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Dear Ms. Solomon:

**Re: Proposed Guidance on Certain Manipulative and Deceptive Trading Practices  
(the “Proposed Guidance”)**

The Investment Industry Association of Canada (“IIAC” or the “Association”) appreciates the opportunity to comment on the Proposed Guidance. The Association generally supports the publication of the Proposed Guidance insofar as it promotes clarity as to IIROC’s expectations in this realm.

We do, however have some concerns in respect of some of the language in the background material and the actual Guidance Note that results in ambiguity about the scope of firms’ responsibilities. In general, the Proposed Guidance would be improved by including clearer requirements for specific types of behaviour that is of concern and should be monitored.

We also believe that, in light of the implementation of the short marking exempt (SME) order marking requirements, the Proposed Guidance may be premature. Once the provisions of the SME requirements are in place, it will allow regulators to more effectively target the types of trading that is of concern, and has prompted the Proposed Guidance.

**Specific Concerns**

Section 2.2.2 *Trading Supervision and Gatekeeper Obligations* in the Notice, states that a

*“Participant must have reasonable procedures to address fact situations when manipulative and deceptive activities may be more prevalent such as to:*

- *determine whether orders being entered by insiders or other persons with an interest in affecting the price of a security.”*

We question whether this represents a change in existing expectations, particularly in respect of institutional practice and previous guidance issued in this regard. The previous guidance, issued as Market Integrity Notice 2002-012, *Regulation ID Order Markers and Order Inhibition During Regulatory Halts & Suspensions*, recognized the fact that in the institutional realm, it is often not possible to ascertain whether insiders or persons with an interest in affecting the price of a security are involved. The Market Integrity Notice states, “...when acting for an institutional client, a Participant will not be expected to inquire prior to accepting or executing an order whether the institutional client has become the holder of more than 10% of the securities of a particular issuer. However, if the Participant has actual knowledge that a client, including and institutional client is an insider or significant shareholder of an issuer, the participant will be under an obligation to ensure the proper marking of any order by that client in the securities of that issuer.

- *“Monitor trading activity by persons with multiple accounts”*

It is unclear as to whether this means individuals with multiple accounts or corporations with multiple accounts. It is also unclear whether this includes master and sub accounts.

- *“address the additional risks resulting from the fact that efforts to manipulate a security are more likely to: occur at the end of a calendar month or on the expiry of derivatives; or be centred on illiquid securities.”*

It is not clear whether this provision applies to listed derivatives or OTC derivatives or both.

Also under section 2.2.2, the Notice states that:

*“The guidance emphasized that the source of, or means with which an order is entered does not relieve a Participant of responsibility for, and the supervision of, such orders including:*

- *Implementation of systems reasonably designed to prevent the entry and execution of “unreasonable” orders and trades on a marketplace whether the Participant or a DMA client of the Participant is using an algorithmic trading system.”*

We are concerned with the use of the term “unreasonable order”, as it is not a defined term or one for which guidance or examples have been published.

In the actual Proposed Guidance Note, we have the following comments relating to the Questions and Answers section.

- 1. Are there trading strategies which could be employed through an automated order system that IIROC considers manipulative and deceptive practices?**

The category of “Abusive Liquidity Detection” will be very problematic in terms of its potential scope. Liquidity detection can be a legitimate and useful strategy in furtherance of best execution. Order routers are programmed to search for liquidity as part of their functioning. The ability to ascertain traders’ intention in respect of their liquidity detection is not something that is subject to any objective measure, and may result in many alleged violations for ordinary course best execution strategies. Existing UMIR Rule 2.2 has appropriate language to capture the abusive trading behaviour, without introducing uncertainty into legitimate trading practices.

**2. Is a Participant required to undertake compliance testing to detect for any manipulative and deceptive trading strategies?**

The answer to this question implies that pre-trade controls must be used to detect layering, spoofing and quote stuffing. The nature of these practices is that they can only be detected once it is clear that there is a pattern, so that pre-trade detection is not possible, and post trade analysis is the means by which these strategies are possibly detected. In any event, it may be very difficult to ascertain such trading strategies, even on a post trade basis. We are concerned that the Proposed Guidance imposes an obligation to detect and prevent certain strategies on a pre-trade and short term post-trade basis, where such strategies can only be ascertained once a clear pattern is established.

**3. Is there an exception from the prohibition on manipulative and deceptive trading available for persons with Marketplace Trading Obligations?**

We are concerned that the answer to this question is vague and will lead to uncertainty as to what behaviours are of concern to regulators. It would be helpful if the Proposed Guidance would articulate more specifically what type of trading is regarded as problematic.

**4. In what circumstances would IIROC consider that a Participant or Access Person is not participating in a manipulative or deceptive activity while engaging in algorithmic or high frequency trading strategies?**

This question appears to start with the presumption that algorithmic and high frequency trading strategies are inherently abusive. Given the predominance of such strategies in the normal course of business, it is impractical to start from this presumption, and may set up a “guilty until proven innocent” context for the majority of trading that takes place. It is important that in formulating rules and guidance, the specific behaviours of concern be identified in order to not impede normal business practices and allow the market to carry on in an efficient manner. HFT and algorithmic trading are not in and of themselves problematic, and should be subject to the same rules as other trading. It is the strategies for abusing the technology, rather than the technology itself that should be targeted.

**5. Is an Access Person, Participant or client engaging in algorithmic or high frequency trading subject to the order designation requirements?**

It should be made clear that firms are obligated to only monitor the activity going through their individual firm in respect of accounts that should be marked as short marking exempt (SME). The way in which firms can monitor such accounts are to ask the client to declare if they should be designated as SME at the outset, and to require firm action if the firm detects a pattern in trading that would indicate that a designation would be appropriate.

It should be noted that at this time, the technology to detect what trading should result as an account being marked as SME is not available. Currently firms are undertaking best efforts to manually watch for patterns to determine if the designation is appropriate.

Thank you for considering our input. If you have any questions, please do not hesitate to contact me.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'S. Copland', written in a cursive style.

Susan Copland