



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

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Dear Ms. MacLean and Ms. Baldwin:

**Re: Additional Comments on Budget-Proposed RRSP/RRIF Anti-Avoidance Rules**

Thank you for meeting with us by teleconference on July 27 and September 15, 2011 to answer questions regarding the proposed anti-avoidance rules with respect to registered retirement savings plans (RRSPs) and registered retirement income funds (RRIFs) including draft legislation released on August 16 and explanatory notes issued on September 1. We agree with Finance and CRA concerns with some swaps that have been undertaken, and agree with anti-avoidance rules to address them. As you know, IIAC represents broker-dealers whose clients include an important portion of the investors and issuers in this country. Our comments reflect our members' experience with their clients' needs and concerns, as well as our members' ability to meet the requirements of the rules reasonably. Below is a summary of our comments and recommendations and an attachment provides additional detail.

- 1. Policy Concern:** While the RRSP/RRIF rules are patterned on tax-free savings account (TFSA) provisions, TFSAs allow for in-kind withdrawals and compensating contributions in the following year, so legitimate swaps can be made by withdrawing a property in kind at the end of December and replacing it with a new property in early January. RRSPs and RRIFs lack a similar mechanism for making legitimate swaps, and using trades instead (if this is possible) exposes investors to price-change and foreign-exchange risk and additional costs.

*We recommend that the draft legislation be amended to permit: (i) swaps between RRSPs and RRIFs of the same annuitant; (ii) permanently the removal of non-qualified and prohibited investments from RRSPs and RRIFs, and (iii) the prescribing of a limited number of other legitimate swaps to enable Canadians to effectively manage their retirement portfolio, with provisions to be agreed upon with the CRA that prevent improper increases in the value of registered plan property or disguised withdrawals.*

**Transition for Canadian RRSP and RRIF Holders:** Due to the election-caused delay in passage of the Budget bill, the originally intended transition interval for RRSP advantage rules until July 2011 was not reasonably able to be used and did not provide the opportunity that we believe the government had planned.

It is the fact that so many Canadians are now investing in the markets that makes it important, we believe, for the introduction of the rules in this country to be accompanied by a period of time to allow those who had invested legitimately, according to the rules in place for a considerable length of time, to arrange their financial affairs without undue penalties. We think that this is not only important, but also fair and reasonable, as we believe our industry and the government are in agreement that the vast majority of investors undertake swaps legitimately, and as the RRSP/RRIF proposals note that the CRA has challenged successfully a number of tax-planning schemes undertaken by a small number of taxpayers enabling RRSP annuitants to access their RRSP funds without including the appropriate amount in income under existing *Income Tax Act* (ITA) rules.

*We request that the government: (i) provide an additional transition period for swaps to be permitted running from July 1, 2011 through December 31, 2012 and (ii) amend the application date of the change to paragraph (c)(i) of the definition of "advantage" in subsection 207.01(1) to property acquired by RRSPs and RRIFs after March 22, 2011.*

- 2. Implementation by Financial Institutions and the CRA:** Last, but extremely important in the immediate term, is the fact that a number of the new requirements will be very challenging (and in one case reasonably impossible) to implement. This is due to the extent of required systems and procedural changes (especially to manage what could be the same non-qualified assets in the same account – some at 1% and others at a 50% penalty rate), outstanding questions, tight implementation dates and the lack to date of public communication by the government to ordinary taxpayers and the media on the implications of the rules.

*As the CRA has also identified that workarounds will be required at least in the first year, and as it is possible that this may result in an inability to receive and use effectively what information is provided, we request: (i) a delay in requirements of financial institutions until January 1, 2013 and (ii) application of the rate of 1% on the fair market value of non-qualified investments until the end of 2012, followed by the application of the 50% special tax rate on all non-qualified assets as of January 1, 2013, with the Minister of Revenue able to address any hardship cases.*

We appreciate the time that you have spent answering our questions and elaborate on the three points above in Attachment 1. Please call or e-mail me if there is additional detail on our recommendations or explanations that you may find useful.

Yours sincerely,



## Attachment 1

### DETAILED COMMENTS ON RRSP/RRIF ANTI-AVOIDANCE RULES

We believe that the industry's, government's and vast majority of Canadians' interests in a smooth implementation of the RRSP/RRIF anti-avoidance proposals should be the same, namely, enabling taxpayers to accumulate savings for retirement, while preventing those who deliberately try to take advantage of the tax laws beyond what was intended.

#### 1. Policy Issues

Saving for retirement has become more challenging due both to a lower interest-rate environment accompanied by more volatile capital markets and to the move away from defined benefit plans, which the federal government, with provincial and territorial counterparts, has been working to address. We believe the public policy goal of encouraging and facilitating saving for retirement warrants efforts to identify legitimate swaps and ways to prevent them from being used for abuse.

Our members had understood that the Finance Department release, "Government of Canada Proposes Technical Changes Concerning Tax-Free Savings Accounts October 16, 2009" (2009-099), and the RRSP/RRIF anti-avoidance rules announced in the 2011 Budget were aimed at stopping intentional efforts to take inappropriate advantage of the tax plans (e.g., by deliberately over-contributing, by frequent transfers in and out where the TFSA constantly grew as the frequent flips took advantage of price fluctuations). From our joint discussion on September 15, we understand that the government's intention was to fully prohibit swaps.

In looking for a balance between helping Canadians save for retirement and prohibiting abusive manipulation, we appreciated hearing that Finance would likely agree that there may be many, possibly the majority of, swaps that would not be considered offensive from a policy perspective. In our view, not only are the vast majority likely to be legitimate, preventing them and requiring a trade instead will be problematic for many Canadian investors for three reasons:

- Prohibiting all swaps between registered and non-registered plans effectively will force the holder to sell and repurchase the securities, placing the holder at a double "disadvantage", that is, to a negative change in price and to two – sale and purchase – commissions, both factors negatively impacting rates of return. These commissions pay for third-party service providers, as well as stock exchange, clearing and settlement, confirmation mailing and other costs, that are not incurred when a swap journal entry is done.
- The sale by one account and purchase by another on the market (that is, on the TSX or TSX Venture exchange or a regulated alternative trading system or ATS) at the same price is not permitted under Investment Industry Regulatory Organization of Canada (IIROC) rules for accounts with the same beneficial owner. Known as "wash trading", this is seen as the effort by a party to influence the price of a security by creating trade volume ([http://www.iiroc.ca/English/Documents/Rulebook/UMIR0202\\_en.pdf](http://www.iiroc.ca/English/Documents/Rulebook/UMIR0202_en.pdf)).

- While a comment was made that a client could engage in the swap, pay a penalty and apply for relief under subsection 207.06(2) – waiver of tax payable – our members believed that they had to, due to the wording in the Budget, put in place systems to prevent all swaps. This means that this retroactive claim approach is not workable. In addition, it appears that the conditions in subsection 207.05(3) for waiver of the tax will require an income inclusion to the annuitant – an undesirable result.

Below are eight common swap transactions that we believe Canadians are not likely to see as efforts to avoid taxes. In some cases, this is because tax is paid in the tax year. In other cases, the transactions have been understood for many years to be consistent with the tax efficiency intended by successive governments to enable Canadians to save for retirement.

The first example, as far as we can see, presents no opportunity for abuse:

**1. *Plan-to-plan swaps of the same annuitants:*** As currently written, the definition of "swap transaction" in draft subsection 207.01(1) excepts transfers of property to RRSPs and RRIFs in the circumstances permitted under paragraph 146.3(2)(f). If an individual wished to swap property between two different RRSPs or RRIFs of which he or she was the annuitant, it would require *two* transfers to occur, or the sale and repurchase of the property. However, this would not be feasible in some circumstances, or would result in unintended consequences beyond those mentioned above. The following are scenarios in which transfers or sale and repurchase of property would not be as efficient an alternative as a swap transaction, in addition to leading to other negative impacts described above:

- Where an individual wished to swap property between a non-spousal RRSP and a spousal RRSP (both of the same annuitant), to process such a swap as instead two transfers would taint the property within the non-spousal plan and require it to then be treated as a spousal plan. This could result in unintended attribution to the contributor spouse should the annuitant need to withdraw the funds depending on the timing of such a withdrawal.
- If one of the plans is a locked-in RRSP/RRIF, transfers may not be permitted under the governing pension legislation, whereas a swap would be permitted.

***Recommendation:*** We recommend that the exemptions from the definition of "swap transaction" in draft subsection 207.01(1) be expanded to include swaps between RRSPs and/or RRIFs of the same annuitant (which would include, for example, swaps from any locked-in account, such as a locked-in retirement account (LIRA) to an RRSP or RRIF), spousal or not; specifically:

1. RRSP-to-RRSP (same annuitant)
2. RRIF-to-RRIF (same annuitant)
3. RRSP-to-RRIF (same annuitant) and vice versa
4. RRSP-to-Spousal RRSP or Spousal RRIF (same annuitant) and vice versa
5. RRIF-to-Spousal RRIF or Spousal RRIF (same annuitant) and vice versa.

The second example is aimed at providing a permanent way for annuitants to be able to correct a non-permitted holding as easily and quickly as possible:

**2. Removing non-qualified investments and prohibited investments:** Annuitants may be unaware that an investment is non-qualified or prohibited, or of some detail of the rules describing such investments. At other times, an investment may become non-qualified or prohibited only after it is acquired by a registered plan. Once the offending investment is discovered by the annuitant or the registered plan issuer, it should be removed quickly from the plan, commonly to date by a swap of the offending investment out of the registered plan in exchange for cash or qualifying securities of equal value from the annuitant's non-registered account. Alternatively, if the investment is held within a TFSA, it can be removed by way of a tax-free in-kind withdrawal, which increases contribution room for the following year. However, if the swap option is completely eliminated with respect to RRSPs and RRIFs, removal of the offending security may become unfairly burdensome for reasons beyond those mentioned above. For example:

- If a security is thinly traded or has no determined market, a forced sale to someone other than the annuitant would probably yield unfairly low proceeds. This is particularly onerous in the case of Canadian Controlled Private Corporations (CCPCs) and similar private securities in which the taxpayer holds a significant interest where the individual assumed significant risk to start and build a company.
- If a cease-trade order has been placed on the security at the time it becomes offending, then it could only be removed by an in-kind withdrawal, which forces the annuitant, due to circumstances beyond his or her control, to bring the fair market value of the security into income.
- If the offending security happened to be in a LIRA, it could not be withdrawn directly, and would first have to be swapped for securities in the annuitant's non-locked-in RRSP (assuming this is permissible as discussed) and then withdrawn from the RRSP and taxed. If there were not sufficient assets in the annuitant's non-locked-in RRSP, the annuitant would first have to make a sufficient contribution to his or her RRSP, even if this forced the individual to make an excess contribution.
- If the annuitant were over 71, he or she would be unable to remove the asset or avoid penalties using the foregoing solution, and would be limited to withdrawing the offending investment in stages from his or her life income fund (LIF) or locked-in retirement income fund (LRIF), not exceeding the maximum amount each year.

We are unaware of any policy reason for causing the above burdens on taxpayers, especially elderly ones or in situations where the problem could not have been foreseen, when the taxpayer merely wishes to remove offending investments from his or her RRSP or RRIF without incurring collateral damage.

**Recommendation:** We hope that the draft legislation will be amended to permit permanently the removal of non-qualified investments and prohibited investments

through swaps by expanding the exemption in (c) of the definition of "swap transaction" in subsection 207.01(1) to read as follows:

“(c) a transfer of a prohibited investment or a non-qualified investment from the registered plan, in circumstances where it is reasonable to conclude that the retention of the property in the registered plan would result in a tax being payable under Part XI.01 of the Act.”<sup>1</sup>

The third category of examples are swaps between registered retirement and non-registered accounts belonging to the same taxpayer, which we believe are legitimate if a client is to achieve the best after-tax savings results without the problems or unintended consequences summarized above or additional ones referenced in the examples that follow:

**3. *Paying RRIF minimum payment:*** Sometimes swaps are undertaken to facilitate a required minimum cash payment from a RRIF. To avoid selling securities in the RRIF at an inopportune time in the market cycle, cash in a non-registered account outside the RRIF is switched into the RRIF in exchange for securities in the RRIF. The RRIF cash withdrawal then can be made and will be taxed in the current year. A swap is preferred over a withdrawal in kind so that the amount withdrawn can be limited to exactly the minimum amount, and so that taxation at source can be avoided, or can be funded with cash.

**4.a *Rebalancing and restructuring:*** Swaps between non-registered and registered plans take place to restructure or rebalance a portfolio as the client approaches retirement and moves towards a portfolio more weighted in fixed-income investments – one of the principles of good financial planning. Also, shares of a company may be transferred outside of the RRSP into a non-registered account in exchange for securities that are less volatile, for example, preferred shares or bonds, during periods of market volatility. Alternatively, an error may have arisen leading to a security being more tax-efficient if placed in the RRSP (e.g., equities would be swapped out and bonds swapped in for a more tax-efficient and still legitimate result). Changes in personal circumstances also may lead to a change in a portfolio due to other reasons unconnected to seeking inappropriate advantages (for example, death of a spouse). The exchange between non-registered and registered accounts will trigger a capital gain or loss, with the former taxable and any superficial loss deemed to be nil.

**4.b *Delivery against payment (DAP) transactions:*** As discussed verbally, clients often have a registered account and possibly a non-registered account at a particular financial institution and a non-registered account at another. This can be for many reasons, including for convenience (e.g., one may be close to home and the other close to work) and for privacy reasons (e.g., to keep their financial accounts separated at more than one institution). A new issue of securities that the client wishes to buy may be available only in the financial institution where the non-registered accounts are held. Where a client wants to transfer a security in the non-registered account at the other financial institution to the registered account at the particular institution, it is normally processed as a DAP

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<sup>1</sup> The draft original reads: “(c) a transfer of a prohibited investment from the registered plan, in circumstances where the controlling individual is entitled to a refund under subsection 207.04(4) on the transfer.”

transaction. This involves a transfer from the non-registered account at the other institution to the non-registered account at the particular institution, followed by a swap from that non-registered account to the registered account at that same institution. As discussed, it is possible to open a new registered account at the other institution and do the swap at that institution and then a T2033 transfer to the registered account at the particular institution. However, this will create an additional registered account, a T2033 transfer to fund the new registered account and an early account closing fee, all of which is unnecessary and costly.

5. ***Achieving fee efficiency:*** Securities are swapped to minimize trade commissions while allowing the owner to maintain ownership of his or her position without affecting markets (the IIROC securities rule mentioned above precludes trades when there is no beneficial ownership change). By not allowing a swap, the owner will have to sell his or her securities at one price and buy them at another. Capital gains will be realized and any superficial loss will be deemed to be nil, with the client also disadvantaged by price and foreign exchange risk and commissions on both sides of the trade.
6. ***Obtaining emergency cash:*** The inverse of 3., a pensioner has cash from the sale of a security in his or her RRSP or RRIF and a security that has temporarily declined in value in a non-registered account. Instead of being allowed to swap the security into the registered account for cash coming out, the client will have to sell the security, draw on a line of credit or carry a balance on a credit card to access the needed funds, with additional costs.
7. ***New subscription for private company shares:*** There are many scenarios for a company to raise funding, with private placements (often referred to as an initial public offering or IPO) being among the most cost-effective ways to do so for private and public companies alike. A private placement of shares (e.g., of a CCPC) is normally achieved by having an individual (who is an accredited investor) complete a subscription agreement to commit to purchasing the shares on a future delivery date. On the delivery date, the shares are received into the individual's non-registered account, and from there can be swapped into the individual's registered account for cash. The cash remains in the non-registered account if that account has already forwarded cash to the company issuer with the subscription agreement. If not, then the cash is paid directly to the company issuer (essentially a DAP transaction) on behalf of the individual. It is these mechanics of getting subscription shares into an RRSP because of applicable securities and trust law constraints – factors likely not known by most – that require the swap. Such an impact on a viable funding mechanism for companies may not have been well understood and should be of concern in terms of its possible effect on business formation in this country.
8. ***Facilitating stapled units:*** As promised, we are providing additional information regarding these investments. In general terms, a stapled security involves two or more separate securities that are “stapled” together such that the securities are not freely transferable independently of each other. Each component is a property for purposes of the ITA, and the components are stapled only for trading purposes. They are traded as units on the TSX, where their trading symbol ends with "UN". In some cases, the securities may be “unstapled” at the option of the investor or the issuer. The unstapling may be temporary – until the security is traded – or may be permanent and irrevocable.

When acquired, cost should be allocated between the components based on relative fair market value. This is generally relevant only if the securities become unstapled. The fair market value of one or more components may be ascertained in advance of acquisition if any components are already publicly traded, or an estimated allocation of fair market value may be provided in advance by the issuer. In some cases, an allocation of fair market value may be difficult to estimate until the security has been unstapled and one or more components have begun trading independently.

Stapled securities may be issued by the issuer of the components or by another entity. They may include components issued by one or more entities. The components may be of the same type or not. For example, when Canadian Pacific Limited split into five corporations in 2001, Merrill Lynch issued CP Holding Company Depositary Receipts (CP HOLDERS), which stapled shares of the five corporations together to facilitate a market among shareholders who wished to retain the same relative interests in the five corporations.

A member has provided an example of how swaps have been commonly used when stapled securities have been issued. A stapled unit is issued that includes a debenture and units of a limited partnership. The debenture is a qualified investment for an RRSP but the limited partnership unit (LPU) is not. Holders put in orders for stapled units, accompanied by instructions for immediate unstapling with the debentures to be acquired by their RRSPs, and the LPUs to be acquired by their non-registered plans. This has been facilitated in the past through a purchase order into the non-registered account, followed immediately by a swap of the debenture into the RRSP. In such a case, relative fair market value at the time of acquisition must be determined and the appropriate share of the acquisition cost must be charged to the registered accounts.

In this example, if restapling is required for subsequent trading, then the components could not be sold publicly unless the debenture could be swapped back to the non-registered account.

**Recommendation:** We believe that activities 3. through 8. above should be permitted and urge the government to ensure that the legislation introduced provides for acceptable provisions to be prescribed. We would like to work with Finance and the CRA to identify workable requirements that minimize as much as possible the opportunity for abuse while permitting specified swaps.

## **2. Transition for Canadian RRSP and RRIF Holders**

Due to uncertainty about the Budget bill's passage in light of the election, the proposals' transition period was almost over by the time the Budget passed in June. Nor has there been any public communication that we are aware of yet of the implications of the anti-avoidance proposals that are affecting those Canadians not seeking to avoid paying the taxes that they should.

As the proposals were examined in more detail and their ramifications were understood, it became apparent that there would be serious concerns from individuals due to their particular situations, considerable confusion due to the length of time swaps have been permitted, and complexity in finding solutions for those who were not seeking tax advantages. There are public relations issues associated not only with RRSP and RRIF holders to be dealt with, but also with companies relying on private placement (and even public) funding.

From our discussion on July 27, we understand that the government is considering additional transition relief in certain cases. One example we raised was start-up companies that received their initial capital from management and directors through RRSPs, who have seen their investment rise significantly in value in their RRSP or RRIF, and who would have to remove these shares or incur penalties. Such investors may not have the capital "outside" of their RRSP or RRIF to swap out the position and would be forced to sell the position, possibly sending a negative sign to the market and damaging the company's prospects. We perceived some willingness to consider options for transition in the case where there is little or no liquidity and where there are other annuitants receiving income after March 22 and the flow of income cannot unilaterally be "turned off".

Another situation we believe requires grandfathering is the one where a significant shareholder of a publicly traded security or publicly available mutual fund holds a nominal amount of such a security (in relation to the taxpayer's full interest) in their RRSP or RRIF. He or she (if not wishing to sell the security) must now remove that security by way of in-kind deregistration (and pay deregistration taxes) or make other financial arrangements to enact a swap prior to December 31, 2012 due to the expansion of the prohibited investment provision to now include securities held in RRSP and RRIF plans.

At the same time, the RRSP/RRIF proposals note that the CRA has successfully challenged a number of tax-planning schemes undertaken by a small number of taxpayers enabling RRSP annuitants to access their RRSP funds without including the appropriate amount in income under existing ITA rules.

**Recommendation:** As noted in 1. above, we believe that taxpayers should be entitled to permanently remove both prohibited and non-qualified investments from registered plans. Given that there will be cases of permitted swaps where there is minimal or no liquidity for particular investments that must be removed from the RRSP or RRIF – and there may be no or minimally more liquidity in five years' time – we recommend that the extension of the rules governing prohibited investments to RRSPs and RRIFs be grandfathered to exclude their application to assets held by RRSPs and RRIFs on March 22, 2011. We believe that this could be done by amending the application date of the change to paragraph (c)(i) of the definition of "advantage" in subsection 207.01(1) to property acquired by RRSPs and RRIFs after March 22, 2011.

### **3. Implementation for Financial Institutions and the CRA**

Implementation of reporting, special tax and other requirements will be challenging for financial institutions due to unanswered question, extent of required systems and procedural

changes, tight implementation dates and lack, to date, of government communication to the general public on the issue in light of outstanding questions.

Two-thirds to three-quarters of IIAC members are small businesses by StatCan's definition – the federal government has re-announced the federal Red Tape Reduction Commission with a focus on small businesses and our March 31, 2011 submission to the Commission strongly recommends the upfront provision of administrative relief in cases where it is essentially impossible to achieve full compliance due to the receipt of information later than required for development of systems changes cost-effectively.

Moreover, we believe that considerably more implementation work will be required for RRSPs and RRIFs than for TFSAs due to the age of existing RRSP/RRIF systems. There will also be a greater need for staff involvement due to the fact that there currently are more than 40 times the value and double the number of RRSPs and RRIFs compared to TFSAs, and because TFSAs are currently of relatively low value with few complex holdings. Pending answers to a series of questions posed to Finance and the CRA, most work to date necessarily has been targeted at stopping swaps rather than developing systems when it is uncertain what is required.

We understand that the CRA also has identified that workarounds will be required in the first year at least, and possibly longer. It is possible that this may result in an inability to receive effectively and use productively what information is provided. As an example, the proposal to provide copies to the CRA of letters sent to clients advising them that an investment is now non-qualified do not, due to requirements of the Office of the Privacy Commissioner of Canada (OPC), include the clients' social insurance numbers. Receiving copies of letters without SINs will make the CRA's task of data entry and reconciliation infinitely more challenging and impractical.

***Recommendation:*** We request a delay in implementation of provisions to coincide with the end of December 31, 2012, consistent with the recommendation in 2. above. During this interval, the CRA can challenge aggressive tax planning inconsistent with the intent of RRSPs and RRIFs, while the CRA and our industry build the necessary systems for, for example, non-qualified investment reporting.

Additionally, the 1% tax is to be levied against any non-qualified asset held on March 22, 2011 and earlier, and at a rate of 50% of the value of assets acquired after March 22, 2011. To track both types of assets – on-or-before-March-22- versus after-March-22-acquired investments – will require systems changes and significant ongoing effort, particularly as a single account can end up with both “1%” and “50%” non-qualified securities due to different purchase dates. Other issues to be resolved include how to process reversals of taxes already applied, what gets sold first – old or new shares – or whether the client chooses, and whether the CRA will ensure a client is not subject twice to the 50% tax due to a transfer.

Moreover, clients who have assets grandfathered at 1% will be financially disadvantaged if they transfer their accounts compared to those who do not, as the transfer will lead to an immediate 50% special tax once the assets are in the receiving institution. This will lead to an inequality in outcome or to undesirable situations for clients who want to consolidate

assets in another financial institution for greater cost-efficiency but will not do so due to the special tax impact.

***Recommendation:*** We suggest application of the rate of 1% in *all* cases until the end of 2012, followed by the application of the 50% rate on *all* non-qualified assets as of January 1, 2013, with the Minister of Revenue able to address any hardship cases.

In conclusion, we believe that it would be more understandable to Canadians, and easier to implement for financial institutions and the CRA, if both non-qualified and prohibited investment rules were the same, with a single penalty rate, consistent with what we believe to be the government's goal, that is, that these assets be removed from RRSPs.

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