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

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Dear Sir:

Re: Provisions Respecting the Execution and Reporting of Certain "Off Marketplace" Trades (the "Proposed Amendments")

The Investment Industry Association of Canada (IIAC) appreciates the opportunity to comment of the Proposed Amendments. The Association supports the general objectives and spirit of the Proposed Amendments, however we have some concerns about certain of the logistics and practicalities in respect of implementation.

Orders routed to foreign marketplaces

We are concerned about the proposal to impose the "better price" requirements on trades executed on non-transparent foreign organized regulated markets. In general, when orders are routed to such foreign markets, they are executed by a third party rather than the Canadian dealer. Very few Canadian firms have control over the details of how these trades are actually executed unless they have an affiliate in the relevant foreign jurisdiction. As such, the control of the order will be in the hands of the third party, and the originating firm will not be privy to the executing firm's routing algorithm and may not be aware of whether the order will be filled on a dark or lit market.

In order to execute such trades, Canadian dealers would have to require their foreign service providers to comply with Canadian regulatory standards. This may not be possible in certain circumstances. Where foreign firms agree to provide this service to Canadian clients, it would require the creation of entirely new algorithms or more often, the use of manual processes. This would drive up the cost of execution significantly, ultimately prejudicing clients. In addition to increased costs, Canadian firms would

require an indemnity from these third party firms, and if it could not be provided, they would have to stop routing orders to the foreign market.

In respect non-interlisted securities, orders would generally be sent directly to third party dealers or market makers. The order will be crossed internally and reported via ACT. The trade would not show up on an exchange, however the client may be able to obtain better price improvement than they would, had they sent the order to an exchange. It should be noted that very few retail orders in the US end up trading on lit markets

In the case of interlisted securities, clients may be prejudiced, in that firms may not send their orders to the foreign market with the interlisting out of a concern that they will not be able to comply with Canadian securities regulation. This limits the venues on which investors can find liquidity, which may impair their ability to achieve best price and/or best execution. Clients should be able to make this determination if they are informed about the differences in pricing rules. Where clients are informed about the differences in the price improvement rules, they should be permitted to instruct their firms to access foreign markets.

Technological Issues

Item 5 of the Notice - *Technological Implications and Implementation Plan,* indicates that there are no technological implications of the Proposed Amendments on Participants, marketplaces or service providers. Our members have advised us that this statement is not accurate. In order to comply with the Proposed Amendments, firms and their service providers will have to reconfigure their logic and order flow systems to reflect the new requirements. In addition, due to the proposed new reporting structure (to IIROC), a number of processes and interfaces will have to be altered, as currently firms do not have trades going through IIROC systems, as they are currently reported by traders to the exchanges. The Proposed Amendments would require centralization of certain systems and supervisory structures. This all comes at a cost. We believe the net benefits of the Proposed Amendments are negligible, and certainly outweighed by the costs to reconfigure routing systems. In addition, requiring foreign service providers to undertake special procedures when executing trades from Canadian firms will significantly add to costs, as Canadian firms will have to absorb these technical and operational costs. .

The net result of the Proposed Amendments appear to have the unintended consequence of creating a protectionist regime in Canada. If Canadian dealers are not able to comply with the Proposed Amendments, they will be unable to completely service the needs of their clients. As such, clients will likely move to foreign dealers so as to be able to buy and sell non-interlisted securities, or interlisted securities that have greater liquidity in the foreign jurisdiction. It may also discourage foreign firms from sending their order flow to Canada as they would be required to reconfigure their routing requirements.

IIROC Questions

In response to the specific questions posed in the Notice, we have the following comments.

1. **The anti-avoidance rule introduced to UMIR on the introduction of the Order Protection Rule only applies to an order from a Canadian account denominated in Canadian funds. Should the anti-avoidance rule proposed in the Order Exposure Rule be similarly limited to provide greater flexibility to a Participant handling the order from a non-Canadian account or a Canadian account denominated in a foreign currency? '**

   Yes, the Order Exposure Rule must also be limited, in order to provide clients with the widest access to foreign marketplaces, thus increasing their ability to achieve best price and best execution. As noted above, imposing the conditions in the Proposed Amendments may have the effect of discouraging firms from accessing foreign marketplaces due to the inability or unwillingness of their execution firms to reconfigure algorithms, or the increased costs resulting from such firms reprogramming or undertaking manual processes to comply with Canadian regulation.

   In order to properly ascertain the full effect of the Proposed Amendments, we seek clarification as to whether firms must route to a dark pool in Canada before they access the US market.

2. **Are there alternative approaches which would ensure that the policy objectives of the Order Exposure Rule and Dark Liquidity Amendments are achieved when an order is entered on a foreign organized regulated market?**

   In order to allow clients to benefit from access to foreign markets without significant cost implications, an informed consent provision could be introduced. This would allow clients to provide consent to have their trades executed on foreign markets, understanding that the Canadian version of "better price" regulation may not apply if the trade is executed on foreign marketplaces. This will ensure that clients have access to liquidity on foreign marketplaces without the increased cost structure of accessing those marketplaces.

3. **To what extent should "off-marketplace" trades that have been reported to IIROC be publicly disclosed? If there is public transparency of certain "off-marketplace" trades:**
   - **How frequently should the disclosure be updated?**
   - **Through what channels or mechanisms should the disclosure be made?**
   - **Should there be disclosure of each individual trade (being that information that would have been publicly disclosed if the trade had been executed on a marketplace) or should the information be aggregated for each security over the disclosure period?**

   Currently information about off marketplace trades is not disclosed, and we are not aware that providing such disclosure would solve a market problem, contribute to market integrity or provide particularly useful or valuable

information. We are concerned that public reporting of such information may result in disclosure of competitive information about firms trading positions. If firms' trading positions on certain trades can be ascertained, competitors may be able to take advantage of this information. For instance if a firm has a significant long position in a security, and this becomes known amongst its competitors, this may affect the pricing if the firm takes action to divest themselves of the position.

If such disclosure is provided, we question how it would be presented. Certain private and off marketplace trades are undertaken in compliance with regulation, but in that manner to preserve confidentiality. It is critical to understand what details IIROC would require to be reported and disclosed on such transactions. For instance, does IIROC anticipate disclosing details on private transactions such as trades of securities with hold periods between accredited investors? Currently this information is not disclosed as trades are not executed through marketplaces, and as such the volume is not reported. Unless it is clear what is being reported, this information could ultimately cause confusion in the market.

If IIROC decides that such information should be disclosed, we understand that IIROC would have to build a system to facilitate this disclosure. Matters such as the standard protocols to be used to upload information on to the system must be addressed as this affects the operations and costs to the dealers as well. A cost/benefit analysis of this initiative should be undertaken to ensure that the market will accrue benefits from this disclosure that are at least commensurate with the set-up, monitoring, and operational costs.

4. **Are there any other types of "off-marketplace" trades which should be reported to IIROC (e.g. trades in listed securities pursuant to the exercise of an over-the-counter derivative or forward contract)? What level of public transparency would be appropriate for these additional "off-marketplace" trades?**

   We do not believe the types of trades articulated above should be reported. One of the issues relates to the sheer volume of information, given the number of securities that would be affected. The volume of information would be significant task to report, and the ultimate value of the information would be questionable, given the volume and the lack of context for the reported trades. For instance, firms may undertake swaps or OTC option contracts in furtherance of a hedging strategy. While this may fall into the reporting and disclosure regime, given that this is only a part of a transaction, it would not be clear what is being hedged, limiting the usefulness of this information. Creating volumes of public information without context does not increase transparency and ultimately results in processes without a purpose and potential investor confusion.

   It is also important for IIROC to be very specific in articulating what constitutes and "off marketplace trade" as it is not clear exactly what trades should be reported under the Proposed Amendments. The potential scope of the Proposed Amendments is very wide and it is unclear what is intended to be captured. For

instance, would off marketplace trades include forward contracts, repo contracts, swap transactions, bond trading, intercompany trades, etc.?

Thank you for considering our comments

Yours sincerely,

Susan Copland