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Toronto, ON M5H 3T9

October 9, 2012

Dear Ms. Di Lieto and Mr. Corner:

Re: Proposed IIROC Restricted Dealer Member Category (the "Proposal")

The Investment Industry Association of Canada ("IIAC" or "the Association") appreciates the ability to comment on the Proposal to create a new Restricted Dealer category. We understand that IIROC has developed the Proposal in an effort to address the problems created by the provisions in NI 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* which allowed FINRA members to register as exempt market dealers ("EMDs") and subsequently obtain certain exemptions which allowed these firms to carry on brokerage activities in Canada.

We agree that the solution to this problem must require firms that undertake brokerage activities in Canada to be IIROC registrants. However, the compromises contained in the Proposal effectively establish two "classes" of IIROC registrants, which ultimately undermines the objectives of achieving a level playing field among Canadian and US dealers. The Proposal would result in the creation of a structural competitive advantage for US based broker dealers, which is not justified by any demonstrable improvements to the variety of investment products available for Canadian investors.

It should be noted that our comments reflect the views of our members that do not have an EMD affiliate. Certain members that have EMDs within their corporate structure have indicated that they may have a different perspective in respect of the Restricted Dealer category. We have encouraged these members to express their views in a separate submission.

The IIAC believes that all dealers, including FINRA dealers, must be fully registered and compliant with IIROC rules in order to undertake brokerage activities in Canada. We are very concerned that the Proposal allows FINRA dealers access to Canadian markets to serve Canadian clients, while granting them a competitive advantage by deferring to FINRA's financial operations rules. Although the FINRA rules relating to financial operations may appear comparable to IIROC rules, there are differences that would result in such firms having a competitive advantage over Canadian investment dealers operating under IIROC rules.

For instance, the FINRA financial operations rules allow firms to use portfolio margining, which means every listed security has a margin rate. The result is that every client that uses prime brokerage would be entitled to more leverage than if they were using a Canadian IIROC dealer.

Ultimately, this means Canadian firms must have more capital to transact business, which affects the economics of doing business. FINRA firms are provided with a competitive advantage as they require less capital to do the same business in Canada with Canadian clients.

It is not clear if there are other discrepancies between IIROC and FINRA rules that would provide competitive advantages to FINRA EMDs. We recommend that a detailed analysis of the rules be conducted to ascertain where Canadian firms may be put at a further competitive disadvantage.

We also seek clarification as to whether FINRA EMDs could undertake underwriting activities under the Proposal. We do not believe that it is appropriate for an entity other than a fully compliant IIROC firm to underwrite and sign a prospectus.

Further, we understand that US regulators are not proposing similar exemptions to allow Canadian firms reciprocity in the US markets. We do not believe it is appropriate to provide FINRA firms with greater access to the Canadian market and Canadian investors when Canadian firms are not offered similar access to the US market. US regulators have shown little willingness to recognize firms outside their borders. This is evidenced by a number of initiatives that have required FINRA involvement from the start to finish of transactions, including clearing and settlement, even in foreign securities.

The Proposal states that one of the potential advantages to creating a Restricted Dealer category would be to provide Canadian investors with greater access to a broader product base. We respectfully disagree. Canadian dealers are able to provide Canadian investors with an extremely wide range of global products and it is not clear that FINRA dealers have access to a greater variety of products. The primary difference between IIIROC and FINRA dealers is not the product range, but the ability to offer better credit terms due to the portfolio margining available under FINRA rules. This provides FINRA dealers with a regulation based structural cost advantage unrelated to product availability.

In order to ascertain the scope of the competitive issue, it is important to understand the type of business that FINRA EMDs are undertaking in Canada. It has not been demonstrated if, and to what extent that FINRA EMDs are important to the Canadian capital markets, or provide services beyond what Canadian dealers can provide. We

understand that the CSA has undertaken surveys to better understand this issue. The results of these surveys should be shared with the industry so that Canadian firms can better understand the competitive landscape.

Should IIROC decide to permit FINRA dealers to be registered under a Restricted Dealer framework, we see no reason why FINRA dealers owned by Canadian based entities should be excluded from this category. Under the Proposal, Canadian IIROC dealers would not be permitted to take advantage of the Restricted Dealer structure to serve their clients. This restriction would put Canadian owned dealers at a disadvantage not only to US firms, but other foreign FINRA registrants that could operate through the US regulatory framework. This restriction cannot be justified by any investor protection or market integrity rationale. To the extent that the exemption from full IIROC registration is available to foreign dealers, it should also be available to Canadian owned FINRA broker/dealers to ensure there is no regulatory arbitrage in favour of such firms.

If IIROC proceeds with offering the Restricted Dealer category of membership to FINRA dealers we have the following additional concerns:

Supervisory Credentials

We note that the Proposal does not require that existing FINRA EMD UDPs, CCOs, Supervisors, Directors or Executives be subject to the IIROC proficiency requirements. We do not believe this is appropriate, given that the Restricted Dealer must comply with IIROC Business and Trade Conduct regulations. It is important that Supervisory personnel have the appropriate background to understand the rules for which they must oversee compliance.

Participating Organization restriction

Given that the orders to be transacted by Restricted Dealers are fundamentally Canadian orders, UMIR should apply to Restricted Dealer members who electronically route orders to a Participating Organization for execution on a Canadian marketplace.

Introducing / Carrying Broker Relationships

In terms of how the Proposal would affect introducing firms, we believe it is unfair to allow clients to have greater access to FINRA registrants, but not allow firms to do so. If Canadian investors are able to deal with the FINRA EMD registrants, it is unclear why Canadian introducing firms can not deal with US carriers. Under the Proposal, it appears that a FINRA firm could register as a Restricted Dealer and offer carrying broker services to EMDs but not to Canadian firms. This may place Canadian firms at a competitive disadvantage, depending on the services offered by the FINRA carrying firm.

Enforceability of Sanctions

The Proposal is unclear as to the scope of IIROC's ability to sanction FINRA firms for violations of IIROC rules. We are concerned that FINRA firms facing a potential significant fine may choose to close their Canadian Restricted Dealer rather than subject themselves to IIROC imposed sanctions. We question whether there is an agreement with FINRA to impose IIROC sanctions in such circumstances so that firms cannot make

a business case to avoid compliance by rolling up their Restricted Dealer in such circumstances. It is important that FINRA have rules and oversight ability to enforce Canadian fines on the parent of the Restricted Dealer if it folds up under the threat of an IIROC sanction.

Application of Complaint Handling Rules

It is also not clear if the Restricted Dealers would be subject to the same procedures relating to client complaints as IIROC dealers. Would such firms be subject to Comset reporting, OBSI membership requirements, and the IIROC arbitration program? Would complaints be handled through IIROC or FINRA?

Obligations Under Information Sharing Agreement

We question the nature of the cooperation agreement in respect of information sharing between IIROC and FINRA. Under the agreement, does FINRA have a positive obligation to advise IIROC if they detect a compliance problem with a FINRA dealer that is registered as a Restricted Dealer, or is this information required to be shared only in the event of an IIROC request for information? We have seen recent cases where problems quickly spiral out of control. It is crucial that IIROC have the ability to take action on a timely basis to limit damage to the Canadian market if a problem is detected by FINRA.

Specific IIROC Questions.

1. **Should the Restricted Dealer Member proposal be implemented as a grandfathering proposal only to facilitate the migration of existing EMD or restricted dealers (including pending applicants) that have been identified by the CSA as conducting brokerage activity? Or should the Restricted Dealer Member proposal be implemented so that it continues to be available to potentially new entrants to the Canadian marketplace?**

   We believe that all firms conducting brokerage activities in Canada should be registered as full IIROC dealers to ensure there is a level playing field among market participants. If however IIROC introduces the Restricted Dealer category, it should only be permitted for those who are currently undertaking brokerage activities in the Canadian market, and for a specified transition period, and not available to new entrants. If it is available to new entrants, it should also be available to Canadian dealers that have FINRA registrants in order to ensure that Canadian firms are not placed at an unfair disadvantage to foreign FINRA firms.

2. **Do you agree that the proposed IIROC Restricted Dealer Member category should be subject to a de minimis threshold, so that a firm that exceeds the prescribed de minimis threshold would be required to transition to full IIROC Dealer Member status and be subject to all IIROC Dealer Member Rules? If you agree that a de minimis threshold is appropriate, what is the appropriate basis for such a threshold? For**

example, should the de minimis threshold be premised on any of the following:

- **a prescribed number of Canadian clients;**

- **a prescribed percentage (e.g. 5%) of the aggregate consolidated gross revenue of the Restricted Dealer Member, and any of its affiliates operating in Canada, derived from the investment dealer activities of the Restricted Dealer Member and its affiliates in Canada, as calculated at the end of the firm's most recently completed financial year;**

- **a prescribed percentage (e.g. 5%) of the aggregate consolidated gross revenue of the Restricted Dealer Member and any of its affiliates operating in Canada, derived from Canadian resident clients in respect of Canadian securities, as calculated at the end of the firm's most recently completed financial year;**

We do not think it is appropriate to provide a de-minimis exemption to FINRA registered firms, and that all firms should be subject to full IIROC registration. If a threshold is established, it would be inappropriate to base it on any percentage of a firm's total business, given the potential size of certain FINRA dealers would exceed the entire size of many Canadian firms. The Canadian market is comprised of a majority of small and medium sized firms which are comparatively tiny to many FINRA registrants. As such, any de-minimis threshold is likely to exceed the size of many IIROC registrants' business.

3. **Existing FINRA/EMD firms are generally restricted to dealing with only "accredited investors" as defined under National Instrument 45-106 Prospectus and Registration Exemptions (NI 45-106).[4] Firms who have been registered as restricted dealers pending the CSA's policy review of the issues discussed in CSA Staff Notice 31-327 have instead been restricted to dealing with only "permitted clients".[5] We are proposing that IIROC Restricted Dealer Members should also be restricted to dealing with only certain types of retail customers, in recognition of the fact that a Restricted Dealer Member will not be subject to all of IIROC's Dealer Member Rules. We have some concerns that the "accredited investor" threshold for retail customers may be too low for purposes of the proposed Restricted Dealer Member category. Do you agree that a retail customer restriction should be applied to Restricted Dealer Members? If you believe a retail customer restriction is appropriate, what is the appropriate basis for such a restriction? For example, should an IIROC Restricted Dealer Member be restricted so that it can only deal with one of the following types of "retail" customer:**

    - **an "accredited investor" as defined in NI 45-106?**

    - **a "permitted client" as defined in NI 31-103?**

- **a retail client who beneficially owns financial assets having an aggregate realizable value that, before taxes but net of any related liabilities, exceeds $10 million, which is the existing threshold for "high net worth non-individuals" in IIROC's definition of "Institutional Customer"?**

  We believe that the playing field should be level, such that all regulations should apply to all firms operating in that sphere. As noted above, in order to make a clear assessment of the competitive landscape it is important to know in what areas such FINRA dealers are operating at present. The surveys undertaken by the regulators should be available to industry to allow them to understand where they are in competition with foreign entities operating in an advantageous regulatory framework.

Thank you for considering our comments. If you have any questions, or would like to consult further with our working group, we would be pleased to meet with you.

Yours sincerely,

Susan Copland