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

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July 19, 2007

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Dear Sirs and Mesdames:

Re: Joint CSA and RS Inc. Notice on Trade-Through Protection, Best Execution, and Access to Marketplaces

The IIAC commends the CSA and RS for their efforts to adapt regulation to the new reality of multiple marketplaces and the other developments described in the Joint Notice. Given that the multiple marketplace environment in the Canadian context is in its early stages, it is important for regulators to work with industry to develop flexible, principle-based regulations that allow for adaptation as the issues and practicalities of operating in this environment emerge over time.

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General

We agree that that preferred structure for equity markets is an integrated one. Specifically, we strongly support full integration, with mandatory linkages provided at the marketplace level, consistent with the system in the US. In light of the movement toward free trade in North America, and the significance of the TSX on the global stage, it is important to have a structure that is effective and efficient, as well as consistent with other major markets where it is possible and practical to do so.

We will address the three elements contained in the Joint Notice in turn.

Trade-Through Obligations

The IIAC supports the stated objectives of price discovery, liquidity, competition, innovation, market integrity and fairness, consistent levels of transparency and accessibility for all market participants. In order to consistently achieve these objectives, market participants require access to a consolidated market feed as well as smart routers. The consolidated market feed can efficiently be supplied by the visible marketplaces or other third party vendors. Smart routing, however, should be provided by the marketplaces in order to ensure access for participants that choose not to develop their own systems or subscribe to third party vendor solutions in order to comply with the requirements.

The requirement for marketplaces to provide smart routing is particularly important for smaller dealers. If the onus for routing orders is placed on dealers rather than marketplaces, it may have a disproportionate detrimental effect on smaller dealers with fewer technological resources. The resulting imbalance could potentially alter the structure of the industry in favour of larger firms, and may preclude small firms from directly providing trade execution from their own trading desks.

Rather than requiring dealers to develop their own solutions to prevent trade-throughs, the responsibility should reside with the visible marketplaces to interconnect and allocate orders amongst themselves. Dealers, however, would be free to build additional platforms and systems where they deem it necessary or relevant for their particular business model.

We agree that it is appropriate to foster competition among marketplaces. However, the burdens of fostering a competitive environment should be allocated fairly. Marketplaces benefit from being able to enter the market, and as such must bear a proportion of the costs to the industry of fostering a competitive market environment. In respect of the responsibility for compliance with the trade-through obligation, it is appropriate, and more cost efficient to the industry as a whole to impose certain burdens of that competition, such as the responsibility for smart routing on the marketplaces, rather than at the dealer level. The marketplaces would ultimately be able to recover connectivity

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costs over time through charges for these routing services within a competitive pricing environment.

The precedent for an integrated marketplace centered approach exists in the US, through Regulation NMS. We support this approach and urge the Canadian regulators to implement a consistent system. While the proposal contained in the Joint Notice appears to put the responsibility for trade-through protection on marketplaces, it provides the marketplaces with the ability to re-direct that responsibility back to the dealers. This is not acceptable. There must be a clear and unambiguous assignment of responsibility to the marketplaces.

It is also critical that the marketplaces be responsible for ensuring accessibility on a consistent and reliable basis prior to their launch. Co-ordinated and successful industry-wide testing must be mandated to ensure all aspects of transactions operate as anticipated, amongst all stakeholders. This has recently been an issue with the proposed launch of a new marketplace, resulting in significant time and cost expenditures by the market participants. It is the responsibility of the CSA to ensure that marketplaces meet a minimum standard in terms of their technological capability to launch. Dealers should not be responsible for subsidizing the infrastructure and start up costs of entities that provide uncertain value to their business, and to the industry as a whole.

CSA Questions:

1. ***In addition to imposing a general obligation on marketplaces to establish, maintain and enforce written policies and procedures to prevent trade-throughs, would it also be necessary to place an obligation on marketplace participants to address trade execution on a foreign market?***

   There are a number of concerns with the requirements for dealers to consider all foreign markets to comply with trade-through obligations. First, there is no similar US requirement. Second, Canadian dealers are typically not members of any foreign marketplace. Given that a foreign dealer would be required to intermediate, direct control over the routing of any such order would be removed. Also, many small Canadian dealers do not have foreign affiliates to provide global execution. The resulting costs to execute on foreign markets would be punitive, leading to issues relating to level playing field and anti-competitive regulation, especially in light of proposals for free trade in securities where larger global firms may have significant and unfair advantage over domestic dealers.

   Local rules and requirements must be balanced, and consider the outcomes in the context of these free trade discussions.

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The requirement to consider "all foreign marketplaces" could end up being very onerous, and not achieve the best outcomes for clients. With foreign markets, the best execution considerations related to cost, certainty and speed of execution must trump any foreigntrade-through requirement in order to ensure the spirit and practical objective of the regulation is achieved. In addition, as noted above, imposing such obligations on market participants rather than marketplaces in relation to trade-through obligations will impose costs that may have a detrimental effect on the market structure of the industry.

It is not clear that the clients would ultimately have any material benefit from a foreign trade-through obligation. They will, however, bear the significant costs associated with implementing this requirement. Currently, the price differences between a security traded on a Canadian market and other foreign markets are minimized to the extent possible and feasible, due to factors such as arbitrage trading, speed of global execution and information distribution. The CSA should also consider the costs and impacts of other potential risks such as settlement, trading costs, credit and counterparty risk, foreign exchange volatility, foreign regulations and rule making before entrenching this obligation.

In practice, in order to appropriately serve their clients, dealers do consider other markets where an issuer is actively traded. Certainly for Canadian/US interlisted issuers, it is reasonable to expect that a dealer will make every effort to ensure that a better price is not available in the US before trading in Canada, taking into account foreign exchange and access costs. We do not believe it is necessary to implement a regulation, as market forces have, and will continue to adequately deal with the issue.

2. What factors should we consider in developing our cost-benefit analysis for the trade-through proposal?

In developing a cost-benefit analysis, it is important to look at *total* industry costs, rather than individual costs to dealers and marketplaces. For instance, the cost to individual dealers of developing smart order routers may be less than the cost to a marketplace of doing so, however, when the cost is aggregated among all of the dealers, it will certainly be much higher than the aggregated costs of to the marketplaces. Inefficiencies in linking different systems, as well as the increased testing costs must also be considered.

In addition, the analysis should take into account access fees, settlement and clearing fees, as well as the cost of surveillance and monitoring of the trading on each marketplace. The considerable costs that will borne by the CSA and SROs in their efforts to conduct cross market surveillance should not be taken lightly. The

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regulators would also benefit in the same manner as the dealers if many of these new services were consolidated at the marketplace level.

On a macro level, the global costs of a system which is inconsistent with the US should also be factored into the cost-benefit analysis. Having a distinct regulatory structure and unique requirements will present a barrier, and may discourage global investors from investing capital in the Canadian capital markets.

4. Should trade-through protection apply only during "regular trading hours"? If so, what is the appropriate definition of "regular trading hours"?

Trade-through protection should only apply between transparent markets that are open for regular trading. For example, if the secondary market for trading is open to 6:00 pm, and the primary market closes at 4:00 pm there may be no ability to transact and should be no trade-through obligation after 4:00 pm.

Extending trade-through protection would introduce unwarranted complexity and an increased risk of non-compliance. In addition to the impracticalities of moving orders to other markets after usual trading hours, all client orders with pre-established time priority in the first market would lose their priority on submission to the second market, without any guarantees of fills or better prices.

There can also be significant liquidity and volatility issues on a secondary or after-hours market. It should also be noted that news announcements made after regular market hours can cause an order to be traded at an unfair price where one party has received the news while the other party has not had time to digest the impact.

The parameters of when the protection is in effect must be clearly disclosed to ensure investor expectations are aligned with reality.

We suggest that the regular trading hours should correspond to existing historical Canadian market hours (9:30 am – 4:00 pm Eastern time) until such time that this would put the Canadian capital markets at a material disadvantage to other North American market centres. We are not in favour of any mandated change to such hours which would effectively represent a regulatory extension of firms' operating hours.

5. Should the consolidated feed (and by extension, trade-through obligations) be limited to the top five levels? Would another number of levels (for example, top-of-book) be more appropriate for trade-through purposes? What is the impact of the absence of an information processor to provide centralized order and trade information?

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The consolidated feed and trade-through obligations should apply to the entire depth of the book. This is essential for compliance with best execution obligations. By enforcing the depth of book, all displayed quotes are treated fairly and equitably. Any alternative will result in situations where executions may trade-through displayed better prices to the detriment of the clients displaying their limit orders. As a result, clients may get a worse fill than available.

The availability of a consolidated data feed is essential for compliance with the trade-through obligations in the multiple marketplace environment.

6. Should there be a limit on the fees charged on a trade-by-trade basis to access an order on a marketplace for trade-through purposes?

The creation of a system ensuring a captive market for new and unproven marketplaces presents many problems in respect of its implications for the need for further regulation to counterbalance the effects of mandated patronage to such marketplaces. In the course of our member consultations on this part of the proposal, it became apparent that this issue introduces certain complexities that affect the structure of the industry and require a more in-depth and specific consultation process.

In general we believe it is not appropriate to regulate the pricing decisions of marketplaces or market participants. However, since the proposed trade-through requirements effectively create a clientele for marketplaces that may otherwise not exist, it is appropriate to ensure that marketplaces provide value to this captive market. Rather than regulating the manner in which the marketplaces price their services, we advocate an approach that does not require market participants to access the marketplace for the purpose of trade-through obligations until it can be demonstrated that the market has established some relevance. Given the costs associated with subscribing and connecting to a market, the determination of whether a market is relevant must go beyond its ability to display best price on a few specific securities. This relevance approach rewards market performance rather than subsidizing unproven or underperforming markets by mandating dealer access.

We acknowledge that developing the criteria to determine market relevance is no easy task. At this stage, one of the primary impediments to developing a model is the lack of information relating to how trading will flow in the Canadian multiple marketplace environment. In order to understand the behaviour of the market, trading will have to be analyzed in the context of several factors, including pricing, and the other elements of best execution. Without this data, and without an understanding of the practical operational issues that come from experience with the

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market, it is premature to impose obligations on market participants that will have significant effects on the structure and the economics of the industry.

We recommend that the trade-through obligations be held in abeyance until some meaningful data can be collected which will assist in setting appropriate thresholds to determine whether a market is relevant for the purposes of imposing trade-through obligations. We suggest that an appropriate time frame for gathering such data is one year. Once the standards are established, we believe that it is appropriate for the CSA consider the ability of new marketplace entrants to meet such standards in a reasonable time before approving them as new exchanges or ATSs.

Alternatively, the regulators may consider the limitation on access fees as proposed by Regulation NMS. The $0.003 per share fee would apply to visible auction marketplaces which would be required to connect with each other for trade-through obligations. This approach would not require the assessment of marketplace relevance, but would introduce certain other complexities related to pricing regulation into the regulatory equation.

7. Should the CSA establish a threshold that would require an ATS to permit access to all groups of marketplace participants? If so, what is the appropriate threshold?

If the trade-through requirements are to achieve their intended purpose, it is important that market fragmentation does not undermine the objective of the regulations. Consistent with our comments in 6, we recommend that ATSs should provide access to all groups of market participants when they have been deemed to be a relevant marketplace.

8. Should it be a requirement that specialized marketplaces not prohibit access to non-members so they can access, through a member, (or subscriber), immediately accessible, visible limit orders to satisfy the trade-through obligation?

- ***Should an ATS be required to provide direct order execution access if no subscriber will provide this service?***
- ***Is this solution practical?***
- ***Should there be a certain percentage threshold for specialized marketplaces below which a trade-through obligation would not apply to orders and/or trades on that marketplace?***

As noted above, we support the concept of access based on the establishment of relevance as a marketplace. One of the factors to consider to determine relevance may relate to trading thresholds. Where access is mandated, it is important to

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ensure that the ATS have appropriate technology in place to easily allow participants to access its market. Individual participants should not be subject to the costs of access when they may otherwise elect never to participate in that particular ATS.

In developing the requirements for non member access, it is important for the regulators to consider the arrangements for oversight of the non-member/non-subscribers.

9. Are there any types of special terms orders that should not be exempt from trade-through obligations?

The exemption of special terms orders (all-or-none, minimum quantity, special settlement, odd lots etc.) is appropriate.

12. [In respect of an exemption from trade-through obligations for after-hours trading sessions at a specific closing price]. Should this exception only be applicable for trades that must occur at a specific marketplace's closing price? Are there any issues of fairness if there is no reciprocal treatment for orders on another marketplace exempting them from having to execute at the closing price in a special facility if that price is better?

As noted above, we support the proposal that trade-through obligations only apply during regular trading hours. Those participants who choose to trade in after hours trading sessions should not be subject to the obligations or protections offered by the regulation.

13. Should a last sale price order facility exception be limited to any residual volume of a trade or should it apply for any amount between the two original parties to a trade? What is the appropriate time limit?

Such an exception should be limited to the volume that is traded during that session. The time period for order entry should be limited and standardized to minimize the occurrences of trade-through. We believe that 60 seconds should be sufficient time to make a trading decision to participate in a Single Price Session. We however do not believe that it would be contrary to public interest to extend the prescribed time up to 2 minutes.

14. Should trade-throughs be allowed in any other circumstances? For example, are there specific types or characteristics of orders that should be subject to an exemption from the trade-through obligation?

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We are concerned that the regulation relating to Normal Course Issuer Bids would restrict the transactions to the exchange on which the security is formally listed, despite the availability of a better price on another market on which the security trades. As noted above, special terms orders should be exempt from prescriptive trade-through requirements. Any abuse of this exemption could be captured under UMIR 2.1 "Just and Equitable Principles". In the case of all-or-none and minimum size orders, the trade-through obligation should not apply to orders that are already in the special terms book where the trade is triggered by the marketplace algorithm. In such cases there may be an unintentional trade-through of orders on another visible marketplace.

Other specific situations to consider include stop orders, short orders where pricing is managed by an exchange, and any terms order that crosses in the board lot book.

It should also be noted that there are potential conflicts in tick sensitive trades, so that relief will be required from either trade-through obligations or tick rules.

Situations where special terms orders are used to avoid a trade-through obligation would be prohibited. The CSA and RS should provide clear guidance with examples of how they would interpret this exemption.

Best Execution

We commend the CSA and RS for adopting the broader, more functional concept of best execution, and the focus on the process to achieve best execution, rather than basing compliance on a trade by trade basis.

CSA Questions:

15. Are there other considerations that are relevant?

The elements of price, speed of execution, certainty of execution and overall cost of the transaction sufficiently cover the considerations related to best execution.
We note, however that many participants and their clients take into consideration other elements that may add risk and cost to their implementation of a trading strategy. Best execution should be viewed as a process and designed around the needs of the client. For example, a client may want to remain dollar neutral or sector neutral when executing a transition or basket of buys and sells. This client may interpret the proposed elements of best execution very differently from another client that has a single stock objective. We believe that the CSA and RS should focus on a principle based rules for best execution where dealers can demonstrate with consistent policies, procedures and practices that the objectives of their clients are being met in similar context as other regulatory obligations, such as suitability.

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16. How does the multiple marketplace environment and broadening the description of best execution impact small dealers?

As noted above, depending on where the onus lies for ascertaining best price and routing orders, the multiple marketplace environment potentially increases the costs to small dealers to a level where they may be unable to compete. The proposed requirement to consider *all* marketplaces outside Canada compounds this problem. If this requirement is retained, the standard for determining whether it is appropriate to consider all foreign marketplaces must be reasonable.

The unintended consequence of such a regulatory structure is to foster an environment where competition and market survival is based on ability to develop and finance technology rather than on the core services provided to clients.

We are also concerned that the obligation to consider possible liquidity on marketplaces that do not provide order transparency could prove to be problematic. The reasonable likelihood of liquidity test is subjective, and it may be difficult to demonstrate in retrospect that this test has been met. If this requirement is retained, it should be clarified. The general obligation to provide best execution and the demands of clients will support the use of "dark pools" so long as they provide the appropriate value proposition at an economic price. A prescriptive application of this obligation appears to be unwarranted and will be difficult to enforce without appearing unfair and punitive. We believe that market forces will address the concerns that the CSA and RS raise.

The costs associated with trade desk reviews related to compliance with trade-through obligations is also potentially significant, but difficult to determine and quantify at this point.

17. Should the best execution obligation be the same for an adviser as a dealer where the adviser retains control over trading decisions or should the focus remain on the performance of the portfolio? Under what circumstances should the best execution obligation be different?

Our view is that the advisor can choose to execute trades through any dealer(s) to the advantage of its clients, taking into account a variety of factors, including soft dollar arrangements, certainty and speed of execution, etc. Dealers facilitating such transactions bear the responsibility for compliance with best execution requirements, so there is no reason to impose such requirements on the advisor. As part of their fiduciary duty to their clients, they should already be dealing with their obligations to provide best execution and ensure that their actions meet the ongoing objectives of the portfolios and assets they manage.

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18. Are there any other areas of cost or benefit not covered by the cost-benefit analysis

In addition to the answer we provided to question 2, the cost-benefit analysis for the best execution requirements must take into account that each marketplace has designed its own connectivity protocol, trading rules and service levels. The cost and time that the dealers must incur in order to ensure that they are able to connect to the markets must be recognized.

19. Please comment on whether the proposed reporting requirements for marketplaces and dealers would provide useful information. Is there other information that would be useful? Are there differences between the US and Canadian markets that make this information less useful in Canada?

The information to be provided by the marketplaces is critical to determining whether that marketplace is providing best execution. It is not clear what use that the information to be provided by the dealers would have for the public or for firms. Imposing such additional reporting requirements merely adds costs and introduces inefficiencies without any commensurate benefits, particularly in the early stages of operations under the new regulatory regime. It is important to allow the system to be up and running, so that the data to be collected and analyzed is reliable and appropriate. As noted in the cost-benefit analysis, the costs of gathering, organizing and analyzing the data is significant. It is important, therefore, to ensure that any such requirements yield relevant and useful information that will justify the costs. In order to understand what information is relevant, and the best way to collect and analyze it, it is important to have an operating framework in which these decisions can be made on an informed basis. As such, we recommend that the reporting requirements be deferred until the market has been operating in the context of the proposed regulations for a reasonable amount of time. At that point, a more informed decision can be made about the required information and the costs and benefits associated with its collection and analysis.

20. Should trades executed on a foreign market or over-the-counter be included in the data reported by dealers?

Currently there is no infrastructure to provide this information, and it would have to be done on a client-by-client basis. Given the potential cost, and the lack of tangible benefits, we do not support such a requirement.

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21. Should dealers report information about orders that are routed due to trade-through obligations?

See answer to 19. above.

22. Should information reported by a marketplace include spread-based statistics?

Initially, simple volume statistics are all that should be required in respect of marketplace operations. This information is important to establish if trading thresholds have been met, and trade-through obligations have been triggered. It is critical to ensure that marketplaces collect and report volume data in a consistent manner. For instance, it should be established whether a trade in a security is counted once, or twice (as a buy and a sell).

23. If securities are traded on only one marketplace, would the information included in the proposed reporting requirements be useful? Is it practical for the requirement to be triggered once securities are also traded on other marketplaces? Would marketplaces always be in a position to know when this has occurred?

This information is not particularly useful in a single marketplace scenario. The cost to provide such information is not justifiable by the utility of the information.

Direct Access

We agree that it is important to clarify the obligations for marketplaces, dealers and dealer-sponsored participants (DSAs). Although the primary objective "to level the playing field between dealers/participant organizations (collectively, "POs") obligations and client obligations to comply with the trading rules" appears reasonable as an overarching goal, there are several problems with the specific elements of the objective and the proposed implementation. It is important when imposing regulation and responsibilities on various parties, to take into account the market structure and expertise available to the participants.

Definition of Dealer-Sponsored Access

In respect of the new definition of "dealer-sponsored access" (DSA), we note that by the use of the terms "electronic connection" and "access its order routing system", the

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definition could be broadly interpreted to include almost any order that electronically transmitted to a dealer. This implies that there are two types of orders; the traditional phone, fax and e-mail orders and all other orders that employ consistent technology for transmission to dealers to be rotationally considered dealer-sponsored access order flow. Taken literally, this definition could include orders where there may be no trader intervention but clearly not a case of direct access to a marketplace (for example algorithmic trades, program trades, list based trades etc.) We believe it is important to clarify that any Dealer Sponsored Access requirements would only be intended to cover sponsored trading access by non PO were there was no possible intervention by the sponsoring PO. PO's should be able to establish policies and procedures that would include filters, order routing logic and supervision as appropriate, on orders that would still be electronic in nature, but would not attract any requirement for RS to have direct contractual obligations with the end user.

The IIAC commends the decision by the CSA and RS to expand the availability of DSA to IDA Policy 4 clients. The existing eligibility criteria is very problematic for some entities that have the appropriate level of sophistication and market knowledge and should currently be eligible. It should be noted that the current TSX policy 2-501 rules extended eligibility to US entities, however, did not include other jurisdictions with similarly robust regulatory regimes such as UK.

DSA Client Contract with RS

We have a number of concerns with respect to the requirement for DSA clients to sign a contract with the regulation service provider (RS). Although it is beneficial to ensure DSA clients are aware of their obligations and provide a means of enforcing them, the regulators should consider certain issues that may arise as a result of prescribing a direct contract with RS.

The contractual relationship effectively creates a new requirement for clients to be registered with RS.

It should be recognized that in certain circumstances, clients may not be permitted to sign a contract with a SRO (eg: certain public entities) or others may not be willing to sign (eg: international clients). The result could be that many institutional investors either bypass the Canadian markets, or access them through the US via interlisted securities. This could have a material impact to liquidity of Canadian marketplaces. Clients may also wish to negotiate the terms of the contract.

We note that other jurisdictions have not required direct contracts with an SRO (assuming that the merger between the IDA and RS will be successful) but have required contracts with the marketplace. We believe that existing practice of requiring the DSA agreements to be approved by the marketplace with the appropriate compliance to rules

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as a contractual obligation between the sponsor and the client is sufficient. The addition of an obligation to a SRO would imply that the DSA users would gain quasi membership without all of the rights, obligations and costs that apply to the sponsoring dealer. We also believe that since the sponsor is expected to be the member of the various markets where trade-through obligations will be enforced, the dealer must be the one held responsible as they ultimately control the access and the technology used by the DSA client.

If a contractual relationship is imposed, the process and administration relating to these contracts must be clearly defined, as in many cases a DSA client will have multiple brokers and the employees may have access to some marketplaces with one dealer and potentially different access with another dealer.

Aside from the general concerns regarding the requirement for the contractual obligation, we have the following concerns with the actual contract.

Specific concerns about the DSA agreement proposed by RS include:

- The agreement only makes a reference to the Access person needing to comply with UMIR and provides a chart in Schedule B of items that apply. The requirement to comply with the gatekeeper requirement (UMIR 10.16) while not being required to comply with any supervision obligation (UMIR 7.1) does not provide them with the obligation or expectations to have the tools to identify items to be reported.

- Section 6 of agreement does not provide any specific language as to qualifications or requirements for training or course approval. It leaves this open ended to the discretion of RS.

- Section 8.3 unreasonably extends RS jurisdiction to client trading representatives for seven years despite the fact that they do not sign any agreement. The representatives are only named by the Access Person in an electronic filing.

- Section 4.1, allows for the option of an "employee" to file notices. If the agreement is contested it may be difficult to establish that employee had the authority to bind the Access Person.

Training Requirements

The proposed rules require that each DSA client trader and supervisor must complete a prescribed course such as the Traders Training Course. In addition to being impractical,

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it is the industry's common perception that the current course is out of date and may not be entirely relevant for DSA client regulatory requirements. The current TSX and TSX Venture DMA rules require the dealer to provide training and updates. We believe this is an appropriate way to ensure clients are trained. If the regulators are concerned with the content and application of these programs we suggest standardizing certain documents/training materials to be used by firms. The regulators could also set a higher standard and provide clearer expectations of the material to be covered by such programs, and provide assistance with issuing notices and regulatory updates designed for DSA clients.

The regulators are considering an exemption for foreign clients that have equivalent training. However the concern that is often raised is that clients are not well versed in UMIR, and do not have a sufficient understanding of the technical requirements or differences to other foreign markets. We note that at present PO's go to great lengths to interpret and implement the numerous requirements to comply with provisions such as UMIR 7.1. Despite all of these efforts, there continues to be challenges and divergent interpretations to existing rules and enforcement actions for technical violations. Given that the vast amount of expertise and resources remain within the sponsoring firms, so should the responsibility.

New Obligations for ATSs

We support the proposal that ATSs must develop a compliance program for surveillance of subscribers that are not dealers. Since subscribers become "Access Persons" and there is no traditional dealer involvement, there should be supervision and compliance reviews of their activities, similar to the programs required by other dealers.

CSA Questions

24. Should DMA clients be subject to the same requirements as subscribers before being permitted access to a marketplace?

On a high level, it is not necessary and is, in fact, undesirable to subject DMA clients to all of the same requirements as subscribers. The effect will be to duplicate systems that exist at the PO level, and impose additional regulatory costs on such clients. The objective of ensuring proper supervision and compliance can be achieved by working within the current structure to address the specific concerns of the regulators. This would involve imposing specific and targeted new requirements on exchanges and ATSs, as well as dealers and DMA clients, rather than taking a broad brush approach to regulating such clients.

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The fact that POs control and develop the technology to access the marketplaces is critical in understanding the market structure and imposing obligations on its participants. Given this reality, the requirements applicable to clients can not be the same as POs, as they cannot be responsible for any technical rule violations caused by systems issues at their sponsoring firm. In some cases the DSA client may believe in good faith that they technically comply with UMIR while a system may be dropping or incorrectly adding a marker.

We also note that currently the PO's receive trade desk reviews and regulator audits from RS and the IDA. We query whether the DSA clients will be subjected to such reviews and audits. In addition to identifying deficiencies, these reviews can also provide the benefit of preventing future violations and highlight where policies, procedures, supervision and compliance programs can and should improve before being the target of an enforcement action.

It should be clear to the POs exactly what regulatory responsibility for their clients that they will retain. If this is not explicit in the regulation, the new provisions may lead POs to incorrectly believe that they are transferring some of their regulatory responsibilities to their clients.

25. Should the requirements regarding dealer-sponsored participants apply when the products traded are fixed income securities? Derivatives? Why or why not?

There currently no need for the training requirements to apply to over-the-counter products such as fixed income, due to the involvement of an in-house trading desk in such transactions. We however believe that the same DSA regulations and requirements should apply to all listed products when they trade on an exchange or ATS, as the same regulatory concerns and potential marketplace abuses are present.

26. Would your view about the jurisdiction of a regulation services provider (such as RS for ATS subscribers or an exchange for DMA clients) depend on whether it was limited to certain circumstances? For example, if for violations relating to manipulation and fraud, the securities commissions would be the applicable regulatory authorities for enforcement purposes?

The existing regulatory fragmentation creates confusion and inconsistency. As such, it is appropriate that RS continue to have jurisdiction for market trading infractions by PO's and subsequently all IDA members after the merger. We believe however, that so long as the DSA client's are not full members of the new proposed merged SRO they should fall under the jurisdiction of the provincial

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regulators. In most cases the institutional DSA clients are already registered with the provincial regulators as advisors, and would be covered by their reviews and compliance programs. It does not make sense to duplicate this requirement and add additional costs to the industry and ultimately the end investor/general public.

27. Could the proposed amendments lead dealer-sponsored participants to choose alternative ways to access the market such as using more traditional access (for example, by telephone), using foreign markets (for inter-listed securities) or creating multiple levels of DMA (for example, a DMA client providing access to other persons)?

As noted above, the requirement to sign an agreement with RS may lead some foreign dealer-sponsored participants to find alternative ways to access the market. This is a general concern in respect of layering requirements on such participants, particularly in situations where the regulatory concern can be dealt with at the marketplace or PO level. One effect that imposing the full slate of regulations on DSA clients may have is to erode the important functions that the Canadian brokers play in facilitating these transactions.

Given that Canada represents only approximately 3% of the global marketplace, clients are likely to find access to Canadian markets through the US or other markets rather than deal here directly.

28. Should there be an exemption for foreign clients who are dealer-sponsored participants from the requirements to enter into an agreement with the exchange or regulations services provider? If so, why and under what circumstances?

See section relating to DSA Client Contract with RS above.

29. Please provide the advantages and disadvantages of a new category of member of an exchange that would have direct access to exchanges without the involvement of a dealer (assuming clearing and settlement could continue to be through a participant of the clearing agency).

We are concerned that such a category of member would not be subject to the gatekeeper oversight that dealers presently provide. There is a real risk that market integrity would be compromised, unless UMIR is applicable to the clients of such an exchange.

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Conclusion

Operating within a multiple marketplace environment presents a number of challenges for market participants as well as for those regulating the markets. We recognize that practices and regulation will evolve as the industry becomes familiar with the environment. It is particularly important during this transitional phase to provide a flexible and adaptive regulatory environment and not entrench prescriptive regulation in light of such uncertainty.

The IIAC appreciates the opportunity to comment on behalf of our members on these important regulatory instruments. If you have any questions or comments related to our response, please do not hesitate to contact me.

Yours sincerely,

cc:
Alberta Securities Commission
British Columbia Securities Commission
Manitoba Securities Commission
New Brunswick Securities Commission
Securities Commission of Newfoundland and Labrador
Registrar of Securities, Department of Justice, Government of the Northwest Territories
Nova Scotia Securities Commission
Registrar of Securities, Legal Registries Division, Department of Justice, Government of Nunavut
Ontario Securities Commission
Prince Edward Island Securities Office
Saskatchewan Financial Securities Commission
Registrar of Securities, Government of Yukon

c/o Ontario Securities Commission