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Attention:

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Re: IIROC Fee Model Guidelines – Amendments

The Investment Industry Association of Canada (IIAC or Association) appreciates the opportunity to provide comment on IIROC Notice 14-0096 (the Notice) detailing proposed changes and clarifying amendments to IIROC Fee Model Guidelines. The IIAC acknowledges that IIROC has issued the Notice, in part, to address concerns brought to IIROC's attention by Dealer Members. An industry working group of IIAC Member firms assisted in the evaluation of the Notice. Our working group was primarily focused on debt and money market offerings and the associated IIROC levy requirements.

Proposed IIROC Changes

IIROC acknowledges in its Notice that in certain cases, such as provincial debt offerings, the IIROC levy is incommensurate with the revenues earned by the dealer from the offering. IIROC proposes to address this by introducing a cap on the underwriting levies collected equal to 5% of a Dealer Member's revenues from an offering.

While we do not oppose the introduction of the concept of a cap, we believe a level of 5% is set arbitrarily too high to be beneficial for offerings with a commission of 10 cents or less and therefore does not provide the necessary level of relief to impacted dealers. We recommend a lowering of the cap. We also request clarification on how a Dealer Member's "revenue" from an offering is determined under the IIROC Guidelines. Further, per section 12 of the Guidelines, the calculation of underwriting levy is based on the aggregate principal amount of the offering or the maximum price at which the securities are offered, while the calculation of levy cap is based on the revenue to the dealer. Additional clarification is required on how the levy cap would apply in the event that a dealer makes zero "revenue" on a distribution.

We are concerned, however, that IIROC's proposed solution (the cap) fails to get to the heart of the matter. Namely, IIROC's levy framework has failed to keep pace with the evolution of the 'new issue' marketplace. Changes in Canadian product offerings and the associated dealer and issuer practices, including those pertaining to dealer remuneration; need to be reflected accordingly in IIROC's fee mechanism. If structured incorrectly, IIROC's levy mechanism can be seen as penalizing the dealer, or penalizing the activity of investment product distribution itself, thereby hampering capital raising in Canada.

The Notice, therefore, serves as a timely reminder to our Members that a more wholesome review of IIROC's levy framework is warranted. While we understand this was not the objective of the Notice, we believe this is what is required at this time.

In our view, IIROC's levy framework should be structured to achieve the following:

1. Reflects the economics to the Dealer Member and issuer of the underlying securities offering
2. Removes ambiguity leading to consistent interpretation across Dealer Members and IIROC
3. Is operationally simple for IIROC and Dealer Members to administer
4. Reflects the resources expended by IIROC in monitoring the "new issue" marketplace

We believe the best way to accomplish the above is by organizing a working group comprised of Dealer Member representatives (from both front and middle office) and IIROC staff. The IIAC would be pleased to assist in soliciting suitable Dealer Member representatives for this working group. As part of the working group IIROC should be prepared to contribute more granular levy and underwriting data so that an in-depth analysis can be performed. It is envisaged that industry members on the working group would elaborate on market practices related to securities offerings such as how/which costs are recouped from issuers and which are borne solely by the dealers.

Clarifying Amendments

We provide the following comments with respect to some of the "clarifying amendments" included in the Notice.

1. Money Market Obligations

The Notice specifies that "Money Market obligations" entitled to an exemption from the underwriting levy must have a term of one year or less, as securities with a longer term are subject to a levy as debt

securities. We note that on occasion there are bonafide Money Market obligations whose term runs slightly past 365 days, on account for such reasons as the 365th day falls on a weekend. We would expect that IIROC provide some discretion in relation to such offerings.

2. Deposit Note Offerings

In the Notice IIROC has asserted its view that Deposit Notes are ‘distributions of securities’ and hence subject to a levy. We see this position as a departure from IIROC’s (and the IDA’s) prior practice in respect of these offerings.

We are concerned that our dealer members are unlikely to recoup the levy on Deposit Notes from issuers. This therefore becomes a new tax directly on dealers instead of a “participation cost” that should be borne by issuers.

The market for Deposit Notes has grown tremendously over recent years with an estimated \$40 - \$50 billion of Deposit Notes issued in 2013. Even at the lowest of the current levy rates (1/300 of 1%), this would translate to an additional \$1.5 million in cost incurred **annually** by the industry.

The wording in the Notice also leaves open the possibility of retroactive application which is of course of great concern to our members.

However, many of the same reasons why we believe Deposit Notes were initially considered out of scope from levies continue to exist today.

Deposit Notes are not “securities” under the Ontario Securities Act and similar securities legislation.¹ While we understand that IIROC’s Fee Model allows IIROC’s Board of Directors to deem Deposit Notes as “securities” for the purposes of levy requirements, the fact that Deposit Note offerings are not offerings of securities under securities law means that these products can be distributed by entities that are not IIROC Dealer Members. Specifically, Deposit Notes are issued predominately by Canadian schedule 1 banks. If the cost of distributing these products through a dealer were to increase as a result of the levy, it is conceivable that these banks could distribute the products directly. Hence why we believe dealers will not be in a position to recoup this cost from the issuer. One unintended consequence of extending levies to Deposit Notes, therefore, is a potential migration of these products outside of the realm of IIROC supervision. We believe this would be contrary to IIROC’s stated market surveillance efforts under its proposed Rule 2800C – debt securities transaction reporting and the introduction of MTRS 2.0.

Furthermore, given IIROC’s assertion in the Notice that “..deposit note offerings are deemed to be distributions of securities...” runs contrary to securities law, we are deeply concerned that it will create confusion in the market and expose underwriters to legal risk not previously contemplated for these product offerings.

¹ See definition of “security” under Ontario Securities Act
http://www.e-laws.gov.on.ca/html/statutes/english/elaws_statutes_90s05_e.htm

Given the minimal investor protection and suitability considerations that continue to be associated with Deposit Notes, we see little IIROC resources having to be extended to oversee this part of the new issue market. This makes it difficult to see justification in paying IIROC a levy on these product offerings.

In light of the above, we request that IIROC reverse its stance on the application of levies on Deposit Notes. We recommend instead that Deposit Notes be discussed as part of the industry working group with perhaps the better aim of determining clarifying language on what qualifies as a Deposit Note.

3. Other

We recommend that IIROC consider as an additional “clarifying amendment” expanding the list of excluded distributions for the purposes of Section 11(b) of the Guidelines to include “Provincial and Municipal securities which are distributed by way of auction”. This would bring consistency with Section 12(d), which already exempts provincial auctions from levies.

In closing, it is not the intention of the IIAC or our Members through this submission to bring about wholesale changes to the IIROC levy framework that could result in material reduction to IIROC’s annual levy revenues. We recognize that IIROC relies on levies for its budgeting purposes and any decrease in levies paid to IIROC from current levels could require IIROC to offset the shortfall by, for example, increasing dealer membership fees. Rather, our objective is to work with IIROC in ensuring the levy framework aligns with more current issuance practices and is equitable to dealers and issuers while adequately compensating IIROC for carrying out its duties in respect of our new issues market.

The IIAC and Members of our working group would be pleased to meet with you to discuss any part of this submission.

Sincerely,

“Jack Rando”