The Pulse of Finance

Newedge

July 8, 2011

VIA E-MAIL

Alberta Securities Commission
Autorité des marchés financiers
British Columbia Securities Commission
New Brunswick Securities Commission
Nova Scotia Securities Commission
Superintendent of Securities, Department of Justice, Government of Northwest Territories
Superintendent of Securities, Yukon
Superintendent of Securities, Nunavut
Superintendent of Securities, Consumer, Corporate and Insurance Services, Office of the Attorney General, Prince Edward Island
Saskatchewan Financial Services Commission
Superintendent of Securities, Government Services of Newfoundland and Labrador
Ontario Securities Commission

c/o John Stevenson, Secretary
Ontario Securities Commission
20 Queen Street West
Suite 1900, Box 55
Toronto, Ontario M5H 3S8

and

M[e] Anne-Marie Beaudoin
Corporate Secretary
Autorité des marchés financiers
800 Square-Victoria, 22nd Floor
C.P. 246, tour de la Bourse
Montréal, Québec H4Z 1G3

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Newedge

RE: Newedge Canada Inc. Comment Letter regarding
National Instrument 23-103 -
Electronic Trading and Direct Electronic Access to Marketplaces

Dear Sirs / Mesdames:

Newedge Canada Inc. ("NCI"), on behalf of itself and its parent company, Newedge Group SA, is pleased to submit this comment letter in response to the CSA's request for comments regarding proposed National Instrument 23-103 Electronic Trading and Direct Electronic Access to Marketplaces and its companion policy, 23-103 CP[1].

Over the past several years, all aspects of trading has evolved at an accelerated pace. Exchanges, ATS's, telecommunication network providers, clearing firms, prime brokers, independent software vendors (front office technology) and others have made considerable human and capital investments to increase the efficiency and productivity of trading.

All trading, including voice orders, are at some point in the workflow performed electronically. The Toronto Stock Exchange was an early adopter of an electronic trading floor having closed its traditional trading floor in April of 1997. Countries such as the United States have been at the forefront in this area allowing Canada's regulators the unique perspective to implement best practices.

We believe a regulatory framework should strike a fine balance to allow fair and equal access to all participating dealers, both domestic and foreign. The rules should not be overly cumbersome, but seek to address in a reasonable manner the various risks present in this industry for all stakeholders: marketplaces, trading firms, clearing brokers and others.

As the Proposed Rule seems to target high frequency trading, we encourage the CSA to review recent academic studies relating to high frequency trading with empirical evidence and conclusions from these studies[2]. They were conducted by respected experts and researchers. US futures was the asset class studied, but findings can be extrapolated to all asset classes.

Based on Newedge's experience in the USA, pre-trade risk management systems are expensive to acquire and maintain. Costs are comprised of software licenses (both one-time and on-going), hardware infrastructure to support this framework, maintain and integrate into a participant dealer's workflow, and on-going support costs. With continued pricing pressures on execution and clearing costs, costs will outstrip the ability of smaller participant dealers to absorb them and remain in this market.

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[1] Newedge Group is one of the world's largest brokerage organizations offering its customers clearing and execution facilities across multiple asset classes including futures, securities (fixed income and equity), options, FX and various OTC instruments (Newedge refers to Newedge Group, a 50%-50% joint venture between Credit Agricole-CIB and Société Générale, headquartered in Paris, France, all of its worldwide branches, subsidiaries and other units. Newedge Group maintains offices in 15 countries, and is a member of over 85 exchanges worldwide).

[2] http://www.theifm.org/rfm-special-Issue2011.pdf

It is our submission that marketplaces (Exchanges, ATS's, electronic crossing networks, etc.) are best suited to implement pre-trade risk management for all incoming orders. We believe a uniform adoption across the multiple Canadian marketplaces would decrease costs to participant dealers and decrease third party pre-trade risk management arbitrage across. As an example, the CME has successfully implemented a risk management system, called the Globex Credit Control System. All participants' electronic client orders must pass through this filter, which checks an overall credit and clip size (maximum order quantity) limits. Proprietary trading systems and independent software vendors (ISVs) must send their orders through this system[3]. The CME has recently publicly released information relating to more robust functionality and pre-trade risk metrics.

The CSA acknowledged that it has closely reviewed a number of international initiatives such as SEC Rule 15c3-5. We would like to note that this rule is specific to the equity and option market and does not apply to the futures market. We have no objection that Canadian futures are part of NI 23-103 for Canada. However, considering the fragmentation of the equity marketplaces in Canada, we believe it requires additional clarification. As an example, could a dealer participant of an exchange specializing in equities, but not a participant of Canadian derivatives exchange, be provided DEA to that derivatives exchange? If so, can the dealer pass his derivatives DEA to his clients?

In general, NCI agrees with the view of the CSA that technology surrounding trading has evolved and that a framework is important in managing risks associated with it. It is with this spirit that Newedge Canada's comments and feedback are based upon.

Part 3 subsection 11(5) – Trading by DEA clients / "Passing" of DEA

NCI agrees that in general, DEA clients should not provide or pass on their direct electronic access to another person or company. However, there are circumstances where we believe this should be allowed and/or clearly specified in NI 23-103. Those situations are:

1. The DEA client is a foreign dealer and affiliate of the participant dealer (subject to the affiliate foreign dealer being regulated in a satisfactory regulatory regime in its home country).

   NCI noted that in NI 23-103, the CSA has already facilitated certain arrangements currently in place for institutional global dealers. However, it doesn't seem to permit affiliates of the participant dealer to "pass" their DEA to their clients, which is an important arrangement currently in place at some global dealers, primarily those that have the equivalent "dealer / broker-dealer" registration category.

[3] http://www.cmegroup.com/globex/introduction/process.html

These affiliates are usually highly regulated and subject to DEA rules in their country. In some cases, the affiliates are owned by a global major financial institution. In addition, the end clients are typically highly sophisticated institutional clients such as financial institutions which are also regulated.

The entities usually share the responsibility of monitoring the "end" DEA client activities with certain responsibilities assigned to each. However, each entity is responsible with its own local regulator. Furthermore, the participant dealer in Canada remains ultimately responsible to Canadian regulators and marketplaces.

Under this type of arrangement, we believe the risks to the Canadian market are very low. To a certain extent, this type of arrangement provides exposure to an international customer base for both foreign and domestic sponsor participants, thus beneficial for Canada. For the aforementioned reasons, we believe that NI 23-103 should allow a foreign dealer that is an affiliate of the participant dealer to provide or pass on its DEA to its own clients.

2. The DEA client is an IIROC member and participant dealer.

In certain circumstances, an IIROC member and participant dealer may rely on DEA to access all or a specific marketplace. The segregation of the marketplaces in Canada by products, where equities are only traded on certain exchanges and derivatives on others, results in certain dealers specializing in one asset class. As such, this dealer may want/rely on DEA to access other marketplace(s) for practical reasons or other reasons such as the cost associated with an exchange membership.

The dealer may already have arrangements with some of his clients to provide them DEA. The dealer should be able to provide access to all the Canadian marketplaces it accesses through a membership or DEA. We also noted that this restriction would be made to the detriment of the smaller investment dealers.

In this scenario, where both dealers are strongly regulated, risk management and supervisory controls, policies and procedures could be determined in an agreement between the dealers as one may be in a better position to monitor for compliance with the trading rules and the other to monitor for suitability.

In these circumstances, we believe that the DEA client should be allowed to provide or pass on its DEA to its own clients as the risks to the Canadian market would be very low.

3. The DEA client is an IIROC member (subject to the condition that it would be granted DEA under Part 3 subsection 6(2) which we discuss further below).

This scenario is similar to the previous one. However, the DEA client is an IIROC member but not a participant dealer. We see this type of situation arising when very small dealers rely on DEA from their carrying brokers.

Again, we believe that the DEA client should be allowed to provide or pass on its DEA to its own clients as the risks to the Canadian market would be very low. This restriction would again be to the detriment of the smaller investment dealers.

Part 3 subsection 6(2) – Provision of Direct Electronic Access

The Proposed Rule states that DEA can only be provided by a participant dealer to a registrant that is a participant dealer or portfolio manager. As stated by the CSA, this limitation is to avoid dealers to "opt-out" of the UMIR.

NCI is questioning this limitation and believe it could also lead to confusion. We believe that DEA should not be limited to the two categories specified in Part 3 subsection 6(2) but be extended to all investment dealers that are IIROC members.

Under the proposed rule, it seems that there is no restriction for a dealer which is only a participant of an exchange specialized in derivatives, to be granted DEA to an equity marketplace. This would result in the dealer not being subject to UMIR.

Another situation that is probably most likely in the Canadian context is a dealer which is only a participant of an equity marketplace that wants DEA to an exchange specialized in derivatives. It may prefer DEA as the cost associated with an exchange membership could be significant. In this scenario, the dealer would avoid being directly subject to the rules applicable to the derivatives exchange.

The concept of registrant "participant dealer" to be granted DEA could pose some questions and issues. The impact of such restriction may prove to be significant as some registrants may want DEA for their own account or for the accounts of their clients, instead of a direct membership/access with a marketplace, for multiple reasons.

Two attenuating factors to the CSA's concern of DEA "opting-out" of UMIR should be considered.

- The participant dealer providing access must be an IIROC member and marketplace participant. As such, it is subject to UMIR, IIROC Rules and the applicable exchange rules. The participant dealer providing access is ultimately responsible for all orders entered on the market via its participant number.
- We believe that the supervisory controls, policies and procedures required under NI 23-103 for participant dealers providing DEA will be sufficient to manage the risks associated with DEA. In addition, the participant dealer providing access usually has a significant expertise in the products traded and can better monitor trading adherence to the rules.

For the reasons stated above, NCI believes that DEA should not be restricted to a registrant that is a participant dealer or a portfolio manager but should also include any IIROC member.

Part 2 subsection 3(2) – Risk Management and Supervisory Controls, Policies and Procedures

The Proposed Rule requires that all orders are monitored and include "automated pre-trade controls and regular post-trade monitoring. What is meant by "automated?" Is it meant to check each and every order before it reaches every marketplace? What is the definition of 'regular'? Is an end of day or next day check to ensure the client is within their overall credit limit sufficient?

Part 2 subsection 3(3) – Risk Management and Supervisory Controls, Policies and Procedures

The Proposed Rule requires that risk management and supervisory controls, policies and procedures required must systematically limit the financial exposure of the marketplace participant, including:

1. preventing the entry of one or more orders that would result in exceeding appropriate pre-determined credit or capital thresholds for the marketplace participant and, if applicable, its DEA client;
2. preventing the entry of one or more orders that exceed appropriate price or size parameters.

It is possible during a trading day for the DEA client to appear offside while there are many open orders in multiple markets, but at the end of day when all orders have been cancelled or executed to be well within their overall limits. Is there any consideration to the strategy a client is trading, perhaps the client is perfectly hedged using derivatives? What may appear to be excessive by way of outstanding equity orders across the various execution venues, may actually be a near-perfect hedge utilizing equity options or futures (in Canada or the US).

What if a DEA client uses one participating dealer for executing equity orders and another participating dealer for clearing? Which of the two is responsible for pre-trade risk controls, which is responsible for post-trade monitoring, and which is responsible for capital and credit assignment?

We would like to see more guidance regarding calculations of capital and credit. We would also like more thoughts around the demarcation of responsibilities between executing brokers, clearers, and especially corresponding clearers.

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DEA access to individuals

NCI agrees with the view of the CSA, that in certain circumstances, sophisticated individuals may be permitted DEA and/or that DEA should not be limited to institutional clients as per IIROC definition. Some individuals and/or non-institutional clients may have the knowledge and expertise to be granted DEA subject to the firm risk management and supervisory controls, policies and procedures.

Thank you for allowing us to provide you with our comments on the proposed rule. If you have any questions or would like further information regarding this matter, please do not hesitate to contact the undersigned at (514) 841-6208 or Martin Boileau, Compliance Officer, at (514) 841-6290.

Sincerely,

Newedge Canada Inc.

JP St-Cyr

Jean-Pierre St-Cyr, CA, LL.B.
Chief Compliance Officer