

November 24, 1999

British Columbia Securities Commission  
Alberta Securities Commission  
Saskatchewan Securities Commission  
The Manitoba Securities Commission  
Ontario Securities Commission  
Office of the Administrator, New Brunswick  
Registrar of Securities, Prince Edward Island  
Nova Scotia Securities Commission  
Securities Commission of Newfoundland  
Registrar of Securities, Northwest Territories  
Registrar of Securities, Yukon Territory  
Registrar of Securities, Nunavut

c/o Mr. John P. Stevenson, Secretary  
Ontario Securities Commission  
20 Queen Street West  
Suite 800, Box 55  
Toronto, Ontario M5H 3S8

Mr. Claude St. Pierre, Secretary  
Commission des valeurs mobilières du Québec  
800 Victoria Street  
Stock Exchange Tower  
P.O. Box 246, 22<sup>nd</sup> Floor  
Montreal, Québec H4Z 1G3

Re: Notice of Proposed National Instruments, Companion Policies, and Ontario Securities Commission Rule under the Securities Act

To the respective representatives of the Canadian Securities Administrators:

The Ontario Teachers' Pension Board (OTPPB) is responding to the Canadian Securities Administrators (CSA) request for comments in respect to the "Notice of Proposed National Instruments, Companion Policies, and Ontario Securities Commission Rule under the Securities Act", respecting the Alternative Trading Proposal (ATS).

We commend the CSA for recognizing that the trading environment is changing and that, if Canada is to continue to have a viable capital market, the Canadian marketplace must keep pace with changes that are occurring globally. The CSA is endeavoring to formulate a made-in-Canada solution that recognizes how the market currently functions, the changes that ATS's bring to this market, and how participants in the securities market will transact in the near future. Changes are required in the regulatory framework for advances that ATS, Crossing Networks and the Internet have already introduced. However, there must be flexibility in the regulatory framework to adjust to future changes in we transact.

### **Future Market Environment**

The market environment has changed dramatically in the past five years and will continue to change. In this environment it is essential that the regulatory framework be open to change, and support; (1) an equal entry and a level playing field for all participants (2) the development of a more sophisticated market and (3) a more open market. A large segment of the investment industry in Canada have financially done very well conducting business in a manner similar to how it was conducted ten years ago and do not want change. They have a natural reaction to resist and oppose change while adopting a posture similar to an ostrich with its head in the sand while being stalked by a lion. The consequence of this approach is predictable. Underwritings, listings and trading will move to the United States at an accelerated pace with negative consequences to Canadian companies and investors.

The primary thrust of the CSA's proposal is to create a regulatory environment that accommodates the innovation and the change offered by alternative trading system services. An objective is to introduce opportunities for change and the flexibility for continuing change, while preserving and improving a viable, efficient, and liquid capital market in Canada.

The Ontario Teachers' Pension Plan Board congratulates the CSA on its proposal and endorses the overall direction of the ATS Proposal. However, how the regulations are implemented will determine if the marketplace is strengthened or if good intentions are twisted to the advantage of some participants, and the Canadian marketplace shrinks in importance.

### **Summary of OTPPB Position**

Our comments are directed to the creation of a Canadian marketplace that is recognized as the dominant market for Canadian companies by both Canadian and non-Canadian investors. To achieve this, the marketplace must have liquidity and be viewed as being fair to all participants.

### **Regulatory Commitment to Ensure Implementation**

There will be resistance from some, within the investment industry, to implementation of any changes and little consensus agreement. However, the Canadian marketplace has already lost significant ground, and any additional delay will only increase the slippage. The phased approach suggested by the CSA is the most practical method to start the process. It is important that the CSA not be deterred from its objective.

### **The Phased Approach**

The ideal starting date for implementation is as soon as possible. There will be difficulties particularly on the technical side relating to integration. The sooner they are tackled the sooner solutions will be found.

We believe that the CSA should have an oversight role in the implementation of the phasing in process. There are always difficulties with the introduction and integration of systems. An advisory group will be required to drive the process, otherwise it could easily bog down in details.

### **Market Regulation**

We expect the Toronto Stock Exchange (TSE) to propose that they be the consolidator and regulator of ATS's. The fear we have with this proposal, is that the TSE has resisted change and been steadfast in its opposition to ATS's and Crossing Networks. They have considered going

into competition with Versus's LYNXX. If Canada is to regain some of the trading volume that it has lost to the U.S. we will need flexibility and innovativeness. The TSE has rarely shown these attributes.

*ATSS will require independent oversight from either the IDA or a new advisory group*

### **Consolidation of Exchanges**

One of the dangers of the realignment of trading between Canadian Exchanges is that each has a monopoly on the segment of the market designated for it. While this will hopefully produce some efficiency, it also increases the risk that interested parties will attempt to stifle innovation.

### **Data Consolidator**

The primary criterion for the Data Consolidator must be technical expertise, and the secondary requirement should be good communications. The third requirement should be independence from other participants that have an economic self-interest in promoting a particular market function such as an ATS. We would like to see the Data Consolidator operate on a cost-recovery plus basis. The Data Consolidator should be able to charge for additional information and services that exceed what has been proposed. The ability to generate additional revenue in excess of what would be received from a 'cost-recovery' approach will provide the incentive for the Consolidator to provide service and be innovative.

### **Regulation of Foreign ATSS**

When an investor is choosing the markets to which it will direct an order; one of the key determinants is which market is viewed as the primary market. The determination of this is the volume traded. If foreign ATS's are active in Canada, their activity will not be recorded by the Data Consolidator. The activity will be recorded elsewhere giving the impression that the level of activity in Canada is less and encourage the direction of orders to the home market of the foreign ATSS.

A foreign ATS handling Canadian stocks should not be exempt from Canadian regulation, and the activity should be reported to the Data Consolidator. If this is not done the objective of preserving and developing a viable, liquid, efficient capital market in Canada will have been undermined.

*If it is an objective to have a market that is viewed as treating all equally and fairly, Foreign ATSS should be subject to the same rules and regulations as Canadian ATSS when handling Canadian stocks.*

### **Price Display**

*Section 9.1 in National Instrument 21-101 – Marketplace Operations, is a point of confusion.*

### **Exactly what is meant by "Transaction Fee"?**

If this is an ATS usage fee, and a commission fee is on top of the transaction fee, then we agree this 'transaction fee' should be shown. However, if "Transaction Fee" means commission fee, then it should not be shown. At present, all parties within the market transact at a price and then the commission is applied. The commission is a matter for determination between client and broker. Clients reviewing their trades can determine the quality of the fill they received.

Investors currently negotiate the commission rate they pay. Our expectation is that there will be range of transaction fees paid by investors using ATS, just as there is when investors transact through brokers.

***To avoid confusion trades in an ATS should be handled in the same way as all other trades: At the price at which the trade occurred. The commission paid is a matter for determination between client and broker and between client and ATS. If the transaction fee is in addition to the commission and is greater than \$0.005, we agree with the CSA proposal that it be included in the price disclosed by the ATS.***

### **Depth of the Market**

The minimum standard should be the information market participants have now. This level of disclosure has served the market well, and the technical infrastructure exists to continue providing this information. Subject to this minimum there should be no restriction or limitation on the level of additional information that a marketplace may choose to display.

***The CSA objective is to improve the viability and competitiveness of the Canadian equity market. The regulations should be to outline the minimum information that is provided, not to restrict the information. Restricting information and the ability of parties to compete by providing service and information is counterproductive to the CSA's objective.***

### **Derivative Trading – 2.3 Capping and Pegging (National Instrument 23-101 – Trading Rules)**

The intent of point 2.3 is to prohibit price manipulation between an underlying stock and a Call or Put that a party has sold. While the intent is notable, there are some practical difficulties. If the stock is listed on an Exchange, how does one determine which order and investor was responsible for the latest price movement? There are many option holders, all with different exercise prices. How does one keep track of all the purchasers and sellers of both stocks and options? At the institutional level, there are generally separate trading desks for both equity trading and option trading. In executing orders for portfolio managers the equity desk may inadvertently purchase or sell a stock at a price that negatively impacts the value of an option that the derivative desk has sold.

A good derivative desk should have a variety of programs. The range of these programs and their intent go far beyond attempting to ensure that a single option position does not move to a level where the option is 'In-The-Money'.

***A growing and viable futures and options market will improve the liquidity and the growth of the Canadian equity market. This is an objective; prevention of manipulation and fraud is also an objective. However, a rule that is directed towards manipulation will be difficult to police and may have a detrimental impact on the development of the Canadian derivative market. It therefore needs to be more closely examined.***

### **Short Selling**

In National Instrument 23-101 – Trading Rules section 3.1 (1b) the "Up-Tick" rule is being proposed. This is a U.S. rule that exists for the protection of the Specialist. In Canada we do not

have a “Specialist” market; we have an “Upstairs” market. Currently in Canada a stock can be shorted at a price at least equal to the last sale of a board lot as displayed by the market consolidator. This practice has assisted the growth of basket trading and assists trading between equity baskets and index derivatives. The trading of baskets versus derivatives creates activity within the market and helps to maintain an orderly market. The application of the “Up-Tick” rule would significantly reduce arbitrage activity and the development of the Canadian Futures and Options market.

When investors purchase stocks they do not own we do not impose a condition that they can only purchase if the price is higher than the price at which the last trade occurred. Why then impose this condition if they want to sell a stock they don’t own?

*We believe that the current practice of permitting ‘short selling’ at a price now lower than the price at which the last board lot has traded is more suited to the Canadian equity market.*

### CSA Questions

- 1. Is 40% of the average daily dollar value of trading volume in any type of security traded in Canada an appropriate threshold or should it be lower (for example, 10% or 20%)?**

There has been a move to rationalize trading in Canada with different exchanges concentrating on different sectors of the market. If an ATS was to handle in excess of 40% of the trades in a stock it does not help investors to have that ATS now become an exchange. We would then have a multitude of exchanges and what would happen if trading in a particular stock for which ATS1 was an exchange declined and ATS2 now handled the required percentage to be classified as an exchange?

In order to determine if an ATS had become the dominant marketplace for a security it would be necessary to add a time span in which the predominance of trades occurred in an ATS, perhaps over six months to one year.

- 2. Should the CSA retain the second volume threshold set out in paragraph 6.5(1)(b) of the Instrument relating to 50% of the average daily dollar value of the trading in any security and 5% of the average dollar value of the trading volume in any type of security trading in Canada?**

We want to be positioned to help develop the Canadian market. The declaration that ATS1 is now an exchange for company X and Y and that ATS2 is the exchange for companies A, B, C and the TSE is the exchange for other large companies will be confusing to investors and is unlikely to assist the development of the market

- 3. Is it feasible to require ATSS to calculate the volume threshold when dealing with foreign markets?**

With more and more companies listing their shares on exchanges outside of their home market it will become more difficult.

**4. Should Trading of securities of reporting issuers on an ATS be limited to securities that are listed on a recognized exchange?**

Yes, the definition of ATS securities is broad enough.

**5. Which foreign markets should be included in the Appendix to the instrument?**

No limitation should be placed on the securities that can be traded in an ATS, subject to compliance with applicable securities laws in Canada.

**6. Should there be a de minimis exemption for principal trading in order to encourage dealers to invest in ATSs?**

Yes, but limit their ownership to 10% in an ATS. We want Canadian dealers to be innovative and able to compete with international dealers. If greater participation with ECNs will help them, this should be encouraged. However, there is a risk that if a large dealer owned more than 50% of an ATS they could re-direct orders away from the exchange and that a very fractured equity market would result. This is the reason we recommend that their ownership be restricted to 10%.

**7. What types of activities should lead the CSA to the conclusion that an ATS is carrying on business in a jurisdiction?**

An ATS is carrying on business in a jurisdiction if it is providing a resident with access to its trading systems or services. With the Internet and the creation of Global Indexes, more trading will be done across jurisdictions.

**8. What limitations should be placed on the ATS activities in a dealers' jurisdiction if the CSA adopts the Home Jurisdiction Approach?**

We would be cautious on the subject of Home Jurisdiction since Home Jurisdiction may not only be another Canadian jurisdiction but may also be a foreign jurisdiction. If care is not exercised in this area there may be a move for participants to seek out the most beneficial Home Jurisdiction for the supplier. Home Jurisdiction has the real possibility of introducing a tilted playing field.

**9. Are there any alternative approaches that should be considered by the CSA?**

No, The CSA has adopted a flexible approach and is seeking input.

**10. Should the foreign ATSs be required to be a regulated entity in its home jurisdiction? If so, must it be regulated under the securities laws of the home jurisdiction?**

Some form of regulation is required, however this will be dependent upon the regulations applicable in the home jurisdiction of the foreign ATS.

**11. Should access to the foreign ATS be through a Canadian dealer contracting a dealer that is regulated in the foreign jurisdiction (home jurisdiction of the foreign ATS?)**

Yes, with reference to trading in non-Canadian stocks. Institutional investors will want the ability to trade non-Canadian stocks through foreign ATS.

**12. Should this approach be limited to acceptable home jurisdictions, and if so what jurisdictions should be approved as acceptable?**

We are not in a position to offer comment on this question at this time.

**13. Should the availability of the Home Jurisdiction Approach depend on the activities of the registered dealer in the jurisdiction where the investor is located?**

There will need to be some Administrative Agreement between CSA members and other regulators. If a problem occurs investors will want to know which regulatory body they will be dealing with and in which jurisdiction the problem will be settled.

**14. Should the answer to the above question depend upon whether the home jurisdiction is another Canadian jurisdiction or a foreign jurisdiction?**

If an ATS is handling Canadian stocks the jurisdiction should be Canadian. If the ATS is handling foreign stocks investors will need to be aware of the home jurisdiction that has precedence for the settlement of disputes.

**15. Should the availability of the Home Jurisdiction Approach depend on whether the Canadian registered dealer is an affiliate of the ATS?**

There are two types of ATS trading that this and other questions refer to (1) ATS trading of Canadian companies and (2) ATS trading of non-Canadian companies. The regulatory framework should be directed to ensuring fairness.

**16. Should remote access be limited to dealers who are members of a self-regulatory organization?**

It should be limited to dealers that are members of a self-regulatory organization

**17. Should ATSS be allowed to trade outside the closing bid-ask of the principal market or should they be required to trade within closing bid-ask on the principal market? Should this change if the exchanges extend trading to include evening hours?**

An ATS should be allowed to trade outside the closing bid-ask of the principal market or closing bid-ask on the principal market. An ATS should be able to set whatever hours it wishes to operate as should the exchanges. What is the closing bid-ask other than posted prices at which parties were prepared to transact at a particular point in time? If parties are prepared to transact at other price levels at a time when the exchange is closed they should be able to do so.

**18. Should ATSS operate in the pre-opening period of the principal market or should there be a no-trade time period until the principal market has opened for trading?**

Our response to question 17 applies to question 18.

**19. Should the display of data include the volume of each price level for the best five prices on the bid and offer for each participant system?**

The above is the minimum that should be received. We should continue to receive all the data we currently receive, and suppliers should be encouraged to compete on providing additional data and services

**20. Should an ATS have to contract with the exchange on which a security is listed or should it still be able to choose the exchanges that will perform the market regulation function? This question should be considered from both of the following perspectives: pre-exchange restructuring and post-exchange restructuring.**

The pre-exchange restructuring had the benefit that if one exchange was determined to stifle innovation, a supplier had the ability to approach another Canadian exchange. If the TSE has any involvement with an ATS then the IDA should be responsible for market regulation.

**21. If an ATS is going to trade all listed equities (senior and junior) should it be required to contract with both exchanges for oversight or with only one? This question should be considered from both of the following perspectives: pre-exchange restructuring and post-exchange restructuring.**

One exchange or the IDA.

**22. Should any restrictions be placed upon an ATS when there is a regulatory halt imposed by the market where the security is listed or quoted? Should it matter if a halt is imposed by a recognized quotation and trade reporting system?**

If the primary market has imposed a trading halt, ATS should not trade the security until the halt has been lifted.

Change has always been a factor within the investment markets, however recently the speed and permutations of change have accelerated. The CSA is to be commended for tackling the issue of ATSs and their place within the investment market. One of the difficulties the CSA faces with future regulation of ATSs is devising a framework that provides the guidelines investors want without stifling innovation. Electronic Trading will continue to grow and become the avenue through which most trading of equities, fixed income, derivatives etc. will occur in the future. However it is impossible to forecast exactly what it will look like in five years time.

The advent of the Internet and electronic trading systems have changed how people invest and introduced investing to a broader community. It is responsible for the creation of; the discount broker, forcing the NYSE to examine how it will operate in the future to remain competitive, created a number of new ATS and Crossing Networks, the merger of stock exchanges in Europe, and the replacement of physical trading floors with electronic systems. However in this environment one cannot sit on the sidelines and wait for the situation to become clearer. Electronic systems are interconnecting trading around the world. If we do not create an

environment that is conducive to electronic trading, the trading of Canadian stocks and other related businesses will move to jurisdictions that are more accommodating.

The Ontario Teachers' Pension Plan Board appreciates the opportunity to respond to the CSA request for comments and would be pleased to discuss its comments with representatives of the CSA.

Yours truly,

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Ontario Teachers' Pension Plan Board