

CANADIAN SECURITY TRADERS ASSOCIATION, INC.

P.O. Box 3, 31 Adelaide Street East, Toronto, Ontario M5C 2H8

CSTA

October 10, 2000

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 John Stevenson, Secretary
Ontario Securities Commission
20 Queen Street West
Suite 1900, Box 55
Toronto, Ontario M5H 3S8

- and -

Claude St. Pierre, Secretary
Commission des valeurs mobilières du Québec
800 Victoria Square, Stock Exchange Tower
P.O. Box 246, 22nd Floor
Montréal, Québec H4Z 1G3

Dear Sirs/Mesdames:

Re: Alternative Trading System Proposal

The Canadian Security Traders Association Inc. (“CSTA”) welcomes this opportunity to respond to the Canadian Securities Administrators’ (“CSA”) July 28, 2000 request for comments with respect to the Alternative Trading System Proposal.

The CSTA is a recently incorporated association that includes members from the Institutional Equity Traders Association (“IETA”), the Montreal Institutional Equity Traders Association Inc. and the Vancouver Security Traders Association. One of the CSTA’s main objectives is to try to have an ongoing dialogue with self-regulatory organizations, local and national governments and their agencies in respect of the regulation of the markets in which securities are traded.

The CSTA’s membership is comprised of approximately 700 institutional and equity traders in the Canadian marketplace. With such a large membership, our association has a wealth of first-hand knowledge of the various strengths, weaknesses and challenges of the Canadian marketplace. Our perspective has come not only from large block institutional trading activity, but also from many smaller orders which represent millions of individual investors and pensioners participating in the stock exchange through mutual funds, pension plans and administered RRSPs. We believe that as such, we represent the interests of institutional investors as well as individual investors. We also believe that we can help the CSA better understand and improve the Canadian regulatory framework.

We will first provide our general comments on the proposal and then address the specific requests for comments.

Overview

Our members responded to the July 2, 1999 proposal (the “1999 Proposal”) through the IETA on October 13, 1999. We are now also in favour of many of the changes that have been made to the 1999 Proposal, including the elimination of the cross-interference, capping and pegging rules and the

changes to the short selling rule. However, it appears that our main concern remains unresolved. In the IETA's earlier submissions, we expressed our strong view that the first priority for securities administrators should be the preservation of a strong, centralized, Canadian capital auction market with a Central Limit Order Book that will provide a fair, liquid and transparent market for all Canadian investors. Only then can ATs properly be integrated into the Canadian market. Otherwise, we believe the CSA runs the danger of fracturing the Canadian market.

The competitive forces of the market are not always going to act in the best interest of the market - they will act in their own best interest. Regulators must ensure that client access to liquidity and visibility are a prerequisite. The visibility of the Canadian market (display of broker numbers and market by price) are attributes that attract international investors to the Canadian market place. Removing visibility from our market is counter-productive to the long term growth and viability of the Canadian capital market.

Central Limit Order Book

The strongest downfall of the ATS Proposal, in our view, is the continued absence of a focus on promoting a strong and stable centralized auction market prior to adding new competitors. The request for comments states the CSA's view that it is best not to introduce a central limit order book at this time and that the data consolidator and market integrator have been proposed as alternatives in order to minimize fragmentation. We continue to believe that a strong Central Limit Order Book must be established in order to prevent further market fragmentation in the Canadian market. This system should be the first priority of the CSA and should be put in place before outside competition from ATs is introduced.

The presence of a Central Limit Order Book is imperative in order to maintain an orderly, fair, and competitive auction market. A Central Limit Order Book that requires strict time/price priority across all ATs and ECNs will encourage and promote full disclosure of the best bid or ask, while at same time providing small retail investors with the confidence to participate in an active, competitive, auction market.

Our greatest concern comes from our fear of fragmentation within the Canadian market place, as this will disadvantage the smaller retail investor. We have always believed that the CSA has been a champion of the small investor. Unfortunately, in this case, it may be that the concerns of all users have not been addressed by the ATS proposal. By allowing fragmentation, when combined with the lack of liquidity in the Canadian market, investors will likely look south of the boarder to effect their trades because of greater transparency and liquidity.

Transparency is the most effective route to investor fairness. We are concerned that the possible benefits to be gained by the introduction of ATSS could be outweighed by the lack of market transparency that would result. As such, we believe that the focus should be on preparing the marketplace to make complete trading information available to investors prior to increasing the number of sources of such information and the potential market fragmentation that could result.

Responses to Specific Requests for Comment

Set out below are the CSTA's responses to the CSA's specific requests for comments. Our responses follow the same numbering set out in the CSTA's requests. Our viewpoint reflects the reality that the majority of our members are equity traders. The general theme to our comments is the importance of developing and maintaining a strong Canadian marketplace. To that end, we have attempted to consider the effects of each of the CSA's proposals on the end user, the investing public. A large component of this concern must necessarily focus on the cost of each part of the proposal to the Canadian firms involved, as they face increasing competition from US and on-line broker dealers in attempting to offer low cost trading to Canadian investors.

- 1. Should broker ID numbers be collected and disseminated by the data consolidator? If yes, should the customer decide whether the broker ID is disseminated?**

We reiterate the need for a Central Limit Order Book, without which investors will never be sure of receiving the best market for an order. In the absence of a Central Limit Order Book, we believe that the effective consolidation of data becomes even more imperative in order for the Canadian marketplace to absorb the introduction of ATSS. As such, it is imperative that the data consolidator provide as much relevant information as possible, including broker ID numbers. Accessing this data from other sources would increase costs and would raise problems of accuracy and accessibility.

The request for comments states that the CSA is considering excluding the collection and dissemination of broker ID numbers by the data consolidator. We believe that broker ID numbers are an important source of information that must be provided across the markets through the data consolidation process in order to ensure accuracy and accessibility. The omission of this information will decrease information transparency and competition for all market participants.

The ability to source liquidity using broker ID numbers is a daily necessity in the Canadian market where many thinly traded stocks exist. Indeed, the Canadian marketplace has developed around such access to broker ID numbers, which are a keystone of transparency in our marketplace.

Broker ID numbers promote competition in the marketplace as institutional traders are able to seek out the most competitive offers for block trading. The display of broker ID numbers also plays an important marketing and business enhancing role for the Canadian brokerage community. In addition, broker ID numbers can provide early and effective indications of unfair trading activity.

Given the recent trading cases and the ensuing internal compliance requirements, broker ID numbers are used extensively to monitor trades and traders by both buy and sell side compliance officers. They also provide useful information for issuers and investors.

We understand that other markets have had instances where some promoters boldly display fake trades without the sanction and legitimacy of an exchange print, which would have otherwise prevented the false display. This type of illegal activity is aberrant to a fair, visible market place.

We see no viable reasons for changing access to broker ID numbers in the Canadian context. Our experience can be contrasted with the NYSE, which recently announced that the cost involved in providing this information would be prohibitive. In our marketplace, the technology to provide this information is already available and gives us an advantage over US markets in trading Canadian stocks. Without broker ID numbers, Canadian order flow will move south to the US. We cannot understand why access to this important data, and the resulting competitive advantage, would now be restricted.

In our view, the customer should **not** have the ability to decide whether the broker ID number is disseminated. These numbers are used extensively to monitor trading by all market participants as they provide valuable information about who is trading a particular stock, and the volumes they may be trading.

2. Who should provide market regulation for ATS?

We believe that the market regulation of ATSs should be by the jurisdiction in which they operate and reside. However, we also believe that the regulation of ATSs by existing exchanges would raise a serious conflict of interest. One solution is for ATSs to be regulated by a SRO like the IDA. Another cost-conscious solution would be the suggested compromise in the request for comments that would see the exchanges move market regulation into separate divisions or subsidiaries which would be insulated from the parts of the exchange that compete with the ATSs. A prototype for this type of regulation is found in the creation of the NASD-R, which has been approved by the SEC and seems to be working well.

13. Should there also be an exception based on number of shares traded (in addition to value of shares traded)? Are there any other exceptions to the display requirements that should be included?

We believe that the focus of any regulation of display requirements should be on customer fairness. In keeping with current practice, an order should be displayed as per client instructions, regardless of size. In other words, any order that is given to the marketplace should be displayed to all, regardless of the size and/or dollar value.

The CSA says “the handling of block size orders differs from other orders”. By requiring all orders with a value of less than \$100,000 to be displayed in an ATS/ECN, a presumption is made that this protects the small investor. As stated earlier, without the Central Limit Order Book the small investor is still not guaranteed the best price execution as securities can trade at higher or lower prices away from the small investors order.

16. Should special order audit trail requirements be adopted? Under what circumstances should the requirements be imposed? To whom should the requirements apply? What additional information should be collected?

17. Should the audit trail requirements be established by the CSA or should the requirements be determined by the exchange, approved agent or the IDA?

All participants in the Canadian marketplace should be subject to whatever minimum audit trail requirements are necessary. In this regard, the open display of broker numbers adds visibility and clarity to any audit trail. ATSS should have, or already do have, the ability to produce audit trails. In order to regulate the audit trail requirements in a cost-effective manner, we believe that the CSA should only establish new audit trail requirements if the requirements already in place do not meet the goals of a well-regulated Canadian marketplace.

18. Should the display requirements for over-the-counter orders or trades be expanded from market makers to all dealers?

19. Should the information be sent to the data consolidator or another party?

We believe that the display requirements for over-the-counter orders should be expanded to provide as much information as possible and should be sent to the data consolidator to be made available to all interested parties. However, the final answer to these questions will depend in part on the effect of the exchange restructuring process on the CDN reported market, as noted in the request for comments.

20. Should the short selling provision be limited to trades facilitated on a marketplace or should they apply to dealers trading outside of a marketplace?

In order to be effective, the short selling rule must apply equally to all market participants. In the absence of a Central Limit Order Book, and to avoid potential abuse and further market fragmentation, the short selling rule should be based on the last sale of a board lot displayed by the data consolidator.

Conclusion

Our firm view remains that the first priority for the CSA should be strengthening the Canadian market in order to ensure our competitiveness in a global marketplace. We are extremely concerned that the current proposal contemplates the introduction of ATs into the Canadian marketplace in the absence of a Central Limit Order book. The absence of a Central Limit Order book combined with the proposed elimination of broker numbers could lead to market fragmentation and decreased transparency and consequently deprive the Canadian markets of the very strengths which have made them so competitive with their US counterparts.

If you have any questions, or wish to discuss our comments, please do not hesitate to contact any of the following:

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We thank you for this opportunity to again respond to the Alternative Trading System Proposals.

Yours truly,

Greg Uchiyama
Secretary, Canadian Security Traders' Association