



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

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Via Email: sguptabhaya@iiroc.ca, marketregualtion@osc.gov.on.ca

June 26, 2017

Sonali GuptaBhaya
Director, Market Regulation Policy
Investment Industry Regulatory Organization of Canada (IIROC)
Suite 200 – 121 King St. W
Toronto, Ontario M5H 3T9

Market Regulation
Ontario Securities Commission
Suite 1903, Box 55
Toronto, Ontario M5H3S8

Dear Ms. GuptaBhaya:

Re: Proposed Amendments Respecting the Reporting of Certain Trades to Acceptable Foreign Trade Reporting Facilities (Proposed Amendments)

The Investment Industry Association of Canada (IIAC) appreciates the opportunity to comment on the re-published Proposed Amendments. We continue to appreciate the objectives of the Proposed Amendments – ensuring large orders have access to certain liquidity pools in the U.S. and to accommodate trading practices by mitigating certain impacts posed by FORM Guidance. However, as currently drafted, the Proposed Amendments still do not address FORM Guidance’s impact on retail investors. We believe IIROC’s policy objectives can be achieved without negatively impacting long-standing retail trading practices.

Policy Objectives

In IIROC Notice 16-0082, IIROC stated that it believes the FINRA Trade Reporting Facilities (ORF or TRF)¹ are sufficiently similar to marketplaces in Canada, based on its research into the regulation of those

¹ Over-the-Counter Reporting Facility (ORF) and FINRA/Nasdaq Trade Reporting Facility and FINRA/NYSE Trade Reporting Facility (collectively TRF)

marketplaces, and that “allowing certain trades to be reported to those facilities would not contravene the policy objective of the FORM definition”. Therefore, there would be no disadvantage to allowing trades of any size to be reported on those marketplaces. It is not clear why if those trading facilities are deemed acceptable that they should only be available to investors trading over 50 standard trading units (STUs) and \$100,000 in value. In IROC Notice 17-0111, IROC stated that it does not distinguish between retail and institutional investors, but that allowing all trades to be reported to an *acceptable* trade reporting facility, regardless of size or value, would not meet the policy objective of ensuring that large orders have access to liquidity in foreign markets. That statement does not explain how access to ORF or TRF, which have been deemed acceptable trading facilities, by smaller investors would prevent or limit access for larger orders or in any other way contradict or impede IROC’s policy objectives for larger orders. Furthermore, IROC has not articulated any investor protection issues or market integrity issues with respect to the use of ORF or TRF facilities for retail/smaller investors. We ask IROC to explain the policy rationale in its differential treatment of investors.

Unresolved Retail Investor Challenges

In addition to the concerns outlined below, the IIAC’s 2016 Response Letter is attached as Appendix A. We believe the retail concerns put forth are still relevant and should be considered.

The Proposed Amendments still do not consider Canadian investors who maintain U.S. currency investments trading inter-listed securities who may be subject to a foreign exchange charge if routed to a Canadian marketplace (e.g. situations where the Dealer Member is not certain of an execution on a U.S. FORM). Investors who want to settle a trade for an inter-listed security in U.S. currency will be subject to a foreign exchange charge. Canadian investors should be able to direct orders of inter-listed securities originating from a U.S. currency account in reliance of Best Execution rules. We support disclosure of order handling practices that apply to client directed orders. Knowledgeable Canadian investors would, given the option, settle inter-listed trades in U.S. currency with better execution quality and lower costs on the ORF and TRF.

Generally, Canadian investors with retirement investments (e.g. snowbirds) who may also be self-directed traders, do not trade large block-type orders or execute trades originating from derivative-related contingent orders. Canadian investors who trade inter-listed securities originating in U.S. currency, for the purpose of retaining U.S. currency, are disadvantaged by this policy.

Clarification Required

We request clarification as to whether trades for 50 STUs and over \$100,000 reported to an ORF/TRF would be subject to the Order Protection Rule.

While we acknowledge and understand that "bundling" of individual client orders to achieve 50 STUs and \$100,000 in value is not permitted, we seek clarification regarding if one order that would be filled in increments to meet the dollar value requirement is permissible. For example: one "order" with an initial

value of greater than \$100,000 and greater than 50 STUs that trades in increments of less than \$100,000 (e.g. \$50,000 + \$50,000 in value) until the full order is filled completely. Does IIROC's policy intend to enforce that "trades" reported to acceptable FTRFs must execute greater than 50 STUs and \$100,000 immediately, or can an "order" for greater than 50 STUs and greater than \$100,000 (with the intention/expectation of an immediate execution) be directed to an acceptable FTRF? We are concerned that an "order" for greater than 50 STUs and greater than \$100,000 routed to an acceptable FTRF and subsequently executed as multiple trades of less than \$100,000 per trade could be contrary to IIROC's proposed policy.

While understanding the importance of liquidity needs for institutional investors, we cannot overlook the impact to retail investors who seek quality execution. We appreciate your consideration of the IIAC member concerns outlined in this Response and the 2016 Response and we look forward to continued dialogue on this issue.

Yours Sincerely,

"Adrian Walrath"

Appendix A

2016 IIAC Response Letter

(begins on following page)

Naomi Solomon
Managing Director
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Via Email: sguptabhaya@iiroc.ca, marketregulation@osc.gov.on.ca

June 20, 2016

Sonali GuptaBhaya
Director, Market Regulation Policy
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Suite 2000 - 121 King St. W.
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Susan Greenglass
Director, Market Regulation
Ontario Securities Commission
Suite 1903, Box 55, 20 Queen Street West
Toronto, Ontario M5H 3S8

Dear Ms. GuptaBhaya and Ms. Greenglass:

Re: Proposed Amendments to UMIR – Acceptable Foreign Trade Reporting Facilities (“FTRF”)

The Investment Industry Association of Canada (IIAC)¹ appreciates the opportunity to comment on the above-captioned proposed amendments to UMIR (“Proposed Amendments”). We are pleased to see that IIROC has taken into consideration, in part, our previous comments on the impact of the guidance issued without prior consultation in December, 2014, regarding the definition of Foreign Organized Regulatory Market (“FORM”). The introduction of an exception under UMIR 6.4 to allow large trades to be reported to a FTRF mitigates the challenges posed by the FORM guidance with respect to access to liquidity and the impracticality of changing long-standing institutional trading practices.

¹ The IIAC is the national association representing the investment industry’s position on securities regulation, public policy and industry issues on behalf of our 138 investment dealer member firms (“IIAC Members”) that are regulated by IIROC. These dealer firms are the key intermediaries in Canadian capital markets, accounting for the vast majority of financial advisory services, securities trading and underwriting in public and private markets for governments and corporations that is fundamental to economic growth.

While the Proposed Amendments support the principle of market efficiency for institutional order flow, we remain concerned that market efficiency for retail flow is compromised by the FORM guidance. If the original policy reason for requiring executions to take place on a FORM is negated due to the current view that regulation over FTRFs and marketplaces in Canada is sufficiently similar, then there is no contravention of the original policy objective of the FORM definition by allowing either retail or institutional trade flow to be reported to a FTRF. It would also be inconsistent to apply the FORM guidance as a means to preclude reporting trades to a FTRF which are not subject to price-improvement under UMIR, when executions on a non-transparent FORM are permitted but similarly not subject to price improvement, and given the intention in any event to withdraw the proposed anti-avoidance provision².

Regulatory intervention in long-standing retail trading practices by application of the FORM guidance will weaken retail trading market efficiency and should not be implemented without a clear benefit which outweighs this cost. We therefore recommend that IIROC inform any consideration of trading restrictions with the review of data respecting retail southbound order flow to better understand its scope and market impact, in order to avoid unintended negative consequences for retail investors.

Clarification of Proposed Amendments

To understand how the Proposed Amendments would operate in practice, we query whether the bundling of orders to achieve the trade size threshold would be acceptable. In addition, we believe that a “basket trade” or basket of orders should be allowed to meet the trade size threshold given basket trading’s importance for institutional investors.

We are also unclear about the impact of reporting trades to a FTRF with respect to trade-through obligations. Under UMIR 6.4(3) (and as further reflected in Policy 5.1 Part 4), the exemption for trading on a FORM is not available to orders for Canadian accounts denominated in Canadian funds that are part of an intentional cross, pre-arranged trade, are for more than 50 standard trading units, or which have a value of greater than \$250,000 if the entry of the order on a FORM would avoid execution against a better-priced order on a marketplace. It would appear that large trades reported to a FTRF should be subject to the same trade-through obligations.

Finally, we do not believe that more order flow will be driven southbound if no minimum size requirement is applied to contingent orders related to derivative transactions, as where these transactions are executed is driven by the currency of the derivative.

Unaddressed Retail Trading Challenges

Retail accounts denominated in USD

² See IIROC Notice 15-0277 – *Proposed Provisions Respecting Best Execution*, at page 17.

Retail accounts denominated in U.S. dollars (USD) ought to be excluded from the application of the FORM guidance. A retail client directing trades of inter-listed securities to the U.S. should not be prejudiced from accessing lower cost FTRFs in favour of FORMs at higher cost or be obliged to trade on Canadian marketplaces contrary to instructions and at higher cost due to a technical restriction which no longer has an applicable policy foundation. Client-directed trading to the U.S. would further not qualify as “systematic routing” of retail order flow, whether ultimately reported to a FTRF or executed on a FORM. As such there is no clear policy rationale advanced by prohibiting USD accounts from accessing FTRFs.

Ultimately, undesirable outcomes may follow if non-Canadian retail clients with USD accounts are no longer able to be accommodated through competitive costs and immediate executions and they turn to U.S. broker-dealers; or if Canadian retail clients with USD accounts are harmed should best execution not be achieved for their U.S. orders. There is no reason that a client with a USD account should be deprived of best execution which they also expect for their U.S. orders, and be placed at a disadvantage by prohibiting access to the best priced and most certain liquidity in the U.S. market.

Retail Market Orders Submitted Outside of Regular Trading Hours

A segment of retail market orders for inter-listed securities is submitted by clients for execution before or after traditional Canadian market trading hours. To achieve best execution for these immediately tradeable orders, some dealers’ best execution policies permit consideration of trading opportunities on other trading venues rather than holding the order until all marketplaces or the principal or the primary market is open for trading in Canada. Since there is more limited liquidity outside of regular Canadian trading hours, reporting trades to FTRFs is also considered so as not to compromise the dealer’s ability to find the best price and obtain best execution for retail clients who are also sensitive to factors such as speed and certainty of execution.

A complete restriction on executions reported to FTRFs through the FORM guidance would unreasonably impair dealers’ ability to achieve best execution for retail clients’ immediately tradeable orders in periods when domestic liquidity may be more limited. While IIROC has indicated that there is a need to balance the effects that an “increase” in order flow to the U.S. would have on the health of Canadian markets, this balance is not achieved through an absolute restriction on consideration of FTRFs for all retail order flow, especially in periods when domestic liquidity is more limited. In addition, the diversion of any of this order flow to be reported to an FTRF would not comprise “systematic routing” of order flow to the U.S. in circumstances where the dealer is considering other sources of liquidity and employs legitimate criteria for its retail routing strategy for these circumstances to achieve best execution.

Order Exposure Rule and Retail Flow to FTRFs

The exception to UMIR 6.3 (the Order Exposure Rule) that allows a Participant to withhold a small client order from immediate entry on a displayed marketplace if the order is executed on a FORM should be expanded to include reporting to FTRFs for excepted small orders, if the FORM definition is not amended. This would allow the Participant to fulfill its best execution obligation by considering liquidity on all non-transparent venues, not only those that are FORMs.

Foreign Service Providers Handling Retail Southbound Flow

IIROC's expectation that Participants would rely on the UMIR 6.4(2)(d) exemption to execute retail trades on a FORM may be unrealistic for dealers that employ foreign service providers which deal with FTRFs to execute retail order flow in the U.S.. Canadian dealers' ability to transact in the U.S. may be curtailed altogether as a result of the lack of practical ability to avoid FTRFs. Effectively barring retail clients from participating in U.S. markets due to dealers' inability to continue long-standing retail trading practices in the U.S. will result in a disproportionately negative experience for retail investors.

In conclusion, while we appreciate the intention of the Proposed Amendments to support institutional market efficiency, the IIAC believes that retail market efficiency should also be supported as equally important to a healthy marketplace. We are concerned that inflexible regulatory intervention through strict application of the FORM guidance with respect to all retail order flow will not bring benefits to the Canadian market that are outweighed by its costs. We look forward to the results of the review of retail southbound order flow and would be pleased to continue a dialogue on these critical issues.

Yours sincerely,

"Naomi Solomon"