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ASSOCIATION CANADIENNE DU COMMERCE DES VALEURS MOBILIÈRES

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January 9, 2008

Dear Sirs/Mesdames:

Re: Proposed Amendments to NI 21-101 *Marketplace Operation* and NI 23-101 *Trading Rules* (collectively, the "Proposed Amendments")

The Investment Industry Association of Canada (IIAC) appreciates the opportunity to comment on the Proposed Amendments, as published on October 17, 2008. The Proposed Amendments provide a much more practical and efficient regulatory framework for a multiple marketplace environment as compared to the existing best price obligation imposed on dealers in the IIROC Universal Market Integrity Rules (UMIRs). We commend the CSA and IIROC for responding to industry concerns expressed in response to previous requests for comments on this issue

Our responses to the specific questions are provided below, as well as several suggestions as to how the regulation might be improved to deal with other complications that have arisen as the industry has evolved from single to multiple marketplaces.

CSA Question 1: Should marketplaces be permitted to pass on the trade-through protection obligation to their marketplace participants? If so, in what circumstances? Please provide comment on the practical implications if this were permitted.

In order to ensure the regulatory framework operates in an efficient manner and that compliance is assured, marketplaces must not be able to avoid their obligations by establishing policies and procedures that instead require dealers or other marketplace participants to take steps to prevent trade-throughs. The existing regulatory model which places the onus on market participants to comply with best price obligations has resulted in excessive costs and inefficiencies, and has

placed a disproportionate burden on small firms to develop the processes and technology to comply with best price obligations. As noted by regulators, despite the best efforts of firms to comply with their regulatory obligations, there are many violations of the best price rule under the current framework. As such, allowing marketplaces to pass the obligation back to other marketplace participants would defeat the purpose of the Proposed Amendments. It would also result in confusion as to where the ultimate responsibility for the trade-through obligation lies. Situations where marketplaces should be able to pass the trade through obligation back to other participants should be confined to circumstances where dealers make the election to take responsibility for this function, including an inter-market sweep order and where a firm chooses to use its own smart order router rather than relying on the marketplace technology.

CSA Question 2: What length of time should be considered an "immediate" response by a marketplace to a received order?

It is difficult and inappropriate to specify and fix a particular time increment, particularly since the evolution in technology will change what is considered reasonable over time. We are not aware of any fixed standard in the US regulation, and do not believe one should be set in Canada. We do believe it is appropriate to have a standard, as there must be some certainty as to when dealers can undertake self help measures. However, the standard should not be one that is a fixed, discrete measure of time. A more appropriate measure of immediacy should be put in relative terms to the performance of other marketplaces. Marketplace performance and reasonable response times could be established by comparing statistics provided by the marketplaces. Responses outside of an established percentage range (which excludes outlying statistics) could form the basis for whether a marketplace provides immediate responses. This would ensure that marketplace speed is reasonable relative to their peers, and that dealers are not required directly or indirectly by regulation to support underperforming systems. Dealers should have the ability to avoid particular markets where they can demonstrate that they have reasonable concerns in relation to performance. It is critical to ensure that measurements are consistent in terms of when the timing starts and ends, and what activities are included.

CSA Question 3: Are any additional exceptions necessary?

The proposed exceptions are appropriate, however some improvements could be made to provide clarity and increase efficiency to market participants. In particular, the exceptions relating to systems issues should place a higher standard on the marketplaces to demonstrate that they have resolved the issues. For instance if a marketplace experiences a systems issue or is missing immediate response targets a material percentage of time, this should trigger a requirement for the marketplace to notify the market of the issue and at that time quotes should not be protected on the marketplace. The notice should not be rescinded until the marketplace can demonstrate to its regulator that the issues have been resolved. Only at this point should the exception be lifted for that marketplace. This will ensure that the market is not compromised by having to potentially route to and subsequently through a marketplace that is experiencing problems.

CSA Question 4: Please comment on the various alternatives available to a marketplace to route orders to another marketplace.

This question raises a number of issues, including the responsibilities and processes applicable to Direct Market Access transactions. Also, the Proposed Amendments appear to assume that dealers are members of or subscriber to all marketplaces. The lines of responsibility in respect of compliance and settlement are not clear in respect of jitney trades where a transaction is conducted for one dealer under the number of another dealer who is a member of or subscriber to the marketplace. The Proposed Amendments appear to be imposing US type regulations around jitney trades, without taking into account that Canada has different infrastructure in place. A "jitney

order" is currently defined under UMIR as an order entered on a marketplace by a participant (the "Executing Dealer") acting for or on behalf of another participant (the "Originating Dealer"). If the definition were adjusted to reflect the current multiple marketplace environment then a participant of a marketplace could execute trades for other market participants that are not necessarily members of, or have an agreement with the marketplace where the trade is executed. It could read "an order entered on a marketplace by a participant of that marketplace ("the Executing Dealer") acting on or on behalf of an IIROC approved member dealer (the "Originating Dealer").

Settlement of trades executed in this manner would need to be explored further to ensure that CDS, market participants and the marketplaces can effect trades in this manner, or if additional development will be required around the rules and/or technology. This is an issue that is potentially complex and should be on the list of issues to be discussed with the OSC working group that is being formed to deal with implementation issues.

CSA Question 5: Should the CSA set an upper limit on fees that can be charged to access an order for trade-through purposes? If so, is it appropriate to reference the minimum price increment described in IIROC Universal Market Integrity Rule 6.1 as this limit?

In order to fulfill the objective of fostering competition for the benefit of the industry and investors, marketplace fees should be taken into consideration in some manner. Rather than setting limitations on fees, we believe the better approach is to allow marketplace fees to be taken into consideration in determining the best price. In this way, marketplaces cannot structure fees in a way where it appears to have the best price, forcing the dealer to trade on the market, while its fee structure makes the trade uneconomic for the dealer and ultimately in the long run, the clients.

As an example, a member firm was subject to the following situation recently in respect to the strict application of the current best price requirements. The firm had a client that was purchasing larger volumes of a security which was trading at approximately $0.01. The firm's buy orders were processed through the smart router, which in turn sent to the orders to new marketplace, as it had the best price. Based on that marketplace's trade fee formula, the firm paid on average over 30% of the value of the trades executed in trade fees. One trade with a value of $5,000 cost the firm $1,800 in trade fees. It appears that the reason that members are charged so aggressively on these active orders is the incentives that the marketplace offers for passive orders to gain order flow. With the current best price obligations members feel that they are essentially held hostage by the marketplace to trade there, regardless of the economic costs of doing so.

If the CSA prefers a more structured limitation on fees, the proposed limitation based on tick increments is acceptable, provided that the language is clarified to indicate that the acceptable increment is ½ a tick per marketplace, and that the total "all in" charge cannot be more than the existing fees.

CSA Question 6: Should there be a prohibition against intentionally creating a "locked market"?

There should be a prohibition against intentionally creating a locked market. This is consistent with US regulation. The prohibition should apply to all market participants including marketplaces. It should be borne in mind in the drafting of the prohibition that if fees can be considered in determining best price, locked markets may sometimes result.

Reporting Requirements

The IIAC supports detailed marketplace reporting requirements to allow market participants to assess the performance and relevance of each marketplace in relation to their business models. As noted above, factors related to performance should be able to be considered by dealers in determining their choice to route to particular markets.

We are concerned however about the requirement for dealers to collect, consolidate and report its order routing statistics as required by section 4.4 of NI 23-101 in the Proposed Amendments. In the absence of proper context, these statistics will not provide useful information to the industry. These statistics do not provide the information that would inform users of the basis of trading decisions, such as whether a market was chosen due to speed of execution, proven liquidity or a soft dollar arrangement.

In respect of the statistics to be reported, it is not clear what the intended information is intended to be conveyed. For instance, are firms to report where the order was routed or where it was eventually executed? Also, what is required in respect of passive orders?

What is important, and what appears to underpin the requirements is a need to ensure that dealers are not acting in a manner that conflicts with the interests of their clients. This objective can be achieved in a far less technically burdensome and more principles based manner by requiring firms to develop and publish an order execution policy. The policy would be available to clients on demand and via the firms' website. This could form part of a firm's conflict of interest procedures and could be placed in the regulations relating to conflict of interest. The firms' adherence to their order execution policy is easily auditable. Disclosure of firms' order execution policy will provide investors with transparency in respect of how orders are handled in a clear and understandable manner rather than having clients try to interpret statistics without appropriate information as to why certain routing decisions were made.

Prior to implementing a regulatory requirement that requires significant technological expenditures, it must be demonstrated that this information will provide material value to the industry and that this value can not be generated by other means. These reporting requirements will require significant resources to develop. Given the burdens that are currently being imposed on firms to comply with the best price and prospective trade through obligations, if such detailed reporting will be required, the regulation should allow significant lead time to allow for the development of such systems.

In respect of the data to be provided by marketplaces, it is critical that the statistics provided by the marketplaces are based on identical standards and parameters so that users can be assured that appropriate comparisons can be made between marketplaces.

In order for the information to be useful, certain types of orders should be broken out and not aggregated, as each order type has different characteristics that would be distorted and would distort the reported figure to a degree that it would not be useful. For example pre arranged trades should not be reported with continuous market trades.

The CSA should also work with the industry to develop an appropriate data pricing model. A consequence of creating a multiple marketplace environment is that the costs for data generated by firms' trading on different marketplaces can spiral out of control. While we understand that the CSA is not in favour of a US style formulaic approach, some method of ascertaining and allocating fees in a fair manner must be developed.

CSA Question 7: Should the marketplace statistics focus on units of securities traded instead of orders and number of trades?

If the regulatory concern relates primarily to the small investor, it would be appropriate to have information relating to individual orders and the number of trades.

CSA Question 8: Should the marketplace statistics require separate reporting on specific order types that would include market orders, intentional crosses, and prearranged trades?

This is not necessary. Market orders, limit orders, good till cancelled orders and day orders should all be treated in the same manner once they become executable.

CSA Question 9: Should the focus of the liquidity measures be the number of orders or the cumulative number of shares?

Liquidity is most often equated with the number of shares at a price point, and should be measured that way.

CSA Question 10: Would it be useful to have information about partially or fully hidden liquidity that is available on certain marketplaces? If so, what measures of that liquidity would be most informative?

As noted above, liquidity measured on the basis of number of shares at the particular price points is an appropriate measure.

CSA Question 11: Would it be useful to include reporting similar to the near-the-quote orders required by the SEC in the United States? What price increment away from the quote would be appropriate to use for the Canadian market?

In practice, this is not feasible. Only small "held" retail orders are displayed, and there are so many "hidden" orders that looking at depth of market provides little or no information.

CSA Question 12: Are statistics regarding average realized and effective spreads useful without a consolidated best bid and offer?

No. The only effective way to gauge the quality of one firm's markets and executions in relation to others is if all market participants are judged vis-a-vis the same inside market or NBBO.

CSA Question 13: Are the time frames used to assess speed and certainty of execution on a marketplace in section 11.1.1 of NI 21-101 appropriate? If not, what time frames should be used?

As noted above, although dealers measure execution quality in fractions of seconds, the important measure is how marketplaces are performing in relation to each other.

CSA Question 14: In addition to the proposed reporting requirements for marketplaces, would other information, such as the following, be useful to dealers or advisors to assess best execution:

(a) a breakdown of the information by order size (i.e. 100-499 shares, 500-1999 shares, 2000-4999 shares, 5000 or more);

(b) the proportion of time that a marketplace had orders that were at the best bid or the best ask;

(c) the proportion of trades (in number of shares or number of trades based on our decision) executed inside the best bid and ask price?

IIAC Members did not express an opinion on this issue.

CSA Question 15: Do you agree that an information processor should disseminate consolidated trade information along with a feed that contains the best bid and best offer and all orders at all price levels (along with the marketplace identifier/marker)? For practical reasons, should the price levels be limited? If so, to how many levels?

It is imperative in a multiple marketplace environment to have an information processor that reports all the information, in order to provide market participants with the essential data for compliance with the trade through obligations. It is a critical tool to determine where to place orders. The information provided by the processor would form the benchmark; as it would assure that all participants have the same information. In choosing a designated information processor, the CSA must ensure that the candidate have the appropriate technological capacity to deal with the complexities inherent in a multiple marketplace environment. There have been many technological developments and the market participants have discovered new requirements since the CSA initially published its application for information processors. These developments and requirements must be taken into account when designating the information processor. In addition, it is critical that there be appropriate governance mechanisms to ensure that the information processor acts in the best interests of the entire market, and that there are not inherent conflicts of interest which would favour certain entities.

Currently, without a consolidated information processor providing information for all price levels, compliance with trade through or best price obligations is not possible for full depth of book. Until such information is provided to all market participants, only top of book is manageable.

IIROC Amendments to UMIRs

We have responded to the IIROC request for comments on their proposed amendments to the UMIRs resulting from the creation of a CSA trade-through obligation. We are very concerned with the proposed supplement to the CSA anti-avoidance provision with one that specifically protects better priced orders on a marketplace when a participant is considering a trade on a foreign organized regulated market.

If this specific obligation is introduced to foreign markets, there will be significant problems in developing systems to comply or monitor this. There are a number of issues that do not necessarily apply to transactions on Canadian marketplaces. For instance, the issues surrounding exchange rates raise a number of questions, including what rate applies, where is the foreign exchange conversion done, at what time in the transaction, and who is exposed to the foreign exchange risk from the trade time to conversion. Even if systems could be designed to comply with this requirement, the benefits of implementing this provision would be marginal, as in practice, arbitrage activity narrows this spread to an insignificant amount in virtually all client orders requiring protection.

There is also the issue of the lack of a consolidated feed for foreign markets as well as questions relating to whether fees are taken into account. In many cases the costs of undertaking a trade on a foreign market may be less, but this may not be able to be considered under the proposed provision.

This provision would also create regulatory asymmetry, as foreign regulators do not have such provisions. Domestically it also creates a non level playing field in respect of IIROC members and those regulated by the CSA or other SROs.

Conclusion

We appreciate the opportunity to comment on this important regulatory instrument and look forward to participating on the working group to assist in identifying and resolving implementation issues. If you have any questions or comments, please do not hesitate to call.

Yours sincerely,

cc:

British Columbia Securities Commission
Alberta Securities Commission
Saskatchewan Financial Services Commission
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
New Brunswick Securities Commission
Registrar of Securities, Prince Edward Island
Nova Scotia Securities Commission
Superintendent of Securities, Newfoundland and Labrador
Registrar of Securities, Northwest Territories
Registrar of Securities, Yukon Territory
Registrar of Securities, Nunavut