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Manitoba 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

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July 21st, 2011

RE: Proposed National Instrument 23-103 *Electronic Trading and Direct Electronic Access to Marketplaces*

Dear Sirs and Mesdames:

TD Securities welcomes the opportunity to comment on the Canadian Securities Administrators' proposed National Instrument NI 23-103 *Electronic Trading and Direct Electronic Access to Marketplaces*. As a diversified full-service broker-dealer, TD Securities is involved in the provision of electronic market access to institutional clients, as well as the operation of algorithmic and electronic trading within the dealer. We are supportive of regulatory efforts to strengthen the integrity of our capital markets and limit systemic risks.

Definition of Direct Electronic Access (DEA)

The proposed National Instrument defines "direct electronic access" as access whereby a client may use a participant dealer's identifier without "additional order management by the participant dealer." We would like to seek clarity on what is meant by "additional order management," because we believe that some management, and in particular order amendment through smart routing, is required for all forms of direct electronic access, to ensure dealers are compliant with UMIR and National Instrument 23-101 *Trading Rules*. TD Securities does not offer direct sponsored (or naked) access as it is our interpretation that relying on a client's technology to comply with dealer responsibilities creates moral hazard and is an avoidance of a dealer's obligations under UMIR.

We suggest the definitions of Direct Market Access and Direct Electronic Access be clarified and delineated such that Direct Market Access refers the manual entry of orders through electronic channels, and Direct Electronic Access refers to automated order generation and automated order entry through electronic channels. The extreme volume and speed of automated order generation systems creates risks to market integrity which are not present with manual order entry, and we believe it is useful to separate the two forms of electronic market access to address risk controls for each specifically.

As an example, we consider the manual entry of orders into a dealer's smart order router or algorithm suite to be Direct Market Access, and orders originating from automated trading algorithms, either managed by clients or internally by dealers, to be Direct Electronic Access. Risk controls for Direct Market Access should be primarily focused on input entry errors on order size or price, whereas automated trading systems require more robust controls for order rates, total notional risk exposure, and technology failure.

Additionally, we believe some of the references to "electronic trading" in the proposed National Instrument may extend the scope of the Instrument beyond what is intended. In today's environment all trading is electronic to some degree. For instance, traditional high-touch brokerage business frequently involves smart-routing systems, algorithms that facilitate multiple markets trading (including access to dark pools) as well as scheduled trading algorithms (such as VWAP or market participation algorithms). While we do not believe that the proposed National Instrument intends to cover all trading, the extension of requirements to all "electronic trading" (without a clear definition of the term) may in fact introduce additional and potentially conflicting regulatory requirements on existing business that would not generally be considered electronic.

The Provision of Direct Electronic Access

The proposed National Instrument stipulates that direct electronic access may be provided to a "participant dealer", a "portfolio manager," or to an analogous entity covered by the IOSCO Multilateral Memorandum of understanding. We would like to request clarification what is meant by "portfolio manager" in the context of the proposed National Instrument, and whether this definition is intended to correspond with the existing registration requirements as set out in NI 31-103. If the definition is intended to be different, then we ask for clarification on what requirements must be met to determine that a particular client meets the definition of "portfolio manager."

We also ask that the CSA clarify under what conditions DEA may be provided to non-registrants. For instance, some existing DEA clients, such as hedge funds, are not currently registrants, but the language of proposed NI 23-103 neither specifically permit, nor prohibits, the provision to

DEA to these clients. Additionally, we would like to understand to what standard the CSA intends to hold both registrants and non-registrants with respect to compliance with marketplace rules and regulations, and whether registration status impacts the client's liability in using DEA.

We do not believe it is appropriate to grant DEA to individuals, and view DEA as an institutional facility. We believe that granting DEA to certain individuals, such as former floor brokers or registered traders, would require a separate qualification process and further complicate the regulatory process around the provision of DEA. Additionally, the provision of DEA to individuals opens the possibility of certain currently-registered individuals, such as current "pro traders," relinquishing their registration status in favour of DEA in an attempt to transfer the ultimate regulatory responsibility to the dealer providing DEA and away from themselves. We believe this would be a form of regulatory arbitrage and should be avoided.

Marketplace Participant Controls, Policies and Procedures

TD Securities is broadly supportive of requirements to supervise market bound order flow in an effort to contain systemic risks. However, we are concerned that the proposed controls and requirements, when applied equally to both DEA clients and participant dealers' internal systems, will result in undue complexity and may cause unintended side-effects that undermine the overall purpose of the proposed National Instrument.

In general, we do not believe it is appropriate to hold participant dealers to the same regulatory standard as DEA clients, since DEA clients are not generally subject to the same regulatory oversight as the dealers themselves. For instance, dealer credit risk is currently addressed through capital requirements imposed on dealers, and market integrity risk is currently addressed by UMIR (among other regulations). On the other hand, DEA clients may not be under any such oversight, and it is therefore appropriate to impose standards such as those envisioned in the proposed National Instrument.

With respect to pre-trade risk controls for client trading, we believe the controls should be aligned to the risk associated with the client trading activity. Orders entered manually by Direct Market Access customers should be subject to "fat-finger" error controls with limits on order size, price and total notional. Orders entered by clients using automated order generation systems require more robust controls for pre-trade credit and capital, order rates, total notional, suspension of trading connections and technology testing, given the high order rates these systems are capable of.

We seek clarity on the scope of pre-trade risk controls proposed by NI 23-103. A Direct Electronic Access client may have multiple relationships with a dealer, including institutional cash equity trading, equity option trading, prime brokerage services, foreign exchange and fixed income trading. It is impractical and cost prohibitive to build a pre-trade risk control system which monitors the real-time net aggregate credit and capital risk for a client across all business lines and asset classes. In addition, a DEA client may have multiple executing dealer relationships settling to a single clearing account. The credit and capital risk is ultimately borne by the clearing dealer and it is infeasible for any individual executing dealer to monitor the net aggregate credit and capital risk for a clearing dealer with respect to that client. We recommend any pre-trade credit and capital risk controls for automated trading be applied to the specific client DEA relationship and not aggregated across business lines, asset classes and executing dealers.

Moreover, DEA services are typically segregated from other areas of the business (such as institutional full-service brokerage) out of consideration of client confidentiality, and a

requirement to aggregate across those business lines would be at odds with prudent and accepted business practice.

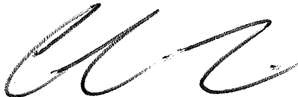
We note the pre-trade risk controls, as proposed in the NI 23-103, are broadly defined and generally based on principles rather than specific risk thresholds. For example, the requirements to "ensure compliance with applicable marketplace and regulatory requirements on a pre- and post- trade basis" and the requirement to "ensure that the entry of orders does not interfere with fair and orderly markets" can be broadly interpreted and cannot be directly measured or implemented using electronic systems. A electronic pre-trade control system will need to be based on specific, detailed and procedural rules which can be expressed in well-defined programming logic. We recommend these requirements be more clearly defined to assist in our evaluation of the costs and timeline to build pre-trade risk controls for Direct Electronic Access.

DEA Client Identifiers

TD Securities is supportive of the creation of a unique client identifier for DEA clients, to be shared with regulatory bodies. We believe this is consistent with standard business practice in the market today.

In summary, TD Securities is broadly supportive of the CSA's efforts to provide clarity on the regulation of direct electronic access and many of the provisions in the proposed National Instrument. We nonetheless seek certain clarification on certain areas of concern, as described above. We appreciate the opportunity to comment on this topic, and are readily available to discuss further.

Yours very truly,



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