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Dear Ms. GuptaBhaya:

Re: Proposed Provisions Respecting Best Execution (the "Proposed Provisions")

The Investment Industry Association of Canada (the "IIAC" or the "Association") appreciates the opportunity to comment on the Proposed Provisions.

The Association supports the development of a clearly articulated regulatory framework that sets out firms' obligations with respect to best execution. The regulation and enforcement of the best execution requirement has significant impact on firms, from an operational, compliance, efficiency, cost and client service perspective. It is critical that this framework sets out the regulatory expectations, while recognizing the differences between firms' business models and resources, and providing firms with flexibility on how to achieve best execution in specific circumstances.

The IIAC is concerned that the Proposed Provisions have been developed based on many of the policies and procedures in place at large integrated firms with significant resources and capacity to develop, test and monitor, detailed and comprehensive processes and procedures that require significant data input and analytic capabilities that are not available or practical for the many small and independent firms to which this Proposed Provisions would apply. The regulation should be developed to serve the client, while accommodating the spectrum of firms' business models and resources.

Furthermore, while we commend IIROC's objective to combine its Fair Pricing Rule for OTC securities with the existing UMIR best execution requirements in order to create a single Dealer Member Rule in regards to best execution and applicable to all listed and OTC Securities, we are concerned the drastic differences in the two markets make a singular approach impractical and unworkable. As such we recommend that IIROC reconsider this approach.

Policies and Procedures

While we support a principles and policy based approach to best execution, rather than regulation based on a trade by trade basis, we have a number of concerns about certain elements of the Proposed Provisions.

Non-Executing Dealers

In particular, the expansion of the scope of the regulation to include non-participants is potentially extremely problematic. The requirement for Dealer Members that employ another Dealer Member to provide execution services to have best execution policies and procedures will impose a significant and unreasonable burden on firms that do not have the resources or expertise to develop meaningful best execution policies or review the routing practices and outcomes of an executing dealer. By employing an executing dealer, the Dealer Members have structured their business in accordance with existing IIROC regulation governing Introducing and Carrying brokers, which contemplates that such dealers do not have the required resources or expertise to undertake this function themselves.

The Proposed Provisions are unclear on the scope of review that a non-executing broker is expected to undertake to ensure that its executing broker is achieving best execution consistent with the policies of the broker and the executing broker. Executing brokers currently have best execution policies and procedures to support them. It is reasonable for dealers to take measures to understand their executing brokers' best execution policies, determine if they are consistent with their policies, and obtain periodic confirmation that the executing broker has tested its systems to confirm that they are achieving best execution based on this understanding. It is important to understand that executing brokers do not have the ability to accommodate specific client driven best execution strategies. Beyond that, requiring these dealers to contract or

otherwise develop the expertise to create the requisite policies and undertake the review of their executing dealer is an unnecessary duplication of effort and will add significant costs to operations, with questionable benefits to the client and the industry in general. Furthermore, reporting currently provided by carrying brokers to the non-executing dealer does not contemplate this level of supervision, and would require extensive development and cost that would add to the burden on independent firms that rely on the services of executing brokers today.

The burden of this requirement will fall on small and mid-sized firms, for listed as well as OTC products, as they are the primary users of executing brokers. The difficult market conditions and the disproportionate effect of regulation on these firms has already resulted in a significant decrease in the number of small and independent dealers. Imposing another expensive and time consuming regulatory requirement on these dealers will certainly result in further reductions in the number of such dealers able to provide clients and issuers with an alternative to large sized firms.

The Notice in which the Proposed Provisions are published does not document existing problems with actual best execution for non-executing firms. Given the material costs of implementing the Proposed Provisions, the regulators should be able to provide clear evidence that there is a systemic or wide ranging regulatory problem in this regard, and that the requirements in the Proposed Provisions will solve this problem.

Prescribed Content of Policies and Procedures

In respect of section 3300.3, *Best Execution Policies and Procedures*, the wording of section (a) is overly prescriptive in stating that the policies must outline a process designed to achieve best execution, which includes an extensive list of items. Given that not all of these items will be relevant to all firms, we recommend that the language be amended to allow for flexibility in respect of items that are not relevant to particular firms.

The highly prescriptive requirements regarding what is to be included in the policies and procedures will be very difficult and onerous for firms to articulate in all required circumstances. Trading strategies can differ significantly based on the size and nature of different orders, the client, the type of securities involved, and the demand for particular securities. In addition, prevailing market conditions at the time of the trade will also influence the trading strategy. It is unrealistic to anticipate and document all of these variables into a written policy.

In particular, there are a number of provisions in section 3300.3 *Best Execution Policies and Procedures* that are unclear or difficult to translate into practice. For instance, in section 3300.3(a)(i)(A), it is unclear how best execution and the investment objectives of the client are connected, as in most organizations suitability and execution are separate functions. For institutional firms, investment objectives may not be known. Once the

decision has been made to execute then the objective should be to get the best price given liquidity restrictions.

In section 3300.3(a)(i) (B) it is unclear if firms are expected to publish all possible conflicts of interest. Members question how they might identify these conflicts prior to an actual trade being submitted for execution.

In respect of section 3300.3 (a)(iii)(A), it is not clear how long these records should be maintained. Presumably such records should be maintained until the client has accepted the price which should be 30 days after the delivery of the month-end statement, but this is not articulated.

In addition, we note that the mandated content of the policies in section 3300.3 (b)(ii)(B) and (F)(2) reference trading in a "particular security", which could be interpreted to place the requirement on a trade by trade basis in certain circumstances.

OTC Securities

Currently, dealers' best execution obligations in respect to OTC securities are outlined in IIROC Rule 3300 *Fair Pricing of Over-The-Counter Securities*, with further IIROC expectations detailed in accompanying Guidance Note 11-0257. In several circumstances, the language contained in the Guidance Note has been imported into the Proposed Provisions in section 3300. We are concerned this has the effect of introducing new requirements which in some cases are not aligned with current business practices. We are particularly concerned with proposed section 3300.3(a)(iii)(A), which could be interpreted to require dealers to maintain audio recordings as part of their OTC transaction records. The use of audio recordings is currently not a widespread industry practice and would be a large undertaking for dealers to adopt. It would also be unnecessary given other transaction records maintained by dealers. We request the wording in this section be changed as follows: "transaction records, which could include audio recordings that allow the Dealer Member to reconstruct the basis of on which an over-the-counter security transaction prices was determined to be fair."

We also ask for clarification on what the status of Guidance Note 11-0257 will be following IIROC's adoption of the Proposed Provisions and particularly whether it can continue to be relied on by Members or whether revised guidance will be issued by IIROC to better align with the revised rule.

The Proposed Provisions also lists four broad factors dealers are to consider for achieving best execution with respect to the execution of all client orders (listed and OTC). We believe that several of these factors have less relevance and are more difficult to interpret as it relates to OTC transactions.

One factor listed is 'prices & volumes of historical trading activity'. Whiles such information is easily observable and attainable for listed products, it is a considerably larger challenge for OTC transactions, and in certain instances such information may be very stale or non-existent. A second broad factor listed is "speed of execution", a term which we view as having less meaning in OTC markets where certain large orders or orders in thinly traded securities need to be worked carefully by the dealer, and are sometimes best measured in days and not minutes.

The above illustrates our general concern that the Proposed Provisions rest heavily on IIROC's experience with listed markets, and fail to consider some of the nuances associated with OTC transactions. The structure of OTC markets, and the way in which client indications are received and executed places a greater dependence on dealer judgement. We are concerned, therefore, that the prescriptive nature of the proposed rule could impair dealer judgement to the detriment of the client and efficient market functioning.

While IIROC's objective to create a single best-execution rule covering both listed and OTC products is commendable, we are concerned about the feasibility of this approach given the disparity of the two markets.

Testing and Review

The requirement to review and test the execution based on the detailed and prescriptive policies in the Proposed Provisions will be quite burdensome, particularly for small firms and those employing executing brokers. The degree of detail and the amount of data that must be collected and analyzed will require significant resources and expertise, some of which may not be currently available in Canada. Certain of these resources are currently available in the US, provided by their marketplaces, but not through marketplaces or vendors in Canada.

Section 3300.3(a)(iii)(E), which requires documentation by introducing brokers with respect to due diligence reviews of carrying brokers' prices against other possible sources is problematic. It is unclear if this only applies to introducing brokers, as this is the only time introducing brokers are specifically referenced in the document. Given that introducing brokers and other non-executing brokers do not generally have the internal expertise to carry out this due diligence, significant additional costs would be incurred to obtain data from different sources that the non-executing broker may not have access to today. The obligations identified within section 3300.3 (a) (iii) are already obligations of executing dealers, which are all subject to IIROC audit to ensure compliance. As such the benefit of the additional effort is not clear.

The result is that the degree of testing and monitoring the elements of best execution as mandated in the Proposed Provisions will require a significant developmental cost. For example the elements in section 3300.3(b)(i) dealing with the speed and certainty of

execution, as well as the overall cost of the transaction when costs are passed through to clients may not be available to dealers, or very expensive to access through various vendors. Given that the marketplaces have the data that would be required to develop the metrics and test the systems, it may be more effective to shift elements of the testing and monitoring costs to marketplaces.

Smart Order Router ("SOR") vendors may or may not release data regarding the performance of their routers. Currently, these vendors release this information only on a case by case, or reactive basis, where problems occur, but do not consistently provide results of any testing and monitoring. Such testing and monitoring does not appear to be done consistently, so requiring it to be done on a firm by firm basis for various types of orders and clients will require significant and likely expensive changes to the relevant systems. These expenses will no doubt be passed on to the firms.

From an executing broker perspective, in order to undertake testing and monitoring on a firm by firm basis, a solution must be developed that would require the non-executing broker to use a specific order entry system that may not be consistent with firm's business plan or operations. As stated above, it would be reasonable to expect non-executing brokers to obtain written confirmation from its executing broker that the executing broker has undertaken the appropriate monitoring and testing, and that it is achieving best execution consistent with its standards. It should not be incumbent on the executing broker to provide specific details and data to enable the non-executing broker to test but rather the non-executing broker should be able to rely on the confirmation of the executing broker that it monitors and has tested.

Disclosure to Clients

While we agree that a Dealer Member should define and document its best execution policies internally, we question the value add the average retail client will get from disclosure describing those policies in the detail prescribed by the Proposed Provisions.

In respect of the disclosure of firms' best execution policies to clients, it should be noted that most clients, in particular retail clients, are not interested in, or necessarily capable of understanding the detailed disclosure required in the Proposed Provisions. Given the expanded disclosure provided to clients under CRM2, providing an additional set of non-solicited disclosure compounds the vast amount of information given to clients, which may result in clients becoming overburdened with documentation and as a result, not reading any of it.

More specifically, while the requirement to describe the dealer's obligations under section 3300.2 and the factors considered by the dealer in achieving best execution are relevant to clients, many of the details required under section 3300.8 are not useful to clients in choosing the services of a dealer. Given that that dealers cannot foresee and articulate particular strategies for each trade in advance, the prescribed disclosure will

likely become generic boilerplate disclosure, listing marketplaces and standard industry entities employed by most dealers, and very general principles of achieving best execution.

Any differences in strategy between Dealer Members on routing to any of a marketplace, FORM or intermediary would be underpinned by the dealer's obligation to achieve best execution. Where a retail client, through a smart router achieves "best price", we question the value add to the client relationship on presenting a list of marketplaces the dealer member participates, since dealers effectively must have some sort of access to all relevant marketplaces under the Order Protection Rule. Furthermore, if executed on multiple marketplaces, the client currently may request the details on which exchange the trade was executed.

As to the intermediary disclosure, while we agree with the requirement on Dealer Members to review its outsourcing arrangements, including the use of any intermediary for order flow, we would submit that a disclosure/attestation to the client does not add additional value to the client relationship above and beyond disclosure of the obligation of achieving best execution.

Although certain disclosure such as the requirement in section 3300.8 (c)(vi) to disclose conflicts may be relevant to a client in making an informed decision, the requirement in general should not serve as a mechanism to educate a client on UMIR. For the average retail client, detailing how a Dealer Member achieves compliance with UMIR 6.3 would often be irrelevant, and where applicable, could not be detailed enough to add value to the relationship, as the application of the exceptions in UMIR 6.3 are trade and situation specific.

We would agree that it could be relevant for a client or prospective client to understand if the Dealer Member participates in afterhours markets or not. Conversely, if the Dealer Member's policy provides that moving an order from one marketplace to another supports best execution, we question the value add on disclosing the circumstances on when a Dealer Member may move an order from one marketplace to another above achieving best execution.

In respect of institutional investors and self directed clients, articulating a detailed policy is impractical, as frequently such clients direct the manner in which they want their order to be traded.

Training

The Proposed Provisions are not clear with respect to the types of employees to which the training requirement applies. For instance, it seems clear that it would apply to trade desk employees, but does it apply to investment advisors?

Other issues/questions

It is not clear whether the best execution policies and procedures, testing and disclosure requirements apply to trades undertaken on other markets.

Yours sincerely,

Susan Copland