



May 5, 2011

Re: IIROC response to comments on over-the-counter securities fair pricing rule and confirmation disclosure requirements

This summary responds to the four comment letters received on the proposed over-the-counter securities fair pricing rule and confirmation disclosure requirements that were re-published for comment on June 4, 2010. We have considered the comments received and we thank all the commenters for their submissions. The comments specific to the proposed Rule and draft Guidance Note have been summarized to correspond with the major components of the proposed amendments, followed by IIROC staff response to the comments.

Over-the-counter traded security fair pricing rule and draft Guidance Note

We have received the following comments regarding the over-the-counter (OTC) securities fair pricing rule:

- Three comment letters indicated their support for the proposed fair pricing initiative.
- One comment letter stated that minimal guidance was provided in the Notice as to how market participants fulfill their obligations or what amount of effort constitutes “reasonable” in terms of effort and price fairness. The comment letter indicated that guidance by regulators suggesting that access to the consolidated prices from Canada’s primary dealers, such as those that form the basis of the CanDeal composite, would constitute “reasonable effort” will standardize the application of the rule while increasing compliance by marketplace constituents.

IIROC staff response

We refer the commenter to the draft Guidance Note attached to the IIROC Notice requesting comments which provides guidance relating to the “reasonable efforts” requirement. We believe that the guidance provided therein is sufficient in that it states the standard which must be met in carrying out this duty, and provides an example in the context of an illiquid security. The proposed fair pricing rule is drafted as a principles-based rule. The context of each transaction will determine the manner in which a Dealer Member satisfies the fair pricing requirement and the degree of effort required. As a result, it would be inappropriate for IIROC to designate the consultation of one specific source of market information as a means of satisfying the fair pricing requirement.

Fixed income security yield disclosure to clients

We have received the following comments regarding the requirement to disclose on trade confirmations the yield to maturity for fixed income securities:

- One comment letter indicated its support for the inclusion of a requirement to disclose the yield on fixed income securities on trade confirmations delivered to clients.
- One comment letter indicated that some clarification regarding the disclosure of yield may be appropriate, particularly regarding the types of securities that are included in (or excluded from) “fixed income” securities. The comment letter asked whether guaranteed investments or principal protected notes were included in the definition.
- One comment letter suggested that the yield disclosure should only apply to retail clients, and would appreciate specific clarification from IIROC as to whether the yield disclosure requirement also applies to institutional clients.
- One comment letter stated that IIROC should be clearer on whether it is necessary to print “callable” or “the coupon rate may vary” for the applicable debt securities, on the front or back of the confirmation. The letter indicates that a service bureau has confirmed that they will encounter difficulties in adding this information due to the restricted space available, and therefore it would be preferable if a brief statement could be added to the back of the confirmation.

IIROC staff response

As the proposed amendments relating to yield disclosure indicate, the requirements apply to “all other debt instruments, other than stripped coupons and residual debt instruments.” The yield disclosure requirements applicable to stripped coupons and residual debt instruments will continue to exist in clauses (20) and (21) of Dealer Member Rule 200.1(h). Since the proposed amendments apply to debt securities only, guaranteed investment certificates (GICs) and principal protected notes (PPNs) are not subject to the yield disclosure requirements. It should be noted with respect to GICs and PPNs that the concept of yield disclosure is basically inapplicable. In the case of GICs, the yield is the stated coupon rate. With PPNs, the yield is generally unknown at the time of purchase.

The yield disclosure requirements apply to debt transactions executed by both retail and institutional clients, therefore no distinction is made between retail and institutional clients in the proposed amendments. We have deliberately framed the rule in this manner to reflect IIROC’s strongly held view regarding the significance of yield information to both retail and institutional clients.

The notations of “callable” and “the coupon rate may vary” for applicable debt securities must be printed on the front of the trade confirmation, as is the practice with other requirements contained in Dealer Member Rule 200.1(h) concerning confirmation requirements. We believe that allowing these notations to be printed on the back of the confirmation may often result in the client missing this important disclosure item.

As we have indicated in response to previous comments regarding the operational issues associated with the proposed amendments, we acknowledge that the proposed requirements will require Dealer Members to update their systems in order to include the required information on trade confirmations. Having said that, IIROC has consulted with the major service bureaus to ensure the rules can come into effect according to a reasonable implementation plan. Similar proposals are being passed by FINRA in the United States that are more complex than the IIROC proposed requirements in terms of the amount and possible variations of disclosure required, yet

implementation issues do not appear to be an impediment to the viability of the FINRA proposals. IIROC believes its proposed requirements relating to disclosure achieve an effective and relatively streamlined form of disclosure.

Remuneration disclosure statement to retail clients

We have received the following comments regarding the remuneration disclosure requirement on trade confirmations sent to retail clients:

- One comment letter states that the mark-up or mark-down on OTC equity security trades should be required to be disclosed on trade confirmations. The proposed inclusion of the statement "The investment dealer's remuneration on this transaction has been added to the price in the case of a purchase or deducted from the price in the case of a sale" is an improvement on the current state of disclosure, but does not go far enough to give retail investors concrete information on what they, in fact, have paid for their trades.
- One comment letter suggests that IIROC should allow for the remuneration statement to be situated on the back of the trade confirmation, due to its lengthy explanation. The comment letter also indicates that it may be difficult for service providers to differentiate between some dealer members' retail and institutional trades.

IIROC staff response

As we have previously indicated, there are structural impediments to determining the actual, dollar amount of remuneration received by a Dealer Member with respect to a transaction involving an OTC debt security. These impediments could result in clients receiving inaccurate information which would, in all likelihood, give rise to greater client confusion. IIROC believes that the same structural impediments and possibility of client confusion exists for OTC equity transactions.

With respect to the suggestion that the remuneration disclosure statement be situated on the back of the confirmation, it should be kept in mind that the remuneration disclosure statement is proposed as an alternative to disclosing the actual amount of the Dealer Member's remuneration on the trade confirmation. In light of that fact, we believe that allowing the remuneration disclosure statement to be printed on the back of the confirmation would diminish the value of the disclosure to a point that it could no longer be considered to be an appropriate alternative to disclosure of the actual dollar amount of remuneration.

With respect to the operational issues relating to the printing of the remuneration disclosure statement, we refer the commenter to our response on the preceding page regarding the operational issues associated with the proposed amendments generally. Furthermore, there is no requirement to suppress the remuneration disclosure statement on confirmations for institutional clients. To be clear, the requirement applies only in respect of retail clients; however, we have no objection to Dealer Member providing the statement to both retail and institutional clients.

Other Issues - Implementation

We have received the following comments regarding the implementation of the proposed amendments:

- One comment letter indicated that the proposed effective date of six months from publication for the confirmation disclosure requirement does not provide enough time for Dealer Members to make the required system changes as Dealer Members will be reliant upon third-party service providers for many of the systems changes. Aside from the vendors' work requirements, Dealer Members will also need to make necessary changes to some of their in-house systems and allow

time for adequate testing. The likely timing of IIROC's approval of the rule is also problematic as the six month implementation period will straddle firms' fiscal and calendar year end where system freezes are common. The limited amount of space currently available on the client confirmation continues to be an issue in need of address by Dealer Members and also contributes to the need for some additional time.

- In respect of the yield disclosure and remuneration disclosure statement requirements, one comment letter stated that Dealer Members need to avoid any manual interventions in order to comply with these new requirements. The comment letter suggests that the cost of monitoring these new processes will outweigh the benefit, which may result in Dealer Members being non-complainant with IIROC regulations.

IIROC staff response

We have agreed to lengthen the period of time in which Dealer Members must implement the system changes, relating to confirmation disclosure, to one year after IIROC staff issues a Notice confirming that approval of the amendments has been received from IIROC's recognizing regulators. Dealer Members will need to revise their systems as required to include the required information on trade confirmations. The level of manual intervention will need to be determined by each Dealer Member, although we anticipate that Dealer Members will design their systems to avoid manual intervention to the greatest extent possible. The confirmation disclosure requirements have not changed from the time IIROC first proposed these amendments and the service bureaus have been aware of this proposal since that time. IIROC firmly believes that the direct benefit to investors, and the related enhancement of investor confidence in the industry, outweighs the associated costs. IIROC has given careful consideration to the appropriate length of time for the implementation period relating to the confirmation disclosure requirements and we expect Dealer Members to be compliant with these requirements by the implementation date, particularly in light of the one year implementation period.