

## **Proposed New Canadian Soft Dollar Guidance**

The Canadian Securities Administrators (CSA) published a proposal for the “Use of Client Brokerage Commissions” on January 11<sup>th</sup>, 2008. The proposal is out for a ninety day comment period which ends on the 10<sup>th</sup> of April. If the recommendations are adopted, the new rules will go in to effect in six months. This places the likely implementation of the rules around the end of the fourth quarter of 2008.

The most interesting part of the proposed rules is the disclosure requirements for soft dollars to clients by investment managers. The disclosure requirements fall under two main categories, narrative (descriptive) disclosure and quantitative disclosure. The CSA stated that in formulating the narrative disclosure they “reexamined the current narrative disclosure included in Part II of the SEC’s Form ADV and the Investment Management Association’s Pension Fund Disclosure.”

The narrative disclosure requires that managers describe the nature of the arrangement they have with broker dealers to use client brokerage commission to pay for order execution services and research services. It is required that the names of broker dealers and third parties that provided research other than order execution be disclosed together with the type of research they provided. The CSA specifically requires that, if a dealer or third party is affiliated with an investment advisor, that relationship should be separately disclosed, as well as the type of research received.

Furthermore, the narrative disclosure requires that clients be apprised of the process for selecting dealers to effect securities transactions. It must be disclosed to clients the factors that were considered, as well as whether receiving research from a dealer affected the process. It must also be disclosed if affiliated entities are treated differently in the selection process.

Additionally, the narrative disclosure should include the procedure for determining that the commissions paid for execution and research are reasonable and that clients have received reasonable benefit from the use of the research paid for with commissions.

The quantitative disclosure portion of the regulation has been limited to the client-level, excluding the security level requirement in the July 2006 proposal. The regulation stated that quantitative figures may be aggregated. The level of aggregation has to be predetermined by the investment advisor based on the client’s needs as well as the advisor’s business structure.

The regulation requires the disclosure of total client commission paid for the reporting period. It also requires that investment advisors “provide reasonable estimate of the portion of aggregate commissions that represents the amount paid, or accumulated to pay, for [research] other than order execution.”

The new proposal expanded the definition of research to allow for seminars, trade journals and expert networks. These services must be used in the investment decision process to qualify.

Also, to clarify their “temporal standard” on what services qualify as order execution, the CSA stated that “order execution services” start from the point at which an order life cycles begins (after the investment decision is made), and would generally include those goods and services that are used to decide how, when or where to place an order or effect a trade.” For example post-trade analytics, pre-trade analytics, order management and algorithmic trading software could fall under order execution services

On the subject of how the CSA’s regulation may differ from the SEC’s, the regulator noted that “[while they] believe the temporal standard may be different from that included in the SEC Release, [they] do not believe the difference would cause any issues regarding the eligibility of particular goods or services between jurisdictions. Rather, [they think] this should only result in differences in how an eligible good or service has been categorized between the two jurisdictions; for example, a good categorized as research under the SEC's temporal standard might be categorized as order execution services under the Proposed [CSA] Instrument.”