



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

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Director

James E. Twiss
Vice President, Market Regulation Policy
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Suite 900, 145 King Street West
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May 21, 2010

Dear Mr. Twiss:

Re: Proposed Guidance on Locked and Crossed Markets (“Proposed Guidance”)

The Investment Industry Association of Canada (the “IIAC”) appreciates the opportunity to comment on the Proposed Guidance. In general, we find that the Proposed Guidance offers helpful and clear information relating to the practical application of the regulation relating to locked and crossed markets. We do, however, have a few comments and suggestions that may assist in improving the clarity of the guidance.

Question 1: Is the entry of any order that results in a “locked market” a violation of a Participant’s or Access Person’s obligations under the Locked and Crossed Order Provisions or UMIR?

In respect of the recognition that locked or crossed markets may be created unintentionally as a result of “race conditions”, we would like further guidance as the criteria, such as the data speed that would determine that race conditions may be a factor. Currently the speed of trading as between Participants can vary greatly due to order entry that ranges from manual to those undertaken by high speed algorithmic programs. As such, the existence of race conditions can depend on which participants are in the market at the time of the trade. This is a factor that, with the evolution of technology, becomes a moving target. We also are unclear whether it is something IIROC systems can monitor to the accuracy of milli and soon to be micro seconds which is become the standard for latency measurements.

Given the difficulties of determining on a case by case basis whether a Participant has intentionally created a locked or crossed market, we presume that IIROC will be looking at trends in respect of participants’ trading patterns rather than isolated trades. Where trends have been identified, further investigation into the conditions of particular trades could then be examined. Trade by trade enforcement where there has been no identifiable pattern would consume valuable resources that are more appropriately focused where evidence suggests that an ongoing issue exists.

The guidance indicates that although it will not be considered to be an intentional lock of the markets when securities legislation requires that the order be entered on or executed on a particular marketplace (ie: where the securities are subject to resale restrictions in the US under Regulation S). However, in limited circumstances (where a Participant is selling less than 50 board lots of 144(a) securities) the prohibition on entry of an order that would have the effect of crossing the markets may result in a conflict with UMIR 6.3, which requires that an order be exposed on a market in a timely manner.

Question 2: Is a Participant required to move a properly “booked” order on one marketplace to another marketplace to trade with an order that was subsequently entered on that other marketplace where the latter order caused a “locked market”?

We agree with the guidance offered in respect of this question.

Question 3: May an order to purchase a security be entered on a marketplace if an order to sell the same security at the same price has been entered on another marketplace by the same person or group of persons?

We agree with the guidance offered in respect of this question, and the recognition that such trading strategies constitute manipulative and deceptive activity.

Question 4: Are all “rebate arbitrage” strategies acceptable?

We agree with the guidance offered in respect of this question.

Question 5: Is it a violation of UMIR to enter an order on a marketplace that “bids-through” or “offers-through” an order on another marketplace even if the order that “bids-through” or “offers-through” does not “trade”?

We agree with the guidance offered in respect of this question.

Question 6: During a “crossed” market”, may a Participant or Access Person execute against the order that has caused a “crossed” market or the order that was “bid-through” or “offered-through”?

We agree with the guidance offered in respect of this question.

Question 7: If markets are “locked” may a Participant or Access person intentionally enter an order that would have the effect of increasing the volume displayed at the bid or the ask price?

This situation causes some concern, to the extent that smart order routers may operate to increase the displayed volume. In addition, it also demonstrates the problems with the Order Protection Rule that can force Participants to make financially detrimental trades by not allowing the placement of passive orders, and requiring the Participant to pay taker fees imposed by certain marketplaces where they would otherwise not trade.

Question 8: What happens if a Participant or Access Person uses an order type or order router functionality that is designed to “re-price” orders and the re-pricing locks the market?

Although it is generally appropriate to place the onus on Participants and Access Persons to prevent trade-throughs, in respect of short sales this may not always work where order routers are operated by certain marketplaces which re-price shorts according to the downtick rule, which may result in prices below the NBBO. This situation should be recognized as an situation enumerated in question 1, where the creation of a locked or crossed markets is unintentional.

Question 9: May a client instruct the entry of an order that has the effect of creating or continuing a “locked” or “crossed” market?

We agree with the guidance offered in respect of this question.

Question 10: May a client electronically enter an order that has the effect of creating or continuing a “locked” or “crossed” market?

We agree with the guidance offered in respect of this question.

Question 11: May the policies and procedures adopted by a Participant allow it to exclude from consideration protected orders displayed on a particular marketplace?

We agree with the guidance offered in respect of this question.

Question 12: Is there an exception from the prohibition on intentionally “locking” or “crossing” markets available for persons with market making obligations?

We agree with the guidance offered in respect of this question.

Question 13: Are there restrictions on the limit price at which various specialty orders may be entered?

We agree with the guidance offered in respect of this question.

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

Yours sincerely,

Susan Copland