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

April 12, 2011

Mr. Jacques Tanguay
Vice-President, Regulatory Division
and
Mr. Anthony Tamvakologos
LOPR Participant Coordinator
Bourse de Montréal Inc. (the Bourse)
Tour de la Bourse, P.O. Box 61
800 Victoria Square I
Montreal, Quebec H4Z 1A9

Dear Messrs. Tanguay and Tamvakologos:

Re: IIAC Member Concerns with Large Open Position Reporting (LOPR)

We are writing on behalf of the members of the Investment Industry Association of Canada (IIAC or Association) to raise concerns regarding implementation of Large Open Position Reporting (LOPR), which is scheduled to be implemented on July 25, 2011. The IIAC is the professional association representing 200 investment dealers in Canada. Our mandate is to promote efficient, fair and competitive capital markets for Canada and assist our member firms across the country.

We appreciate speaking with both of you and Mr. Barillo on April 7, 2011 and are following up on our conversation. While the additional information made available was helpful, a further meeting will be very useful to more quickly address concerns, which fall into the following four categories:

1. While we accept it is late in the process to reflect on this, is the purpose of the additional information being sought by the Bourse reasonable based on evidence from the Canadian marketplace?
2. How can issues regarding privacy, confidentiality, information security, etc. be fully addressed?
3. Is there a more straightforward, cost-effective and accurate way to obtain and report the data?
4. What adjustments can be made to the implementation timeframe to reflect the challenges, of which the Bourse may as yet be unaware, in the reporting required?

Note: Our comments below focus on options as a number of our members do not deal in futures, however, futures reporting will present generally similar problems for firms that trade in futures.

1. Purpose

An April 22, 2010 Bourse de Montréal Inc. circular referenced the intention to implement LOPR changes in the coming months for security and automation purposes, which our members support. It said that the current process would be gradually phased out and that it was possible that some additional identification information would be required.

Documentation made available subsequently did not provide clarification regarding how the changes tied in to the Bourse's regulatory purpose (as different from efficiency goals). While we understand that the general reporting requirements have been in the Rules for many years, and that the requirements are similar to what have been in place for some time in the U.S., our members report that they have not had to file LOPR reports directly in the U.S., and that the U.S. firms through which our members clear do not have the members' client SIN or address information nor the roll-up at the beneficial level that the new LOPR reporting requires. As well, our members are not aware that the information they are submitting at present has provided evidence of any material issues to the Bourse under the current reporting system, or that the reporting has enabled the Bourse to address areas of regulatory concern.

For our members, options trading represents at most 2%-3% of their business, and trading in Bourse-listed options typically comprises less than half of this amount thus evidence of some regulatory goal is important as reporting technology available from U.S. vendors and service providers that facilitate the requirements in the U.S. is not directly transferable to the Canadian context. Also, while Canadian service providers may believe that they will be ready for the July 25, 2011 launch for one of the options, we believe that such solutions do not address the full range of concerns expressed by our members. ***For these reasons, we would appreciate understanding specifically what regulatory goal(s) is(are) being pursued and what benefits reporting to date has provided.***

2. Privacy, Confidentiality and Security Concerns

Privacy

As indicated in our conversation, our members have concerns with the legality of providing certain information as required under the Bourse rule given that this could expose our member firms to the risk of non-compliance with Canadian laws. The request for firms to provide account owner ID information, such as the client's social

insurance number (SIN), social security number (SSN) for U.S. clients or any number for a foreign individual appears contrary to federal privacy legislation under the *Personal Information Protection and Electronic Documents Act* (PIPEDA), as well as provincial privacy legislation, and, in the case of SINs, the federal *Income Tax Act* (ITA).

PIPEDA currently defines personal information as "information about an identifiable individual but does not include the name, title, business address or telephone number of an employee of an organization." Section 7(3) indicates that an organization may only disclose personal information without the knowledge or consent of an individual if the disclosure meets one of the exemptions listed. In our opinion, providing information such as a client's SIN, SSN or other individual number is information about an identifiable individual and does not fit into one of the exemptions listed in Section 7(3) of PIPEDA. As such, providing this information to the Bourse under the LOPR requirements would violate the legislation. We believe that it is for this reason that the Financial Transactions and Reports Analysis Centre of Canada (FINTRAC), which receives, analyzes, assesses and discloses financial intelligence on suspected money laundering, terrorist financing and threats to the security of Canada, specifically says that SINs are "not to be provided to FINTRAC on any type of report" (Guideline 6E: Record Keeping and Client Identification for Securities Dealers; http://www.fintrac-canafe.gc.ca/publications/guide/Guide6/6E-eng.asp#441).

During conversations with the Bourse, it became apparent that only the last four digits of the SIN need be provided to the Bourse. We appreciate this effort to address our members' concerns, but a number of our members have determined that, since such information is only required to be provided for those trading futures and options, the pool of individuals is reduced from the general pool of those trading general securities and therefore this could be considered a contravention of PIPEDA to the extent that the last four digits of a SIN may be enough information to identify an individual. At the same time, we believe that this option could cause potential residual identification issues where two or more clients have the same last four-digit identifier.

Given the analysis as set out above and the Bourse's intention also to require address information, our members did not feel it would be appropriate to provide this information to the Bourse to be used as a unique identifier. We now understand that the Bourse has an external opinion regarding the acceptability, from a privacy perspective, of using the last four digits only. ***Our members would appreciate receiving a copy of the opinion and may have further questions, including as regards the Canada Revenue Agency's (CRA's) views on the use of a partial SIN for other than tax purposes.***

Confidentiality of Information Transmitted

Our members have a number of concerns regarding the transfer of client data to the Bourse from their in-house electronic systems, which are required to comply with the LOPR requirements. The new information that is to be provided is highly sensitive for our members and has a higher security classification than trading data alone. We understand that the Bourse's security and audit policies used for the Bourse itself will apply. ***Due to the need to meet compliance requirements and be subject to regulatory examination, including on matters of confidentiality, our members would appreciate a summary of those parts of the Bourse policies that will apply to the exchange of data so as to satisfy our members' compliance/internal control departments that the data will be appropriately secured in transit and within the Bourse.***

We understand that in terms of security of the data in transit the Bourse uses a "private network connection." ***We would appreciate further clarification as to what type of connection this is, as the type of connection could affect the security provided.***

With respect to graphical user interface (GUI) access, our members have questions regarding authentication and authorization. ***We would appreciate further details as to how individual users are authenticated and authorized, and a description of the security measures used for any transmission of information between firms and the Bourse using the GUI option.***

In addition, our members are responsible for the destruction of confidential data relating to each client when the data is no longer needed. ***IIAC members would appreciate information as to how data will be destroyed after the retention period ceases and what evidence will be provided to members to allow verification of this.***

Finally, a usual course of action in circumstances where information is transmitted to a third party is to have the third party sign a confidentiality/non-disclosure agreement. ***We suggest that this may be appropriate under the circumstances and welcome your views on this.***

3. <u>Systems and Procedural Issues</u>

Currently reporting frequency is weekly and manual; a move to automated, more frequent filing makes sense conceptually, however, there are a number of impediments that make this difficult and should be addressed.

Reporting Timing

Technical Notice 11-003 states that the reporting time deadline is 9:30 p.m. on the same day as the transaction takes place, which would be unworkable from a systems

perspective as the service providers used by our members engage in overnight batch processing and, as such, this reporting would not be completed until the following day. We are pleased that this has been recognized by the Bourse, however, even an 8:00 a.m. report is problematic at the present time for member firms.

In this regard, we suggest that the Bourse consider the extensive analysis undertaken some years ago by the Canadian Securities Administrators (CSA) and industry with respect to National Instrument (NI) 24-101 – Institutional Trade Matching and Settlement, which proposed same-day matching of a significant majority of institutional securities trades. The analysis concluded that NI 24-101 would require a move from batch processing, which was also found to be not cost-justified by the reduction in risk, and the size of the institutional market for our members is considerably larger than the Bourse-listed options market. ***For these reasons, the Association strongly recommends a time frame for LOPR reporting consistent with that set out in NI 24-101, namely, to no later than noon on the business day following trade date (noon on T+1), at least at inception of the new LOPR requirements.***

This will be a significant improvement over the current reporting for Bourse purposes. Once the new requirements are fully in place, there could be discussion of shortening the timeline to a reporting deadline earlier in the day. NI 24-101 target thresholds, for example, were phased in over time with less overall industry disruption.

On a final point, we understand that U.S. regulators do not require reporting in instances where there are no positions to report (the U.S. regulators instead accept a report from the member participant that no longer has any positions to report and provides a final report showing positions going under the reportable threshold; the member participant is not required to report again until positions have reached reportable thresholds in the future. ***We suggest that this be considered as a way to reduce unnecessary reporting.***

Expanded Disclosure

Beneficial ownership: Approved participants must take into consideration (aggregate) all open positions held in all accounts owned or controlled by a client. Our members are not certain how 'control' is to be defined and, more importantly, there is currently no business or other regulatory purpose of which IIAC members are aware for which accounts are required to be aggregated in this manner, particularly in terms of aggregating corporate with personal data. For example, there is no requirement for beneficial owner aggregation in terms of the holding of stocks, bonds, mutual funds. Notably, FINTRAC does not require beneficial ownership information to be stored electronically, nor that all of the records of any beneficial owner be linked together, thus any effort for IIAC members to link will be fully manual, which increases the risk of human error.

FINTRAC, whose regulatory goals – like the Bourse's – are in the public interest, requires efforts to verify the identity of beneficial owners on corporate accounts, but recognizes that this may not always be immediately possible. As noted above, to the extent that there are beneficial ownership roll-up requirements in the U.S., they appear not to have been extended through to the underlying clients of those of our members trading through U.S. firms.

We understand that a circular is being prepared to clarify that corporations and partnerships will be reported as separate entities as the intention is only to combine individuals with their registered companies and that when an individual has a personal and a joint account, the two should be aggregated as 100% of each account (leading to some over-reporting).

The Bourse also mentioned that every account that is more than 50% beneficially owned by the same person or entity will need to be aggregated, however, percentage beneficial ownership data by control may not exist, for example, in the case of joint accounts of spouses. Furthermore, linking wholly-owned corporations to individuals is very challenging and linking corporate entities with multiple beneficial owners, each with varying ownership proportions, is next to impossible as far as we are aware by current service providers. Additionally, it is noteworthy that, in instances where the economic or beneficial ownership is shared, control over the account or positions may not be shared to the same extent or ratio as the economic interest. This is evident in the current reporting regime imposed by the Commodity Futures Trading Commission (CFTC) and Chicago Mercantile Exchange (CME), where the focus is on control more so than pure economic ownership. Also, staff at the Options Clearing Corporation (OCC) could not confirm that U.S. regulators require aggregation of beneficial owners to the extent that certain communications with the Bourse have led some of our members to believe.

We recommend that, to start, the requirement be to link accounts of the same individual or same business number while further discussion on how control (as different from ownership) is to be determined and what account types to link takes place. Then, to the extent that there is a requirement to aggregate individual accounts with other individual or business accounts that a holder may 'control', before operational and systems changes can be undertaken we request the Bourse to provide succinct guidance on what should be aggregated.

Who reports: The requirement for introducing brokers (and other non-clearing broker Bourse approved participants or foreign approved participants) to report directly and for clearing brokers not to report for these entities may prove challenging for some members. Thank you for providing detail regarding the ways in which introducing and clearing brokers can work with each other. ***Our member may have further questions in this regard.***

Definitions

Account owner types: We understand that the multiple account-holder break-down is required to help the Bourse with its risk analysis – for example, because the risk of a retail client differs from that of an algorithmic trader which differs from that of a financial institution – however, definitional clarifications are required. Information is captured and classified in different ways on different account documentation forms and at present a number of the proposed categories are not captured at all (e.g., the category titled 'proprietary firms primarily algorithmic'). Moreover, despite know-your-client (KYC) requirements, it would be inappropriate for the approved participant to determine a client type on behalf of the account-holder if this has not been done so for other purposes. We believe that there is a need for the adoption of well-defined industry-wide standards. ***We recommend that the Bourse use the same classification as that found in the 'Joint Regulatory Financial Questionnaire and Report', the content and format of which has been agreed to by a number of Canada's self-regulatory organizations (SROs)***, ***including the Investment Industry Regulatory Organization of Canada (IIROC) and the Bourse. To the extent that this is not possible as a way to enhance the consistency and take advantage of coding logic that already exists, we would like to discuss clearer instructions and a more straightforward list of categories.***

Speculative vs. hedging: A field for speculation vs. hedging use does not currently exist in member systems to our knowledge. If this information is captured informally, it would almost certainly be exclusively in manual form. If captured in an electronic format for other reporting purposes (e.g., for compliance purposes, where hedging and speculation in futures trading attract different capital requirements), it is not currently in a format from which usable information can easily be extracted for LOPR reporting purposes. Also, clients may not want to signal their intentions. ***Should the information nevertheless be required, our members would like to discuss a clear Bourse notice of why the information is being requested and how it will or could be used, to allay client concerns that this information may lead to differential pricing or penalties. As well, we would like to suggest that the default not be set to speculator as planned and that a dropdown option of N/A or blank be added.***

The original Bourse circular said that it was not contemplated that a change would be made to the current reporting thresholds (number of gross open positions above which positions must be reported). Our members generally do not consider 250 contracts, the current reporting limit, to be 'large' in the sense of being of regulatory concern. ***We would like to discuss whether the minimum reporting threshold should be raised, and tiered for retail and institutional clients in keeping with already established self-regulatory organization (SRO) risk-based guidelines and practices***

Systems Issues

Systems issues are complicated as they affect not just the clearing and introducing brokers, but also their service providers, such as Broadridge (Brokerage Processing Services), Broadridge (Dataphile) and IBM, however, as far as we know, none of the providers contacted have identified a straightforward systems-based way to make the necessary technology changes to provide some of the data required (e.g., roll-up by beneficial owners). As mentioned above, there are considerable issues surrounding the identification of beneficial owners operationally, and this also applies from a systems perspective where an owner is a part owner of a position. Also, with respect to account owner categories requested, there has been no demand for service providers to provide fields for such a breakdown and this would require not only processes and procedures to gather some of the missing information, but also systems programming.

Addresses: The reporting of addresses always presents a challenge to the extent that addresses must be matched for aggregation purposes. Despite efforts to ensure structured addresses (e.g., not just two lines for addresses, but a separate field for street number, street, apartment number, drop downs for east/west/north/south, etc.) and the existence of parsing logic, getting to "clean" data is a manually iterative process when data does not match although there is less of a concern regarding the typical Canadian- or U.S.-based resident. This is further complicated when an account has multiple holders, and addresses for the second, third and other holders are in free- rather than structured format. When the data is unstructured, particularly in the case of foreign addresses, it will be more difficult to compare and aggregate accounts. Also, an approved participant's own inventory accounts generally have no identifier or address, which will have to be addressed by firms.

Country codes: The International Organization for Standardization (ISO) allows the use of both two and three-character country identifiers. While two digits are used as country identifiers for internet and numbering purposes including in technology-intensive infrastructure providers such as those that the Bourse noted, in Canada three-letter identifiers are used in members' client address databases, including for CRA XML filing, FundSERV and, for example, Canada Post requirements. They are also more straightforward for members' dispersed clerical staff doing data entry as they are more easily identifiable as the countries to which they relate (e.g., what country is AS?). ***As the country identifiers are to be used for address purposes, we strongly advise acceptance of three characters for country abbreviations***. ***While Bourse project staff have now advised that this is a not an option, we believe that it makes considerable economic sense for one organization to make a change instead of the majority of, if not all, approved participants and their service providers.***

Account IDs: With respect to required versus optional fields, we noted above that there may not be addresses or account owner ID numbers in some cases, although these fields should be completed over time. ***Our members therefore believe that the***

GUI and SOLA Access Information Language (SAIL) reporting logic should not make completion of the address field or account owner ID field mandatory/required until it can be determined that there is a number, letters or "dummy" in that field for all accounts and we hope that there will be discussion between the Bourse and industry representatives of any account owner ID standardization for non-Canadian, non-U.S. persons. Bourse officials can run reports periodically to ensure that the number of incomplete fields is proportionally small (typically, a firm may verify/check and update data once a year, approaching year-end in preparation for tax reporting).

Reporting options: The two proposed solutions are either technologically intensive thus costly (using the MX proprietary SAIL protocol, rather than, say, the FTP or SFTP services that CFTC, CME, and the OCC accept for LOPR filing) or manual (the GUI approach, which requires an employee of the member participant to upload a file or select a function to declare that there are no positions to report). As the final GUI documentation was provided only on March 31, 2011 and given the outstanding issues and technical concerns noted above, our members are unable in most cases to make a valid determination on whether they would prefer to adopt the SAIL or GUI approach. A number are looking at adopting the GUI solution and then moving to a SAIL solution due to the implementation date, which is undesirable. ***As noted below, additional time would allow firms that might like to use SAIL to do so without the cost of an interim GUI solution.***

4. Implementation Date

While advice of the LOPR was sent in April 2010, material work on development, as you can appreciate, only begins once business specifications have been provided and analysed. The first business design and specifications guides were received almost nine months after the initiative was first announced (without industry input), with additional required information being received as late as March 31. Once specs are available, work must be then be scheduled with competing demands within firms for systems development for CRA, CSA, SRO, other regulatory, and business purposes, with available resources increasingly in demand as regulatory changes continue to expand at a rapid pace

Under the best of circumstances, the issues described above – the extent of the additional data required, the change required to back out reporting from existing clearing broker systems and to start reporting for introducing brokers, the unresolved privacy and confidentiality issues, and the need for answers to other outstanding questions – suggest to us that it would be prudent to undertake further discussions.

While we understand that a small number of service providers have advised that they can meet the July 25, 2011 implementation date, we have been told by many firms that none of the existing books-and-records service providers to IIAC member firms have developed the more comprehensive technical solutions beyond a simple

interface to help meet the Bourse's proposed reporting requirements. Moreover, systems changes do not need only to be made on the service provider front; considerable operational, compliance and other changes must be made by the firms themselves although answers are still outstanding.

We hope to discuss with you balanced implementation of changes in a way that meets the needs and abilities of both the Bourse and its approved participants and, in an ideal situation, in a way that involves the various service providers, in the same manner that changes are made with industry input to systems of other key infrastructure providers such as CDS and FundSERV. ***To enable this to happen, we respectively request that the implementation timelines be extended by at least six months into the New Year (almost all companies have systems freezes over year-ends) to accommodate resolution of the issues set out in this letter and provide firms with the opportunity to develop systems cost-effectively to comply with the new requirements. Alternatively, the additional reporting could be phased in based on the results of joint discussion.***

We would be pleased to discuss these matters further and would like to meet as soon as possible given the tight timelines for implementation. We would be pleased to host a meeting at our Toronto offices.

We would also welcome discussions more generally on ways to work together during the business requirements and specifications development phase so that key challenges can be addressed mutually, facilitating planning and smoother implementation in future.

In the meantime, if you have any questions, please contact Deborah Wise at 416-687-5472 or Barbara Amsden at 416-687-5488.

Yours truly,

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