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Invested in America

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Alberta Securities Commission
Autorité des marchés financiers
British Columbia Securities Commission
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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and

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Re: Request for Comments: Proposed National Instrument 23-103: *Electronic Trading and Direct Electronic Access to Marketplaces*

Dear Sirs and Madams:

The Securities Industry and Financial Markets Association ("SIFMA")[1] appreciates the opportunity to comment on Proposed National Instrument 23-103: *Electronic Trading and Direct Electronic Access to Marketplaces* (the "Proposal"). SIFMA applauds the Canadian Securities Administrators ("CSA") for their efforts to reduce risks in the Canadian market and the potential for international regulatory arbitrage. SIFMA members and their affiliates are active in the global financial markets, including the Canadian securities market. SIFMA believes that it can provide helpful insights on the Proposal based on its experience with the recently effective U.S. Securities and Exchange Commission ("SEC") Rule 15c3-5, *Risk Management Controls for Brokers or Dealers with Market Access* ("Rule 15c3-5"), as well as other recent U.S. market structure initiatives that address similar concerns as those contained in the Proposal.[2]

## I. Risk Management and Supervisory Controls

### A. Allocation of Controls

SIFMA believes that the Proposal takes a reasonable and balanced approach with regard to the allocation of risk management and supervisory controls between the participant dealer and an investment dealer—particularly with regard to financial controls. We believe that the allocation of financial controls is important to achieving the purposes of the Proposal most directly. Permitting such allocation increases efficiency, specifically by allowing financial controls to be set by parties with the most complete information. As correctly noted in the Companion Policy to the Proposal, in certain circumstances, an investment dealer with the direct customer relationship will be in the best position to effectively assess the customer's financial resources.

### B. Immediate Post-Trade Information

Proposed Section 3(3)(b)(iv) would require that marketplace participants' controls must ensure that compliance staff receive "immediate order and trade information." The Companion Policy, however, notes that compliance staff are not required to carry out their compliance monitoring of such immediate trade information in real time. In light of the very substantial costs of providing information to compliance staff on a real-time

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[1] The Securities Industry and Financial Markets Association ("SIFMA") brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association. For more information, visit www.sifma.org.

[2] For your reference, a letter containing SIFMA's comments on the SEC's proposal to adopt Rule 15c3-5 is available at http://sec.gov/comments/s7-03-10/s70310-56.pdf.

basis, the CSA should reconsider the benefit of requiring that immediate information be made available, if such information will not be put to immediate use. Rather, the CSA should consider requiring that such information be made available to marketplace participants' compliance staff as soon as needed for the compliance staff to conduct post-trade surveillance in accordance with their normal processes.

The CSA also should provide clarification on which personnel will be considered "compliance staff" and thus those who are required to be provided with immediate access to order and trade information.

### C. Clearly Erroneous Trades

Proposed Section 16 would require marketplaces to have the capability to cancel, vary or correct clearly erroneous trades. Where a marketplace has retained a regulation services provider, the Proposal requires that the marketplace not cancel, vary or correct a trade unless instructed to do so by the regulation services provider.

CSA should consider whether the Canadian markets would be better served by a uniform approach across all marketplaces, rather than different marketplaces and transactions being subject to different rules and standards, depending on whether the marketplace has retained a regulation services provider. Under a uniform rule, either (i) each marketplace would have the authority to determine whether a trade on that marketplace is clearly erroneous, or (ii) a regulation services provider or a securities commission makes the determination for all marketplaces.

### D. Fixed Income Securities and Other Instruments

The CSA should clarify the extent to which the Proposal applies to trading in instruments other than equity securities, such as fixed income securities or security futures. These instruments may trade on exchanges or other quotation systems that would fall under the definition of "marketplace" as defined in National Instrument 21-101. To the extent that trading in fixed income securities and other instruments is intended to be captured by the Proposal, we would urge the CSA, in implementing the Proposal, to be cognizant that the trading platforms and processes that exist for fixed income securities and other instruments may differ from the equity platforms and processes. More technological investment and phase-in time may be required for implementation of the Proposal in these other markets.[3]

[3] *See, e.g.*, Exchange Act Release No. 64748 (June 27, 2011) (SEC release adopting a later Rule 15c3-5 compliance date for fixed income securities, among other things).

## II. Direct Electronic Access

### A. Exempt Market Dealers as DEA Clients

Proposed Section 6(2) would permit a participant dealer to provide direct electronic access ("DEA") to a registrant only if the registrant is a participant dealer or a portfolio manager. This restriction would prohibit a participant dealer from providing DEA to an entity that is registered as an exempt market dealer ("EMDs"). This restriction is not necessary to protect the Canadian markets and unnecessarily discriminates against EMDs. EMDs, although not members of the Investment Industry Regulatory Organization of Canada ("IIROC"), are fully registered and regulated. While the Proposal indicates that the CSA are concerned that EMDs are not members of IIROC or subject to the Uniform Market Integrity Rules ("UMIR"), there are various other categories of permissible DEA clients that are not IIROC members or subject to UMIR, including individuals and unregistered entities. We cannot see how EMDs' use of DEA could present a greater risk than the use of DEA by individuals or unregistered entities that are not subject to direct regulatory oversight and have no regulatory responsibilities.

The CSA should consider the potential consequences of maintaining the proposed exclusion. For example, since unregistered firms are permitted to be DEA clients, EMDs could potentially form unregistered affiliates and conduct their DEA activities through the affiliate, free from regulatory supervision.

The proposed exclusion of EMDs from acting as DEA clients would have the effect of discriminating against many non-Canadian firms. Frequently, non-Canadian firms whose activities would generally qualify for an exemption from Canadian registration may register as an EMD in order to conduct a limited business. Separate from their EMD business, these firms are often DEA clients of Canadian participant dealers in order to access the Canadian markets themselves and provide access to their clients. If these firms are excluded from being DEA clients, they are likely to terminate their limited EMD activities and operate on an unregistered basis in order to qualify for DEA. This is especially true because, under proposed Section 11(2)(c), many non-Canadian firms with DEA would be permitted to facilitate trading for the account of their clients, so long as the firm is not registered as an EMD. If the cost of engaging in a limited EMD business is the ability to receive DEA and provide clients with access to the Canadian markets, many non-Canadian firms will view that cost as too high and stop providing EMD services. Such a result would not seem to provide a regulatory benefit.

### B. Definition of DEA

In order to comply with the Proposal as it relates to DEA, firms need a clear understanding of the definition of "direct electronic access" and what it covers and does not cover. In this regard, we would ask that the CSA provide additional guidance on the definition. For example, the definition contained in proposed Section 1 states that it includes orders transmitted "without re-entry or additional order management by the participant dealer." The CSA should clarify what types of activities by a participant

dealer would constitute re-entry or order management. For example, would a participant dealer's application of risk controls or intelligent order routing systems qualify as re-entry or order management?

### C. Written Agreements

Proposed Section 10 would require that, in order to grant DEA to a client, a participant dealer must have a written agreement in place setting forth various specific obligations of the DEA client. The CSA should reconsider whether this requirement is essential. Many participant dealers currently have DEA arrangements in place with clients. Requiring that all these relationships be renegotiated and new contracts be entered into would be exceedingly burdensome. In addition, while the Proposal would require DEA clients to agree contractually to comply with regulatory requirements and financial limits, these contractual obligations are unnecessary to protect the markets. The Proposal primarily places the obligation of ensuring DEA client's compliance on the participant dealer. The manner in which the participant dealer chooses to satisfy itself that the DEA client will comply with these requirements – be it through a written agreement or otherwise – should be left to the particular participant dealer to decide.

### D. Training of DEA Clients

Proposed Section 9 would require that participant dealers ensure that each DEA client have "adequate" knowledge of the relevant marketplace and regulatory requirements and provide any needed training—both before granting DEA access and on an ongoing basis. The CSA should consider providing further guidance on how a participant dealer may establish that the client's knowledge is adequate. May participant dealers rely on representations from the client, absent reason to believe the representations are false? Could the participant dealer rely on the DEA client's background and the participant dealer's prior experience with the client, or would something more be needed?

The CSA also should clarify the type of training it envisions taking place. Could the participant dealer fulfill this obligation by sending each DEA client written materials, or would more interactive training be required? Would the participant dealer be required to follow up with examinations of individual employees of the DEA client to confirm they are knowledgeable?

Further, according to the Companion Policy, participant dealers may need to "require the client to have the same training required of marketplace participants." The CSA should reconsider whether this is feasible or necessary. Once the controls required under the Proposal are in place, all of the DEA clients' trading will be subject to regulatory controls under the exclusive control of the participant dealer. With their trading filtered as such, it is questionable whether it is necessary to require the DEA client to have the same level of proficiency as a marketplace participant.

### E. Affiliates as DEA Clients

Proposed Section 3(4) would require that risk management controls be under the direct and exclusive control of the marketplace participant, while proposed Section 3(5) would require that any third party providing risk management controls must be independent from each DEA client of the marketplace participant.

The CSA should consider excepting the application of these provisions in cases of DEA clients that are affiliates of the marketplace participant providing access. In many cases, global firms arrange to have affiliated entities trade directly through an affiliated marketplace participant. The affiliate that is the DEA client uses pre-trade risk controls that are set by the firm on a global basis, but are not directly controlled by the marketplace participant. The entity providing the controls in this case is not "independent," because it is an affiliate of both the DEA client and the marketplace participant. However, because these firms are related entities, the marketplace participant is not subject to the types of financial risks that arise from providing DEA to unaffiliated clients.

## III. Automated Order Systems

### A. Interference with Fair and Orderly Markets

SIFMA supports the goal of preventing automated order systems from causing market disruptions. However, proposed Section 5(1) would require that automated order systems "must not interfere" with fair and orderly markets. The CSA should consider whether this requirement sets a feasible standard, given that even the best designed automated order systems pose some risk of unintended consequences during times of unforeseeable market conditions. At most, the CSA should consider whether the rule should require that automated order systems be "reasonably designed" so as not to interfere with fair and orderly markets. In practice, a reasonably designed automated order system, which is constrained by the risk management and supervisory controls required under proposed Section 3, is unlikely to interfere with fair and orderly markets.

### B. Knowledge and Understanding of Automated Order Systems

Proposed Section 5(2) would require that marketplace participants have the necessary knowledge and understanding of any automated order system used by its clients in order to manage its risks. SIFMA has concerns regarding the level of knowledge of a client's automated order system that the CSA would expect. As the Proposal acknowledges, the workings of automated order systems are considered proprietary and highly confidential. Clients of marketplace participants are likely to be uncomfortable with sharing much detail about their systems' features and programming due to these confidentiality concerns.

If clients are unwilling to share this information, this requirement may have the impact (whether intended or not) of forcing these clients to become a marketplace participant themselves in order to access the market without divulging their proprietary systems to potential competitors.

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We would be pleased to discuss these comments in greater detail with the CSA and their staff. If you have any comments or questions, please do not hesitate to contact me at 202.962.7300 or avlcek@sifma.org.

Sincerely yours,

/s/ Ann Vlcek

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