

13.1.2 TSX Request for Comments - Changes to the Market-On-Close System

**THE TORONTO STOCK EXCHANGE
CHANGES TO THE MARKET-ON-CLOSE SYSTEM**

REQUEST FOR COMMENTS

The Board of Directors of TSX Inc. has approved amendments (Amendments) to the Rules of the Toronto Stock Exchange (Rule Book). The Amendments provide for three changes to existing Market On Close (MOC) procedures: (i) an increase in the duration of the price movement extension period; (ii) the publication of an indicative calculated closing price; and (iii) a revision to the manner in which the calculated closing price is calculated on a "failed" MOC security. 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 Monday, February 14, 2005 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 Rule Book.

I. Background

In March, 2004, TSX began to phase-in the MOC system, mainly for symbols in the S&P/TSX 60 Index. TSX believes that the MOC facility provides improved access, fairness and liquidity to the marketplace.

Market priced MOC orders may be entered into the MOC Book during the MOC pre-opening session. During the blind limit order offsetting session, limit orders, seeking a part of the imbalance (contra-side), may be entered. During the Price Movement Extension (PME), limit orders on the contra-side of the imbalance may be entered. Order details are not publicly displayed for orders marked MOC.

The closing call is the mechanism by which the final calculated closing price (CCP) is determined. It combines the orders in the MOC Book and the continuous market book to determine the official closing price of a security. The CCP is determined using similar logic to the calculated opening price. The CCP uses the following drivers in making its calculation: price at which the greatest volume can trade; price at which there is the least imbalance; and price closest to the last sale price.

The PME parameter is a price control parameter used to determine whether the CCP adequately reflects the true price of a security or whether additional trading time is required to allow the market to adjust the CCP to an acceptable level. The PME is an extension of the imbalance offset, designed to solicit further liquidity and prices to offset the imbalance posted at 3:40 pm. The Closing Price Acceptance (CPA) parameter is a price control parameter that is used to either accept or reject the CCP that is derived from the PME.

II. Discussion of Rule Book Amendments

1. *Price Movement Extension duration*

The PME period currently extends from 4:00 p.m. to 4:05 p.m. The PME is used in the event that the CCP for a MOC Security at the close exceeds the volatility parameters determined by TSX. It is TSX's view that extending the PME by 5 minutes will provide market participants additional time to source liquidity in response to a significant price movement at the close. The Amendments provide that the duration of the PME period will be from 4:00pm to 4:10pm.

The large index rebalancing activity associated with the closing of the Manulife/John Hancock transaction on April 28, 2004 severely tested the ability of market participants to source additional liquidity during the five minute PME period. TSX received numerous complaints that the five minute window was too short and that better closing prices would have resulted for many securities if the duration of the window was expanded. Many participants advised that the focus on Manulife that was required of them during the five minutes post-close meant that they were unable to attend to trading other securities in the MOC Book post-close, and that another five minute extension would have provided them with the time they needed to effect such other trades.

The proposed extension of the duration of the PME will result in a shortened Special Trading Session (from 4:15 p.m. to 5:00 p.m. instead of the current Special Trading Session of 4:10 p.m. to 5:00 p.m.). TSX has consulted widely with market participants in connection with these proposed changes and we have not received any objections to the proposed shortening of the Special Trading Session.

The following sections of the Rule Book have been amended to provide for this proposed change: 1-101 Definitions ("MOC Book"); 4-902(3)(e); 4-902(4)(a) and (b).

2. *Indicative Calculated Closing Price*

As a further safeguard against unexpected closing results, TSX believes that an indicative calculated closing price (ICCP) should be broadcast at 3:50 p.m. The ICCP will indicate what the closing price for a MOC Security would be if, at the time of calculation, the regular trading session had ended. The ICCP will provide market participants with an early warning regarding potentially large price movements at the close. We believe that the ICCP broadcast will prompt market participants to offer additional liquidity in response to unexpected price volatility. The ICCP broadcast will also provide investors with continuous market orders additional information about the potential close rather than receive an unexpected surprise at the close. The broadcast will be disseminated in the same manner that the MOC Imbalance is broadcast at 3:40pm each Trading Day. Specifically, the ICCP message will be sent to data and trade station vendors for redistribution.

The following sections of the Rule Book have been amended to provide for this proposed change: 1-101 Definitions ("Indicative calculated closing price"); 4-902(3)(c).

3. *"Failed MOC" Procedures*

Under the current rules, where the CCP for a MOC Security exceeds the CPA volatility parameters at the end of the PME period, the last sale price of a board lot in the regular session becomes the closing price. Using this method, it is possible that a large number of MOC Orders will expire and be removed from the MOC Book. The Amendments provide that where the CCP for a MOC Security exceeds the CPA volatility parameters at the end of the PME period, the CCP will be determined to be the price at which most shares trade, leaving the least imbalance, where the price does not exceed the CPA volatility parameters. TSX believes that, with this amendment, a greater number of MOC Orders will be able to be executed in a "failed" session, as all tradable MOC Orders will be matched, up to the new calculated closing price value. It is our view that matching the maximum volume of stock to the CPA volatility parameters will also lower the risk for indexers going into the next day's market.

The following sections of the Rule Book have been amended to provide for this proposed change: 1-101 Definitions ("Last Sale Price"); 4-902(4)(b); 4-902(5)(b).

4. *Other Revisions*

The Amendments include other minor clarifying revisions to the Rule Book. The following sections of the Rule Book have been amended to provide for these incidental revisions: 1-101 Definitions ("MOC Limit Order"); 4-902(3)(b).

III. Change in Volatility Parameters

The following changes do not require a Rule Book change. They are being provided for information purposes only.

1. *Price Movement Extension Volatility Parameters*

Currently, the MOC system compares the CCP at the close against the price of the last board lot sale and the VWAP during the last twenty minutes of the continuous market. If the CCP falls outside of the range that extends from the greater of 10% above: the VWAP (calculated during the last twenty minutes of the continuous market) or the last board lot sale, down to the amount that is the lower of 10% less than: the VWAP (calculated during the last twenty minutes of the continuous market) or the last board lot sale, closing is delayed by five minutes. This five minute period is called the PME period and the 10% volatility parameters are referred to as the PME volatility parameters. During the PME period, market participants can enter more limit orders into the MOC Book and are provided with what the indicative closing price would have been at 4pm. This is intended to be a safeguard or a brake on the market to ensure that all market participants have an opportunity to react to a potential price swing of unusually large magnitude.

TSX believes that the 10% PME volatility parameters are too wide for an S&P/TSX 60 Index security and that these volatility parameters should be reduced from 10% to 5%. This view is consistent with statistics that show that, other than activity that occurred on April 28, 2004 (which was the result of an unusually large index portfolio rebalancing associated with the Manulife acquisition of John Hancock), there has only been one instance where the CCP would have exceeded a 5% volatility parameter. In this one instance, having a reduced volatility parameter of 5% would have given a warning to marketplace participants that something unexpected was happening to the security's price and would have placed the security into the PME period. This would have resulted in increased trading that likely would have produced a CCP that better reflected the true price of the security.

There have been a number of instances where a security's CCP has hovered around 4% from either the last sale or the VWAP. This statistic confirms our belief that the 5% parameters are not too large. The narrower parameters will allow participants to react to price swings of a smaller magnitude, which will ultimately result in a CCP that best represents what the closing price of a particular security should be.

2. *Closing Price Acceptance Volatility Parameters*

If a security is traded during the PME, its closing price is calculated again at 4:05pm. (Note that above we propose a rule amendment that will change the PME from a five minute duration to a ten minute duration, which will result in the closing price being calculated again at 4:10 p.m. rather than at 4:05 p.m.) If the closing price calculated at the end of the PME lies outside the acceptable range, this security will be considered to have been a "failed MOC". The acceptable range, or the range between the CPA volatility parameters, is the range that extends from the greater of 20% above: the VWAP (calculated during the last twenty minutes of the continuous market) or the last board lot sale, down to the amount that is the lower of 20% less than: the VWAP (calculated during the last twenty minutes of the continuous market) or the last board lot sale.

TSX believes that it is beneficial to change the CPA volatility parameters from 20% to 10% to be consistent with the move of the PME from 10% to 5%. The current CPA volatility parameters of 20% are extremely broad and have not been particularly useful to date. The narrowing of the CPA volatility parameters is also consistent with our proposed change to the "failed MOC" procedures (see above under "Discussion of Rule Book Amendments - Failed MOC Procedures"). Because the new failed MOC procedures will provide that the CCP cannot exceed the CPA volatility parameters, it is important that the CPA volatility parameters not be too wide otherwise they will not be a useful reflection of what the closing price should be. We have consulted with numerous market participants who are in agreement with our proposal to shift to 10% CPA volatility parameters, particularly when they will be used in conjunction with the proposed new procedures for a failed MOC.

IV. Eligible Securities Determination

The following changes do not require a Rule Book change. They are being provided for information purposes only.

TSX believes that the MOC system has been very well received by market participants and is already a valuable feature for trading on Toronto Stock Exchange. TSX expects that market participants will continue to increase order entry in the MOC Book as they become more familiar with the MOC system and the benefits that MOC can provide to participating organizations and their clients.

S&P/TSX Composite Index

TSX intends to add symbols from the S&P/TSX Composite Index (that are not already in the S&P/TSX 60 Index) into the MOC Book in 2005. Our current proposal is that these symbols will be brought into the MOC Book in a phased-in approach. We believe that a staggered, phased-in roll out for the S&P/TSX Composite Index symbols, an approach that is similar to the S&P/TSX 60 Index MOC Book roll-out, will be easily understood by industry participants and can be readily achieved by TSX. We are in the process of determining the order in which symbols will be rolled out into the MOC Book. As with the original roll out of the symbols currently in the MOC Book, TSX will provide ample notice to participants prior to adding S&P/TSX Composite Index symbols to the MOC Book.

International Indices

Market participants or international indexers may make a submission to TSX to request that a symbol from an international index be added as a MOC Security. A submission must include any relevant documentation from the international index provider of pending index activity (for example, a rebalancing of the index). For a security to be considered eligible for the MOC Book, it must have achieved at least Cdn \$1 million average daily trading value in the previous quarter. (This minimum daily trading value does not apply to MOC Securities that are in the S&P/TSX 60 Index or S&P/TSX Composite Index.) TSX will provide notice to Participating Organizations before adding such a symbol to the MOC Book.

Special Requests

A security that does not fall under any of the above categories may also be added to the MOC Book. In order to be included in the MOC Book, the issuer must make a formal request to TSX to have its security added to the MOC Book. Inclusion is at the discretion of TSX, but TSX will consult with market participants before making its decision. At a minimum, the symbol's average daily traded value for the previous quarter must be greater than Cdn \$1 million. TSX will provide notice to Participating Organizations before adding the symbol to the MOC Book.

Public Interest Assessment

The Amendments are designed to increase liquidity at the close and to enable participants to better source such liquidity. As well, the Amendments will allow a greater number of MOC Orders to be executed in a "failed MOC" session. The Amendments have been developed after extensive consultation with market participants and regulators. For these reasons, TSX believes that the Amendments are not contrary to the public interest.

We submit that in accordance with the Protocol for Commission's oversight of Toronto Stock Exchange Rule Proposals between the Commission and TSX, the Amendments would 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.

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 March 29, 2004)	POLICIES
<p><u>PART 1 - INTERPRETATION</u> 1-101 Definitions (Amended)</p>	
<p>(1) In all Exchange Requirements, unless the subject matter or context otherwise requires:</p>	
<p>“Book” means the electronic file of committed orders for listed securities but does not include the MOC Book.</p> <p>Amended (March 29, 2004)</p>	
<p>“Calculated closing price” means the closing price for MOC Securities calculated in the manner determined by the Board.</p> <p>Added (March 29, 2004)</p>	
<p>“Closing Call” means the execution of orders on the combination of the Book and the MOC Book to derive the calculated closing price.</p> <p>Added (March 29, 2004)</p>	
<p><u>“Indicative calculated closing price” means the price that is calculated for a MOC Security immediately before the broadcast of such indicative calculated closing price, that indicates what the calculated closing price for the MOC Security would be if, at the time of calculation, the Regular Session had ended, without reference to volatility parameters.</u></p> <p><u>Added (●, 2004)</u></p>	
<p>“Last Sale Price” means:</p> <ul style="list-style-type: none"> (a) in respect of a MOC Security, the calculated closing price or the last board lot sale price of the security on the Exchange in the Regular Session if the closing price acceptance parameters are exceeded; and (b) in respect of any other listed security, the last board lot sale price of the security on the Exchange in the Regular Session. <p><u>AddedAmended (March 29, ●, 2004)</u></p>	

RULES (as at March 29, 2004)	POLICIES
<p>“MOC Book” means the electronic file that holds MOC Orders entered between 7:00 a.m. and 4:0510 p.m.</p> <p>Added<u>Amended</u> (March 29, 2004)</p>	
<p>“MOC Imbalance” means the difference between MOC Market Orders to buy and MOC Market Orders to sell MOC Securities, calculated in the manner determined by the Exchange.</p> <p>Added (March 29, 2004)</p>	
<p>“MOC Limit Order” means an order for the purchase or sale of a MOC Security entered <u>in the MOC Book</u> on a Trading Day for the purpose of executing at the Last Sale Price of the security on that Trading Day, provided that the Last Sale Price does not exceed a specified maximum price or fall below a specified minimum price, but does not include a Special Trading Session Order.</p> <p>Added<u>Amended</u> (March 29, 2004)</p>	
<p>“MOC Market Order” means an order for the purchase or sale of a MOC Security entered in the MOC Book on a Trading Day for the purpose of executing at the Last Sale Price of the security on that Trading Day, but does not include a Special Trading Session Order.</p> <p>Added (March 29, 2004)</p>	
<p>“MOC Order” includes a MOC Market Order and a MOC Limit Order.</p> <p>Added (March 29, 2004)</p>	
<p>“MOC Securities” means securities in respect of which MOC Orders may be entered as designated by the Exchange from time to time.</p> <p>Added (March 29, 2004)</p>	
PART 4 – TRADING OF LISTED SECURITIES	
DIVISION 9 – SPECIAL TRADING SESSION	
4-901 General Provisions (Amended)	
<p>(1) All listed securities shall be eligible for trading during the Special Trading Session, provided that a MOC Security shall not be eligible for trading until the completion of the Closing Call in respect of that MOC Security.</p> <p>(2) Except as otherwise provided, all transactions in the Special Trading Session shall be at the Last Sale Price for each security.</p>	

RULES (as at March 29, 2004)	POLICIES
<p>(3) Except as otherwise provided, the normal rules of priority and allocation and all other Exchange Requirements shall apply to the Special Trading Session.</p> <p>Amended (March 29, 2004)</p>	
<p>4-902 Market-On-Close</p> <p>(1) Eligible Securities</p> <p>MOC Orders may only be entered for MOC Securities.</p> <p>(2) Board Lots</p> <p>A MOC Order must be for a board lot or an integral multiple of a board lot of a MOC Security.</p> <p>(3) MOC Order Entry</p> <p>(a) MOC Market Orders may be entered, cancelled and modified in the MOC Book from 7:00 a.m. until 3:40 p.m. on each Trading Day. MOC Market Orders may not be cancelled or modified after 3:40 p.m.</p> <p>(b) The MOC Imbalance is calculated <u>and broadcast</u> at 3:40 p.m. on each Trading Day.</p> <p>(c) <u>The indicative calculated closing price for each MOC Security is broadcast at 3:50 pm on each Trading Day.</u></p> <p>(d) (e)—Following the broadcast of the MOC Imbalance, until 4:00 p.m. on each Trading Day, MOC Limit Orders may be entered in the MOC Book on the contra side of the MOC Imbalance. MOC Limit Orders may be cancelled until 4:00 p.m.</p> <p>(e) (d)—In the event of a delay of the Closing Call for a MOC Security, MOC Limit Orders may be entered in the MOC Book for such security on the contra side of the MOC Imbalance between 4:00 p.m. and 4:05<u>10</u> p.m. MOC Limit Orders may not be cancelled during this time period.</p> <p><u>Amended (e, 2004)</u></p> <p>(4) Closing Call</p> <p>(a) The Closing Call shall occur on each Trading Day at 4:00 p.m. The Closing Call in a MOC Security shall be delayed for a period of five<u>ten</u> minutes (and therefore occur at 4:05<u>10</u> p.m.) in the event that the price that would be the calculated closing price for the MOC Security exceeds the volatility parameters determined by the Exchange.</p>	

RULES (as at March 29, 2004)	POLICIES
<p>The Exchange will forthwith broadcast a message identifying the MOC Security that is subject to the delay.</p> <p>(b) In the event that the price that would be the calculated closing price for a MOC Security exceeds the closing price acceptance parameters determined by the Exchange at 4:0510 p.m., the calculated closing price for the MOC Security will be the last sale price of a board lot in the Regular Session<u>price at which most shares will trade, leaving the least imbalance, where the price does not exceed the closing price acceptance parameters determined by the Exchange</u> for such security.</p> <p>(c) Orders shall execute in the Closing Call in the following sequence:</p> <p>(i) MOC Market Orders shall trade with offsetting MOC Market Orders entered by the same Participating Organization, according to time priority, provided that neither order is an unattributed order; then</p> <p>(ii) MOC Market Orders shall trade with offsetting MOC Market Orders, according to time priority; then</p> <p>(iii) MOC Market Orders shall trade with offsetting limit orders in the Closing Call entered by the same Participating Organization, according to time priority, provided that neither order is an unattributed order; then</p> <p>(iv) MOC Market Orders shall trade with offsetting limit orders in the Closing Call, according to time priority; then</p> <p>(v) limit orders in the Closing Call shall trade with offsetting limit orders in the Closing Call entered by the same Participating Organization, according to time priority, provided that neither order is an unattributed order; then</p> <p>(vi) remaining orders in the Closing Call shall trade according to time priority.</p> <p>(d) An order for a MOC Security shall not execute if, at the Close<u>close</u>:</p> <p>(i) an automatic closing delay has been initiated in the MOC Security because the calculated closing price exceeds the volatility parameters determined by the Exchange; or</p>	

RULES (as at March 29, 2004)	POLICIES
<p>(ii) the participation of the MOC Security has been otherwise delayed by a Market Surveillance Official.</p> <p><u>Amended (●, 2004)</u></p> <p>(5) Unfilled Orders</p> <p>(a) Except as otherwise provided in this Rule, all MOC Orders that are not completely filled in the Closing Call shall expire at the end of the Closing Call and will be removed from the Book and the MOC Book.</p> <p>(b) In the event that the closing price acceptance parameters are exceeded for a MOC security, MOC Market Orders shall trade with offsetting MOC Market Orders <u>and any limit orders at the last sale price of a board lot in the Regular Session price at which most shares will trade, leaving the least imbalance, where the price does not exceed the closing price acceptance parameters determined by the Exchange</u> for such security. All remaining MOC Orders will be removed from the Book and the MOC Book.</p> <p>(c) All other orders, that are not marked as MOC, that are not completely filled in the Closing Call shall be eligible for trading in the Special Trading Session.</p> <p><u>Amended (●, 2004)</u></p> <p>(6) Application of Exchange Requirements</p> <p>Except as otherwise provided in this Rule, all Exchange Requirements shall apply to the entry and execution of MOC Orders.</p> <p>Added (March 29, 2004)</p>	