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Director, Montreal

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Mr. James E. Twiss
Vice-President Policy of Market Regulation
Investment Industry Regulatory Organization of Canada
121 King Street West, Suite 1600
Toronto, ON M5H 3T9

Email: jtwiss@iiroc.ca

Dear Mr. Twiss:

RE: Proposed Guidance on the Guarantee by a Participant of a Trade Price for a Client Order

The Investment Industry Association of Canada appreciates the opportunity to comment on IIROC's *Proposed Guidance on the Guarantee by a Participant of a Trade Price for a Client Order*.

As IIAC celebrates its fifth anniversary in 2011, its continued success in reinforcing value and relevance is reflected in the fact that today 180 member organizations representing 95% of IIROC member firms are members of IIAC. These firms range in size from small regional firms to large organizations that employ thousands of investment industry professionals across the country.

In this letter, we will comment on the proposal to expand the scope of this Proposed Guidance for Rule 7.5 of the Universal Market Integrity Rules ("UMIR"). We note that, in general, the expansion of this rule is perceived positively by our members, and reflects IIROC's mission to protect investors while enhancing the efficiency and competitiveness of the Canadian capital markets.

Background

Guarantees by a Participant of a trade price for a client order has been described under Rule 7.5 of UMIR since 2006. This Rule imposed a certain number of restrictions regarding the trade price of a transaction between a Participant and its client.

In this new notice, which repeals and replaces the guidance of February 2006, certain restrictions applicable to Rule 7.5 remain unchanged, including:

- 1) recorded prices, and the prohibition from providing a “negative commission” to a client,
- 2) the guarantee, by a Participant, of a trade price based on a benchmark event,
- 3) profit-sharing with the client as a result of hedging activities, and
- 4) the procedures for prior notification of IIROC.

What is changing in the proposed version is IIROC’s addition of the possibility for a Participant to guarantee a predetermined amount (percentage) of "outperformance".

Outperformance

When a Participant wishes to guarantee, as principal, a trade price that "outperforms" a benchmark event even before the Participant has undertaken any of its hedging activities, IIROC will deem this outperformance to be reasonable only if it is based on historical hedging activities over the preceding calendar quarter. The results must also be obtained through hedging activities that relate to the same, or to substantially similar, securities. The guaranteed outperformance may not be higher than the lesser of either 50% of the historical outperformance, or 30 basis points.

In addition, Participants who intend to offer such a guarantee must have adequate policies and procedures already in place in conformity with IIROC requirements.

As in the case of trade price guarantees, IIROC must also be given notification of the outperformance.

Comments

Outperformance

On page 3 of Appendix “A”, the paragraph titled "Guaranteed Outperformance" is the principal addition to the Proposed Guidance, and it is generating the greatest number of comments from stakeholders. Our members' concerns and comments can be summarized as follows.

It would appear that IIROC prefers to keep this type of guarantee activity to a minimum by imposing conditions that many of our members characterize as "highly restrictive."

Gathering historical hedging activities statistics presents a challenge for industry, even for investment dealers operating nationwide. To track, measure, store and maintain historical data on this scale is difficult and expensive, requiring significant investments in information technology by members. Furthermore, it may be equally difficult for IIROC to keep track of, and use effectively, all the incoming data. And finally, the requirement for historical outperformance data puts newcomers to this market at a competitive disadvantage compared to Participants already operating in this niche.

The reference period defined in the text also raises questions. Reference is made to "historical data over the preceding calendar quarter". Interpretations differ widely, **we suggests that further details and clarification would be advisable.**

Benchmark Event

A Participant may be asked by a client to guarantee the price of a security based on a benchmark event. IIROC limits these to two, namely the "MOC" (Market-on-Close) and the "VWAP" (Volume-Weighted Average Price calculated for a given period). The Proposed Guidance also mentions "any other benchmark price which has been approved by IIROC". **It is recommended that a full list already approved benchmarks be included in the new Notice and/or that the new Notice could reference a document on the IIROC's website that could be updated as the market progresses.**

Traders and Risk

Comments received from members on trading desks frequently addressed risk issues. Traders, by definition, are risk managers. Traders would prefer to offer their clients guarantees in an environment where the risk-taking is more the result of their own initiative. In this context, the traders' comments include the observation that the Proposed Guidance is attempting to catch up to other markets that already allow both guarantees and profit-sharing. However, the attached terms are perceived as too restrictive if that is the case, and IIROC is attempting to limit this activity with overly tight regulation. **A suggestion would be to permit Participants to offer clients this type of guarantee with a lower guarantee, and without the historical data requirement.**

Presentation

Many of our members stated that they had difficulty identifying the new elements in the Proposed Guidance, and the general opinion is that this text as drafted is not particularly user-friendly. **We recommend that when the Notice is published as final, a track-changes version be provided.**

Thank you for your interest in our comments and those of our members. If you have any questions, please feel free to contact the undersigned.

Best regards,

“Marcel St-Amour”