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British Columbia Securities Commission
Alberta Securities Commission
Saskatchewan Financial Services Commission
Manitoba Securities Commission
Ontario Securities Commission
New Brunswick Securities Office
Office of the Attorney General, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
Registrar of Securities, Northwest Territories
Registrar of Securities, Nunavut
Registrar of Securities, Yukon Territory

C/O John Stevenson, Secretary
Ontario Securities Commission
20 Queen Street West,
Suite 1903, Box 55
Toronto, Ontario M5H 3S8
&
Madame Anne-Marie Beaudoin
Directrice du secrétariat
Autorité des marchés financiers
800, square Victoria, 22e étage
C.P. 246, Tour de la Bourse
Montréal (Québec) H4Z 1G3

Dear Mr. Stevenson and Mme. Beaudoin:

RE: Proposed NI 23-102, Use of Client Brokerage Commissions as Payment for Order Execution Services or Research ("Soft Dollar" Arrangements)

ITG Canada is pleased to have the opportunity to offer its comments on proposed National Instrument 23-102. We believe that it is important for the regulators to provide further guidance and clarity on the appropriate use of commission dollars.



This issue has been the focus of much debate in this country and in other jurisdictions, such as the US and UK over the past several years. We believe that the guiding principle in the debate should always be the fulfillment of fiduciary responsibilities and the achievement of Best Execution for clients.

ITG Canada is a specialized brokerage and technology firm that provides innovative technology solutions spanning the entire investment process. Our sophisticated solutions include pre-trade analytics, advanced trade execution technologies and post-trade evaluation services.

As an “execution-only” institutional brokerage firm, ITG Canada does not offer traditional, fundamental research. We do not make recommendations regarding the economy, industry sectors or specific securities issues. ITGC provides clients with technology tools which help optimize the efficiency of the trade process, and measure and reduce transaction costs, both implicit and explicit. We believe that the sophisticated technology tools that we provide to clients fall under the umbrella of “order execution services”, rather than research, and thus can be clearly paid for with commission dollars.

We are supportive of the commissions’ efforts to provide guidance on this subject to the financial community. We believe that it will be helpful for the financial services industry in this country if the commissions can provide more clarification for dealers and asset managers as to the status of which services qualify as “research”, including analytical tools and applications commonly used in the industry.

We are pleased to provide the following response to questions posed by the CSA in the Request for Comments: Notice of Proposed National Instrument 23-102, Use of Client Brokerage Commissions as Payment for Order Execution Services or Research (“Soft Dollar” Arrangements) dated July 21, 2006.

Question 1:

Should the application of the Proposed Instrument be restricted to transactions where there is an independent pricing mechanism (e.g., exchange-traded securities) or should it extend to principal trading in OTC markets? If it should be extended, how would the dollar amount for services in addition to order execution be calculated?

ITG Canada believes that it would be possible to extend the instrument to principal trading in OTC markets if there was transparency in the pricing of these transactions. However, until current practices in OTC markets change, the proposed instrument should be restricted to transactions in securities that have transparent fees or commissions and which can be independently priced; i.e. exchange-traded securities. We do not believe that OTC transactions, in which some, or all, of the fee charged, is not readily defined and known to the customer, should be eligible for soft dollar transactions. This restriction would include OTC transactions in over-the-counter derivatives and principal transactions in the debt market.

Question 2:

What circumstances, if any, make it difficult for an adviser to determine that the amount of commissions paid is reasonable in relation to the value of goods and services received?

When services are bundled together, including execution, research and other “soft dollar” services, it becomes extremely difficult to determine the cost of each of the services provided. Because these services cannot be “broken out” by cost, it is difficult, if not impossible, to do any sort of cost comparison for these services against an appropriate market value. If the value of the service received cannot be identified, then it is also difficult to allocate the cost of the service back to the client. Further, if specific costs cannot be separated out from total commissions, it would be difficult to track the use of services relative to the benefits received by specific clients.

If asset managers are to use commission dollars to pay for various services received from dealers, they must be able to clearly define and articulate the services received and their value. Further they must be able to allocate those costs to specific clients in relation to the benefit received. Simply put, as long as services are bundled, there is no clarity as to how commission dollars are being used to benefit the client.

Question 3:

What are the current uses of order management systems? Do they offer functions that could be considered to be order execution services? If so, please describe these functions and explain why they should, or should not, be considered “order execution services”.

The proposed policy suggests that “order execution services” begin at the point at which “an adviser makes an investment or trading decision” and concludes “once settlement is completed”. In current practice, if an adviser uses an OMS system, the first step following the investment decision (whether made by a manager or system) is to enter that “order” into the OMS system.

The OMS system provides the primary link between the portfolio management system, the execution process and the book of record. The order management system has multiple functions throughout the execution process and provides electronic connectivity to brokers, access to algorithmic trading applications, and access to marketplaces. It is the Order Management System which tracks the life cycle of the order, including the destination to which an order has been sent, the fills received, the details of orders completed and balances outstanding. **This administrative management of an order directly parallels the functionality once provided by a trader manually handling an order.**

Modern technology has automated these processes in Order Management Systems and has enabled advisers to more efficiently manage the trade process. These systems allow traders to handle increasingly complex types of transactions in an increasingly complex market structure. The OMS is the primary vehicle which collects the data which an adviser can use to measure the timing, impact and quality of execution received. Without an integrated OMS system, it is very difficult for an adviser to be able to measure the quality of execution and hence to know whether he/she has achieved Best Execution.

Order execution services should include technology and services which assist in the execution of an order from the point at which the order life cycle starts; i.e., after the investment decision is made. Therefore, Order Management Systems should be included in the definition of what constitutes “order execution services”. We do not believe that the order life cycle extends beyond settlement; therefore such services as custody should not be included under the definition of “order execution services”.

Question 4:

Should post-trade analytics be considered order execution services? If so, why?

ITG Canada believes that post-trade analytics should be considered part of order execution services. Post-trade analytics enable the adviser to measure the quality of execution and to make trading decisions based on that information. Post-trade analytics also facilitate the adviser in making future decisions about how trades should be allocated among the brokers who provide execution services and the method of execution that is most appropriate (e.g. trader-managed, agency/principal blocks, algorithms, DMA, etc.).

Post-trade analytics are an integral part of the trading decision process not part of the research or analysis as to which security should be bought or sold. They are the key source for information which an adviser uses to measure the quality of execution and determine how trading commission dollars should be allocated to achieve Best Execution on behalf of customers.

Question 5:

What difficulties, if any, would Canadian market participants face in the event of differential treatment of goods and services such as market data in Canada versus the U.S. or the U.K.?

We believe that it is important that our Canadian regulators adopt a consistent “principle-based” approach with regulators in other major jurisdictions (esp. the US and UK). That said, we think that it is also important to consider each country’s market structure and business customs in determining specific interpretations of those principles.

At a very minimum, the principles used in establishing rules should be consistent across jurisdictions - e.g. considering “soft dollars” as acceptable practice or not, whether or not the specific definitions and rules are absolutely congruent. Most advisers and dealers in Canada execute transactions in multiple markets, including the US, the UK, Europe, Asia, South America and others. They may also have subsidiaries or affiliates located in these markets that trade in both their own local markets and foreign markets. Having consistent regulatory standards across jurisdictions decreases the possibility of cases of regulatory arbitrage.



At the same time, it is also important to consider the relative size of Canadian markets and the fact that this market is dominated by a few large entities, both in the dealer and adviser community. It is important that our regulations do not disadvantage smaller firms and create barriers to entry for these firms in competing against larger entities.

The overriding consideration for regulators must be to determine what is in the best interest of investors (retail and institutional) in order to create healthy, competitive capital markets and to ensure fair and transparent marketplaces.

Question 6:

Should raw market data be considered research under the Proposed Instrument? If so, what characteristics and uses of raw market data would support this conclusion?

ITG Canada believes that raw market data should not be considered part of research under the proposed instrument since there is no value-added service provided such as analysis or manipulation of the data as part of the feed. Raw market data, in and of itself, does not add value to an investment or trading decision.

The cost of raw market data should be included as part of the cost of trading or research services when it is integral to providing analytics or tools based on raw market data. For example, an historical analysis of trade patterns which influences investment strategies (Stock A vs. Stock B) would qualify as research under the definition.

Question 7:

Do advisers currently use client brokerage commissions to pay for proxy-voting services? If so, what characteristics or functions of proxy-voting services could be considered research? Is further guidance needed in this area?

ITG Canada is not currently involved in paying for proxy-voting services for clients and has no comment on this issue.

Question 8:

To what extent do advisers currently use brokerage commissions as partial payment for mixed-use goods and services? When mixed-use goods and services are received, what circumstances, if any, make it difficult for an adviser to make reasonable allocations between the portion of mixed-use goods and services that are permissible and non-permissible (for example, for post-trade analytics, order management systems, or proxy-voting services)?

As stated earlier in this response paper, we believe that when services are bundled it becomes very difficult to determine the cost and value of each specific service. Similarly, if clients use commissions as partial payment for mixed-use services, it is difficult to determine whether the cost paid for the specific service reflects the true value of the service provided. The more that execution and other services are “bundled” together and the cost/value of each service not clearly defined, the more difficult it is to determine if commissions dollars used to pay for these services have been allocated correctly to the clients who have received the benefit associated with those goods and services.

Further, the administrative overhead of managing the tracking and accounting for such use of brokerage commissions becomes onerous for managers if they are to provide any sort of transparent reporting on the use of commission dollars to their clients. Advisers would have to be able to track the specific value of each mixed use service received, the payment values and methods used for payment (soft/hard dollars) and be able to assign the appropriate allocation of those costs to the clients in relation to their perceived usage/benefit received.

Some examples of mixed use services which should not be allowed under this proposed instrument would be:

- A quote terminal which primarily provides publicly available market information but may have some limited analytic capabilities.
- A newspaper which provides generally available information but may have one column of advice or recommendations on markets.

Question 9:

Should mass-marketed or publicly-available information or publications be considered research? If so, what is the rationale?

We do not believe that mass-marketed or publicly available information would fall under the definition of research if it does not provide value added original information and analysis.

Question 10:

Should other goods and services be included in the definitions of order execution services and research? Should any of those currently included be excluded?

ITG Canada believes that services such as pre/post trade analytics and order management systems should be included in the definition of order execution services since they are services directly linked to the execution of specific orders and are integral to the measurement of the quality of execution and the achievement of Best Execution.

Question 11:

Should the form of disclosure be prescribed? If prescribed, which form would be most appropriate?

We believe that regulators should establish the principles for disclosure required by asset managers and should set minimum standards that must be met for disclosure. These standards would include the scope of information required (e.g. total amount of commissions used for execution vs. other services, costs of services provided, allocation and weighting among dealers of services provided, average/high/low rates paid per dealer) and the frequency of disclosure.

When “soft dollar” arrangements are made between an adviser and a dealer, there must be a Soft Dollar agreement completed and kept on file by both parties.

Question 12:

Are the proposed disclosure requirements adequate and do they help ensure that meaningful information is provided to an adviser's clients? Is there any other additional disclosure that may be useful for clients?

We are in agreement with the proposed disclosure requirements as outlined and believe that they are helpful in increasing transparency and ensuring that advisers are accountable to their clients on the use of commission dollars. It is important that all disclosure be provided in a clear and simple format that is easily understood. We believe that annual public disclosure of information is appropriate and should include a description of services provided as well as an affirmative statement by the adviser that all soft dollar arrangements are solely for the benefit of their clients.

Question 13:

Should periodic disclosure be required on a more frequent basis than annually?

We believe that periodic disclosure on an annual basis is sufficient. Realistically, it will be necessary for advisers to track data on a monthly/quarterly basis in order to ensure that they are fulfilling any arrangements in place. It may be appropriate to require advisers to make such information available on request to clients.

Question 14:

What difficulties, if any, would an adviser face in making disclosure under Part 4 of the Proposed Instrument?

The greatest difficulty that advisers will have in making the type of disclosure required will be the administrative burden of tracking commission allocations, the cost of services provided and the allocation of costs/benefits to the appropriate account. Commissions used for soft dollar payments may be used in trades for one or more clients whereas the benefits to be derived from the services purchased are allocated across multiple accounts. The allocation of commission dollars for payments for mixed-use goods and services further complicates this fair distribution of costs vs. benefits.



In addition, commissions may be negotiated and may change due to a variety of circumstances depending on the nature of the transaction (executed by a trader on an agency or principal basis, executed via Direct Market Access (DMA), part of a basket trade) and the liquidity profile of a security. Trades done a principal basis may have embedded costs which are not easy to report and will be difficult to report on a transparent basis to clients.

Question 15:

Should there be specific disclosure for trades done on a “net” basis? If so, should the disclosure be limited to the percentage of total trading conducted on this basis (similar to the IMA’s approach)? Alternatively, should the transaction fees embedded in the price be allocated to the disclosure categories set out in sub-section 4.1(c) of the Proposed Instrument, to the extent they can be reasonably estimated?

As stated previously, we believe that instrument should be restricted to transactions in securities that have transparent fees or commissions and which can be independently priced; i.e. exchange-traded securities. We do not believe that OTC transactions, in which some, or all, of the fee charged, is not readily defined and known to the customer, should be eligible for soft dollar transactions. This restriction would include OTC transactions in over-the-counter derivatives and principal transactions in the debt market.

Thank you for the opportunity to comment on these important issues.

Yours truly,

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