



October 12, 2006

Alberta Securities Commission  
British Columbia Securities Commission  
Manitoba Securities Commission  
New Brunswick Securities Commission  
Securities Commission of Newfoundland and Labrador  
Registrar of Securities, Department of Justice, Government of the Northwest Territories  
Nova Scotia Securities Commission  
Registrar of Securities, Legal Registries Division, Department of Justice, Government of Nunavut  
Ontario Securities Commission  
Prince Edward Island Securities Office  
Saskatchewan Financial Services Commission  
Registrar of Securities, Government of Yukon

c/o John Stevenson, Secretary  
Ontario Securities Commission  
20 Queen Street West  
Suite 1900, Box 55  
Toronto, Ontario M5H 3S8  
E-mail: [jstevenson@osc.gov.on.ca](mailto:jstevenson@osc.gov.on.ca)

Madame Anne-Marie Beaudoin  
Directrice du secrétariat  
Autorité des marchés financiers  
800, square Victoria, 22e étage  
C.P. 246, tour de la Bourse  
Montréal, Québec H4Z 1G3  
Telephone: 514-940-2150  
Fax: 514-864-6381  
e-mail: [consultation-en-cours@lautorite.qc.ca](mailto:consultation-en-cours@lautorite.qc.ca)

**Re: CanDeal Response to CSA Request for Comments on Notice of Proposed Amendments to National Instrument 21-101 Marketplace Operation and Companion Policy 21-101CP and National Instrument 23-101 Trading Rules and Companion Policy 23-101CP**

---

CanDeal appreciates the opportunity to respond to the request for comment to the Canadian Securities Administrators (CSA) regarding proposed amendments to the ATS rules (National Instruments 21-101, 21-101CP, 23-101 and 23-101CP) with respect to debt market transparency and certain other aspects of the proposed amendments.

**Introduction**

Regulators and other key marketplace participants including investment dealers (their wholesale, middle-market & retail desks; wealth management divisions and compliance departments), investors, issuers, and others have recognized that the Canadian debt markets are in the midst of a profound transition unlike anything the industry has ever witnessed.

At the root of this momentous change are contributing factors such as market globalization, trade execution speed and transparency all of which are largely facilitated through the growth of new technologies.

Throughout this evolution, the Canadian fixed income markets have made very important advances towards the end goals of improving:

- Price discovery
- Trade execution
- Transparency
- Instantaneous electronic reporting of trade blotters, audit trails, allocations etc.
- Compliance and audit testing before and after the fact
- Straight through processing (STP)
- Seamless online access to global markets (liquidity)
- The infrastructure for electronic trading, transparency, trade confirmation & STP, and as required, oversight or surveillance
- Consolidated historical data, through the creation of a data set of tick by tick price and trade information stored in a accessible database

Based on CanDeal's experience with Canadian and international participants, these achievements have elevated the Canadian marketplace to an advanced globally competitive position. Regulators, dealers, borrowers and investors, domestically and abroad, recognize that Canada has an electronic debt securities marketplace that provides a fair and efficient environment that ensures a high level of integrity and liquidity for its participants. Globally, all levels of industry participants are faced with increasing regulatory burdens and scrutiny: best execution, compliance, audit and benchmarking demands. It is important for those with a vested interest in the Canadian debt securities market to continue to promote a competitive environment driven by private sector initiatives. To date, these initiatives are meeting or exceeding the transparency requirements of many segments in the marketplace. The Canadian debt market has its own unique characteristics in terms of structure, size, volume turnover etc. We should be careful not to assume that solutions that work in other very different markets will be successful here or more importantly we must take care that imported solutions do not cause irreparable damage. Further investigative work is required before making structural changes.

### **Recommendation**

CanDeal recommends an extension to the current exemption until December 31, 2011. We believe that the retail and institutional marketplaces are best served through the development of distinct solutions, and we would recommend that regulators continue to work with industry participants to address retail fixed income market participation concerns including:

- a) Guidelines and expectations in regard to mark-up (commission) disclosure and investor education,
- b) Difficulties accessing relevant 'in context' market data and
- c) Utilizing credible sources for oversight and surveillance.

## Specific Responses to Questions

### Question #1:

**Should there be a mandatory requirement to report and disseminate information related to designated government debt securities? What are the benefits and disadvantages of this and the alternative approaches?**

There should not be any further mandatory requirements to report and disseminate information related to any Canadian debt securities at this time.

Industry consultations with regulators have concluded that a) the fixed income markets are very different from the equity markets, b) transparency requirements within the fixed income marketplace between institutional and retail investors differ, c) education, monitoring compliance and the disclosure of fixed income commissions (mark-ups) are unique issues pertaining to the retail market, and d) current levels of transparency are generally adequate for the institutional marketplace. The focus of concern centres on assuring fair pricing for direct retail participation, while simultaneously ensuring that wholesale trading activity is not impaired by solutions. We appreciate that the CSA recognizes many of the fundamental differences between equity and debt markets and between the varying needs of the retail versus the institutional investor. At issue is whether a single legislated solution suitably fulfills the needs of all participants in the marketplace. We submit that it does not. Only customized solutions should be pursued to optimize the dealing environments for these sectors. It must be remembered that undesirable regulated transparency requirements imposed upon the institutional marketplace could negatively impact these participants; including the substantial investments that are professionally managed through institutional funds on behalf of retail investors.

Further, much more information gathering is needed in order to make a 'best informed' decision, in regard to determining the relevance, priority and resolution around retail participation issues such as disclosure, suitability, education or transparency.

Specifically, we need to answer:

- How substantive are the perceived retail issues?
- Will the IDB's continue their voluntary participation in CanPX?
- What constitutes best execution in retail fixed income?
- What is the degree of retail investing in 'single security' fixed income versus managed funds?
- Will transparency resolve best execution or mark-up concerns for debt securities that are 'single dealer' supported?
- What are the primary products (issuers, structures etc.) that retail investors participate in?
- What are anticipated trends in terms of product demand?

It is also important to note that private sector initiatives to improve transparency access and surveillance are burgeoning.

In the realm of fixed income, each investment dealer that is a Primary Dealer, having core competencies in wholesale market making and product originations, play a vital role as liquidity providers. To date, CanDeal has in effect acted as a market consolidator,

bringing together 12 (of 13) Primary Dealers. The real-time, market pricing aggregated by CanDeal is the most complete source of pricing information available. In CanDeal's case, our market data is broadly available through Canada's largest data information infrastructure (for less cost than CanPX data).

CanDeal has recently taken steps to arrange for up to the minute intra-day and closing benchmark Government of Canada Bond and T-Bill data to be accessible for free on one of Canada's leading financial websites – TSX.com. In the near future, CanDeal will also be initiating more affordable data accessibility alternatives. In addition, CanDeal has offered Canadian regulators access to what is likely the largest and most complete database of tick-by-tick market data.

Specific to retail fixed income participation, one must also consider the implications, in terms of safeguards and guidance of the relatively new (May 15, 2006) and evolving IDA Policy 5B - Retail Debt Market Trading and Supervision. "Policy No. 5B sets standards regarding activity in the retail debt market. While Policy 5B reiterates those improper activities listed in Policy 5, which might also occur in the retail market, it also adds a requirement to establish mark-up, mark-down and commission guidelines and supervise mark-ups, mark-downs and commissions to ensure that any deviations from those guidelines are justified." – IDA Bulletin 3539, May 8, 2006. We submit that any changes in 21-101 be deferred until the impact of this policy on the investment dealer and retail investor communities can be assessed.

The CSA have also been very involved in establishing the guideline and implementation timetable for the Transaction Reporting and Electronic Audit Trail System (TREATS), which is meant to help regulators monitor trade and trade related activity.

**Question #2:**

**Should dealers be subject to order and/or trade transparency requirements for government fixed income securities? If so, should they be required to report order information, trade data or both?**

As a result of our recommendation and our answer to Question 1 above, Question 2 falls outside of the scope of our position. However, in the context that the CSA proposed approach does carry, we will address Question 2.

It is crucial to note that the emerging fixed income ATS businesses operating in Canada are quite different in terms of their methods and philosophies. For example, it is important to note that the CanDeal ATS trading methodology is not based on firm orders being displayed openly to all marketplace participants, where non-discretionary trade execution rules are followed. CanDeal's trading methodology is based on simultaneous one-to-one request for quotes that are specific to a dealer, an institutional investor, a specific security and size of trade. Trade execution discretion resides with the institutional investor and dealer. Essentially, this methodology, which is patterned after traditional telephonic trading, positions itself in direct competition to the telephone.

Mandatory, legislated transparency that targets a request for quote ATS to report executed trades and that excludes request for quote telephonic trade reporting will create an unfair environment. It will drive participants who wish to avoid trade reporting away

from disclosed, electronic request for quote trading and ultimately defeat most of the important goals that the ATS legislation itself was meant to achieve, including the amount of transparency currently offered by ATSs as institutional investors return to the more opaque telephonic trading environment. In addition, CanDeal considers revenues from market data as an important aspect of its financial sustainability and therefore must object to trade reporting on this basis. A regulated transparency initiative, particularly if placed upon the CanDeal ATS (that is at the forefront of many of the advancements that are being sought after through the creation of 21-101) can only be viewed in a detrimental light.

**Question #3:**

**What type of pre-trade information should be disseminated? Should it include indications of interest?**

As a result of our recommendation and our answer to Question 1 above, Question 3 falls outside of the scope of our position. However, in the context that the CSA proposed approach does carry, we will address Question 3.

A firm, executable order posted electronically into a marketplace where there is an implicit understanding that all of that particular marketplace's participants are eligible to see and act on the order, and where an understanding exists that the order will be displayed to an information processor for information purposes only, is the only type of pre-trade information that should be disseminated.

Indications of interest (IOI), as currently understood in the marketplace for secondary trading of fixed income instruments, should not be included. Technology has expanded the range of options available for market participants to communicate, including email, instant messaging, and proprietary networks. IOI's by their nature are incomplete. The question of what constitutes an IOI must be considered in the context of completeness of information communicated (date, time, duration, size, price, limitation, qualifications, or commitment to the indication). Further, there may be issues of confidentiality around the communication.

**Question #4:**

**Are the reporting timelines appropriate -- i.e. order information in real time and trade information within one hour of the time of the trade?**

As a result of our recommendation and our answer to Question 1 above, Question 4 falls outside of the scope of our position. However, in the context that the CSA proposed approach does carry, we will address Question 4.

Order information, as we describe in Question 3 above is appropriate in real-time and so are trades executed on those orders. One hour delayed reporting of trades executed utilizing other trading methodologies i.e. telephonic may or may not be appropriate for the Canadian market depending on the market conditions, the counterparties, the size of the trade, the security etc. Herein lies part of the dilemma. This part of the question should only be answered by those at risk i.e. the dealers, the institutional investors and those who rely on borrowing money in the institutional debt markets in Canada.

**Question #5:**

**Are the volume caps applicable to government fixed income securities set out in the Companion Policy to NI 21-101 adequate? Should there be further tiering of volume caps for the different types of government bond securities?**

This is a question that should only be answered by those at risk i.e. the dealers, the institutional investors and those who rely on borrowing money in the institutional debt markets in Canada.

**Question #6:**

**Should we require pre-trade transparency for corporate fixed income securities? If so, should the requirements be applicable to marketplaces only or should they also apply to dealers?**

See answers to Questions 1, 2 and 3 above.

**Question #7:**

**Should the time for reporting the trades be reduced (for example, should all trades be reported and disseminated in real time)?**

See answer to Question 4 above.

**Question #8:**

**Has the process for designating benchmark corporate fixed income securities been effective? Please explain your response.**

Not relevant for CanDeal to comment.

**Question #9:**

**Has there been sufficient progress, both regulatory and industry-driven, regarding fixed income transparency to date? For retail investors? For large and small institutional investors?**

See introduction and answer to Question 1.

**Summary**

It is CanDeal's position that since the original publication of NI21-101, the investment dealer community and the ATSs have made considerable progress in improving market transparency, and that further adoption of electronic trading solutions will continue to improve the situation. Meetings with industry participants have concluded that the institutional market is adequately served and progressing at an acceptable pace. Institutional participants have stressed their concern related to risks associated with

mandatory trade reporting in the Canadian environment and we should pay heed. As further investigative work is concluded in regard to retail fixed income issues, industry participants and regulators should work in partnership to prioritize issues, monitor progress and implement made-in-Canada solutions.

Other notes regarding the Notice:

We would be concerned about the practicality of the approach discussed in Part 12, below. Typically, technology counterparties would enter into agreements that would protect Intellectual Property Rights. We would suggest that consideration be given to an approach that incorporates counterparty agreements to accommodate this requirement.

(7) Part 12 is amended by adding the following section 12.3:

**12.3 Availability of technology specifications and testing facilities –**

(1) For at least two months immediately prior to operating, a marketplace shall make available to the public any technology requirements regarding interfacing with or access to the marketplace.

(2) After the technology requirements set out in subsection (1) have been published, a marketplace shall make available to the public, for at least one month, testing facilities for interfacing with and access to the marketplace.

Yours truly,

Jayson Horner  
President & CEO  
CanDeal