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GLOBAL BANKING AND MARKETS

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Via Email

Re: Proposed Amendments Respecting Net Asset Value Orders and Intentional Crosses

Scotiabank appreciates the opportunity to comment on the proposal by CIRO to amend UMIR by introducing an explicit definition for a "Net Asset Value Order", clarifying the expectations of handling such orders, and relaxing the prohibition on entering jitney orders as one side of an intentional cross.

General Remarks

Scotiabank's supports CIRO's proposed amendments. Dealers routinely accommodate client instructions to trade ETFs at prices related to a fund's published NAV using workflows that comply with

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UMIR but which do not explicitly identify the nature of the transaction to the public. Introducing an explicit order marker will allow the broader investment community to have better insight into the nature of these transactions, particularly when they are material in size. We also agree with clients' desire to price block transactions in relation to a fund's net asset value, particularly in situations where fund families are engaging in transactions among funds from the same family, and where a certain fund's NAV may be struck in relation to the NAV of an ETF holding. Indeed, this is not CIRO's first foray in this area, as 2015 amendments to UMIR related to the definition of a basis order explicitly recognized the need to price transactions based on the underlying asset value of an ETF.

Notwithstanding the above, we believe that NAV-linked transactions should be used in contexts where economic reasons exist to avoid trading the ETF in the traditional and continuous secondary market. We would be concerned about any developments where NAV-linked orders are used by investors, particularly within the retail community, to bypass the secondary market. We have seen examples of such activity and believe it diminishes the value of quoting on ETFs and can lead to a hollowing out of secondary liquidity. Further, since NAV-linked orders are fundamentally bespoke in nature, they are unlikely to be routinely made available to all investors – including direct-investing clients. This raises the potential for investor perceptions of a two-tiered market, leading to concerns over fairness and a potential for reduced confidence in the ETF structure as a whole.

We also support changing the definition of "intentional cross" to remove the prohibition on jitney participants being on one (or more) side of the trade. We believe this restriction currently limits the ability of certain participants to interact on a block basis with the market making community without resorting to workflows which meet the letter but not the spirit of the prohibition. Instead, the restriction has the effect of disadvantaging clients of carrying firms that rely on the broader dealer community for risk capital and facilitation activities.

Answers to Specific Questions

Question 1 *Should we impose any restrictions on the entry of a Net Asset Value Order? (e.g., should we restrict the entry of a Net Asset Value Order to orders greater than a minimum size?) If so, please explain why and set out what the minimum size should be.*

The Net Asset Value Orders designation introduces a mutual fund concept into the ETF trading paradigm. While there are legitimate and necessary reasons for NAV-linked transactions in ETFs, we would be concerned if Net Asset Value Orders became the default means for some investors to access the ETF market. Indeed, we have seen that some in the community, including certain ETF issuers, market "NAV orders" as a way for investors to purchase ETFs notwithstanding low traded volume and therefore poor perceptions of fund liquidity. In those cases, NAV orders serve to circumvent secondary markets in ETFs and diminish the value of price discovery provided by ETF market makers.

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We suggest that this risk can be address through a countervailing policy measure: require dealers to establish policies & procedures that require Net Asset Value orders to be either:

- Greater in size than one PNU of the ETF at question (at the time of order entry), or
- Documented as having bona fide investor rationale for avoiding a continuous secondary market transaction.

We believe dealers should be permitted to service legitimate investor needs, and that it is not CIRO's role to determine which trading strategies are appropriate for an investor at a point in time. However, where investor needs conflict with regulatory policy concerns, documentation of the rationale can serve as a check and balance.

The above approach does not prescribe a specific size, precisely because one size does not fit all in the ETF space.

Question 2 *Should we impose any restrictions on the use of an intentional cross with jitney? (e.g., should we impose a minimum size threshold that would apply when entering an intentional cross with jitney on one side of the trade?) If you believe a minimum size threshold is appropriate, please explain why and set out what the threshold should be.*

We do not believe that a minimum size for jitney intentional cross orders is appropriate or necessary. However, we believe that jitney orders remain subject to UMIR 8.1 requirements for trading against dealer inventory, as the jitney participant is seen as a client of an executing dealer.

Historical concerns related to jitney intentional crossing, as well as jitney broker preferencing, centered on the ability of dealers to establish multi-dealer workflows that would advantage activities from some dealers over those of others. This would be in conflict with fair and equitable principles of trade.To the extent that these concerns remain, we believe it is sufficient for CIRO to monitor jitney intentional cross activity and assess if additional steps are required.

Question 3 *While CIRO would generally expect that a Net Asset Value Order should be executed as soon as is practical after publication of NAV by the issuer of the ETF, should this be directly included as a requirement for entry of a Net Asset Value Order (i.e., where NAV is published after trading hours have ended on all Canadian marketplaces, should Participants be required to execute those trades as soon as trading hours begin on a Canadian marketplace the following trading day)?*

We believe CIRO's expectation is reasonable and consistent with industry practices, and no explicit requirement is necessary.

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Question 4 *The Proposed Amendments would add a new designation of a "Net Asset Value Order" in UMIR 6.2(1)(b) that would be required to be applied with the entry of a "Net Asset Value Order" on a marketplace, and which would be required to be disclosed for display by the marketplace on which the "Net Asset Value Order" is entered. Have you identified any concerns with public disclosure of an order that is a "Net Asset Value Order"?*

We have no concerns with public disclosure that an order is a "Net Asset Value Order."

Question 5 *The definition of a "Net Asset Value Order" as proposed does not require the execution price to be the exact NAV as published by the issuer of the ETF, but instead at a price that references the published NAV. This reference price may include fees incurred by the executing Participant and/or commissions embedded in the execution price. Please identify any concerns with this proposed approach.*

We support this approach.

Question 6 *Have we identified all the material impacts on clients, issuers, Participants, Access Persons, marketplaces or CIRO as a result of the Proposed Amendments? If not, please list any other impacts that you believe will materially impact one or more parties and why. In particular, please provide comments on the potential costs associated with the proposed introduction of a Net Asset Value Order, and associated designation requirements under UMIR 6.2.*

In addition to the identified impacts, we wish to highlight that a requirement for executing dealers to identify the jitneying dealer's end client LEI is impractical and may serve as a functional deterrent to the use of jitney intentional crosses.

First, many jitney intentional cross orders are arranged through "upstairs" negotiation and may not involve the communication of orders via fully integrated electronic means. This includes the use of RFQ platforms, which currently do not communicate underlying client LEIs from a jitneying firm to its executing firm. In practice, this would mean that the executing firm has no means of supplying the underlying LEI.

Second, jitneying firms may have significant confidentiality concerns around sharing the LEI of their underlying client with an executing dealer. This would be equivalent to disclosing the identity of a client directly, a practice that would violate client confidentiality. While it is possible, in principle, to communicate encrypted LEIs to the executing firm, this requires additional investment in infrastructure with little benefit to the underlying client or to the jitneying firm.
UMIR already contemplates several instances where a client LEI is not supplied on trade execution, including "multiple client" transactions and bundled trades. We therefore believe that an appropriate approach is to require the jitneying portion of an intentional cross to be disclosed with the LEI of the

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jitneying dealer, and for the jitneying dealer to maintain adequate records of the LEIs of their underlying clients involved in each jitney transaction.

We anticipate that jitney intentional cross transactions to be relatively rare as a percentage of all Canadian trading activity, and certainly less frequent than the incidence of "multiple client" or "bundled" transactions in the market today. We therefore believe that imposing infrastructure build and costs on participants to support jitney intentional crosses would lead to costs that exceed benefits.

If jitney intentional crosses were to require disclosing underlying client LEIs, we believe most jitneying dealers would opt to meet their counterparties in the market, and result in unintentional crosses. This becomes an "intentional unintentional cross" and is less transparent in its nature to both investors and regulators. In the case of jitney intentional crosses that are also Net Asset Value Orders, the jitneying firms would be left with the gap that exists today, in that they are unable to execute Net Asset Value Order because Net Asset Value Orders are executed through an intentional cross.

We therefore recommend that the LEI requirements on jitney intentional crosses be amended to allow the recordkeeping responsibility to remain with the jitneying firm, thus preserving both functional ease and client confidentiality.

Question 7 *Overall, do you agree with CIRO's qualitative assessment that the benefits of the Proposed Amendments are proportionate to their costs? Please provide reasons for your views.*

Yes.

Closing Comments

This proposal is the result of a comprehensive consultation undertaken by CIRO in response to industry concerns. We commend CIRO staff for their proactive and thoughtful engagement with industry to both understand and address the gap between UMIR requirements and practical investor needs today. We thank CIRO for its approach and appreciate the opportunity to comment on these proposed changes.

Respectfully,

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