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

January 22, 2007

Ontario Securities Commission
20 Queen Street West, Suite 1700
Toronto, ON M5H 3S8

Attention: Randee Pavalow

Dear Randee:

Re: IDA Incorporation By-Law

We are grateful for the opportunity to meet with you, Marsha Gerhart and your CSA colleagues Wednesday, January 31, 2007 in your offices. The purpose of the meeting is to review the draft IDA By-law related to advisor incorporation, in particular liability and supervision, to ensure investors dealing with an incorporated entity are safeguarded to the same extent as investors dealing with employees or agents. We also believe it useful to compare the proposed IDA By-law with the hybrid MFDA incorporated structure, that embraces an employer relationship linked to a corporate entity for the purposes of receipting commissions. Further, at our meeting last October, your colleagues expressed reservations about the extant legal opinion in respect of broker corporation. We have instructed counsel to prepare a more specific legal opinion dealing with the matter of liability. The additional draft legal opinion is enclosed with this letter. We hope that you can provide to your CSA colleagues these materials and the materials previously provided to you at the October meeting.

We believe our forthcoming discussion and the accompanying materials will be helpful in preparing your background documentation for the CSA chairs meeting that we understand is scheduled for early spring.

At our October meeting, you identified five main concerns relating to the IDA By-law and, we believe, relating to incorporation as a business structure, available to both IDA and MFDA advisors as follows:

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1. Liability - is there a need to introduce statutory liability or does (i) jurisprudence, and (ii) the direct liability established between the firm and the client through a written agreement between the firm and the client entered into on account opening, result in the same liability as vicarious liability on the part of the firm for the acts/omissions of an employee advisor?

2. Supervision - are there measures in place leading to the same supervision requirements on the part of the firm as are now in place for the employee and agent relationships?

3. Scope – what is the scope of the proposed structure in terms of who the shareholders can be and what business can be undertaken by the sales company?

4. Tax Opinion – is the tax opinion submitted with the IDA By-law in conflict with the legal opinion submitted with the IDA By-law?

5. Public Interest - is there a public interest aspect to the IDA By-law?

These matters were addressed in the IDA's By-law submission but we are pleased to address these matters again at this time.

1. Liability

Statutory liability to the public for the general conduct of participants is not currently being imposed in the distribution of financial products in Canada by relevant legislation and applicable regulators, notwithstanding the fact that three different business structures (employer/employee; principal/agent; and incorporation) are permissible within these distribution platforms.

Currently, in an employer/employee IDA relationship, the common law principles of vicarious liability are relied upon pursuant to which an IDA firm is liable to a client for the improper activities of its advisor provided that the advisor acts within the scope of his/her employment. Upon the introduction of the MFDA principal/agent by-law, the CSA did not impose any additional requirements relating to the firm's liability to a client but instead relied on the principles of vicarious liability.

However, when the IDA's principal/agent by-law was introduced in 2003, the CSA questioned the validity of vicarious liability in a principal/agent relationship for IDA firms. In respect of the IDA principal/agent by-law, direct liability through agreements had to be established as an equivalent to vicarious liability in an employer/employee relationship. As a result, the legal principal/agent relationship within MFDA and IDA firms is the same however the matter of liability to clients by firms has been addressed differently by the regulators. This inconsistency continues to exist today.

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With respect to the proposed IDA By-law, the IDA took the same approach to liability as in its principal/agent by-law. Specifically:

(a) Section 39.5(d) and Appendix C to the IDA By-law state that the firm (i) is liable to clients and other third parties for the acts/omissions of the sales company, each Approved Person and each person acting on behalf of the sales company relating to the firm's business as if each of the sales company and person were employees, and (ii) is required to ensure that the sales company is liable for the acts/omissions of each person acting on its behalf;

(b) Section 39.5(j) and Appendix C to the IDA By-law state that each sales company, each Approved Person and each person acting on behalf of the sales company who conducts Securities Related Activities on behalf of the firm must comply with and do all acts and things necessary to cause the sales company to comply with all by-laws. In addition, all Approved Persons who carry voting rights in the sales company remain jointly and severally liable to the firm and clients for the acts/omissions of the sales company as if such sales company were acting as an employee of the firm; and

(c) Appendix D to the IDA By-law requires the firm to enter into an agreement with the client, the advisor and the sales company contained in the New Client Application Form in which the firm irrevocably assumes direct liability to the client for the acts/omissions of the advisor whether the advisor is an employee, an agent or a sales company.

We do note that the draft Borden Ladner Gervais ("BLG") letter dated March 17, 2006 (the "BLG March Letter") reflects on whether consideration should be given to imposing statutory liability. However, the BLG March Letter further notes that BLG believes that matters of liability can be adequately dealt with by the combination of IDA Rules, agreements and disclosure documents and therefore the need for statutory liability and remedies is ultimately questioned. In furtherance of this, we attach an opinion from BLG that states that direct liability established through agreements and disclosure as mandated by the IDA By-law is equivalent to vicarious liability in an employer/employee relationship and, therefore, there is no need for statutory liability to be imposed.

We further note that the imposition of statutory liability on IDA firms offering the "sales company" platform will result in inconsistency and continued lack of uniformity in the regulation of advice and therefore a continued uneven playing field among distributors of financial products. Statutory liability is not imposed on the mutual fund or insurance industry that currently operate with incorporated sales agents. The MFDA Incorporation Structure and the MFDA principal/agent By-law currently do not require even the establishment of direct liability between the firm and the client through written agreement. Instead, the structure and By-law rely entirely on the principles of vicarious liability.

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As previously noted there is no statutory liability for firms that operate only in an employer/employee relationship with such firms not being required to make any type of irrevocable agreement with clients relating to liability resulting in reliance on the principles of vicarious liability.

As a result, we respectfully submit that:

(i) The direct irrevocable liability on the part of the firm, the sales company and every Approved Person carrying voting rights in the sales company has been established through the provisions of the IDA By-law and the disclosure to, and agreement with, the client to the same extent as if the Approved Person were an employee.

(ii) There is no need for statutory liability to be created as part of approving the IDA By-law.

2. Supervision

The IDA By-law contains provisions relating to, among other things, supervision, liability, insurance, access to books and records and premises, conducting business in the name of the firm, conducting outside business activities that mirror current similar provisions applicable to advisors in an employee or agent relationship. As a result, we respectfully submit that the regulatory requirements to which the firm is subject in relation to the sales company and each Approved Person and each person acting on behalf of the sales company have been established to the same level as if such persons were employees. Similarly, the IDA will ensure that the firms meet their obligations.

3. Structure

The structure of the sales company has been designed to ensure uniformity with other structures permissible in the financial services industry in Canada as well as the necessary regulatory and public protections. Specifically, the IDA By-law requires that the sales company:

(a) be incorporated under the laws of Canada or a province or territory of Canada;

(b) be in good standing under the laws of the jurisdiction in which it carries on business;

(c) be more than 50% owned by Approved Persons (based on combined ownership percentage of all voting classes of securities both legally and beneficially) (the "Ownership Structure");

(d) exclusively utilize Approved Persons to conduct Securities Related Activities on behalf of the firm; and

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(e) only carry on Securities Related Activities, insurance activities, or such other business as approved by the IDA (no other business has been approved at this time).

The restrictions proposed through the Ownership Structure in the IDA By-law mirror the ownership restrictions in the insurance business. We note that there are no ownership restrictions in the MFDA Incorporation Structure.

Currently, individual advisors who are registered with the IDA are also permitted to be insurance licenced whether they are in an employer/employee or in a principal/agent relationship with the firm. We note that IDA firms are not permitted to also be insurance licenced, therefore, these individual advisors are insurance licenced with another firm that may be an affiliate of the firm that carries the securities business or an unrelated company. In order to simplify business structures and mirror the current ability of an individual advisor to be dually-licenced (carry on both insurance activities as well as securities activities), the IDA By-law provides that a sales company is able to carry on insurance activities in compliance with provisions in the IDA By-law.

Employees and agents are required to conduct all Securities Related Activities on behalf of and in the name of the firm and are permitted to operate under trade names subject to the provisions of the IDA. The IDA By-law, similarly, requires a sales company to conduct all Securities Related Activities on behalf of and in the name of the firm. Individual advisors that operate as employees or agents are also permitted to conduct non-Member business subject to the provisions of IDA regulations relating to outside business activities. We note that the IDA By-law offers more protection relating to business activities. Specifically, the non-Member business activities permitted to be carried on by a sales company are much more restricted than for an individual advisor that is an employee or an agent and are limited to Securities Related Activities, insurance activities in compliance with the provisions of the IDA By-law and only other activities that have been approved by the IDA. We note that there are no restrictions to the business carried on by a sales company in the MFDA Incorporation Structure.

The following additional protections have been put in place in the IDA By-law in order to ensure that clients have the same protections in case of bankruptcy even where insurance business flows through the sales company:

(i) All consideration in respect of all Securities Related Activities must be paid to or received by the firm and not by the sales company - this is similar to the employer/employee and principal/agent relationships; and

(ii) The sales company, Approved Person and all persons acting on behalf of the sales company are not permitted to hold securities, cash or other property on behalf of clients - this is similar to the employer/employee and principal/agent relationships.

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Therefore, if the firm were to become insolvent, the Canadian Investor Protection Fund would step in with respect to client accounts without having to involve the sales company. In the event that the sales company goes bankrupt, it would not be any different than if the employee or agent went bankrupt – the clients would not be impacted as client monies or property would not be held by the sales company and the firm would take control of all dealings with the client under section 39.5(h) of the IDA By-law. The firm is also required to ensure that the required insurance policies such as the fraud bond also cover the sales company as well as the Approved Person. No such requirements or protections exist in the MFDA Incorporation Structure.

As discussed in our meeting, we understand that you wish to discuss the practical structure of a sales company in more detail at our next meeting. We attach as Schedule 'A' to this letter a brief summary of the practical structure of a sales company for your reference. Please note that we have not repeated all of the requirements arising from the IDA By-law relating to the structure.

4. Tax Opinion

We submit that the tax opinion from Davies Ward Phillips & Vineberg dated January 12, 2006 which also attaches this firm's opinion dated September 24, 2001 (the "Davies Opinion") is not in conflict with the long form or the short form legal opinions that have been submitted in support of the IDA By-law.

The Davies Opinion indicates that a structure set up in compliance with the IDA By-law would not result in any source deductions being required on the part of the firm from payments made to the sales company/agent under the IDA By-law. This addresses any concerns that may arise relating to potential contingent liabilities on the part of the firm for failure to withhold. As indicated in the Davies Opinion, the test, for tax purposes, relates to whether an individual qualifies as an employee or independent contractor for tax purposes (agent for regulatory purposes). The Davies Opinion further notes that provided the sales company carries on its business with a level of independence and economic risk similar to that of an individual agent operating as an independent contractor, there are no further tests to be satisfied from a tax perspective in respect of the firm, the sales company and the individual advisor. In addition, the Davies Opinion states that any tax provisions in the *Income Tax Act* applicable to corporations are not considered as an aspect of arrangements with the firm and should not result in any issues for firms.

The Davies Opinion makes no comments on the structure as it pertains to tax other than to note that the consequences of non-compliance with applicable tax requirements can potentially affect each of the firm, the advisor and the sales company involved. As a result, the IDA By-law requires that firms that wish to offer this structure submit to the IDA satisfactory evidence of compliance of all arrangements between the firm and the sales company with applicable tax laws. We note that there is no such requirement under the MFDA Incorporation Structure.

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5. Public Interest

As we noted in our meeting, most other professionals in Canada such as insurance agents, MFDA advisors, doctors, dentists, veterinarians, lawyers, accountants, architects, engineers, nurses, specialist doctors, physiotherapists, midwives, speech pathologists, radiation therapists and hygienists are permitted to incorporate. In 2000, the government of Ontario, through *Bill 152 - Balanced Budgets for Brighter Futures Act, 2000* (the "Incorporation Bill") extended the right to incorporate to a number of professionals such as lawyers, doctors, dentists and accountants. In the readings of the Incorporation Bill, the government indicated that the Incorporation Bill was introduced in response to the governing bodies and professional associations representing these professions that had lobbied for the same incorporation opportunity for these professionals as had been in place at that time for other professionals such as architects and engineers. The government also noted that it had completed consultations with groups of these professionals who told the government that they too would like the option of choosing whether or not to incorporate. The government viewed this initiative as part of a package of incentives directed towards continued economic growth, the encouragement of business investment and the generation of revenue. The incorporation structure that was extended to these professionals did not impact the professional liability that had always existed on the part of these professionals towards clients or patients.

As a result, we respectfully submit that extending the ability to incorporate to other investment professionals, specifically to IDA advisors:

(a) would bring this group of professionals in alignment with other professionals in Canada in terms of business structures,

(b) would level the playing field between investment professionals, insurance agents, IDA and MFDA advisors, in Canada in terms of business structures,

(c) would no longer represent an obstacle to an advisor considering migration from the MFDA to the IDA which would result in the advisor on the IDA platform

- being subject to enhanced proficiency requirements,
- being subject to continuing education requirements, and
- being able to offer a greater array of products and solutions to clients,

(d) would be in line with the current stated movement of the regulators to regulate advice rather than advisors based on the products they sell,

(e) would be in line with the current ongoing movement of the regulators towards uniformity in regulations,

(f) would enable restructuring of firms for the cost efficient delivery of financial services by standardizing acceptable regulatory business structures across different regulatory and distribution platforms,

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(g) would reduce complexity and expense of regulatory compliance while at the same time providing for a structure in place under SRO by-laws, supported by legal and tax opinions, that ensures compliance with applicable laws, public disclosure and protection,

(h) would reduce regulatory arbitrage and the possible movement of advisors towards certain products due to business structures,

(i) would not impact the current protections in place for the public including

- no change in services and reporting,
- no change in liability to a client by the firm as liability would be expressly assumed by the firm for the acts of the individual advisor and the sales company (similar to IDA employee and agent), and
- no impact on CIPF coverage.

Yours sincerely,

"Ian Russell"

Enclosure

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SCHEDULE 'A'

Words capitalized in this schedule, unless otherwise defined herein, have the meaning attributed to them in the attached letter to the Ontario Securities Commission (the "Letter").

Generally, for tax purposes, a corporation is recognized as carrying on a professional practice if the activities of the corporation and its relationship to its employees and clients are similar to those ordinarily associated with a corporation carrying on a business. Otherwise, the income purported to be that of the corporation may be taxed as income of the individual professional who may have individually carried on the business operation previously. The following is a summary of the practical structure of a sales company. The sales company would:

- have the characteristics and the Ownership Structure set out in the Letter,
- be party to an agreement with the member firm and the individual professional advisor relating to Securities Related Business in accordance with the IDA By-law,
- maintain an employer/employee relationship with the individual professional advisor with the services to be performed generally set out in a written agreement and would pay the compensation to such individual,
- maintain an employer/employee relationship with the individuals performing services in connection with the business such as administrative assistants and would pay the compensation to such individuals,
- make clients aware that they are dealing with the sales company rather than the individual advisor - this may be accomplished in various ways including through the sales company having its name displayed in the business premises, on letterhead, business cards and in marketing together with the firm's name in compliance with the IDA by-law relating to trade names and would be accomplished through the disclosure that is required to be made to clients in the New Client Application form in accordance with the IDA By-law,
- own, rent or be generally responsible for the cost of occupying the premises of the business,
- own, rent or be generally responsible for the cost of the furniture, fixtures and major equipment of the business,
- operate a bank account in its own name through properly authorized signing officers - this account would be used for general corporate purposes such as paying the expenses of the business including the receipt of commissions for Securities Related Business from the firm but would not be used to accept or hold client funds in accordance with the requirements of the IDA By-law - clients would, therefore, continue to make cheques payable to the firm in connection with investments and receive cheques in their own name from sales or redemptions of investments,
- purchase or be generally responsible for the cost of the necessary supplies and other expenses to operate the business,

- be covered under the required insurance policies such as the firm's FIB (fraud insurance bond) and the voluntary insurance policies such as errors and omission, and
- otherwise be operating in compliance with all applicable laws including the IDA By-law in accordance with the requirements of the IDA By-law.