13.1.3 Request for Comments - Amendments to the TSX Direct Access Rules

REQUEST FOR COMMENTS
AMENDMENTS TO THE DIRECT ACCESS RULES

The Board of Directors of TSX Inc. has approved amendments (Amendments) to the Rules of the Toronto Stock Exchange (TSX Rules). The Amendments broaden the prescribed classes of eligible clients set out in Policy 2-501(1) in three main ways:

(i) they expand the existing class of investment counsellors and portfolio managers to include other Canadian registrants (for example, investment dealers) other than Participating Organizations (POs);

(ii) they expand the existing class of foreign dealers who are affiliated with POs to include any foreign dealer whose home jurisdiction is a Basle Accord Country; and

(iii) they include a new class of clients that have total securities under management of at least $10 million and who are domiciled in a Basle Accord Country.

The text of the Amendments, shown as blacklined text, is attached. Discussion of the Amendments is provided in Part II below. The Amendments will be effective upon approval by the Ontario Securities Commission (Commission) following public notice and comment. Comments on the proposed amendments should be in writing and delivered by February 13, 2006 to:

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A copy should also be provided to:

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Terms not defined in this Request for Comments are defined in the TSX Rules.

I. Overview

Toronto Stock Exchange (Exchange), similar to exchanges that operate in major capital markets around the world, allows certain customers to access its trading systems through sponsored direct access. This allows a customer's order flow to reach the Exchange quickly as the order passes through electronic infrastructure before entering the trading engine for execution. The sponsored direct access mechanism has been made available through a set of rules and policies of Toronto Stock Exchange. Specifically, Rule and Policy 2-501 provides the prescribed categories of eligible clients, Rule and Policy 2-502 outlines the conditions for connection, and Rule 2-503 clarifies the responsibility of POs that offer this service.

The purpose of sponsored direct access is to facilitate a differentiated service to certain customers. In particular, this service provides convenience as the customer can "self-serve" its needs without intermediary interference. It also reduces the potential for information leakage, as the customer's proprietary trading strategy is not shared with the PO. This has the effect of reducing both explicit and implicit trading costs. Explicit trading costs are reduced as commissions charged by POs are lower on sponsored direct access trading because there are fewer and lower fixed and variable costs borne by the PO. Implicit trading costs decrease as the market impact of information leakage is reduced.

Lower trading costs paid by sponsored direct access clients ultimately add liquidity to the marketplace. These clients typically re-inject their savings from lower trading costs by adding incremental order flow to the market. These clients typically are supported by electronic systems that allow a greater number of orders to be entered and simultaneously managed by the trader, which

adds to the size and depth of liquidity in the marketplace. Therefore, the price discovery process on the Exchange will be improved as sponsored direct access trading increases. This activity ultimately benefits capital markets as a whole.

The sponsored direct access rules were created in 1985, originally introduced as Toronto Stock Exchange Policy XXX. The rules have undergone some changes since then, but as Toronto Stock Exchange has evolved from a member-owned self-regulatory organization (SRO) to a globally competitive, publicly-owned exchange, these rules have not been revised to reflect the way market players interact with each other. The following illustrates the evolution of the eligibility category:

1985 – The original rule covered Canadian "defined financial institutions". Qualifications revolved around credit worthiness. Toronto Stock Exchange was a member-owned SRO at the time.

1994 - Seeking more order flow, the rule was expanded to include certain US qualified institutions, and Canadian investment counselors and portfolio managers.

1996 - To continue to enhance liquidity, the US qualified institution list was expanded to include US broker-dealers and other US registered institutions.

1999 – The rule was revised to ensure that a foreign dealer affiliated with a PO would not have its order flow restricted in any way.

2000 – In response to Canadian Securities Administrators' granting relief from certain suitability requirements, this category was expanded to include order-execution accounts.

II. Discussion of the Amendments

The intent of the Amendments is to modernize the definition of an eligible client to better service the needs of market participants. We also believe that the Amendments will increase order flow and therefore add liquidity to the Exchange. In drafting the Amendments, we have reviewed the Investment Dealers Association's (IDA) proposed Policy No. 4 – Minimum Standards for Institutional Account Opening, Operation and Supervision (IDA Policy 4). Proposed IDA Policy 4 recognizes that client accounts fall under two broad categories, institutional and retail. Proposed IDA Policy 4 will create consistency across the industry on procedures for opening institutional accounts, institutional account suitability review, and supervision of these accounts. In proposed IDA Policy 4, "institutional customer" is defined as: (i) Acceptable Counterparties; (ii) Acceptable Institutions; (iii) Regulated entities; (iv) Registrants (other than individual registrants) under securities legislation; and (v) a non-individual with total securities under administration or management exceeding $10 million. Many of the categories outlined in TSX Policy 2-501(1) already incorporate portions of the IDA's proposed definition of "institutional customer". Because sponsored direct access is very much intended to be used as trading tool by institutional clients, we believe that changing TSX Policy 2-501(1) to better align with the IDA's definition of institutional customer is a logical extension of the sponsored direct access rules.

Expand Investment Counsellor Category

TSX Policy 2-501(1)(b) is being revised to become consistent with proposed IDA Policy 4 – Part I.A.4 (the "registrant" part of the institutional customer definition). This change will allow all non-individual Canadian registrants to be eligible clients, as long as they are not POs. Recently, we have seen investment counsellors upgrade their registration status to investment dealer. This provides increased functionality and a higher profile for these entities. It is illogical that a company can be an eligible client when it is an investment counsellor, but loses this status when it upgrades its registration to investment dealer. The historical rationale for limiting registrant access was protectionist in nature. That is, investment dealers were forced to become POs if they wanted access to the Exchange. We believe that this barrier should now come down, as these entities would be worthy eligible clients.

Expand Foreign Dealer Category

TSX Policy 2-501(1)(c) currently does not treat non-U.S. foreign dealers equitably with their U.S. counterparts, as non-U.S. dealers must have a PO affiliate in order to be an eligible client. We believe that registered foreign broker-dealers from acceptable jurisdictions should be permitted to be eligible clients. We know that the Commission will want to ensure that it, Market Regulation Services Inc. (RS), and/or the Exchange, would be in a position to obtain trading and related account information about all eligible clients if the need arises. As such, we have restricted the expanded rule to include foreign broker-dealers from Basle Accord countries. We would expect that the regulators in these jurisdictions would be in a position to work with us, the Commission, and/or RS if trading information was ever needed from these foreign broker-dealer registrants.

This amendment will allow all foreign broker-dealers in Basle Accord Countries to qualify as eligible clients under Policy 2-501(1)(c), and to send orders to the Exchange via sponsored direct access. These orders may originate with a client or at the foreign broker/dealer itself. The foreign broker/dealer's clients need not be eligible clients themselves in order for the foreign broker/dealer to send their orders through sponsored direct access to the Exchange. With respect to U.S. registered dealers, so long as the U.S. remains a Basle Accord Country, U.S. registered dealers will qualify as eligible clients under Policy 2-501(1)(c),

and will be able to operate in compliance with this policy subsection even if they also qualify as eligible clients under Policy 2-501(1)(e).

Other Institutional Customers (Asset Test)

This rule change attempts to be consistent with proposed IDA Policy 4's definition of institutional customer. We believe that consistent definitions among SROs and marketplaces provide clarity to market participants. Proposed IDA Policy 4 – Part I.A.5 defines an institutional customer as including a "non-individual with total securities under administration or management exceeding $10 million."

This definition recognizes that smaller accounts of non-individuals may indeed represent sophisticated order flow and trading strategies. When using a high threshold financial means test to determine whether a client is sophisticated, the aggregate value of securities held in a company's portfolio is assumed to determine the sophistication of the client. We believe that in this evolving global market, assessing sophistication based solely on assets held is a faulty measurement because technology now allows smaller pools of capital to trade with sophisticated strategies. The sophistication of a client may better be determined by assessing the velocity in which securities are traded through its portfolio.

The new category set out in TSX Policy 2-501(1)(i) uses the language from proposed IDA Policy 4, but narrows this category to include only Basle Accord country domiciles. This should provide protection to Canadian markets if, as discussed above, regulatory investigations with respect to these clients are undertaken.

Housekeeping Changes

TSX Policy 2-501(1)(a) is revised to include "regulated entities" as an eligible client. This is consistent with the drafting in proposed IDA Policy 4. We do not expect that this will substantively change the category. TSX Policy 2-502(5) is deleted in its entirety as we do not operate an eWAP facility. TSX Policy 2-502(6) is deleted in its entirety as we no longer operate the POSIT call market.

III. Amendment Process

After discussion with various POs, proposed changes were raised for discussion at the June 2005 meeting of the Trading Advisory Committee (TAC) for TSX Inc. In July 2005, the Amendments were reviewed and approved by TAC. On July 26, 2005, the Board of Directors of TSX Inc. approved the Amendments.

IV. Other Jurisdictions

Competitors to Toronto Stock Exchange have recognized that expanding sponsored direct access is beneficial to the marketplace, and therefore have reduced related barriers. We summarize our findings below.

New York Stock Exchange – Allows institutional investors that are sponsored by a member firm to enter orders in the DOT system (the NYSE electronic order routing system) anonymously. NYSE does not prescribe any eligibility requirements for institutional investors.

NASDAQ – Similar to NYSE, customers require sponsorship (that is, a dealer to take regulatory responsibility) in order to directly access NASDAQ's SelectNet service. (SelectNet permits NASD member firms to enter buy/sell orders into the system and either direct the order to a market maker or broadcast the order to market participants.) The NASD does not prescribe eligibility categories in its rules.

London Stock Exchange – Members may allow buy-side firms to access the exchange through an automated order routing system, which receives and transmits orders to the Exchange. It does not prescribe eligibility requirements.

Euronext – Members may allow filtered access to clients. Euronext does not prescribe client eligibility requirements and it does not prescribe filter requirements.

As set out above, North American competitors to the Exchange and the major global exchanges comparable to the Exchange do not have any eligibility requirements for sponsored direct access. If the Amendments are approved by the Commission, the Exchange will maintain stronger standards for sponsored direct access than its competitors, while enhancing our POs' ability to serve their institutional clients. We believe that this is a fair balance between access for sophisticated investors and protection for our marketplace.

V. Public Interest Assessment

The Amendments are designed to expand the category of eligible client, the result of which will bring increased liquidity and enhanced price discovery to the Exchange. At the same time, our standards for sponsored direct access eligibility and access will remain among the toughest in the world. For these reasons, we believe that the Amendments are not contrary to the public interest.

We submit that in accordance with the Protocol for Commission Oversight of Toronto Stock Exchange Rule Proposals, the Amendments will be considered “public interest” in nature. The Amendments would, therefore, only become effective following public notice, a comment period and the approval of the Commission.

VI. Questions

Questions concerning this notice should be directed to Deanna Dobrowsky, Legal Counsel, Market Policy & Structure, TSX Group Inc. at (416) 947-4361.

THE RULES
OF
THE TORONTO STOCK EXCHANGE

RULES (as at December 1, 2004)	POLICIES
DIVISION 5 – CONNECTION OF ELIGIBLE CLIENTS OF PARTICIPATING ORGANIZATIONS	
2-501 Designation of Eligible Clients	**2-501 Designation of Eligible Clients**
The Exchange may from time to time prescribe classes of entities as eligible to transmit orders to the Exchange through a Participating Organization.	(1) Prescribed Classes of Entities For the purposes of Rule 2-501, the following classes of entities are prescribed as eligible to transmit orders to the Exchange through a Participating Organization: (a) a client that falls within the definition of "acceptable counterparties" ~~or~~, "acceptable institutions", or "regulated entities" as defined in the General Notes and Definitions section of the Joint Regulatory Financial Questionnaire and Report; (b) a client that is ~~registered as an investment counsellor or portfolio manager~~a non-individual and a registrant under the *Securities Act* of one or more of the Provinces and Territories of Canada, and is not a Participating Organization; (c) a client that is a foreign broker or dealer (or the equivalent registration) registered ~~with the appropriate regulatory body~~ in the broker's or dealer's home jurisdiction ~~and that is an affiliate of a Participating Organization acting for its own account, the accounts of other eligible clients or the accounts of its clients~~, where the home jurisdiction falls within the definition of "Basle Accord Countries" as defined in the General Notes and Definitions section of the Joint Regulatory Financial Questionnaire and Report; (d) a client that in the aggregate owns and invests on a discretionary basis at least $100 million in securities of issuers that are not affiliated with the customer and falls into one of the following categories: (i) an insurance company as defined in section 2(13) of the U.S. Securities Act of 1933, (ii) an investment company registered under the U.S. Securities Act of 1933 or any business development company as defined in section 2(a)(48) of that Act, (iii) a small business investment company

RULES (as at December 1, 2004)	POLICIES
	licensed by the U.S. Small Business Administration under section 301(c) or (d) of the U.S. Small Business Investment Act of 1958, (iv) a plan established and maintained by a U.S. state, its political subdivisions, or any agency or instrumentality of a U.S. state or its political subdivisions, for the benefit of its employees, (v) an employee benefit plan within the meaning of Title I of the U.S. Employee Retirement Income Securities Act of 1974, (vi) a trust fund whose trustee is a bank or trust company and whose participants are exclusively plans of the types identified in (iv) or (v) above, except trust funds that include as participants individual retirement accounts or U.S. H.R. 10 plans, (vii) a business development company as defined in section 202(a)(22) of the U.S. Investment Advisers Act of 1940, (viii) an organization described in section 501©(3) of the U.S. Internal Revenue Code, corporation (other than a bank as defined in section 3(a)(2) of the U.S. Securities Act of 1933 or a savings and loan association or other institution referenced in section 3(a)(5)(A) of the U.S. Securities Act of 1933 or a foreign bank or savings and loan association or equivalent institution), partnership or Massachusetts or similar business trust, and (ix) an investment adviser registered under the U.S. Investment Advisers Act; (e) a client that is a dealer registered pursuant to section 15 of the U.S. Securities Exchange Act of 1934, acting for its own account or the accounts of other eligible clients, that in the aggregate owns and invests on a discretionary basis at least $10 million of securities of issuers that are not affiliated with the dealer, provided that securities constituting the whole or a part of an unsold allotment to or subscription by a dealer as a participant in a public offering shall not be deemed to be owned by such dealer; (f) a client that is an investment company registered under the U.S. Investment

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	Company Act, acting for its own account or for the accounts of other Qualified Institutions, that is part of a family of investment companies which own in the aggregate at least $100 million in securities of issuers, other than issuers that are affiliated with the investment company or are part of such family of investment companies and, for these purposes, "family of investment companies" means any two or more investment companies registered under the U.S. Investment Company Act, except for a unit investment trust whose assets consist solely of shares of one or more registered investment companies, that have the same investment adviser (or, in the case of unit investment trusts, the same depositor), provided, for these purposes: (i) each series of a series company (as defined in Rule 18f-2 under the U.S. Investment Company Act) shall be deemed to be a separate investment company, and (ii) investment companies shall be deemed to have the same adviser (or depositor) if their advisers (or depositors) are majority-owned subsidiaries of the same parent, or if one investment company's adviser (or depositor) is a majority-owned subsidiary of the other investment company's adviser (or depositor); (g) a client, all of the equity owners of which are Qualified Institutions, acting for its own account or the accounts of other Qualified Institutions; (h) a client that is a bank as defined in section 3(a)(2) of the U.S. Securities Act of 1933, or any savings and loan institution or other institution as referenced in section 3(a)(5)(A) of the U.S. Securities Act of 1933, acting for its own account or the accounts of other Qualified Institutions, that in the aggregate owns and invests on a discretionary basis at least $100 million in securities of issuers that are not affiliated with it and that has an audited net worth of at least $25 million; (i) a client that is a non-individual with total securities under administration or management exceeding $10 million, where the client is domiciled in a jurisdiction that falls within the definition of "Basle Accord Countries" as defined in the General Notes and Definitions section of the Joint Regulatory Financial Questionnaire and Report; and

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	(j) ~~(i)~~ a client that enters an order through an Order-Execution Account. (2) Interpretation For the purposes of Policy 2-501(1): 1. In determining the aggregate amount of securities owned and invested on a discretionary basis by an entity, the following instruments and interests shall be excluded: bank deposit notes and certificates of deposit; loan participations; repurchase agreements; securities owned but subject to a repurchase agreement; and currency, interest rate and commodity swaps. 2. The aggregate value of securities owned and invested on a discretionary basis by an entity shall be the cost of such securities, except where the entity reports its securities holdings in its financial statements on the basis of their market value and no current information with respect to the cost of those securities has been published and in the latter event, the securities may be valued at market. In determining the aggregate amount of securities owned by an entity and invested on a discretionary basis, securities owned by subsidiaries of the entity that are consolidated with the entity in its financial statements prepared in accordance with generally accepted accounting principles may be included if the investments of such subsidiaries are managed under the discretion of the entity, except that, unless the entity is a reporting company under section 13 or 15(d) of the U.S. Securities Exchange Act, securities owned by such subsidiaries may not be included if the entity itself is a majority-owned subsidiary that would be included in the consolidated financial statements of another enterprise.
2-502 Conditions for Connections A Participating Organization may transmit orders received electronically from an eligible client directly to the trading system provided that the Participating Organization has: (a) obtained prior written approval of the Exchange that the system of the Participating Organization meets the prescribed conditions; (b) obtained prior written approval of the Exchange for a standard form of agreement containing the prescribed conditions to be entered into between the Participating Organization and an eligible client and the Participating Organization has entered into an agreement in such form with the eligible client; and	**2-502 Conditions for Connections** (1) System Requirements For the purposes of Rule 2-502(a), the system of the Participating Organization is required to: (a) support compliance with Exchange Requirements dealing with the entry and trading of orders by all eligible clients who will have direct access (for example, it must support all valid order information that may be required, including designation of short sales); (b) ensure security of access to the system (for example, through a password that will only enable persons at the eligible client authorized by the Participating Organization to have access to the system);

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(c) met such other conditions as prescribed.	(c) comply with specific requirements prescribed pursuant to Rule 2-502, including a facility to receive an immediate report of the entry or execution of orders; (d) enable the Participating Organization to employ order parameters or filters that will route orders over a certain size or value to the Participating Organization's trading desk (which parameters can be customized for each eligible client on the system); and (e) enable the Participating Organization to transmit information concerning unattributed orders entered by eligible clients to the Participating Organization's compliance staff on a real time basis. (2) Standard Form of Agreement For the purposes of Rule 2-502(b), the agreement between the Participating Organization and the client shall provide that: (a) the eligible client is authorized to connect to the Participating Organization's order routing system~~, eVWAP Facility, or the POSIT Call Market;~~; (b) the eligible client shall enter orders in compliance with Exchange Requirements respecting the entry and trading of orders and other applicable regulatory requirements; (c) specific parameters defining the orders that may be entered by the eligible client are stated, including restriction to specific securities or size of orders; (d) the Participating Organization has the right to reject an order for any reason; (e) the Participating Organization has the right to change or remove an order in the Book and has the right to cancel any trade made by the eligible client for any reason; (f) the Participating Organization has the right to discontinue accepting orders from the eligible client at any time without notice; (g) the Participating Organization agrees to train the eligible client in the Exchange Requirements dealing with the entry and trading of orders and other applicable Exchange Requirements; and (h) the Participating Organization accepts the responsibility to ensure that revisions and updates to Exchange Requirements relating to the entry and trading of orders are promptly

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	communicated to the eligible client. (3) Additional Requirements For the purposes of Rule 2-502(c), the following additional conditions shall apply: 1. Any changes to the standard system interconnect agreement shall be approved by the Exchange in writing before becoming effective. 2. If required by the terms of the agreement between the eligible client and the Participating Organization, the Participating Organization shall ensure that its eligible clients are trained in the appropriate Exchange trading rules, as well as the use of the terminal and system. Training materials regarding Exchange trading rules that the Participating Organization proposes to use must be reviewed by the Exchange prior to use. 3. The Participating Organization shall have the ability to receive an immediate report of the entry and execution of orders. The Participating Organization shall have the capability of rejecting orders that do not fall within the designated parameters of authorized orders for a particular client. 4. The Participating Organization shall designate a specific person as being responsible for the System Interconnect. Orders executed through System Interconnects shall be reviewed for compliance and credit purposes daily by such designated person of the Participating Organization. 5. The Participating Organization shall have procedures in place to ensure that only eligible clients use System Interconnects and that such eligible clients can comply with Exchange Requirements and other applicable regulatory requirements. The eligibility of eligible clients using System Interconnects shall be reviewed at least annually by the Participating Organization. 6. The Participating Organization shall make available for review by the Exchange, as required from time to time, copies of the system interconnect agreements between the Participating Organization and its eligible clients. (4) Order-Execution Account Requirements If the agreement required by Rule 2-502(b) is between a Participating Organization and a client in respect of an Order-Execution Account, the agreement: (a) may be in written form or be in the form of a written or electronic notice acknowledged by the client prior to the entry of the initial order in respect of such Order-Execution Account; and

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	(b) may omit provisions that would otherwise be required by Policy 2-502(2)(c), (g) and (h) if the order routing system of the Participating Organization: (i) enforces the Exchange Requirements relating to the entry of orders, or (ii) routes orders that do not comply with Exchange Requirements relating to the entry of orders to an Approved Trader for review prior to entry to the trading system. ~~(5) eVWAP Facility Requirements~~ ~~(a) Notwithstanding Policy 2-501(1)(i), for the purposes of Rule 2-501, clients eligible to transmit orders to the Exchange's eVWAP Facility exclude:~~ ~~(i) a client that is the resident in the U.S., and~~ ~~(ii) a client entering orders through and Order Execution Account.~~ ~~(b) If the agreement required by Rule 2-502(b) is between a designated Participating Organization and a client with respect to the eVWAP Facility, the agreement may omit provisions which may otherwise be required by Policy 2-502(1)(d), 2-502(2)(d) and (e), and 2-502(2)(3)3 if the system through which the order is transmitted:~~ ~~(i) enforces Exchange Requirements relating to the entry of orders,~~ ~~(ii) enforces the credit limits imposed by the designated Participating Organization, and~~ ~~(iii) has the ability to transmit a trade report to both the client and the designated Participating Organization.~~ ~~(6) POSIT Call Market Requirements~~ ~~The agreement required by Rule 2-502(b) between a Participating Organization and a client with respect to the POSIT Call Market may omit provisions otherwise required by Policy 2-502(1)(d), 2-502(2)(d) and (e), and 2-502(3)3 if:~~ ~~(a) the agreement provides that any person, other than the Exchange, who provides software, hardware or services to the Exchange ("Third Party Provider") to support the operations of, or the services or information accessible through, the trading system which shall include without limitation,~~

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	~~the POSIT Call Market, shall not be liable to the Participating Organization or the eligible client or any other person for any loss, damage, cost, expense or other liability or claim (including loss of business, profits, trading losses, loss of anticipated profits, business interruption, loss of business information or for indirect, special, punitive, consequential or incidental loss or damage or other pecuniary loss) of any nature arising from any use or inability to use the trading system, howsoever caused, including by the Third Party Provider's negligence or reckless or wilful act or omissions, even if the Third Party Providers are advised of such possibilities; and~~ ~~(b) a system through which the order is transmitted:~~ ~~(i) enforces Exchange Requirements relating to the entry of POSIT Orders; and~~ ~~(ii) has the ability to generate a trade report to the client and, for the purposes of disseminating the trade report to eligible clients outside of Canada, to the designated Participating Organization; and~~ ~~(c) the Participating Organization has the ability to access an eligible client's trade report through the STAMP query.~~
2-503 Responsibility of Participating Organizations A Participating Organization which enters into an agreement with a client to transmit orders received from the client in accordance with Rule 2-502 shall: (a) be responsible for compliance with Exchange Requirements with respect to the entry and execution of orders transmitted by eligible customers through the Participating Organization; and (b) provide the Exchange with prior written notification of the individual appointed to be responsible for such compliance.	