclosure would be useful to the extent that it can be accurately compiled. However, the concerns about firms' ability to collect and allocate this information in a way that provides accurate and meaningful data to clients may limit the usefulness of the disclosure.

Question 13:

Should periodic disclosure be required on a more frequent basis than annually?

As a starting point, annual disclosure is reasonable. More frequent disclosure could be considered, but only if the demand for such disclosure and the benefits and costs associated with it justify expansion in the future.

Question 14:

What difficulties, if any, would an adviser face in making the disclosure under Part 4 of the Proposed Instrument?

The proposed disclosure may be difficult and unwieldy, but not impossible for an advisor with many clients. It would be difficult for many firms to collect and allocate the information in a meaningful and cost effective manner. Advisors would have a difficult, if not impossible time allocating services as prescribed among many clients. A pro-rata approach may provide a reasonable compromise. Disclosure should be prescribed on a best efforts basis where it is possible. If the detailed disclosure as proposed is required, a phase in period should be provided, allowing initially for best efforts followed by a more rigorous standard when compilation and allocation of the data is possible.

It should be noted that the proposed disclosure requirements are more stringent than those under US rules, and as a result, could make it difficult for Canadian advisors to obtain all relevant information from US sub-advisors that they may hire. This may further call into question the accuracy and meaningfulness of this information.

Question 15:

Should there be specific disclosure for trades done on a "net" basis? If so, should the disclosure be limited to the percentage of total trading conducted on this basis (similar to the IMA's approach)? Alternatively, should the transaction fees embedded in the price be allocated to the disclosure categories set out in sub-section 4.1(c) of the Proposed Instrument, to the extent they can be reasonably estimated?

Our members have indicated that currently, there is not a significant amount of net trading in Canada. However, whether trading is conducted on a net basis, or with commissions the fees should be negotiated and subject to an assumption on the spread on which disclosure should then be based.

Thank you for providing us with the ability to comment on this important proposed Instrument. If you have any questions or comments regarding this submission, please do not hesitate to contact the undersigned.

Yours truly,

cc c/o: Mr. John Stevenson, Secretary
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Saskatchewan Securities Commission
Manitoba Securities Commission
Ontario Securities Commission
New Brunswick Securities Commission
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