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Sent By Electronic Mail

Canadian Securities Administrators

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and

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Dear Sirs/Mesdames:

Request for Comment - Proposed Amendments to National Instrument 23-103 *Electronic Trading* ("NI 23-103")

This letter is provided to you in response to the Notice and Request for Comment – Proposed Amendments to NI 23-103 (the "**CSA Proposal**") published at (2012) 35 OSCB 9627. Because of the substantial overlap of the CSA Proposal with publication by the Investment Industry Regulatory Organization of Canada ("**IIROC**") of the Proposed Provisions Respecting Third-Party Electronic Access to Marketplaces (the "**UMIR Proposal**" and together with the CSA Proposal, the "**Access Proposals**") concurrently with the CSA Proposal, some of our comments will impact both Access Proposals.

Overlap of CSA Proposal and UMIR Proposal

By virtue of proposed Section 4.1 of NI 23-103, proposed Part 2.1 of NI 23-103 (the CSA Proposal applicable to participant dealers providing direct electronic access) does not apply if the participant dealer complies with similar requirements established by a regulation services provider (i.e. the UMIR Proposal of IIROC). This raises several questions. Firstly, in what circumstances will the CSA Proposal ever apply to a participant dealer? All participant dealers must be investment dealers and all investment dealers must be members of IIROC. All IIROC members must comply with UMIR, and

therefore a participant dealer could not choose to comply with NI 23-103 instead of UMIR. Pursuant to proposed Section 4.2(1) of NI 23-103, only participant dealers may provide direct electronic access. If the CSA Proposal does not apply to participant dealers, then to whom does the CSA Proposal apply?

It appears to be clear that the intention of the CSA and IIROC is for the CSA Proposal and the UMIR Proposal to be substantially the same (as they relate to direct electronic access). However, the wording of the Access Proposals is not identical. Are there policy reasons for wording differences? There do not appear to be any substantive differences between the rules, but different wording could lead to different interpretations. For example, proposed Sections 4.2, 4.3 and 4.4 of NI 23-103 say effectively the same thing as proposed Rule 7.13(1) of UMIR, but in slightly different words. There are grammatical differences that could lead to differences in interpretation. Both proposed Sections 4.1 and 4.2 of 23-103 and proposed Rule 7.13 of UMIR would prevent any registrant, other than a portfolio manager or restricted portfolio manager, from receiving direct electronic access. However, the structure of proposed Rule 7.13 of UMIR makes it clearer that any client of a participant dealer (other than a client that is a registrant but not a portfolio manager or restricted portfolio manager) may have direct electronic access, so long as the requirements of proposed Rule 7.13(1)(a) of UMIR can be satisfied. Absent policy reasons for differences in wording (which we respectfully request to be explained in companion policy guidance), we would recommend that the wording of the CSA Proposal and the UMIR Proposal be identical.

There may be unintended consequences to the effective duplication of the Access Proposals in both NI 23-103 and UMIR. For example, if a dealer participant needs to seek exemptive relief from a direct electronic access requirement, the process for doing so under Rule 11.1 of UMIR is significantly different than the process for doing so in Section 10 of NI 23-103. If a participant dealer seeks an exemption under Rule 11.1 of UMIR that is not related to a specific transaction, then UMIR exemptive relief would require approval of the applicable securities regulatory authority and amendments to UMIR. This process could be especially long and cumbersome compared to the more streamlined exemption process permitted by NI 23-103.

Provision of Direct Electronic Access

In the CSA Responses to Comments on the 2011 proposal, the CSA took the view that using a defined term such as “portfolio manager” provides specificity and clarity. We respectfully suggest that there would be even greater specificity and clarity if the CSA specifically states the categories of registrant that it wishes to prohibit from receiving direct electronic access. Drafted another way, proposed Section 4.2(2) of NI 23-103 could read as follows (blacklined from the current provision)

(2) A participant dealer must not provide direct electronic access to a ~~registrant unless the registrant is (a) a portfolio manager; or (b) a restricted portfolio manager~~ person or company registered in the category of investment dealer, mutual fund dealer, scholarship plan dealer, exempt market dealer, restricted dealer or investment fund manager when the person or company is acting in such registered capacity.

This proposed revision would clarify the categories of entities to which a participant dealer may not provide direct electronic access. This would also clarify that a participant dealer could provide direct electronic access to any other person or company that satisfies the criteria of proposed Sections 4.3, 4.4 and 4.5 of NI 23-103, including:

- registered portfolio managers and restricted portfolio managers;
- banks and trust companies;
- governments (Canadian and foreign), government agencies and crown corporations;
- pension funds and investment funds;
- persons or companies relying upon registration exemptions;
- dealers and advisers registered in a jurisdiction outside of Canada; and
- other corporations, trusts, partnerships and individuals.

While the issue has already been raised by the majority of commenters to the 2011 proposal, we again wish to request clarification as to why registered investment dealers, mutual fund dealers, scholarship plan dealers, exempt market dealers, restricted dealers and investment fund managers (collectively, "**Prohibited Entities**") should be prohibited from direct electronic access, when entities such as foreign governments and trust companies can obtain direct electronic access. This prohibition is particularly confusing since the effect of proposed Section 4.7 of NI 23-103 would generally prohibit a DEA client from delegating direct electronic access to its client and would limit most DEA Clients (other than a portfolio manager, a restricted portfolio manager and a person or company that is registered in an analogous category in a foreign jurisdiction that is a signatory to the International Organization of Securities Commissions' Multilateral Memorandum of Understanding (the "**IOSCO MoU**")) from trading for the account of their clients. We respectfully submit that there is no more harm or risk in allowing a Prohibited Entity registered with and regulated by the CSA to have direct electronic access to trade as principal as there is in allowing, for example, foreign governments, trust companies and individuals to have direct electronic access.

Finally, we are concerned by one of the CSA Responses to Comments on the 2011 proposal, which addressed the use of the term "registrant" in proposed Section 4.2 of NI 23-103. The summary of comment and response are as follows:

> ***Summary of Comment**: Another commenter noted that use of the term "registrant" may be problematic in that the term is defined to include a "person or company registered or required to be registered" and creates ambiguity as to whether a person or company that is relying upon a registration exemption is intended to be caught when the term "registrant" is used.*
>
> ***CSA Response to Comment**: We are of the view that a person or company that is required to be registered would be caught by the use of the term "registrant" and would not be able to use DEA unless it is registered as a portfolio manager or restricted portfolio manager. If such an entity wishes to use DEA, it may apply for an exemption from this proposed requirement.*

We respectfully submit that the CSA Response to Comment does not have any basis in Canadian securities law or policy. A person or company that is required to be registered but that relies upon a registration exemption is not a registrant and is not, by virtue of the exemption, required to be registered. To our knowledge, there are no examples in provincial or territorial securities statutes, local rules, national instruments or multilateral instruments where the term 'registrant' includes a person or company that is required to be registered but that relies on a registration exemption. We therefore respectfully request that the CSA clarify its response to the comment so that it is clear that the term 'registrant' relates only to a person or company that is actually registered. This confusion could also be resolved if the CSA were to adopt the revisions to proposed Section 4.2(2) of NI 23-103 that are suggested in this letter (see above).

We also wish to comment on the last sentence of the CSA Response to Comment excerpted above, which suggests that if an entity that is prohibited from, but wishes to use, direct electronic access, that entity may apply for an exemption from proposed Section 4.2 of NI 23-103. A person or company that is prohibited from obtaining direct electronic access due to proposed Section 4.2 of NI 23-103 cannot apply for an exemption because the prohibition in the section applies to the participant dealer, and not to the person or company wishing to use direct electronic access. Only the participant dealer can apply for an exemption from the prohibition. Also, since most (if not all) participant dealers will comply with the UMIR Proposal and not the CSA Proposal, an amendment to UMIR would be required in order to approve the exemption request. Participant dealers may therefore be unwilling to seek exemptive relief for prospective DEA clients that are prohibited from direct electronic access by virtue of proposed Section 4.2 of NI 23-103 (or the equivalent, proposed Rule 7.13(1)(b) of UMIR).

Trading by DEA Clients

There appears to be confusion in proposed Section 4.7 of NI 23-103 concerning "trading for the account of another person" (4.7(1) and 4.7(2)) and "sub-delegation to a client" (4.7(5)). In Part IV(vi) of the Notice, the references in footnotes 15 and 16 are incorrect. Footnote 15 should refer to proposed Section 4.7(5) of NI 23-103 and footnote 16 should refer to proposed Sections 4.7(1) and 4.7(2) of 23-103. We also note that the proposed NI 23-103 companion policy guidance speaks only to the concept of sub-delegation (i.e. where a DEA client provides its direct electronic access to its clients) and not also to trading for the account of another person.

The concepts of "trading for the account of clients" and "sub-delegation to a client" are very different and should not be confused. In general, we agree with the CSA position that a DEA client should not be permitted to delegate direct electronic access to its clients. We agree that a DEA client should instead impose control on orders it receives, before sending those orders to a participant dealer. But this is where there appears to be confusion: when a DEA client exercises discretionary authority over a client's account or collects client orders and sends those orders to a participant dealer, it is at that moment "trading for the account of clients", even if the DEA client is trading in its own name and not the client's name.

Many DEA clients will seek to trade for the account of clients, and we respectfully submit that this type of trading should not be treated any differently than if a DEA client were to trade for its own account. However, the proposed Sections 4.7(1) and 4.7(2) of NI 23-103 would only permit trading by a DEA client on behalf of its client if the DEA client is a portfolio manager, restricted portfolio manager or a person or company that is registered in an analogous category in a foreign jurisdiction that is a signatory to the IOSCO MoU. This prohibition significantly limits the use of direct electronic access and in our view will cause considerable market disruption and negatively impact trading volumes. Consider the following examples of trading activity that would be prohibited by the proposed Sections 4.7(1) and 4.7(2) of NI 23-103:

- a Canadian pension fund manager operating under a registration exemption that trades for the funds, pools or other accounts that it manages (often assets are held in a separate legal entity from the pension fund manager);

- an unregistered dealer based outside of Canada that trades for a fully managed account of a client based in a foreign jurisdiction;

- an unregistered hedge fund manager based outside of Canada trading for the accounts of the fund(s) it manages; or

- a firm relying on the international adviser exemption that is not registered in its home jurisdiction (as permitted by section 8.26 of NI 31-103) that is trading an incidental amount of Canadian securities for a Canadian permitted client.

We respectfully request that the CSA give further consideration to the proposed prohibition on DEA clients trading for the account of their clients. In our view, there is no more harm or risk in allowing a DEA client to trade as principal as there is for a DEA client to trade for the account of one of its clients (as noted in the examples above). This scenario is far different than a DEA client delegating its direct electronic access to its clients, which is appropriately restricted pursuant to proposed Section 4.7(5) of NI 23-103.

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Thank you for the opportunity to comment on the CSA Proposal. If you have any questions regarding our submission, please do not hesitate to contact Mark DesLauriers (mdeslauriers@osler.com or (416) 862-6709) or Blair Wiley (bwiley@osler.com or (416) 862-5989).

Yours very truly,

Mark DesLauriers
Blair Wiley

c. Naomi Solomon, *Investment Industry Regulatory Organization of Canada*