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CANADIAN SECURITIES ADMINISTRATORS
FORUM ON TRADE-THROUGH AND MARKET STRUCTURE ISSUES

HELD ON FRIDAY, OCTOBER 14, 2005

PANEL:

SUSAN WOLBURGH JENAH - CHAIR
PAUL MOORE
SERGE BOISVERT
CAROL PERRY
PAUL BATES

TABLE OF CONTENTS

1		
2		
3	INDEX OF EXAMINATIONS:	
4	SUBMISSIONS BY MR. TRIPP FOR BMO NESBITT BURNS:	6
5	SUBMISSIONS BY MESSRS. REILLY AND KAIN FOR RBC CAPITAL	
6	MARKETS:	22
7	SUBMISSIONS BY MESSRS. BEATTIE AND SAVONA FOR CSTA: ..	42
8	SUBMISSIONS BY MESSRS. HAYNES AND TUCKER FOR TD NEWCREST.	65
9	SUBMISSIONS BY MR. BRUNELLE FOR NATIONAL BANK FINANCIAL:	84
10	SUBMISSIONS BY MESSRS. COOK AND BAIKIE FOR CNQ:	98
11	SUBMISSIONS BY MR. PARKHILL FOR TSX:	115
12	SUBMISSIONS BY MS. ROBERTSON FOR MARKETS INC.: ...	137
13	SUBMISSIONS BY MS. RUDD FOR TRIACT CANADA MARKETPLACE:..	157
14	SUBMISSIONS BY MR. WATTS FOR SHORCAN ATS LIMITED: ..	171
15	SUBMISSIONS BY MR. MIASNIKOF FOR CPP INVESTMENT BOARD:	187
16	SUBMISSIONS BY MR. STEINER FOR PERIMETER FINANCIAL CORP.	
17	VIA VIDEO-LINK.	199
18	SUBMISSIONS BY MR. ATKINSON, MS. CHAN, MR. TWISS & MR.	
19	HARRIS FOR MARKET REGULATION SERVICES INC.:	209
20		
21		
22		
23		

1 ---Upon commencing at 8:55 a.m.

2 CHAIR: I wanted to say that we are very
3 pleased that so many of you are interested in the issue of
4 market structure and the trade-through rule. We are very
5 much looking forward to the submissions we are going to
6 hear today. We had the benefit of reviewing the letters
7 that were received by many of you, and I wanted to begin
8 just by introducing the people who are sitting with me
9 here and we will, throughout various points hopefully in
10 the presentations, be having questions for you. We will
11 direct our questions to you, you should feel free in your
12 presentations, and I know you will, to address issues that
13 are raised by others who have come before you. So we hope
14 that you will take advantage of the opportunity to do
15 that.

16 We have, as you can see from the agendas
17 that were distributed, we have got a lot of people who
18 have come to make presentations today, about 13 in total.
19 We have had to limit the amount of time people have. We
20 know that you were advised of that in advance; the one
21 exception to that is RS, they have about 45 minutes at the
22 end of the day for rather obvious reasons and we hope
23 that, again, they will take that opportunity to wrap up
24 what has been heard from their perspective.

25 Our staff put out a comment paper, the CSA

1 staff, probably a couple of months ago now on market
2 structures and trade-throughs. And as you know the
3 comment period on that has -- it is still open actually
4 until October the 20th, so next week. But so far the CSA
5 have received a lot of comment letters, about 16, and 13
6 of the commentators who wrote in have also requested the
7 opportunity to present today.

8 We will have a transcript of these
9 proceedings, if you are wondering what the follow up will
10 be. There will be a transcript and it will be made
11 available. We are also going to be obviously considering
12 the feedback that we hear from today's presentations in
13 terms of the issues that we will be grappling with shortly
14 at the Commission and across CSA, but our goal will be to
15 have some sort of a proposal for publication for comment
16 in the first quarter of 2006.

17 We have a lot of staff who have been very
18 heavily involved in reviewing these issues and just to
19 mention a few of them because they have been actually
20 behind the scenes working to get this forum organized. We
21 have got Cindy Petlock, Randee Pavalow, Susan Greenglass
22 and I don't know where Darren is -- there is Darren,
23 Darren Sumarah. And we all welcome you on behalf of CSA
24 staff and ourselves, we welcome you here today.

25 The panel that is up here consists of to my

1 far left: Serge Boisvert, he is here as Jean St. Gelais
2 unfortunately was not able to make it but we are delighted
3 to have Serge here as the AMF representative; to my
4 immediate left is my fellow Commissioner and vice-chair
5 Paul Moore who has been very involved in the trade-through
6 and market structures issues to this point in time;
7 myself, Susan Wolburgh Jenah; and to my right Carol Perry,
8 who is one of our Commissioners; and Paul Bates, another
9 one of our Commissioners, both of whom have a very keen
10 interest in these issues.

11 So with that, unless I have missed
12 something, let me just mention logistically the way the
13 presentations have been grouped is that we have got three
14 or four in each grouping and then we will have a break in
15 between, which I think will be a good way for the day to
16 unfold, an opportunity for people to network and talk to
17 each other.

18 So with that let me welcome BMO Nesbitt
19 Burns, and I understand Mr. Eric Tripp will be making the
20 presentation on behalf of BMO. Mr. Tripp, welcome.

21 MR. TRIPP: Thanks, Susan. Okay here or
22 would you like the podium?

23 CHAIR: Probably for presentation if it is
24 okay for you to venture over there because we are going to
25 have a transcript prepared and they will be able to pick

1 up what you say.

2 SUBMISSIONS BY MR. TRIPP FOR BMO NESBITT
3 BURNS:

4 MR. TRIPP: The informal podium
5 presentation.

6 While it is an informal meeting, it is not
7 an informal issue and you know, I think just judging from
8 the crowd and the number of people that are providing
9 submissions to the CSA on this issue, you can sort of get
10 the gist of how important people really, you know, believe
11 this issue is.

12 So I will try and do it justice with some
13 comments, I will also try and make sure that you are ahead
14 of time here by not overdoing the comments because we
15 incorporated a lot of it in our presentation.

16 So my name is Eric Tripp, Vice-Chairman of
17 BMO Nesbitt Burns, and I manage the equity business,
18 essentially, on the institutional side for the Bank of
19 Montreal. I have been involved in the business for 23
20 years. I am grateful for the opportunity to engage in
21 this public discussion of market structure developments
22 and trade-through obligations and, as I said, this issue
23 is incredibly important, and all informality aside, we
24 have to get this right because it has far-reaching
25 implications going forward for the development of our

1 marketplace.

2 And I would commend the CSA here for the
3 time and focus that they are affording this whole
4 discussion on Canadian market structure and remind them
5 that we lead the world in financial market structure, I
6 would say, based on my experience in dealing around the
7 world, dealing in various other marketplaces in the world.

8 It's my objective to help us continue to
9 lead the world in financial market structure and my
10 company's objective. And so that's one of the reasons I
11 am here today and will stay engaged in this debate as it
12 works its way through the system.

13 There are a lot of issues outstanding right
14 now, best execution, straight-through processing,
15 transaction-related electronic audit trail, data
16 consolidation and trade-through obligations. And the
17 solution to any one of these is going to impact all the
18 rest of them. So one of the -- another of the reason that
19 it is an important issue. And it all boils down to
20 information: Who has it? How is it made available? And
21 how can it be used?

22 The internet has revolutionised everyone's
23 approach to information; instant, plentiful and freely
24 available. It's a level playing field for anyone with a
25 computer and this is the driving evolution of our markets;

1 level playing field.

2 Today's focus is trade-through obligations.
3 My perspective here is as the representative of a major
4 Canadian dealer. I am also on the board of the TSX, just
5 for full disclosure. Here my perspective is the Bank of
6 Montreal, BMO Nesbitt Burns' perspective here, so just to
7 clarify that.

8 And from that perspective, we represent
9 constituents from the broadest spectrum, from the dotting
10 grandparent buying a single share as a birthday present,
11 the baby boomer managing a self directed RSP, the TSX
12 market maker, options traders, proprietary trade
13 facilitators, the most aggressive hedge funds and the
14 largest pension funds. The common denominator is a desire
15 for a fair and orderly market, a level playing field in
16 the competition for order execution. The key -- this is
17 the key to maintaining confidence in our highly efficient
18 marketplace in Canada.

19 And it has been easy to maintain in the
20 past back when the TSX and the BdM both traded common
21 equities, there were systems in place to prevent interim
22 market trade-throughs; then when the TSE took on common
23 equities there was a system in place that prevented
24 intramarket trade-throughs.

25 Now we face the prospect of several

1 alternative trading systems offering unique trading
2 venues. So now we have the need to balance regulation and
3 competition amongst all types of marketplaces. It is no
4 longer a theory, it is a reality; hence our attendance
5 today.

6 We are convinced that achieving balance
7 requires enacting a trade-through obligation that applies
8 to all market participants, dealers and access persons, no
9 exceptions, no opting out. Anything else will leave us
10 open to regulatory arbitrage and regulatory arbitrage is a
11 very bad thing for financial markets.

12 Because the number of marketplaces in
13 Canada is still so small, it makes sense to us that
14 responsibility for ensuring, making sure that
15 trade-through obligations should reside within the
16 marketplaces enforced by regulation, the result would be
17 significantly fewer interlinkages than would be required
18 if every market participant had to implement smart order
19 routing technology. It would be rational for an access
20 person to argue that their trade-through obligation should
21 be limited only to the marketplace to which they have
22 direct access. Unfortunately that opens the door to
23 regulatory arbitrage. Depending on market conditions, the
24 access person might choose to connect directly or place
25 their order through a dealer. If their marketplaces are

1 connected, there will be no opportunity to selectively opt
2 in or out of the obligation. Anything else leaves us open
3 to regulatory arbitrage.

4 We believe that one of the most essential
5 Canadian market structure features will be a centralized
6 -- or is the centralized limit order book and
7 inter-connected marketplaces. Centralized limit order
8 book that exists in Canada is exemplary throughout the
9 world and is one of the reasons, just the structure of
10 that and the structure of the Canadian markets is, you
11 know, one of the, sort of, reasons that we haven't had the
12 scandals that you have seen in the US with the various
13 market places that have evolved there and it is something
14 that we need to maintain here.

15 The Reg. NMS proposal supports top of the
16 book protection. But for Canada we believe that the full
17 depth of the visible book is the appropriate choice. The
18 full depth of the visible book. We don't think that the
19 non-visible portions of iceberg orders should be protected
20 because they don't contribute directly to the price
21 discovery process.

22 Exemptions should apply to special terms
23 orders and orders if which the price or other material
24 terms cannot be determined on order entry. This includes
25 market enclosed VWAP basis, call market and basket orders.

1 We also believe that the trade-through obligation should
2 be limited to the original volume of the trade.

3 Finally, many of those who responded to the
4 CSA's discussion paper put forward the argument that
5 enclosing intermarket trade-through obligations would
6 stifle innovation and competition. Let me make our stance
7 perfectly clear, we are active supporters of technology
8 developments in the marketplace but we are not supportive
9 of a market structure that champions innovation and
10 competition among multiple marketplaces if the result is
11 an erosion of investor protection, fairness, transparency
12 or market efficiency.

13 Whatever the solution to any of these
14 issues, our recommendation to the CSA is to be
15 forward-looking, contemplating possible future states so
16 that when we end up with a market structure -- so that we
17 end up with a market structure that is flexible, fosters
18 innovation and fairness for all market constituents from
19 the smallest retail limit order, which contributes to
20 price discovery as well, to the largest institutional
21 block trade.

22 Those are my informal comments.

23 CHAIR: Maybe I can just kick off because I
24 am sure many of us have questions to ask you. And thank
25 you very much for those comments and for being so

1 succinct. My goodness, we are way ahead of time here and
2 Randee was so worried --

3 MR. TRIPP: I am an expert at that.

4 CHAIR: I just have a couple of questions.
5 One is that you, in your submission you had indicated that
6 you thought the trade-through obligation should apply
7 across the board, you know, to all market players, to all
8 market participants, dealers and access persons; you made
9 that very clear. But in your written submissions you talk
10 about the fact that it should be limited to the original
11 volume of the trade.

12 Could you just explain a little bit what
13 your thinking is on that?

14 MR. TRIPP: Yeah, it was a funny point and
15 when I was looking at my comments I was rethinking the
16 point that we make. What we are trying to say is that we
17 are not -- we don't want to see a situation where a party
18 is obliged to execute anything more than the order that
19 they want to execute; that's that point. And I had
20 trouble as I was rereading it, as well, understanding that
21 point.

22 CHAIR: It helps understand what your
23 objective was. The only other question I have and I am
24 going to turn it over to my colleagues here is, what do
25 you, this may not be a fair question but I am going to ask

1 you anyway.
2 What do you think about where they ended up
3 on this issue in the US?
4 MR. TRIPP: Where they have ended up right
5 now which protects just the top of the book?
6 Well I don't think that is is appropriate.
7 I think we have to protect the whole disclosed book. We
8 are trying to encourage transparency in the marketplace,
9 right. So, you know, we can't try and do that and not
10 sort of satisfy those orders that, you know, are
11 addressing that and are willing to stand up and be counted
12 in the marketplace.
13 CHAIR: Thank you.
14 MR. MOORE: I have a few questions. I
15 found your presentation very interesting and it seems that
16 most of the commentators do support some kind of
17 exemptions from the rule and that they -- some take a more
18 extensive position than others.
19 I noticed on page 3 of the written
20 submission, six paragraphs down, the last sentence, says:
21 "If there is a minimum transaction size on
22 the marketplace, for example, 25,000 shares, those orders
23 should be treated as contingent orders and subject to
24 exemption from the trade-through obligation unless the
25 order to be executed at the inferior price exceeds the

1 minimum."

2 I am just wondering how that would work.
3 Am I correct in interpreting that as once the obligation
4 of others not to trade-through the order on that exchange
5 would apply but the orders on that exchange of 25,000 or
6 more would still have to observe the trade-through rule on
7 other markets?

8 MR. TRIPP: My partner Michelle Peacock is
9 with me. Do you know the quick answer to that?

10 MS. PEACOCK: I believe that the point that
11 we were making was that if, in fact, the trade-through was
12 going to take place in a market that would normally be
13 exempt because you wouldn't know if you could actually
14 trade because there were limits on it, that if, in fact,
15 there were better priced orders that would satisfy that
16 minimum requirement that were on another marketplace,
17 then, in fact, those other orders should be satisfied.

18 MR. MOORE: My first taking of this, which
19 I think is wrong, is that you were arguing for an
20 exemption for block trades of 25,000 or more?

21 MS. PEACOCK: No.

22 MR. TRIPP: No, no.

23 MR. MOORE: No, that is not the case. It
24 took me a while to figure out what you were saying there
25 but I think I understand it. Thank you very much.

1 The next question I have and I don't, I am
2 just curious, I happened to look at the comments that were
3 made in response to Regulation Services notice of 2004,
4 August 20, 2004, 018 -- or, yeah, 018 where they talked
5 about a proposal -- actually it was a combined proposal
6 dealing with off-market trades and this trade-through
7 rule.

8 But with respect to the trade-through rule,
9 I believe, this is a summary of the comments:

10 "BMO is of the opinion that the rules as
11 proposed are too restrictive, BMO notes that an informed
12 consent opt out provision is appropriate for access
13 persons and for participants engaged in proprietary
14 trading..."

15 And then go on on that.

16 But I take it from your comments in the
17 written submission today and your comments today that you
18 don't take that position any longer?

19 MR. TRIPP: That is correct. That is
20 correct. And I have to look at that commentary, when was
21 that provided?

22 MR. MOORE: It was in response to a notice,
23 the RS Market Integrity Notice 2004-018, issued on August
24 20, 2004. And then Barclays, BMO, Canadian Securities
25 Trading Association, Markets Inc. and TSX Markets gave

1 comment letters to that.
2 MR. TRIPP: Okay, I have to go back and
3 look at that.
4 MR. MOORE: Everybody is entitled to change
5 their opinion. I just want to make sure I --
6 MR. TRIPP: I certainly haven't changed my
7 view on this issue for a long time and so I am not sure of
8 the technicalities of that perspective but... Our view as
9 presented in this document is our view.
10 MR. MOORE: And you take the view,
11 obviously now, that the duty with respect to trade-through
12 is owed to the market and it is not based on the fiduciary
13 obligation to one's client and, I think that's --
14 MR. TRIPP: To the market, sure, that is a
15 philosophical way of looking at it, yes, owed to the
16 market.
17 MR. MOORE: Those are the two positions
18 that seemed to come out.
19 MR. TRIPP: We endorse all the various
20 technologies, we are doing our very best to work with
21 Markets Inc., for example. We don't stand against
22 anything that is coming into the marketplace. You know,
23 from a philosophical perspective, we believe that new
24 technology is important for the market, algorithmic
25 trading is important for the market, block-book type

1 trading is very important and we engage in it and, you
2 know, because we think it helps liquidity in the market.
3 So we are doing everything we can in that regard, we just
4 want it to be a level field for all.

5 CHAIR: Just apropos the issue of a level
6 field. Let's assume that we did have, in fact, as a
7 result of the comment a decision to impose the
8 trade-through obligation as you have said, across the
9 board, level playing field, all dealers, all access
10 persons, duty owed to the marketplace, by which I assume
11 also that you would say that it is the marketplace's
12 obligation to enforce or at least to monitor compliance
13 with the trade-through obligation instead of it being
14 vested, if I can call it that, at the level of the access
15 person or dealer.

16 Do you have any thoughts on, or at least
17 any suggestions or input, on how, how in practice one
18 would get to the end game here; which is a trade-through
19 obligation across the board by access persons and others
20 who --

21 MR. TRIPP: Well all of the new
22 technologies will have to link together and --

23 CHAIR: So the CLOB is central to your --

24 MR. TRIPP: Correct.

25 CHAIR: You would have to have that?

1 MR. TRIPP: Fundamental.
2 CHAIR: Fundamental.
3 MR. TRIPP: Yeah, to our view.
4 CHAIR: Thank you, that is very helpful.
5 Any other questions for Mr. Tripp?
6 MR. MOORE: Yeah, I have just one more
7 question. I want to allow people another opportunity but
8 you have been kind enough to keep your oral remarks to a
9 reasonable length of time so that we have time for
10 questions.
11 MR. BATES: Might be a lesson for others.
12 MR. TRIPP: Yes, let that be a lesson for
13 everyone else.
14 MR. MOORE: Some of the commentators
15 commented on the expenses and there seemed to be a general
16 acknowledgement including, I would say, acknowledgement
17 against interest of the positions being taken that this is
18 going to be expensive whether it is imposed upon the
19 marketplace to get the technology to monitor and police
20 this or whether it is imposed on the individual market
21 participants to have the technology and monitor their
22 obligations. And some commentators have come down on the
23 basis that it should be imposed on the marketplace and
24 others come down with the view that it should be on market
25 participants.

1 And just to remind you, you took the view
2 it should be imposed on the marketplace rather than the
3 marketplace participants. And you say that -- you
4 acknowledge about the cost. But I would like to hear your
5 comments on how expensive this is going to be and where
6 should it be placed and why did you decide the marketplace
7 as opposed to market participants?

8 MR. TRIPP: Well we spend several millions
9 of dollars every year in technology in our business. I
10 can't, without scoping out the various, you know, types of
11 technologies that are required to link all these markets,
12 I couldn't give you an informed or even close to a guess
13 in terms of what it is going to cost to link them
14 together.

15 But I would say that the cost will be borne
16 by the participants in the market and that will be handled
17 in the normal practice of negotiating market transactions
18 where there will be a cost that will be incurred by some
19 party and it will be spread across the, you know, the
20 providers of these technologies; the buy side, the sell
21 side, the marketplace, you know, it will be spread across
22 in some manner that gets worked out in the marketplace.

23 And, to me, that is the appropriate
24 approach to it and so it gets borne by the marketplace in
25 that sense. And the cost of doing that is far less than

1 the cost of fragmenting the market, you know, if we don't
2 get this right, in my view.

3 MR. MOORE: Some of the other commentaries
4 suggested that the obligation should be imposed on the
5 market participants with respect to markets to which they
6 had access, and it wouldn't apply to markets to which they
7 didn't have access.

8 I think you take, and I would say a
9 principled approach, and differ on on that, if I interpret
10 this correctly, by saying:

11 "All marketplace participants owe a general
12 duty to the market and thus should be subject to
13 trade-through obligations. We believe this will be best
14 implemented if it is imposed on the marketplace rather
15 than the marketplace participants anything less invites
16 regulatory arbitrage. A participant might reasonably
17 claim that their obligation is limited to their access to
18 a particular marketplace."

19 And that's -- I think RS takes the view
20 that you would limit it to those markets to which a
21 participant had access.

22 "A full service dealer would have no choice
23 but to subscribe to every new marketplace to fulfil their
24 obligations to their clients. This could result in
25 artificial success in the early stages for new

1 marketplaces. Interconnected Canadian marketplaces would
2 also avoid the perennial problem of the lack of a Canadian
3 data consolidator..." et cetera.

4 So I understand the position you are taking
5 and I just want to say when RS gets up, I would like to
6 hear their reasons for saying that the obligation should
7 be imposed on the market participant to which the market
8 -- and it should apply to those markets to which a market
9 participant has access. Because I think your position and
10 their position is different in that regard. Am I correct
11 on that, Mr. Tripp?

12 MR. TRIPP: Yes, I believe so. Where is
13 Tom? He can comment more directly on that.

14 CHAIR: Okay, well any questions?

15 MR. BOISVERT: Maybe just one to clarify.
16 I think in your notes you, in your letter you said that
17 price is only one component of a transaction and best
18 price and best execution are independent concepts and
19 price can be ancillary.

20 MR. TRIPP: Volume is the other aspect of
21 it.

22 MR. BOISVERT: And speed and certainty of
23 the execution. But how in "real life" would you reconcile
24 those different concepts and always fulfilling
25 trade-through obligations?

1 MR. TRIPP: The same way we do today. I
2 mean, we protect against trade-throughs today largely and
3 the marketplace determines the, you know, the CLOB, you
4 know delivers the solution to the issue.
5 So am I misunderstanding your question?
6 MR. BOISVERT: So that is fine. So price
7 would be the first determinant basically.
8 CHAIR: On behalf of all of us, thank you
9 very much, Mr. Tripp. We really appreciate your comments
10 today.
11 MR. TRIPP: Great thank you very much.
12 Thanks for the opportunity.
13 CHAIR: The next presenter is RBC Capital
14 Markets. And appearing for RBC is John Reilly and Tom
15 Kain. Welcome.
16 SUBMISSIONS BY MESSRS. REILLY AND KAIN FOR
17 RBC CAPITAL MARKETS:
18 MR. REILLY: RBC is pleased to have this
19 opportunity to provide its comments to this CSA on the
20 discussion paper 23-403. We also believe this is a very
21 serious issue. We have already submitted our responses to
22 the earlier questions concerning trade-throughs and we
23 hope to use this opportunity to answer any questions that
24 you have on our submission. But we would also like to
25 take this opportunity to offer some insight that may help

1 in determining the next steps in this process.

2 My name is John Reilly, I am head of
3 Canadian Equity Trading and I am here with my colleague
4 Tom Kain who is Director of Portfolio and Electronic
5 Trading. We represent the institutional and retail trading
6 of listed securities for RBC Capital Markets and are not
7 here to offer any opinion nor feedback from any
8 perspective other than the cash equity market.

9 I realize that other participants in
10 today's debate do have comments relating to markets
11 outside the scope of our commentary, and I suggest the CSA
12 hold separate and distinct debates in these areas. We
13 will be happy to have representatives from other parts of
14 our organization comment on the dynamics of the fixed
15 income market, but we thought it best to limit the number
16 of presenters today and focus on the area that seems to be
17 the most controversial.

18 First of all, let me say for the record
19 that RBC supports and welcomes innovation and competition.
20 In fact, we believe that the capital markets thrive and
21 develop in competitive environments. We also believe that
22 if market participants can't compete -- and I will repeat
23 Eric -- in a level playing field, they should exit the
24 market and allow the innovative players to grow and
25 develop effective and efficient practices that benefit all

1 participants in the marketplace.

2 We believe the current practice of allowing
3 trade-through has not been adequately debated and the CSA
4 should discontinue the practice until such time that
5 everyone has had the opportunity to either participate in
6 trade-throughs or decide to ignore them.

7 Current practices has provided one
8 innovative constituent in this case of marketplace that
9 also happens to be a dealer an advantage that we, as
10 participants in the regulated marketplace, do not have.

11 My statistics indicate the market place in
12 question has traded through the posted TSX markets on
13 greater than 30 per cent of their trades to date and it
14 may even be as high as 50 per cent.

15 CHAIR: Sorry, did you say 30 per cent?

16 MR. REILLY: That is what our statistics
17 are. I don't know what they actually are. We have just
18 been trying to keep track. We think it is around 30/35
19 but it may be approaching 50; we don't really know.

20 Albeit we have not seen any real volume in
21 this ATS. In theory, it still goes against the principle
22 of fair dealing. We would suggest that if the practice
23 continues without relief to the trade-through rule that we
24 will, as a firm, contemplate applying to be an ATS
25 ourselves, although I don't know how we will actually do

1 that, but we will contemplate it.

2 Why should our upstairs trading with
3 institutional buyers and sellers be required to place
4 orders in a central limit order book if others are
5 provided with this free option? RBC does not advocate the
6 creation of a two-tiered market but believe that we should
7 all play by the same rules. The rules have been in place
8 for many years, including preorders, always had a
9 provision for trade-through obligations. We as dealers
10 knew the consequences of trading through a better price on
11 alternative exchange and when it occurred we made
12 retribution immediately. These rules and procedures have
13 governed fair and equitable trading practices for many
14 years and should be continued regardless of the
15 competitive landscape for marketplaces and exchanges.

16 As a side note, we fully support ATSS and
17 in fact are looking at innovative ways to participate in
18 these ATSS to benefit the market as a whole.

19 We believe the CSA should stop the current
20 practice of allowing trade-throughs without displacement.
21 This situation not only causes confusion amongst our
22 clients but also threatens the principles that the
23 Canadian marketplace has been built on.

24 We have seen many changes over the past 20
25 years, and I am sure we will see many more over the next

1 20, but the fundamentals and integrity of our marketplace
2 has not changed. We are not a third-world market, our
3 prices should stand the test of time.

4 We have an obligation to the investing
5 community to conduct fair and orderly markets for all
6 participants, which means that orders with the best price
7 should trade first.

8 It is crucial that price discovery
9 mechanism is robust and reliable. If we think there is a
10 better way then let's debate it and come to conclusions
11 that we all believe will benefit the marketplace.

12 Let's take some lessons from our friends
13 south of the border to ensure that market structure
14 debates are conducted in an orderly and effective matter.
15 Let's not just allow certain constituents an advantage
16 over other market constituents in the name of competition
17 and investor choice but let's develop and grow our capital
18 markets where all investors believe they have an equal
19 chance of executing their order at the best price.

20 Now Tom will actually make some comments
21 from the trader portfolio manager perspective.

22 CHAIR: All right. Before you sit down,
23 can I just ask you one question about what you said. I
24 took it, and this may not be fair, tell me if this the
25 wrong implication.

1 When you were talking about let's take some
2 lessons from our friends south of the border and make sure
3 that we have this debate fully and effectively and
4 efficiently and that we not allow any one constituency to
5 overwhelm the debate so that the answer lies in a
6 particular direction.

7 I am taking from your comment, although you
8 didn't say it directly, that you don't think that where
9 they ended up in the US is where one would ideally like to
10 be?

11 MR. REILLY: No. No I actually, I mean,
12 the debate on Reg. NMS was lengthy, there was a lot of
13 constituents that actually had the ability to provide
14 commentary. And where they ended up, I think we can all
15 live with because we all were part of the debate and we
16 know what the implications are with what the outcome is.
17 Whether they decide, you know, fast market/slow
18 markets/access, that's what -- we know what the rules are
19 and we can actually build systems and develop techniques
20 in order to access those marketplaces when we want to,
21 so...

22 MR. MOORE: I have a question too. I think
23 it is clear from the written submission that you say:

24 "In general we are in favour of the
25 trade-through protection believing that prevention of

1 trade-throughs is an obligation that all marketplace
2 participants owe to the market. However, it may be
3 impractical as well as prohibitively expensive to extend
4 the obligation to the marketplace participants that are
5 currently not required to honour this obligation. Rather,
6 a more practical solution would be to extend the
7 trade-through obligation to the marketplaces."

8 So you, like BMO, have come down on saying
9 it should be on the marketplace. It would be
10 prohibitively expensive to put it on the market
11 participants.

12 Why would it be prohibitively expensive to
13 put it on the market participants?

14 MR. REILLY: Again, how you define "market
15 participants" but the actual "end user", the retail
16 client, shouldn't have the obligation to search for
17 liquidity. That is what we as dealers do. We will put
18 the systems in place and we know that if we send it to a
19 marketplace and the marketplaces are obligated to look for
20 trade-throughs, then like it happens in US and the ATSS,
21 if there is a better price they send it to the other
22 marketplace.

23 MR. MOORE: But in this debate it is access
24 persons, and would you put that obligation on them or
25 would you also think that would be prohibitively

1 expensive?

2 MR. KAIN: Let me jump up and deal with
3 that one.

4 Our perspective on that was that we don't
5 think that access persons should be absolved of their
6 responsibility, okay. They owe a duty to the marketplace
7 as well.

8 However, given the number of linkages and
9 the technology required in order for them to, to satisfy
10 their duty to that marketplace, we think it may be more
11 practical, okay, and less expensive in that there will be
12 fewer linkages if you impose the restriction on the
13 marketplaces as well.

14 So, for example, if there are three
15 marketplaces operating, there has to be linkages between
16 those three marketplaces.

17 If there are 50 access persons with
18 linkages to three marketplaces and 50 dealers as well, you
19 see our point, right? The linkages. It becomes, it
20 spirals, right, and the number of linkages between
21 marketplaces, access persons, et cetera, is larger.

22 And so, therefore, in terms of the types of
23 technology that has to be put in place, each one of these
24 individual silos, if I can refer to them as such, the
25 costs are comparable at each individual location. So

1 three versus many.

2 CHAIR: So when you talk about linkages
3 between marketplaces and a central hub or whatever, you
4 are really talking about the CLOB model?

5 MR. KAIN: No, not necessarily, not
6 necessarily. That is a possible solution, okay. But, you
7 know, we, we had the temerity, if you will, to actually
8 make a suggestion, and this is merely a suggestion, as to
9 how you might approach this, this type of a problem, in
10 our submission, stating that you could have marketplaces
11 execute sweep orders when and if a match occurs and on and
12 on -- and I am not going to restate our submission it is
13 publicly available and everybody has the opportunity to
14 read that.

15 But, as an example, that particular
16 scenario that we present doesn't require a single central
17 order book but what it does do is it allows for full
18 trade-through protection and full depth of book
19 protection.

20 MR. MOORE: And, Tom, I have a follow up
21 question. And I know that you are going first and RS is
22 going later and certain others are going later, so I am
23 kind of, I don't know if you have had a chance to read
24 everybody else's comments. But some of the commentators
25 suggest that if, if the obligation is imposed at the

1 marketplace level rather than market participants, it
2 should fall heavily on new entrants like new marketplaces
3 coming in.

4 What would you say to the idea of, for
5 instance, the TSX which still represents over 95 per cent
6 of the volume and new marketplaces coming in to say, no,
7 we would impose the cost of complying and technology et
8 cetera putting the systems in place to monitor et cetera
9 on a proportional basis so that the cost wouldn't fall on
10 the new marketplaces coming in.

11 MR. KAIN: Well, the TSX is going to have
12 to spend the money as well, they have got their -- they
13 are not going to be exempt from these, they wouldn't be
14 exempt from these requirements at all. And I think fairly
15 and simply it is a cost of doing business ultimately.

16 We at RBC Capital Markets bear a regulatory
17 cost and are quite happy to do so because the regulations
18 are in place in order to protect investors and we think
19 this is direct parallel.

20 MR. MOORE: Okay, thank you.

21 MR. KAIN: There are, perhaps, a few things
22 that I would like to address in my, in my, I have prepared
23 some remarks here and I, first of all, would like to thank
24 you all for giving us the opportunity to present to you.

25 As you are all aware we are definitely in

1 favour of full trade-through protection. I had, I was
2 going to mention the fact that we thought it should be
3 placed at the marketplace level but through Q&A that has
4 become pretty clear.

5 Now, the whys and the wherefore of that.

6 We are firmly in the camp that believes
7 without trade-through protection there is no incentive to
8 contribute to the price discovery process. The concept is
9 very simple. If an investor routinely makes their
10 intentions known by exposing a limit order in the
11 marketplace and no benefit accrues to that investor when
12 that limit order is traded through, then that rational
13 investor will stop providing the free option to the
14 marketplace. This has the effect of impairing liquidity
15 and diminishing the price discovery process.

16 It follows from our argument that
17 trade-through protection should be extended only to those
18 orders that are fully disclosed and immediately tradable
19 because those orders are those that contribute to the
20 price discovery process.

21 Large institutions may argue that having
22 trade-through protection in place may interfere with their
23 ability to execute large block trades, however, we would
24 argue that it is inappropriate for these institutions to
25 piggy back off of the price discovery process by trading

1 large blocks whose prices are benched marked off levels
2 established by those who did contribute to the price
3 discovery process. In a word, these institutions owe a
4 duty to the marketplace as well.

5 Others may argue that it is entirely
6 reasonable that there be different price levels
7 established by different types of marketplace
8 participants. Simply, they would state that it is
9 reasonable that a wholesale and a retail market should
10 exist.

11 Our thought, however, is this: If you
12 believe that argument then I, as a dealer, should be able
13 to maintain inventories of securities and I should be able
14 to buy from or sell to clients through my inventories at
15 whatever prices I please.

16 In essence, if the original argument that I
17 outlined, if you believe that is true, they are arguing
18 for a very radically different market structure that we
19 don't think marketplace participants are in favour of.
20 And, in fact, I am not advocating that we go to a dealer
21 inventory model similar to what we see in the fixed income
22 market. I am just saying that is a logical extension of
23 the argument that I have outlined here.

24 Others might argue that arbitrage
25 considerations will eliminate the problem of

1 trade-throughs those that transact at the inferior price
2 would be willing those orders exposed at the -- there are
3 at least two problems with the theory. First, many
4 investors that would transact at the inferior price are
5 doing so in order to benefit over longer-term horizon and,
6 therefore, they would not be willing to trade out of the
7 position for a short term smaller gain, therefore, they
8 are going to pass up any arbitrage opportunity because I
9 don't want to hold -- they want to hold their position
10 over a longer term to gain.

11 MR. MOORE: Tom, you are talking
12 theoretically now?

13 MR. KAIN: I am. I am. And what I am
14 speaking to is, there were some submissions that have made
15 -- I am trying to rebut some of the arguments that I have
16 seen in some of these submissions at a very, very high
17 level.

18 But I don't, in my opinion, I don't think
19 that, I am stating that I don't think these arguments are
20 true, okay.

21 And the other second problem I have with
22 the arbitrage theory is that if a new marketplace
23 implements rules for competitive reasons that enhance
24 their competitiveness, it might make it difficult for some
25 arbitrageurs to operate. For example, a marketplace that

1 imposes a minimum block size constraint, an arbitrageur it
2 doesn't make sense for them to go in and say, if the
3 marketplace has a minimum block size constraint of 10,000,
4 for example, shares, it doesn't make sense for them to go
5 in and buy ten thousand in order to sell 1,400 shares at a
6 superior price. They have got the risk of holding that
7 net position so they wouldn't do so. So the arbitrage
8 argument doesn't fly in that instance as well. And you
9 can list a number of them, I just want to be brief and say
10 I am not so sure about this whole arbitrage argument.

11 Finally, we do find it interesting that
12 they have gone through a pretty similar process in the
13 United States -- John spoke to it -- very, very recently
14 and they have decided to impose trade-through protection
15 down in the United States. Not the full depth of book
16 protection that we would advocate, however we do find it
17 very, very interesting that they've implemented
18 trade-through protection in the US despite the fact that
19 they have historically not really had any. Having gone
20 through that debate they have decided that, yes, this is a
21 good thing we are going to implement it. Whereas, in
22 Canada, we have historically had this protection and we
23 believe that should continue.

24 And that concludes my informal, formal
25 remarks.

1 CHAIR: Thank you. If I could just lead
2 off with one question for you and it is more a
3 clarification only of something you said earlier.
4 You talked about the fact that in terms of
5 where you -- what your position is on the question of
6 whether the trade-through obligations should extend to
7 access persons or just dealers and you said, no, the
8 trade-through obligations should apply across the board.
9 Access persons should not be absolved of their
10 responsibility to the marketplace either.
11 But I think in your submission you are
12 recognizing that there are some obstacles, practical
13 obstacles, perhaps, to imposing the obligation on access
14 persons that would have to be addressed. And you talk
15 about the fact that it could be prohibitive for access
16 persons to have the obligation and there could be
17 unintended consequences that flow from that.
18 But I am just having a little bit of
19 trouble reconciling what you are saying there, so could
20 you help me with that?
21 MR. KAIN: Sure. It may be in the best
22 interest of an access person to have access to a new
23 marketplace, okay. It may allow them to better satisfy
24 best execution requirements et cetera, et cetera, okay.
25 However, as I mentioned in, when I was

1 addressing Paul's earlier question, okay, the cost of
2 maintaining linkages to the access person -- for the
3 access person may be very, very prohibitive. And so
4 therefore a solution, okay, may be that, well, we just
5 won't establish the linkage and so, therefore, their
6 clients, okay, may suffer, okay. It might be in their
7 best interest to establish a linkage if we impose it at
8 that level and don't impose it at the marketplace level.
9 If you impose it at the marketplace level the problem goes
10 away, in essence, okay.

11 MR. MOORE: I do have some questions, I
12 don't want to hog the floor but I see we have 15/20
13 minutes, so.

14 CHAIR: We have probably another --

15 MR. KAIN: You are not going to grill me
16 for 15/20 minutes.

17 CHAIR: We actually have three more
18 minutes...

19 MR. MOORE: Oh, do we?

20 CHAIR: Yes.

21 MR. MOORE: Anyhow, I want to follow up on
22 a few things you have said. I have been struck with that
23 a lot of the debate is theoretical and I have been trying
24 to get down to -- I found the debate in the United States
25 fascinating and the decision to put in the, the

1 anti-trade-through rule was three-to-two, and there was a
2 very strong dissent.

3 But on the first point about the fact that
4 if there is not an anti-trade-through or a
5 no-trade-through rule, investors just aren't going to put
6 in limited market orders. And I am wondering how you
7 respond to the commentators that say this is all theory
8 and there is no actual evidence and if you look at NASDAQ,
9 they did not have an anti-trade-through rule and they had
10 lots of limited market orders in a very viable market?

11 MR. KAIN: That was a dealer market we were
12 dealing with. Very, very different. These were market
13 makers that were involved.

14 MR. MOORE: Okay, would that make a
15 difference?

16 MR. KAIN: I think so. I think ultimately,
17 absolutely. And in order to address some of these
18 theoretical issues, I try to simplify the problem and
19 think, well, what would I do? Okay, and I think of myself
20 as reasonably rational person, a lot of other people may
21 argue with that, but I just think to myself, well, if I am
22 exposing an order and saying I will buy 5,000 XYZ at such
23 and such a level and I see things trading around me, why
24 wouldn't I sit in the weeds? Why would I expose that? Why
25 do I give the market that free option and say to them go

1 ahead if you want, hit me? But it doesn't make sense
2 ultimately for me.

3 And picking on that specific theoretic
4 argument, but I just can't tend to try and go through it but
5 I think unfortunately in many instances because a lot of
6 this is very theoretical, we don't have a situation where
7 we have allowed trade-throughs in Canada and not. We have
8 also had full trade-through protection.

9 MR. MOORE: In the United States I am
10 curious, we looked to the debate in the United States and
11 you have mentioned the way they have gone and some of the
12 commentators -- I don't want to mention names because I
13 read this through and underlined and now I can't remember
14 who said what, but in shorthand, somebody on the other
15 side of debate -- they pointed out and I got a quote from
16 the dissenting opinion in the United States, the
17 majority -- this is the dissenting opinion of
18 Commissioners Glassman and Atkins criticizing the majority
19 decision.

20 "The majority has failed to establish the
21 current trade-through rates indicate a significant
22 investor protection problem. The majority has
23 cherry-picked statistics from the results of the OEA study
24 that appear to justify the adoption of a trade-through
25 rule while ignoring data that called the need for the rule

1 into question. We do not believe that the current minimal
2 trade-through rates indicate that investors are not
3 obtaining best execution, that their orders are being
4 unfairly treated or that investors otherwise suffer
5 economic harm."

6 I am not sure it was these commentators
7 that we have received, but I have read other comments
8 saying this rule isn't going to last, it is still going to
9 have a lot of debate, and you mentioned that as dealers
10 you are gearing up for the rule in the States. How do you
11 feel about that? Do you feel this rule in the States is
12 something that the business community, the dealer
13 community is obviously going to comply with? It comes
14 into effect next year, is the debate over in the States or
15 should we hold our powder try here before we make a final
16 decision?

17 MR. KAIN: I don't, the debate is going to
18 be on. Of course it is going to be ongoing because there
19 is vested interests, okay. There are interests out there
20 that would love trade-through protection to go away and so
21 they are going to continue to debate it.

22 MR. REILLY: I can tell you, as a dealer,
23 we are spending an inordinate amount of money to comply
24 with Reg. NMS. Originally slated for July, I now believe
25 it is going to be pushed back to December because of the

1 cost involved, you know, in implementing it. But we don't
2 have a choice, we have to believe that the debate is over
3 and it is being implemented and we hope that we are not
4 spending all this money for nothing; that will be our
5 issue.

6 MR. MOORE: So, in other words, just the
7 sheer cost and the necessity of people to comply is kind
8 of forcing the debate not to be reopened at least
9 extensively. But I take it from Tom, you say the debate
10 at least in theory will --

11 MR. KAIN: Well I am just stating there are
12 going to be those that are going to say, no, get rid of
13 it, get rid of it, get rid of it because they have got an
14 interest in doing so. But, nonetheless, it is going to
15 stay in place is my thought.

16 MR. MOORE: Yeah, my question really went
17 to, we want to get this decision right, we have been urged
18 to do something immediately to jump in and stop any
19 trade-throughs even in the interim while we look at this
20 question. As you know from the history, we refused to do
21 that and we told RS don't panic on this, don't rush, we
22 will monitor very carefully and see if there is actual
23 evidence of harm. So it is relevant to us to know what is
24 happening in the United States from a model point of view,
25 that is why I am asking the question. So I appreciate

1 your answers on that.

2 MR. KAIN: Again, actually one more point
3 on that. The dissenters and those that were in favour
4 argued extensively, and you eluded to that, but they
5 argued extensively about the statistics.

6 MR. MOORE: Yes.

7 MR. KAIN: You know, cherry pick -- I will
8 pick up, and then there were those, you know, the ones who
9 were in favour of Reg. NMS saying that, no, it is doing
10 harm and the corollary as well.

11 CHAIR: We are actually ten minutes,
12 according to that clock, ahead of schedule. I am going to
13 suggest as a prerogative that we take a five-minute break
14 and just be back at ten to and have our next presenter,
15 who is CSTA, be prepared at ten to ten, if that is okay.
16 And I just want to thank the two of you. That was
17 incredibly helpful.

18 So we will be back at ten-to-ten.

19 --- Upon recess at 9:45 a.m.

20 --- Upon resuming at 10:00 a.m.

21 CHAIR: Next up we have CSTA, appearing on
22 their behalf is James Beattie and Nick Savona.

23 SUBMISSIONS BY MESSRS. BEATTIE AND SAVONA

24 FOR CSTA:

25 MR. BEATTIE: Good morning. Jim Beattie,

1 please. I am here representing the CSTA, I am this years
2 Chair of the CSTA; along with my colleague Nick Savona who
3 is the Chair of the Trading Issues Committee. My day job
4 is head of Canadian Equity Trading at RBC, and I do want
5 to highlight that my comments in no way reflect the
6 opinions that were so adeptly expressed by my colleagues.

7 I have been in the investment business 18
8 years, and I would like to briefly tell you a little bit
9 about the CSTA. First of all, we are pleased to have this
10 opportunity to respond to the request by the CSA on
11 trade-through obligations.

12 The Canadian Securities Traders Association
13 is a professional trade organization that works to improve
14 the ethics, business standards and working environment for
15 members who are engaged in the buying, selling and trading
16 of securities, mainly equities. The Canadian STA
17 represents over 700 traders nationwide in Canada and is
18 lead by governors from each of the three district regions.
19 The organization was founded in 2002 to serve as the
20 national voice for our affiliate organization. The CSTA
21 is also affiliated with the Securities Traders Association
22 of the US, which has 6,000 members globally, making it the
23 largest organization of its kind in the world. We often
24 comment on industry developments and form opinions on
25 trading issues based on input from our membership. Please

1 understand that we are purely a volunteer organization and
2 one that is relatively new to the formal lobby effort --
3 although this is an informal presentation. Nonetheless,
4 our intention here is to highlight issues relevant to
5 trading practitioner.

6 The CSA has used four criteria within their
7 discussion paper in which to address the pertinent issues
8 relevant to market structure and trade-through
9 obligations. The first discussion point of balancing
10 regulation and competition amongst all types of
11 marketplaces must occur within the reality of the unique
12 nature of the Canadian markets.

13 Our capital markets are predominated by two
14 distinct characteristics; a relative lack of liquidity and
15 buy transparency. The Canadian STA believes that we must
16 respect these two characteristics while with CSA attempts
17 to ensure fairness, visibility and to maintain ease of
18 access to our capital markets.

19 The relative illiquidity of the Canadian
20 markets ensures that wide bid/ask spreads can predominate.
21 Reminding everyone that these spreads represents
22 underlying posted orders within the central limit book. To
23 completely eradicate the validity of this order flow is
24 illogical whether it is from an institutional or retail
25 perspective.

1 This is not meant to imply that regulation
2 should be onerous or costly when and if it is required on
3 trade-through. But it does require that we offer all
4 participants a fair and equitable marketplace.

5 The transparency of the Canadian markets
6 remains our global competitive advantage. We can and will
7 attract order flow to our capital markets when
8 participants, especially those on a global basis, find
9 that execution is accessible and relatively easy. This is
10 many times the case for non-North-American investors that
11 may only access the Canadian capital markets on an
12 occasional basis. The transparency factor must remain
13 prevalent in all of our minds. Now might I remind
14 everyone that all traders are in the business of doing
15 business.

16 From a practical purpose, it would appear
17 unseemly for an international money manager to not have
18 received a fill on an order that was displayed within the
19 central limit order book while the stock is traded through
20 the client's limit.

21 Within this discussion on the market
22 structure issues and the determinates that should be
23 considered as part of trade-through obligation, the
24 Canadian STA would like to articulate two fundamental
25 views. One, best execution is not the same as best price.

1 And, two, best execution has not been clearly defined by
2 any industry parties and is currently viewed by our
3 constituents as a process.

4 From a trading perspective, best execution
5 relates to our ability to buy or sell stock subject to the
6 volume, pricing and risk parameters characteristic of that
7 specific name at the exact time of execution.

8 All current participants in the Canadian
9 marketplace are conversant with the time priority rules.
10 And that if your volume constraints require you to test
11 price discovery limits outside the current quote, then you
12 will find some displacement of volume that must be
13 satisfied. This is a standard and well-understood trading
14 protocol in Canada.

15 In many cases the dealing community utilize
16 their trading capital to facilitate the client's ultimate
17 volume request. However, I repeat, our existing trading
18 community is totally conversant with the need to satisfy
19 demand or supply within the central limit order book.
20 Therefore, the process of satisfying your ultimate volume,
21 pricing and risk parameters on a stock must ensure that
22 market structure in Canada allows it to remain a global
23 competitive advantage.

24 Given that view, the Canadian STA maintains
25 that access fees for ATSS must be fair and transparent

1 with accessibility and speed not becoming impediments to
2 execution. Which, by the way, would be contrary to any
3 definition of "best execution". And that liquidity and
4 depth of market are not negatively impacted by the
5 eradication of the strength of the central limit order
6 book.

7 The Canadian STA does, however, recognize
8 the realities of the cost structure inherent in satisfying
9 trade-through obligations. And I would state that the
10 onus should be on the marketplaces to maintain the
11 integrity of trade-throughs. In most case the buy side
12 are not equipped nor trading any type of proprietary
13 capital thereby complicating the realities of any trade
14 costs.

15 The costs of maintaining systems with
16 respect to trade-through would also not be reasonable and
17 practical at this stage for most of buy-side constituents.

18 I will turn it over to my colleague Nick
19 who will continue.

20 CHAIR: Thank you.

21 MR. SAVONA: Good morning. Thank you for
22 the opportunity this morning. I would like to continue
23 where James -- Jim, sorry -- left off.

24 The second discussion point by the CSA
25 recognizing and supporting the role of the retail

1 participation in the market clearly speaks to the need to
2 maintain the integrity of the central limit order book.

3 Institutional investors clearly conduct the
4 majority of their business on the upstairs markets while
5 satisfying the supply and demand restraints of the central
6 limit order book when volume and risk parameters deem it
7 appropriate.

8 The Canadian STA views its comments as
9 complimentary and consistent with the protection and
10 improvement of the role of the retail investor. The CSA
11 objective to "promote greater order interactions and
12 display depth" speaks clearly to the need to an
13 evolutionary process in the Canadian capital markets as we
14 address whatever operating realities present themselves
15 due to trade-through obligations.

16 When researching the Reg. NMS case for
17 trade-through, we must not miss a simple yet key
18 difference between our Canadian capital markets and the
19 USA. They actually have volume going through on their
20 ATSS, it is yet to be seen if Canadian market participants
21 will actually demand ongoing services from an ATS
22 sufficient for many to survive profitably. The Canadian
23 capital markets may likely require far fewer alternative
24 marketplaces.

25 Having said that, our view remains that

1 increased competition is required in the Canadian capital
2 markets and whether there are 2 or 20 marketplaces
3 eventually operating in Canada, we must foster a fair,
4 transparent and accessible market structure.
5 CSA must also ensure that greater order
6 interaction and display depth will occur. This must
7 predominate any of its regulatory actions. But this will
8 never happen with onerous regulatory constraints. Our
9 Canadian capital markets represent our listed corporations
10 well on a global basis because we can offer investors --
11 be they domestic, American or international --
12 transparency, ease of access and execution that does
13 garner global interest.
14 Trade-through protection should be imposed
15 where there are multiple marketplaces trading the same
16 security, otherwise order depth will disappear. Traders
17 from either the buy side or sell side will not post orders
18 in the central limit order book merely to help their
19 competitors achieve an effective price discovery process.
20 Why post a better offer if the profitability of actually
21 getting an execution is lower while others benefit from
22 your information?
23 That being said, given that the Canadian
24 STA adheres to the notion that all marketplace
25 participants should have an obligation and a duty to the

1 markets, if a trade-through obligation is imposed it
2 should be on the marketplaces. The buy side is not
3 equipped at this stage to address the cost nor system
4 issues relevant to all marketplace participants.

5 Over to Jim.

6 MR. BEATTIE: So as a means of
7 consolidating the thoughts of the Canadian STA, we would
8 like to advocate the following market structure
9 characteristics if and when a trade-through obligation is
10 determined: The requirement of a data consolidator to
11 improve accessibility and maintain transparency; access
12 fees that ensure fairness and do not deter participation;
13 that a full depth of visible book be used with full
14 functionality for sweep orders; that the obligation should
15 be simultaneous with the time of execution of the inferior
16 price trade versus post trade; it should be imposed on all
17 better priced pre-existing orders at the time of execution
18 and only on the visible amount of stock traded at the
19 interior price; special terms orders have no standing
20 therefor should not be subject to the trade-through if it
21 is imposed; an exemption should be provided for orders for
22 which the price or other material terms cannot be
23 determined on order entry of the VWAP market on close and
24 some of the others of that nature.

25 Best execution may not necessarily mean

1 best price, obviously. As best execution is termed a
2 process, best price should also be viewed as an objective
3 and not a finite description. However, best execution and
4 trade-through protection are not mutually exclusive
5 propositions. If technological links exist between the
6 marketplaces, there is no reason to assume that orders
7 could not be executed efficiently and quickly while
8 maintaining trade-through protection.

9 Before implementing a trade-through
10 obligation, the CSA should completely understand the
11 industry ramifications and costs relevant to the systems
12 and automation necessary and clearly address issues
13 relevant to access fees.

14 Once market participants have open and
15 efficient access to trade on all market centres on an
16 automated and market neutral basis, competition should
17 ensure that the client order flow is executed within the
18 process relevant to best execution.

19 The CSA should utilize an evolutionary
20 process on any adoption of the trade-through obligation,
21 basing upon empirical analysis and evidence from the
22 Canadian capital markets whilst ensuring that fairness,
23 transparency and access encourage greater order flow on a
24 global basis into Canada.

25 Thank you very much for the opportunity to

1 comment on these matters.
2 CHAIR: Thank you. Questions?
3 MR. BATES: Thanks. Thank you, Tom and
4 Nick.
5 MR. BEATTIE: Let's go with Jim and Nick.
6 MR. BATES: Sorry, Jim and Nick...
7 MR. BEATTIE: Thank you, Peter.
8 MR. BATES: How do we know that we are
9 doing the right thing? You know, everyone -- almost
10 everyone has spoken about this issue of looking to the
11 future, Eric you started that chain of thought and I agree
12 with that. I am trying to understand what your view is and
13 what others may comment on later, is that a kind of matrix
14 that we should be setting up for ourselves to understand
15 whether this is working right based upon some of the
16 arguments that you are putting forward.
17 MR. BEATTIE: So to determine whether it is
18 working? So what is the detriment --
19 MR. BATES: Yeah.
20 MR. BEATTIE: -- I believe obviously in the
21 central limit order book and I believe that the -- a
22 potential way of measuring that is looking at the
23 unexecuted portion of that book relevant to existing
24 trade-throughs that have occurred. That will give you,
25 you know, some insight into someone who has attempted to

1 buy stock or sell stock and not received any kind of a
2 report.

3 And that goes back to our example of using
4 international money manager who isn't conversant with our
5 market, which by the way we do highlight is globally
6 competitive, but puts out an order overnight to buy
7 whatever, ABC, looks at their Bloomberg terminal in the
8 morning and see that stock has traded through and they
9 don't have a report and they can't figure it out. And, to
10 us, that is the absolute detriment to what we have
11 existing in Canada which is a very strong capital market.

12 Nick anything you wanted to add?

13 MR. SAVONA: No. I think transparency is
14 one thing we have to our benefit here in Canada. I mean,
15 talking to the brokers and clients in the States, we are
16 the envy, well, you know, of a lot of the capital markets
17 they can clearly go on to Bloomberg or any system they
18 have and see exactly which broker is bidding, offering,
19 has traded. And that's, you know, we can't lose sight of
20 that; that is something we have to maintain whether it is
21 through a CLOB or some other way of linking up everyone,
22 all the marketplaces together. But that is something we
23 have to maintain here in Canada it is very important, I
24 feel.

25 CHAIR: Just in terms of that issue,

1 because I think one of themes that comes out very clear
2 from both of your presentations, and that of others today,
3 is this concept of we have a real advantage in Canada, we
4 already have a system that promotes the kind of
5 transparency that is the envy of markets around the world.
6 I think Eric referred to the fact that we are number one
7 in terms of the approach to market structure today. And
8 we are way up there, let's not lose that advantage is part
9 of what I am hearing come out of this.

10 And I can understand that transparency
11 obviously is very important for the marketplace. You have
12 got transparency, it encourages order interaction, which
13 encourages more participation in our capital markets. So
14 these are the themes that the CSA identified and people
15 are saying, yes, those are the important considerations.

16 But if I am looking at the markets as a
17 whole, I am thinking how does the upstairs market and the
18 ability to do trades in the upstairs market, which has
19 been permitted in this country for a very long time, how
20 does it fit in with what we are talking about here which
21 is more of an emphasis on transparency, it should all be
22 there, it should all be exposed, et cetera, how do I
23 reconcile that in my mind? How do I separate that and
24 say, oh, but that is something different?

25 MR. BEATTIE: Well I think that is a valid

1 comment, but I think if you look at the evolution of the
2 upstairs market in Canada as opposed to, for example, the
3 US where obviously they are dealing with a specialist
4 system which we don't have that complication.

5 The central limit order book in Canada
6 contributes, I would say a 100 per cent to the price
7 discovery process from an upstairs market perspective.
8 Above and beyond that, there may be risks parameters or
9 volume parameters that dictate you move outside that
10 central limit order book. But when you do that, you do
11 satisfy the supply or demand on either side.

12 So the point I am trying to make is that
13 the upstairs market does show ultimate respect for that
14 central limit order book. And above and beyond that,
15 there is noted -- I mean any displacement is dealt with
16 effectively. I don't know if that answers.

17 CHAIR: That helps. Did you want to add
18 something?

19 MR. SAVONA: No, thanks.

20 MR. MOORE: I have a few questions.

21 You talk about a market consolidator and
22 the original proposal that the CSA came up with when the
23 ATS rules were brought in was for a market consolidator
24 and market -- very much market integration. There was
25 significant debate around these questions from about 1995

1 to 2003, but the decision was made to promote the
2 transparency without requiring a consolidator or market
3 integration through technology connections or marketplaces
4 or market participants. And this decision was really made
5 on the basis of an industry committee, people getting
6 together and some of those committee members are here in
7 this room, who claimed that technology and commercial
8 interests would solve the problem of consolidation and
9 integration. But I seem to be hearing today that we
10 should be going back and re-examining that question?

11 MR. BEATTIE: I absolutely agree we should
12 be going back. I was of the believe that there would be
13 some industry participants that would solve that from a
14 pure profit motivation, that has not evolved; which is
15 actually surprising to myself and a number of my
16 colleagues.

17 MR. MOORE: Once the idea of a market
18 consolidator was done away with, that is when we first saw
19 at least two ATSS come forward, before that we didn't see
20 them at all.

21 Some people say, this is the next question
22 which is related, but it seems to me that market
23 participants historically favoured a central limit order
24 book or CLOB where all orders for security would interact
25 because price discovery is more efficient. However there

1 are very few pure price/time priority marketplaces in
2 existence today. And without pure price/time priority
3 some people feel that the central limit order book is less
4 efficient providing reasons for having competing
5 marketplaces.

6 I take it you take the historical view and
7 wouldn't agree with that view?

8 MR. BEATTIE: Definitely would not agree
9 with that view. You know, absolutely we are supporters of
10 the central limit order book.

11 MR. MOORE: I have two more questions. One
12 and it is based on -- let me get these names right -- Nick
13 what you said. I thought what you talked about in limit
14 orders not being put forward there wouldn't be the same
15 incentive, you mentioned dealers wouldn't have the same
16 incentive.

17 My earlier question to Tom about the NASDAQ
18 was that marketplace didn't have an anti-trade-through
19 rule and there were lots of limit market orders and
20 whatnot, and he responded that is really a dealer market.
21 What is your view on that?

22 MR. SAVONA: Well to reiterate, it is a
23 dealer market. And, also, we don't have that sort of
24 fragmentation here. We don't, at this point, we don't
25 have any locked-cross markets and it is pretty hard to

1 compare the two. It is totally different.

2 But also NASDAQ it has evolved and now it
3 is starting to become very much of an auction market
4 because of the rules that they have changed in the last
5 few years. It used to be years ago you would hate to trade
6 on NASDAQ and now it is almost the other way around and
7 people are having more problems with the New York Stock
8 Exchange than they are with NASDAQ.

9 But even having said that, it is still a
10 very, you know, it is a dealer oriented market; it is not
11 like ours at all and displayed sizes are, you don't know
12 what is behind that either. There is much more
13 transparency here than there is in NASDAQ.

14 MR. MOORE: Thank you. I think this is my
15 final question. The CSTA also put in a response to
16 request for comments when the Universal market integrity
17 rules went out proposed changes by RS in August 20, 2004.
18 And among those questions which dealt with market trades
19 as well but also dealt with trade-through and the
20 questions asked were:

21 "Should an access person who is neither a
22 dealer nor trading through a dealer be subject to the
23 requirement to take reasonable steps to execute first as
24 against better priced orders on any marketplace to which
25 the access person has access?"

1 And then there was another question about
2 applying to non residents. But that was really asking the
3 anti-trade-through question.

4 CSTA responded:

5 "Very concerned regarding the proposed
6 amendments to rule 2.1 concerning access persons. Strongly
7 disagrees with the extension of the obligations of
8 institutions to include displacing better priced orders on
9 any market where the institution meets the definition of
10 access person. States that institutional investors
11 managing client investments have a fiduciary
12 responsibility to seek best execution for their orders
13 which does not necessarily mean filling better priced
14 orders on any marketplace should the consequences mean
15 missing liquidity on another."

16 I take it that the position you are
17 representing today is diametrically opposed to that.

18 MR. BEATTIE: I wouldn't say it is
19 diametrically opposed a much as it has revolved from the
20 reality that we understand our -- and keep in mind we are
21 trying to represent a trading practitioner's view, both
22 buy and sell side, and in many cases the sell side has
23 taken care of any displacement issues on behalf of their
24 buy-side client.

25 So ultimately the buy-side client would be

1 satisfied on their volume which was more important to them
2 for, say, than pricing. The volume issues were the big
3 issue. So I think what that particular answer is trying
4 to address is the volume issue is, for them, the most
5 important constraint. And, as I said, for practical
6 purposes in many cases, the dealer in that community have
7 addressed those placement issues.

8 MR. MOORE: Your organization doesn't
9 represent buy and sell traders --

10 MR. BEATTIE: Yes, we do. That was
11 actually written by Peggy.

12 MR. MOORE: We have disagreements within
13 the OSC as well, so I am not trying to embarrass you.

14 MR. BEATTIE: I don't think they are
15 inconsistent conclusions because the bottom line is what
16 Peggy was saying in that submission is that she needs to
17 achieve volume parameters and she does not want to be
18 impeded in that. And so she is asking for an efficient
19 market. We are asking for the respect of the central
20 limit order book and the ability to still deal with the
21 client's ultimate volume and risk parameters.

22 MR. MOORE: I was a bit amused by your
23 submission and BMO's submission where, you know, the two
24 different submission were different and then I think your
25 explanation, I thought it maybe lay in the fact that you

1 do represent two different sides because your former
2 submission was very similar to what the Canada Pension
3 Plan is saying today in their submission. And so I
4 understand there is a debate not only among regulators and
5 whatnot but even within certain institutions.

6 MR. BEATTIE: Yes. And ultimately what we
7 are trying to represent is access to the Canadian markets
8 that does bring in more order flow, that is beneficial
9 whether you are buy or sell side.

10 MR. MOORE: And everybody wants that.

11 MR. BEATTIE: And that is ultimately our
12 objective. But it also has to be done efficiently,
13 effectively and without impediment. And because of the
14 fact, you know, probably beating a dead horse, but because
15 of the fact that we have had capital markets that are the
16 epitome of what they should be globally, what we are
17 saying is respect the fact that whether you are buy-side
18 or sell-side, I need to be able to execute efficiently and
19 quickly and we also have to respect that central limit
20 order book because we do have constituents who do not have
21 access to all of the marketplaces, et cetera.

22 MR. MOORE: Thank you.

23 CHAIR: Just to sort of go over one point.
24 I think an understanding from what you have said today and
25 also from your submission but more from your submission

1 this comes across very clearly. That what you are saying
2 is you believe there should be trade-through obligation
3 but you are saying don't mandate that until you have tried
4 other -- unless -- unless and until you have the other
5 conditions prerequisite, if I can call it that, in place
6 such as automated trading, which is mandated across the
7 board, and elimination of access fees. Those seem to be--
8

9 MR. BEATTIE: I think that would be an
10 accurate portrayal of what we are trying to say. Those
11 are -- what we are saying is that you need an evolutionary
12 process here so that we do get it right the first time and
13 not something that we have to approach.

14 CHAIR: And so where does the data
15 consolidator lie in that evolution? Because the last
16 paragraph of your submissions says:

17 "Before implementing a trade-through
18 obligation, the CSA should mandate automated trading and
19 eliminate access fees. Once market participants have open
20 and efficient access to trade against the published quotes
21 of all markets entered on an automated and market neutral
22 basis, competition should ensure that customers receive
23 the best prices et cetera, CSA should not adopt a
24 trade-through obligation unless it determines based on
25 empirical analysis that such connectivity and automation
is insufficient to protect against trade-throughs."

1 So I took from this that you are saying,
2 you should do these two things first and then if the
3 marketplace doesn't deal with it on its own, then come in
4 with the trade-through obligation. And were does the data
5 consolidator come into --

6 MR. BEATTIE: I think you have to start
7 reinvestigating the data consolidator because there hasn't
8 been an answer. Which is what we all expected it would
9 have promoted itself and it hasn't. You need that type of
10 data consolidator.

11 So I am saying, that is at the very
12 beginning of this evolutionary process, that is where we
13 are at now.

14 CHAIR: Okay, that is what I am asking. So
15 you are saying really what you need is the automated
16 trading, eliminate access fees and have a data
17 consolidator. That is really it?

18 MR. BEATTIE: Yes.

19 MR. SAVONA: And if not eliminating access
20 fees at least have full transparency of the access fees,
21 and that allows you to take that into consideration of the
22 final price on execution.

23 CHAIR: How practical -- let me ask you
24 this question. How practical is it for CSA to eliminate
25 access fees? This is maybe a question I will ask TSX

1 and --
2 MR. BEATTIE: Yeah, that would be a great
3 question for them. How practical is it? I don't believe
4 it is going to be as practical as as we would like. How
5 is that for a non answer?
6 CHAIR: That is what I feared.
7 MR. BEATTIE: Yes.
8 CHAIR: Thank you. Any other questions for
9 these gentlemen? Thank you both very much.
10 MR. BEATTIE: You're welcome. Thank you.
11 CHAIR: I see that we are five minutes, I
12 guess, ahead of the scheduled time for the break, but we
13 may as well break now. And we are scheduled to resume at
14 11 o'clock and our next presenter, I am just going to see
15 if they are here. Let me go back to the agenda. It would
16 be TD Newcrest, is anyone here for that?
17 MR. TUCKER: We're here.
18 CHAIR: Oh, okay. Why don't we take a
19 half-an-hour but be back just a couple of minutes before
20 five-to and be ready to resume then and maybe we can make
21 up some time and have a longer lunch break. Thank you.
22 --- Upon recess at 10:24 a.m.
23 --- Upon resuming 10:57 a.m.
24 CHAIR: We have TD Newcrest and appearing
25 on their behalf is Ray Tucker and Peter Haynes.

1 MR. TUCKER: Yes.

2 CHAIR: Welcome.

3 SUBMISSIONS BY MESSRS. HAYNES AND TUCKER
4 FOR TD NEWCREST.

5 MR. HAYNES: Thank you so much. My name is
6 Peter Haynes, I am responsible for portfolio trading and
7 index products for TD Newcrest. To my right is my
8 colleague Ray Tucker. I will do the talking, Ray will
9 answer most of the questions I am sure. Ray is
10 responsible for our trade execution group which handles
11 all the order flow from the TD Waterhouse system. Ray and
12 I also co-head our direct market access and algorithmic
13 trading team; buzzwords you hear a lot about certainly in
14 the press and certainly see about the marketplace.

15 Our firm, TD Securities is the securities
16 trading arm of TD Bank Financial Group, we represent a
17 large and diverse client base, 3.5 million individual
18 investors, by virtue of our position as the leading
19 discount broker in Canada through TD Waterhouse, 425 full
20 service investment advisors, I think our CEO and our
21 senior management in capital market groups would like to
22 see that number much higher compared to other bulge
23 bracket Canadian dealers, and we are the number one
24 institutional equity dealer by volume and value over the
25 year-to-date 2005.

1 Our firm position on the trade-through
2 issue is a strong one. And that is that we, first of all,
3 support Market Regulation Services position that there
4 should be an interim rule in place prohibiting
5 trade-throughs from occurring. Further, we support the
6 need for a permanent full depth of visible book
7 trade-through protection in Canada. There are some
8 exceptions to our view, which we will talk about later,
9 and we just do not see how such a rule allowing
10 trade-throughs -- or not allowing trade-throughs would in
11 fact stifle innovation.

12 Some of the key reasons on page 5 of our
13 discussion why we support the trade-through protection in
14 Canada is, first of all, we are very much supporters of
15 competition. We pay a lot of fees to the various services
16 out there and exchanges and if there can be competition
17 which will eliminate monopolistic pricing and other issues
18 such as that, we certainly support competition because it
19 is in the best interest of the market. But we do not
20 support competition that is done at the expense of
21 investor protection. And, at the end the day, that is the
22 key issue for us as a firm and; that is, we are very
23 strong advocates of investor protection and fairness and
24 that is both at the retail and institutional order flow
25 level.

1 I think one of misnomers that we hear a lot
2 and has been written in various submission, some of the
3 submissions and some of the discussion, is that retail
4 investors are, in fact, the only investors who trade small
5 size marketable and limit orders. In fact, I would argue
6 that I think if you were to do a study you would find
7 there are more passive limit orders entered into the TSX
8 book that are, say, less than a 1,000 shares that are
9 entered by institutions than retail investors. And,
10 furthermore, as we see more electronic trading through
11 direct market access trading as well as algorithmic
12 trading, you are going to see the number of marketable --
13 excuse me, limit orders, passive limit orders that sit in
14 the TSX or whatever central limit order book, that number
15 is going to continue to grow.

16 Further, we think it is a culturally
17 ingrained Canadian investor mentality that if you place a
18 limited order on the TSX or wherever you are trading, that
19 if a trade occurs and you have the best price in the book
20 that you will get filled before anyone else.

21 Finally, we do not see any factual evidence
22 that trade-through protection stifles innovation and that
23 in any way, shape or form that the ability to achieve best
24 execution is compromised by a trade-through rule.

25 Some of the reasons why we oppose allowing

1 trade-throughs.

2 First of all, we believe it creates
3 different classes of investors and clients bound by
4 differing rule structures. I know you have heard these
5 arguments in other submissions so I don't need to go into
6 too much detail on those points.

7 You heard the CSTA discussion as well about
8 the perception of our capital markets within the global
9 trading community and Jim Beattie's example of an
10 overnight order flow order that is left on the exchange at
11 and not filed even though it traded at that price or
12 worse. Of course we think the key issue as well as the
13 price discovery mechanism and the potential to impair the
14 price discovery mechanism that on a slippery-slope basis
15 if investors are traded through, they place less limit
16 orders into the central limit book and you have wider
17 bid/ask spreads and ultimately a higher cost of capital
18 for Canadian issuers.

19 And, finally, we believe that a
20 trade-through rule would cause greater harm to less
21 sophisticated market participants. Just expanding on that
22 point a little bit. One of the trends we see in the
23 marketing globally is the ability of individual investors
24 to directly access marketplaces through the internet and
25 other services offered by broker/dealers.

1 Certainly the people in this room who are
2 very educated on this topic and who are generally
3 sophisticated investors, should the Commissioners allow
4 the trade-through rule to take place, we will fully
5 understand and be able to explain that to our clients and
6 live with the consequences of such a rule. What we worry
7 most about, though, are the less sophisticated investors
8 accessing the market and never understanding why their
9 orders were traded through, because it will be very
10 difficult to get this level of education out to the end
11 individual investor who may be accessing the market
12 themselves.

13 Some of the exemptions on page 7 that we
14 support are, first of all, for undisclosed orders in the
15 books such as what they refer to as iceberg orders. We
16 believe that only -- we should only be protecting the
17 orders that are fully disclosed. So if there is a 50,000
18 share order in the TSX limit book of which only 10,000
19 shares is disclosed for the market to see and a trade
20 occurs, we only believe that the 10,000 shares that are
21 visible in the central limit order book to the marketplace
22 should be protected and that orders that are invisible or
23 hidden, should fall behind any of the orders that are
24 executed as part of a sweep in order to ensure that the
25 better price limit orders are satisfied before there is a

1 cross on another marketplace.

2 Secondly, we support an exemption for
3 special-type trades which were discussed at length
4 previously and add to that portfolio trades, which are
5 becoming a much more significant part of the marketplace
6 and are quite complex in their execution standards. We
7 have been working extensively with Market Regulation
8 Services and other regulators to ensure that the structure
9 of our marketplace is conducive to allow portfolio trading
10 mechanisms which take place in other markets to be able to
11 work in Canada and, as such, we believe we need a
12 trade-through exemption for portfolio trades as what we
13 will refer to as a special-terms transaction or a special
14 type of transaction.

15 A couple of other key points that we
16 believe strongly in. First of all, and this is on page 8,
17 we believe the issues should be limited to the Canadian
18 equity asset class at this time. Let's simplify and
19 narrow the discussion. If you want to get into an issue
20 of transparency in the fixed income market, in the
21 derivatives market, it is opening up a very complex issue
22 which is beyond the scope of this discussion. So we do
23 not believe we should be addressing derivatives at this
24 time.

25 In the context of this discussion, we do

1 not favour a block trading exemption. And one of the
2 common discussion points around a block trading exemption
3 defines informational value, for instance, if an order is
4 upon execution expected to move the market that it would
5 be deemed to be, say, a block trade. I can tell you that
6 it is almost impossible ex ante to determine the
7 informational value of an individual order. And, for that
8 matter, it is almost ex post impossible to isolate the
9 informational value of any individual order.

10 In fact, it frustrates me from a regulatory
11 perspective that, and this is just a general comment, that
12 it seems on front running allegations. It seems front
13 running is defined as a crime or to be punished when the
14 person front running is profitable in their front running
15 transaction. However, it doesn't seem, anecdotally
16 through evidence, that anyone who front runs and loses
17 money on that transaction, which is equally guilty of the
18 same offence, doesn't seem to end up being punished or
19 there don't seem to be as many instances where that is
20 punished.

21 And the other analogy I will use here is,
22 we have all read over the last few weeks Finance Minister
23 Goodale's announcement to halt conversions of income trust
24 or corporations into income trusts has knocked nine
25 billion dollars off the income trust market value. And

1 for the number of times we have read this, which is being
2 sensationalized by the media, to try and isolate the
3 impact of that announcement on the marketplace is
4 virtually impossible. Much less significant than what the
5 media says, recognizing that is being sensationalized.

6 The US perspective, it is an interesting
7 anecdotal discussion. We believe it is not directly
8 relevant to the Canadian market structure. They have
9 fast/slow market issues and certainly you know all about
10 the history of the Reg. NMS debates in the US.

11 We believe that the trade-through
12 obligation should be placed at the participant and access
13 person level. We believe that if imposed on the
14 marketplace that it could be a barrier to competition;
15 which we support, we do support competition. There are
16 smart routers that exist between limit order books and
17 they are available to users in the market. And we do
18 admit that a trade-through rule does work only in one
19 direction between call markets such as Markets Inc. and
20 the continuous limit order books, that is just a simple
21 fact of life in linking call markets and continuous books.

22 Finally, on last sale pricing which is one
23 of the questions in the Commissioners' paper. We believe
24 they should only be set with markets that have
25 transparent, open and central limit order books.

1 One final thought prior to conclusion on
2 some of the other submissions that we read. It would be a
3 natural -- it would be natural for the Commissioners to
4 compartmentalise the various submissions that they have
5 seen between dealers, buy-side investors, exchanges and
6 others with vested interests and it would also be natural
7 for you to assume that buy-side views would be perceived
8 to be the least likely to contain bias and we understand
9 that. When we look at the buy-side submissions that were
10 made, we noticed that when you look at the actual
11 no-trade-through recommendations that are -- or allowing
12 trade-throughs that are in those submissions, they really
13 are not too dissimilar to our position even though they may
14 have reached a different conclusion.

15 In the case of one of the papers they refer
16 to ensuring that icebergs are not protected and in the
17 other paper they are concerned about competition; and
18 again we need -- we believe we need an iceberg exemption
19 and we also too are very concerned about any costly rules
20 imposed on the market and we don't think that will be the
21 case with a trade-through rule.

22 In conclusion, back to our key issue, we
23 believe the price discovery mechanism in the Canadian
24 capital markets needs to be ensured through a
25 trade-through protection to ensure a level playing field

1 for all investors. And we will be happy to answer any
2 questions the Commissioners might have.

3 CHAIR: Thank you. Let me just start off
4 by asking you this. We've heard from a few people this
5 morning BMO Nesbitt Burns, RBC, CSTA and now you are the
6 fourth and I don't know if you heard the other submissions
7 or if you were here to hear them.

8 But your comments and your views on this
9 stand out in contrast to what we have heard this morning
10 with respect to where the obligation ought to lie. You
11 say it should be on the participant, others so far have
12 said, no, it should be on the marketplace, and they cite,
13 to some extent, the practicality and the costs of imposing
14 that obligation on the participants as being unwieldy and
15 more onerous than if you just impose the obligation on the
16 marketplace and given that we are not going to have that
17 many marketplaces in the Canadian context and let the
18 marketplace determine how the market participants bear the
19 cost because ultimately that is where the costs flow down.

20 So could you explain why you have -- or at
21 least help me understand why your view on that is
22 different?

23 MR. TUCKER: Well I think the simple fact
24 is we disagree with what they are saying. We believe
25 there is technology out there that will allow you to route

1 between various marketplaces. We, in fact, have
2 technology at TD that we route between multiple
3 marketplaces. Arguably it is used mainly in the US or
4 primarily in US right now. And we think the technology is
5 out there; so that is point number one.

6 Point number two is innovation. I think
7 that if the marketplaces who typically are trying to set
8 up in Canada probably are not flush with capital. I mean,
9 forcing them to build the technology to route between the
10 various marketplaces could prohibit them from entering the
11 marketplace. So stifling innovation, and we want
12 competition as a marketplace.

13 MR. MOORE: Just a supplemental question,
14 though. The other submitters say that it will be
15 tremendously expensive, especially if that is imposed at
16 the market participant level. And, indeed, Bank of Nova
17 Scotia, BM, some of them used the term prohibitively
18 expensive. So wouldn't imposing the obligation at the
19 market participant level really foreclose market
20 participants from participating in alternative ATSS, et
21 cetera, because they would have to then build up all of
22 the infrastructure and the cost. So it would have a very
23 anti-competitive effect?

24 MR. TUCKER: If we felt it was going to be
25 cost prohibitive I would agree. But there is a vendor in

1 Canada right now that has developed some of this
2 technology that we are referring to and the numbers that
3 we have seen are not cost prohibitive and our experience
4 in the US through the TD options subsidiary, I mean we
5 have built the technology and it is not cost prohibitive.

6 MR. MOORE: We would be interested in
7 pursuing this because, I mean not today, but I think this
8 is important the cost and the practicality of whatever we
9 decide should happen is going to be extremely important so
10 if you are right we need to know about it.

11 MR. TUCKER: Okay.

12 MR. MOORE: And then, as Susan said, a lot
13 of the other submitters including some sophisticated
14 dealers have taken a different view.

15 MR. TUCKER: At one point we have made, and
16 certainly we agree on internally, is that there are
17 arguments to be made on both the marketplace level and the
18 participant level. This is a very complex topic from the
19 top down, and we do recognize there are arguments. We
20 have taken the position we do not believe it would be
21 prohibitively expensive and recognize there are opposing
22 views to that.

23 MR. MOORE: Well we will be interested to
24 get into the facts.

25 CHAIR: If I can just ask one more

1 question. You have mentioned that you think that we should
2 limit the inquiry and the decision to the equity market at
3 this point in time, that derivatives and fixed income,
4 that is a whole different kettle of fish and don't try to
5 solve it all at once. And we have heard that from pretty
6 much, I think, everybody else this morning as well, that
7 we really should be limiting any solution here to the
8 equities market.

9 I am a little bit, I guess what I am
10 struggling with is that I can certainly see the logic of
11 that and, you know, a more simple solution is obviously a
12 more attractive one from a variety of perspectives. But
13 to the extent we were to do that, are we not creating more
14 opportunity for the very kind of arbitrage, regulatory
15 arbitrage and ability to take advantage of the fact you
16 are not subject to the trade-through requirement in one
17 type of a product but you are in another that others have
18 said we should be avoiding?

19 I mean, part of what we heard this morning
20 is that you need the trade-through obligation because
21 without it you are creating opportunities for arbitrage.
22 I guess I am asking if we only tackle one element of the
23 marketplace, aren't we creating opportunities for that
24 very, for similar type of arbitrage?

25 MR. HAYNES: There will be a submission

1 this afternoon, Doug Steiner's presentation will focus on
2 trade-throughs and fixed income marketplace. And I
3 commend Doug for his constant focus on a different asset
4 class that doesn't have the same level of visibility and
5 transparency as the equity market anywhere in the world.

6 I will use one, and we believe it is one
7 step at a time. And that is the purpose on focussing on
8 equities.

9 I did a presentation in front of the TD
10 compliance people and I did a study before I did that. I
11 believe I needed 10 to 12 different registrations to be
12 fully licensed to be involved in equity execution in North
13 America whereas my fixed income colleagues literally need
14 none. So it is a completely different marketplace with a
15 completely different market structure which is completely
16 dealer driven. And that is a very, very different
17 marketplace than the agency orientated central limit order
18 book, full transparency of our equity market.

19 MR. BATES: Just on that, I wasn't thinking
20 so much about the fixed income market because I was sort
21 of in the same place that you were on it. I was thinking
22 more about equity derivatives and I wonder how you would
23 see the world unfolding if we take too long to sort of
24 begin to move to look at those markets as well. Do you
25 have a view?

1 MR. TUCKER: Well I guess I am an advocate
2 of walking before we run here. So let's deal with one,
3 tackle one asset class at a time. I don't disagree that
4 other asset classes should be looked at, you know, one
5 after another after this. But I think we should tackle
6 the one market to start with and then move on to the
7 others.

8 MR. HAYNES: We do have a representative of
9 the Montreal Exchange here today, so if I am wrong on
10 anything I say here... When the ME attempted to put a
11 block trading exemption rule in place, that rule has been
12 passed for fixed income products but not equity products
13 at this time. Correct me if I am wrong, Glen, and so
14 again I think that's -- we want to start with cash
15 equities and then take the debate from there.

16 I am concerned, though, about cross market
17 arbitrage Paul. I have certainly -- there have been lots
18 of instances regarding trade-throughs whereby investors
19 have been looking for -- or dealers have been looking for
20 strategic ways to get trades to the tape, whether that be
21 in the Canadian market or elsewhere, and we certainly want
22 to eliminate any of those situations.

23 CHAIR: I think you are answering my
24 question by saying in terms of that concern about cross
25 market arbitrage, and I like that expression that is what

1 I was getting at in my question.

2 You are not saying in principle there is
3 any reason, and nor does anybody else say that in
4 principal there is a reason for the trade-through
5 obligation not to apply no matter which class you are
6 looking at.

7 What you are saying is, we are not there in
8 terms of the transparency and other issues with respect to
9 derivatives and fixed income in Canada and, therefore,
10 start with the equities market and then over time -- is
11 that, would that be correct?

12 MR. HAYNES: Yes, it is. And I will be
13 completely honest to say that we made a submission to the
14 ME originally -- Ray is going to kill me for bringing this
15 up but I want to, I think it is important because it is on
16 file, we made a submission on behalf of TD Securities back
17 in June of 2004, I believe that is when they asked for
18 our comments. And at the time because of our view of the
19 Canadian equity futures market and its position globally
20 compared to other futures markets we supported the ME's
21 request to have a block trading exemption, including
22 equity products. Certainly in hindsight, mea culpa, we
23 admit that is not our view today; that was not the view
24 that we would share going forward. It was a view that at
25 the time we had because of the Montreal Exchange's

1 competitive position with other futures markets and
2 conventions amongst futures markets globally. And that is
3 why we supported that initially but at this point in
4 October of 2005, we wouldn't support that initiative for
5 the ME.

6 CHAIR: Thank you.

7 MR. MOORE: I have a question. A couple of
8 questions. Following right along on this topic, could you
9 explain why you believe, I mean if not just cross border
10 but cross markets, why you believe that connection to a
11 marketplace should create an obligation to that
12 marketplace and not a broader obligation to the whole
13 market?

14 And related to that is, I think what you
15 are saying, is the trade-through obligation should be
16 limited to where a participant has access, why wouldn't
17 you require it across all the markets?

18 MR. TUCKER: That is a difficult question.
19 I mean, I think it is tough to mandate that either a
20 participant or access person has to have access to all
21 marketplaces. Because we might end up with six or seven
22 different marketplaces of which one marketplace sets up
23 and has virtually zero liquidity yet charges potentially
24 exorbitant fees.

25 So I think it would be difficult in a

1 free-market system to mandate, you talk about competition,
2 that might prohibit competition as well if you had all the
3 small dealers, not just the large dealers, have to join
4 every marketplace that sets up.

5 MR. MOORE: But then we would have to get
6 into a pretty good definition of access. If a dealer
7 decides not to have electronic access to a marketplace but
8 then just pick up the phone and put an order in through a
9 dealer or something. I think that is a complicated
10 question here.

11 MR. TUCKER: It is. I am not too worried
12 about because I think the competition will drive that. I
13 mean, if the marketplace has liquidity and given that
14 technology is not as cost prohibitive as it once was, I
15 think that we as dealers and access persons will be able
16 to get to that market place in a relatively economic way.

17 MR. MOORE: The other question I have is
18 more of an observation. I thought it was kind of amusing
19 that you said the buy side might be a little less free of
20 bias. I think self interest is evident in all these
21 comment letters, and I would even say the buy side is
22 pretty good at advocating what they think is in their
23 interest.

24 But, Peter, you did mention that, I think
25 it was you or maybe it was your colleague, but suggested

1 that on some issues their were very close to you. But I
2 think in fairness when I read the CPP, they were saying if
3 you impose trade-through obligation then we submit that,
4 you know, you go just the visible part of the iceberg, et
5 cetera. So they were similar, but I don't think they were
6 admitting, maybe I misinterpreted.

7 But you suggested that on many of their
8 arguments they were very similar to you. You were just
9 saying, given there would be, if there where to be no
10 trade-through allowed or the other way around -- yeah, no
11 trade-through allowed, then they would envisage a regime
12 similar to the one you envisage, is that what you are
13 arguing?

14 MR. HAYNES: The two main submissions made
15 by the buy side are CPPIB and Barclays BGI. When I look
16 at the BGI submission, and if I have read it wrong I
17 apologize to BGI who is not represented here today, that
18 one of main tenants of their argument was related to
19 interm market trade-through protection and the
20 undisclosed, the liability associated with trying to
21 manage an order on one marketplace not knowing what their
22 liability might be because of hidden orders on another
23 market. I felt like that was a very strong part of their
24 argument and assuming that a trade-through rule is put in
25 place with the exemptions that we had suggested, then I

1 think our position, BGI and TD Newcrest, are quite
2 similar.

3 I do understand that they are sensitive to
4 the unknown concerns of impact on competition and
5 innovation and I think that's, I believe, one of the
6 concerns that CPPIB as well, but certainly BGI.

7 In the case of BGI, I felt like one of the
8 strong tenants of their argument involved the icebergs and
9 we support an exemption for obligation to fill iceberg
10 orders on a trade-through

11 MR. MOORE: Thank you.

12 CHAIR: Any other questions? In that case
13 thank you both very much.

14 MR. HAYNES: Thank you very much.

15 CHAIR: You have been very helpful.

16 Moving along, we have National Bank
17 Financial. An appearing for National Bank is Jean-Guy
18 Brunelle.

19 SUBMISSIONS BY MR. BRUNELLE FOR NATIONAL
20 BANK FINANCIAL:

21 MR. BRUNELLE: Yes, good morning. Let me
22 begin by thanking you for the opportunity to present our
23 position on a trade-through debate and as well as the
24 surrounding issues.

25 We believe that this is a serious issue and

1 we applaud your initiative to receive public comment both
2 in written and oral format. Hopefully my comments will
3 add to the earlier comments you heard this morning and not
4 simply repeat them.

5 Our initial response letter to your request
6 for comments was intentionally brief in as much as we only
7 answered two questions.

8 We said that we support a trade-through
9 rule for orders which are visible, accessible and
10 immediately executable. We also stated that for reasons
11 relating to market structure our support of a
12 trade-through rule was limited to equity markets at this
13 time. Attempting to have a rule which serves all markets
14 would only serve to confuse the debate and jeopardize the
15 outcome.

16 We believe that the issue is extremely
17 important in maintaining the competitive position of the
18 Canadian equity market, important enough to be looked at
19 independently of other markets or securities. I will not
20 elaborate as to why right now, but I would be pleased to
21 answer any questions you have on that during the question
22 period and I certainly have my views on those.

23 We will answer the remaining questions in
24 the official CSA request for comments, and we will submit
25 them in the normal course. But today I would like to

1 focus my comments on what we feel to be the more
2 significant issues.

3 In looking at the questions, several themes
4 become apparent. The first or primary theme revolves
5 around should we have a rule and to who and how should it
6 be applied? As stated before, we believe that all limit
7 orders which are visible, accessible and immediately
8 executable should be protected.

9 If one accepts that, then one must also
10 accept that it be applied to all exchanges and ATSS in
11 Canada where identical securities are traded.

12 Forcing a trade-through rule on Canadian
13 and foreign exchanges becomes much more problematic as the
14 issues of jurisdiction and foreign exchange are thrown
15 into the mix. This is a debate onto itself and while a
16 hard and fast rule across the board may not be effective,
17 I am sure a solution for cross border issues can be found
18 once we adopt the principle of trade-through protection.

19 If we accept the premise or principle of
20 trade-through protection for all limit orders on exchanges
21 and ATSS in Canada, then it stands to reason that it
22 should apply to all participants who trade on these
23 markets whether directly or indirectly; in other words,
24 dealers and direct access persons. Anything less would
25 render the rule completely ineffective.

1 How we achieve this technically is a very
2 good question but truly secondary to the primary question.
3 Whether markets hook up to other markets or the traders
4 use smart routers does not matter if we do not have a
5 rule. I am confident that the problem can be resolved and
6 a full examination and debate of which system to be used
7 should be had once we have agreed on something to discuss.
8 At that point, it would make sense to include the
9 technology vendors in the debate as they will be
10 instrumental in making this work.

11 I do not know if technology vendors have
12 submitted comments in this regard as I, for one, would
13 want their input before making any decision on this
14 question.

15 While on the subject of technology I wish
16 to address what appears to be a general concern; that of
17 innovation.

18 Some feel that a trade-through rule will
19 limit innovation. We believe the contrary. Regulation
20 has never stifled innovation. It merely serves to guide
21 it or direct it where we collectively feels it is most
22 beneficial.

23 Now permit me to return to our concept of
24 visible accessible and immediately executable. A blanket
25 trade-through rule which protects all orders, in our view,

1 is wrong. We accept some of the -- we accept some of the
2 reasons why certain parties object to the trade-through
3 concept. And while we believe a rule should exist, we
4 also believe that it's application should be somewhat
5 restrictive. In this way, some of the objections of the
6 opposing view can be dealt with while still protecting
7 qualified or appropriate limit orders.

8 By why protect limit orders in the first
9 place? We believe that qualified limit orders, and I will
10 define more what I mean by "qualified", benefit the market
11 for several reasons but the primary reason is price
12 discovery.

13 We believe that you can only protect what
14 you know to exist. But how do you know if it exists if
15 you can't see it? If we want to protect limit orders
16 because of the benefits the markets derive from them, what
17 benefits do we derive from orders we can't see or we may
18 not even know exists? We are of course talking about
19 iceberg orders. Now some will pretend that because they
20 are immediately executable, they should be protected: I
21 could not disagree more and I will use an example to
22 illustrate my point.

23 Imagine, if you will, a fully invisible
24 book, no prices, no quantities, do we derive any benefit
25 from such a book? Obviously not. An extreme example?

1 Probably. But even if we add quantities to prices, do we
2 now have a book? No. We truly believe that a true order
3 book consists of both price and size and that the
4 combination of the two creates price discovery.
5 Those who argue against the trade-through
6 rule share a major concern, that of displacement; we
7 acknowledge this concern. Not knowing how many shares
8 need to be displaced in order to put up a cross is a real
9 problem which creates undue risk at least to one of the
10 two parties involved. Invisible orders which are afforded
11 trade-through protection create this risk while not
12 contributing to price discovery. We do not believe that
13 this is equitable. In fact, this is reason enough for us
14 to be against a trade-through rule. That said, our
15 objection is only against the invisible orders. We do not
16 need to get rid of the entire rule in order to protect
17 large block orders, we simply must restrict its
18 application.
19 It has also been said that limit orders are
20 free options given up to the marketplace, hence
21 compensation for this option they should be protected. I
22 do not believe that hidden orders provide this option. In
23 fact, I believe almost the opposite that the iceberg can
24 benefit from displacing trades without giving the market
25 that so-called option.

1 To conclude on this point, while we believe
2 in trade-through for limit orders, we believe that order
3 must be visible in order to be protected.

4 Accessibility has been a hallmark of the
5 Canadian equity marketplace. Anyone can buy or sell, bid
6 or offer for any security at any price. This, as much as
7 anything else, leads to efficient price discovery as the
8 market is truly unrestricting. Not only can you display
9 your intentions, anyone can access them.

10 Prices and amounts mean nothing if you
11 cannot get to them. And one could easily argue that an
12 order which is not accessible is not a real order and thus
13 does not contribute to price discovery.

14 Now this is quite different than the
15 American experience where market access, even by broker
16 dealers, was severely restricted up to the creation of the
17 ECNs. Sophisticated traders and investors were frustrated
18 that what they perceived to be the systematic abuse of
19 their orders. Traders could often see prices or quotes
20 but they could not get to them. ECNs were created so as
21 to provide direct access to a limit order book either to
22 place or take liquidity without interference. The freedom
23 from interference as well as the control of their orders
24 are the main reason why ECNs, their market share has
25 mushroomed, exceeding even the optimists' projections.

1 There seems to be no limit to their growth. The
2 restricted markets, New York and to a lesser extent
3 NASDAQ, are running scared. The trade-through debate in
4 the US is a battle between the accessible markets versus
5 the restrictive markets. The accessible markets, the
6 ECNs, are saying make your markets accessible, visible and
7 immediately executable or get out of the way.

8 The market structure which we have taken
9 for granted in this country for so many years has finally
10 taken hold in the US, captured substantial market share
11 and is continuing to evolve. They have done this because
12 market participants have moved their orders to these
13 markets believing that they are better served. The
14 Americans are coming to where we are, let's not go to
15 where they were.

16 If the order is non accessible is it truly
17 an order? Does it add to price discovery? We do not
18 believe so. While we support trade-through protections
19 which are accessible, orders which are restricted in any
20 way should not be afforded trade-through protection. That
21 does not mean that restricted orders can trade-through
22 unrestricted orders; it is the other way around.
23 Unrestricted orders should be allowed to trade-through
24 restricted orders.

25 Not surprisingly the question of technology

1 is not far removed when discussing accessibility. How do
2 we make all orders accessible? As I said before, let's
3 agree with the principle and then we can focus our
4 attention on finding the technology solution for the rule
5 we finally adopt.

6 The last qualifier for trade-through
7 protection is immediately executable. Once again, this is
8 where we are ahead of the Americans and another reason why
9 the ECNs have done so well. The NYSE 30 second rule is a
10 joke and everybody but the specialists know it. In fact,
11 this is at the heart of the debate in the US. Were it not
12 for an enormous lobby effort in congress, the debate would
13 have ended long ago. The NYSE will advance all kinds of
14 reasons why their system is the best however we know and
15 they know it isn't. Why else would they have begun to
16 change their own model? We do not believe that the NYSE
17 should be afforded trade-through protection using their
18 existing model nor do we believe that any Canadian ATS
19 which adopts their model should be afforded trade-through
20 protection as well.

21 The final comment I wish to make concerning
22 eligibility, for lack of a better word, deals with depth
23 of book. We believe that all orders which meet these
24 criteria should be protected. That means depth of book
25 not simply top of market.

1 One of the repeating themes that I hear
2 from those opposed to this rule centres around the rights
3 of the order. They believe that large blocks which want
4 to trade-through are sophisticated and capable of making
5 their own decisions, including accepting a lower price. I
6 have two problems with this argument. Who is to say that
7 a large block is any more sophisticated than a small
8 trade? There exists many experienced and capable retail
9 investors who trade their own account. Obviously
10 sophistication cannot be a test for a trade-through as
11 this is far to subjective.

12 Size, on the other hand, while objective
13 presents an entirely different problem. Why should size
14 matter? Most rules relate to principles which effect
15 everyone. Should larger cars be allowed to drive faster
16 than smaller ones? We do not believe that size can be a
17 factor for allowing trade-throughs.

18 If you allow trade-throughs you will have
19 to allow them for all orders on all exchanges. What would
20 be the outcome of that? One of the benefits derived from
21 a trade-through rule is that limit orders are protected
22 and therefore the only way to get ahead of an order is to
23 improve your price. This encourages competition amongst
24 those placing limit orders which in turns leads to tighter
25 bid and ask price. Tighter spreads benefit the entire

1 market place, including blocks which, for the most part,
2 trade at or in between the quoted spread. The ability to
3 trade-through small orders would eliminate the competition
4 and would lead to greater spreads.
5 Another problem, and this is far more
6 serious, relates to the fragmentation of liquidity.
7 Assuming that orders could trade-through one another, one
8 could easily have several ATSS and exchanges all posting
9 bids and offerings all at different prices. There would
10 be no obligation to seek out a better price. Not only
11 would spreads widen but liquidity would be significantly
12 reduced. A trade-through rule effectively consolidates
13 the different liquidity pools especially when we apply
14 this to the depth of the book. While we want to encourage
15 competition, we are too small a market, especially in
16 relation to the Americans, to encourage fragmentation.
17 The last issue I want to deal with deals
18 with the rights of the incoming order. But what about the
19 rights of the orders already in the book? We agree that a
20 trade-through rule will limit or may even remove certain
21 rights from these large block orders, we feel that this is
22 justified. A trade-through rule preferences the rights of
23 the market as a whole over the rights of the incoming
24 order. This is not a new concept in Canada. As an
25 example, several years ago a legal challenge was brought

1 before the Supreme Court of Canada arguing that the use of
2 roadside checks and the Breathalyzer. The argument was
3 that rights of the individual were being abused. The
4 Court held that while the individual does have certain
5 rights, the rights of society as a whole outweigh the
6 rights of the individual.

7 Now many of you may think I am taking --
8 stretching things a little bit with my .08 analogy and
9 maybe I am. But if one accepts the judgement, then one
10 must also favour rights of the orders of the market as a
11 whole over the rights of a large block order. With that
12 said, I will end my comments here. I would like to thank
13 you for your time and your patience and I will be pleased
14 to answer any questions you have, merci.

15 CHAIR: Thank you. Questions?

16 MR. MOORE: I do have a couple. I have a
17 couple of questions.

18 In following your presentation, in trying
19 to follow your presentation you talked about protecting
20 trades directly and indirectly.

21 What was your view of the -- of the request
22 for block trade exemptions in its derivatives market.

23 MR. BRUNELLE: Our view, and we spoke with
24 the exchange at the time, we were against the concept of
25 it and if it were to be applied to equity derivatives and

1 we were accepting it for futures.

2 The problem that I had at the time was that
3 the rule, unfortunately though they said it would only
4 apply to futures didn't state specifically that it be
5 applied the futures.

6 I share the concern of near markets and I
7 think that if we apply a trade-through rule the first
8 thing we have to do is look at derivative markets to make
9 sure that people aren't getting around the rule by going
10 through a derivative market.

11 MR. MOORE: I won't get into it, but one of
12 the questions, just for the sake of the transcript, is
13 whether the derivative markets really contributes to price
14 discovery et cetera or whether it is because it is
15 derivative it really doesn't serve the same function as
16 limited market orders do in other markets, the cash
17 market.

18 MR. BRUNELLE: Price discovery depends on
19 liquidity. Whichever market has more liquidity will, in
20 effect, become the cash market and the one where people
21 will look to for price. In Canada our derivative markets
22 right now are obviously very second in capacity and volume
23 to the cash market but that may change with time. And if
24 it does change, then the rule will have to be adjusted
25 accordingly.

1 MR. MOORE: My next question is, I think
2 what you are saying is we should agree in principle that
3 there should be an anti-trade-through rule and then let's
4 find the technology --
5 MR. BRUNELLE: Correct.
6 MR. MOORE: -- and presumably address some
7 of the other questions and issues that we would have to
8 such as whether it is going to be in the market place
9 level or down below, who is going to pay for it, et
10 cetera. Does this suggest that you would be in favour or
11 would have been in favour of the immediate imposition of
12 the interim solution of RS or that we should wait until
13 this debate takes place and we solve of some of these
14 questions before we actually put the interim rule that RS
15 requested into effect.
16 MR. BRUNELLE: We believe that the interim
17 rule should be put into place because we believe in the
18 principal of trade-through protection. And I think that
19 if we agree with that principle why delay and then we can
20 address the issues that come from that.
21 MR. MOORE: In other words, you don't
22 believe it is necessary to solve the questions of how that
23 would be implemented and technology et cetera, we could
24 work that out later?
25 MR. BRUNELLE: Yeah, I believe we can.

1 MR. MOORE: Thank you.
2 CHAIR: Thank you very much.
3 We have CNQ next and it is Rob Cook and Tim
4 Baikie, welcome.
5 SUBMISSIONS BY MESSRS. COOK AND BAIKIE FOR
6 CNQ:
7 MR. COOK: Thank you very much. I am Rob
8 Cook and I am the president of CNQ, which is a small stock
9 exchange or, I might say, Canada's third largest stock
10 exchange, which was launched in 2003 for trade and
11 securities in small cap companies. My colleague Tim
12 Baikie is general counsel and corporate secretary of CNQ
13 and you will be pleased to hear that he will be delivering
14 most of the remarks today.
15 Both of us have had long careers
16 principally in market regulation with the Toronto Stock
17 Exchange and at CNQ and our opinions are based on our
18 experience as well as our current position at CNQ.
19 Now as you are likely aware, in addition to
20 our stock exchange, CNQ has made application to the OSC to
21 operate a new alternative market for trading and
22 securities listed on TSX. Our position on this matter is
23 the same no matter whether we are operating a stock
24 exchange or an alternative market or both.
25 In the interest of time, I will turn it

1 over to Tim who will deliver our presentation and will
2 likely answer the questions as well.

3 CHAIR: Thank you, Bob.

4 MR. BAIKIE: Okay, we thank the CSA for the
5 opportunity to make this presentation. I am going to just
6 make a few crucial points and not repeat our written
7 submission. I am also going to borrow from some other
8 written submissions that were made that we thought had
9 good points and reading them I was saying, geez, I wish I
10 had thought of that.

11 We believe it is important that you have a
12 market wide trade-through protection for all better-priced
13 visible limit orders, subject to some technical exceptions
14 that we referred to in our letter. And we agree with the
15 other submissions of the other presenters that protection
16 of limit orders is vital to efficient price formation.

17 And I would suggest you step back. What
18 are the objectives of regulation in this case? You want
19 to foster efficient markets with optimal price formation
20 leading to best execution and fair competition.
21 Trade-through protection, we believe, promotes these
22 goals. It is fair to investors because liquidity
23 providers are awarded, limit orders are protected, you
24 have market-wide price priority, and also price formation
25 leads to better prices for both retail and institutional

1 investors. It is fair to dealers because you will have
2 equal treatment, their obligations, their compliance
3 responsibilities will be set out and it is fair to
4 marketplaces because they are treated equally and, in
5 fact, we believe not having a trade-through rule could be
6 a barrier to entry.

7 We also believe that you should approach
8 regulation with a light touch. In whatever you do, set
9 out the goals but not the details because inevitably there
10 is going to be situations where you are going to need
11 interpretations, exceptions on the spot and if you have a
12 detailed rule it may not work. The other thing is to be
13 mindful of how the rule will work in practice, not just
14 with two market places trading in security but three or
15 four or more.

16 So just to summarise, our recommendation
17 will be across the market trade-through protection to all
18 visible better price orders, it should apply whether or
19 not an access person is a member of a particular market,
20 it should be responsibility of the participant or access
21 person, and, again, don't mandate a solution. To the
22 extent that there are details we recommend that they
23 should be dealt with in an RS rule because that will allow
24 more flexibility.

25 In the concept paper it talked about

1 trade-through and best execution, but these are not the
2 same and they are often confused. Best execution is a
3 duty to the client but the client can take other factors
4 besides price into consideration, such as speed of
5 execution or certainty. The trade-through rule has always
6 been viewed as a duty of the marketplace as a whole and we
7 believe it should not be viewed as protection of a
8 particular marketplace.

9 The two concepts are, however, related.
10 You could say that in executing a 10,000 share order, the
11 fact that 200 shares are at a penny better than another
12 marketplace isn't really a factor in best execution. But
13 if there were 5,000 at a quarter better in another
14 marketplace, it would be. And this will create
15 uncertainty for dealers if sometimes they are permitted to
16 trade-through but sometimes they are not because it will
17 be off side their best execution responsibilities.

18 Also, limit orders contribute to price
19 discovery, as you have heard. They show the buying and
20 selling interest. If orders are traded through, there
21 will be no incentive to commit and you might see spreads
22 start to widen and depth disappear. If price discovery
23 becomes weak, then best execution becomes problematic.
24 What is the best price? How will an institution price a
25 block that it is trying to buy or sell. And for example

1 of the type of market we can go to bad old days in NASDAQ
2 where the market just showed the market makers bids and
3 asks, the better price customer orders were not displayed
4 and could be traded through. The market makers were able
5 to collude on their spreads leading to SEC and I think
6 Department of Justice enforcement action. ECNs were able
7 to exploit this by offering better price discovery, limit
8 order books; what you see is what you get. The SEC also
9 had to bring in a number of rules to bring more order to
10 NASDAQ including order handling rules, customer trading
11 ahead of customer rules and ultimately the trade-through
12 rule that is in Regulation NMS.

13 And another thing is, in all these things
14 you have to take a sort of holistic approach to ensure
15 that the approach you are taking with respect to
16 trade-through rules is consistent with the approach for
17 best execution. So you don't end up with rules that
18 conflict or are at cross purposes.

19 Now we certainly believe the protection
20 must be across all markets and should apply even if a
21 particular dealer access person is not a member of a
22 particular market. And the reason for this is that rules
23 should foster competition and not be a barrier to entry.
24 If a member dealer only has to worry about the
25 trade-through rule in the market, in one market to which

1 it is a member, it won't have an incentive to join another
2 market because all of a sudden it may have a new
3 compliance problem and that it has to deal with the
4 trade-through rule that it didn't have to deal with
5 before.

6 Also, new marketplaces inevitably will
7 start out with a small subset of the membership of the
8 principal market. And this could mean that most dealers
9 are allowed to trade-through prices in the new market
10 because they are not members, people will start to wonder
11 why are my orders being placed there? I can get filled
12 maybe at an inferior price in the main market. And this
13 will lead to poorer price discovery in the new market.

14 We do not believe, though, that that is
15 going to require dealers or access persons to become
16 members of all marketplaces. They can access either
17 through another member, they can enter orders at prices
18 that will not trade-through in the other market, the CSA
19 could mandate limited access in that a marketplace has to
20 allow members of other marketplaces into it for the
21 purposes of complying with the trade-through rule.
22 However, we believe that if this is the case a marketplace
23 should be allowed to charge reasonable but higher fees for
24 non members that are accessing its book because otherwise,
25 again, there would be no benefit to joining because why

1 pay the costs of membership if you can get the better
2 priced orders any time you need to.

3 The other point we feel strongly about is
4 that the compliance with the trade-through rule should be
5 a participant access person responsibility and not a
6 marketplace responsibility.

7 If it is a marketplace responsibility,
8 however, it should not be assumed that they will be
9 routing between the markets. Regulation NMS simply
10 requires markets to prevent an order from trading through
11 better prices in another market. In practice, however, if
12 one market starts routing orders around, all other markets
13 will because of competitive pressures.

14 The main reason we are opposed to this is
15 that there is no real business incentive to route orders
16 to competitors and you could end up with a monopolistic
17 utility like the inter-market trading system in the US
18 which was formed by the various US exchanges, and I think
19 everyone agrees is a callosal example of how not to build
20 a routing system between markets.

21 It will increase latency, there is chances
22 of misfill if orders are going from one marketplace to
23 another to get the better prices there, and it could end
24 up with the entire system moving at the speed of the
25 slowest player. Because you have to send an order there

1 and wait for a response back.

2 It will be a barrier for competition
3 because new marketplaces will have to bear connectivity
4 costs. And, as we noted in the Markets Inc. letter, it
5 will be a very good question to ask if a marketplace will
6 be prevented from operating if it can't get the links in
7 place.

8 And also it could be a barrier to
9 competition.

10 A market may assign a low priority to
11 allowing competing markets to connect to it. And it may
12 have valid business reasons for this, it may say we are
13 not going to get very much order flow from this other
14 market, why should we make it a priority? Now the
15 Commission could mandate that they make this a priority,
16 but the problem with that is a marketplace may have to
17 defer IT development that it feels is important for its
18 competitive position because it has to continue
19 integrating new marketplaces coming in. And the issues of
20 marketplace connectivity are complex enough with two
21 markets, let alone four or five.

22 Now if participants are responsible, they
23 will need smart order routers. However, as you heard from
24 TD, these order routers are available today. Most dealers
25 have them for trading in the US and routing between Canada

1 and the US.

2 Also, apart from a trade-through rule,
3 dealers in particular will have business reasons to want
4 to use order routers of this type to take advantage of all
5 possible liquidity. For example, a passive order they may
6 want to put 60 per cent in the major market and split the
7 other 40 per cent among the other ATS or alternative
8 markets that are trading it to make sure that they get
9 filled.

10 And as we have seen in the US, in time they
11 are going to want to more sophisticated order routers.
12 They are going to want to know if they have got an order
13 in marketplace A and there seems to be more trading going
14 on in marketplace B, that the system will pull the order
15 out of A and put it into B. And, also, if they do see
16 better price issue when they are trying to execute an
17 order in one market and they want to get those prices,
18 they are probably going to want to route the orders there
19 directly rather than send it to the market and hope that
20 the market can route it to the other marketplaces in time.

21 This is the case in the US where they have
22 sweep orders and that also adds to the complexity because
23 the exchange or marketplace has to recognize when the
24 dealer entering the order has taken on responsibility for
25 compliance with the trade-through rule and allow an

1 apparent trade-through to occur.

2 Also rather than a monopolistic system
3 between the exchanges, there will be competition by order
4 entry vendors which will lead to flexibility, lower cost,
5 innovation and customisation.

6 So we thank the CSA for the opportunity to
7 make the presentation. As we said, we feel it is
8 important to foster efficient markets and that
9 trade-through protection is fair to investors, dealers and
10 marketplaces, that it should be a participant
11 responsibility and that the CSA should not mandate
12 solutions in its rule but rather mandate the outcomes.
13 Thank you.

14 CHAIR: Thank you, just maybe one or two --
15 two questions actually for you.

16 One thing that you have made very clear is
17 that, is that you believe the obligation should rest on
18 the participant. And we have heard various things this
19 morning but probably more, I would say, on the obligation
20 ought to rest on the marketplace, not on the participants.
21 So it is interesting to hear the other side of this. And
22 certainly each time we hear a view it seems so reasonable
23 so at the end of the day it is all reasonable.

24 But the question, really, when I look at
25 this from first principles and trying to reconcile your

1 view on this with those of others that we have heard. How
2 do you, I mean one of the other commentators said, look,
3 before you implement a trade-through requirement you
4 should do other things first, you should mandate automated
5 trading, you being CSA, and eliminate access fees. Now
6 you say, no, no you should put the obligation on the
7 participant and let the marketplace charge extra fees of
8 that individual because otherwise what incentive would
9 there be for that for anybody to become a member of that
10 marketplace or to contribute costs.

11 How do you reconcile those different points
12 of view and how do we reconcile those different points of
13 view?

14 MR. BAIKIE: Well traditionally the
15 trade-through rule has been viewed, as I said, as an
16 obligation to the market. So it is was not considered --
17 it was considered a price that a dealer would have to pay,
18 for example, in taking out the other markets. You weren't
19 allowed to factor in the trading fees, although in
20 practice in Canada the markets they all had the exact same
21 trading fees so it was never an issue. I think the key
22 thing, though, is that I said they should be permitted to
23 charge a reasonable additional fee and you would deal with
24 outliers through, perhaps, specific tailor-made solutions.

25 Obviously, if I am setting up a marketplace

1 and I am going to charge somebody \$10,000 to take out a
2 hundred shares at a better price, that is a problem and I
3 shouldn't be allowed to do that.

4 But I think, to date, in marketplaces, I
5 don't think you see any outliers in fees. I think you
6 will see that the fees will probably be very reasonable.
7 If a marketplace is charging much higher fees than its
8 competitors it is not going to get that many orders in the
9 first place and so it is not going to be having better
10 priced orders very often.

11 CHAIR: The other question I had was
12 related to the first thing you said which is not having a
13 trade-through rule could be barrier to entry, in other
14 words, a barrier to competition. Could you elaborate a
15 bit?

16 MR. BAIKIE: It goes to the point that I
17 made later that if a market place is set up and had better
18 prices but people are allowed to trade-through it, then
19 investors are not going to understand why sometimes a
20 dealer has to fill an order and sometimes they don't. So
21 they are just going to give up on that marketplace.

22 CHAIR: Thank you.

23 MR. MOORE: Tim, I have a question. Which
24 is pretty similar to the one that Susan was asking, just a
25 different twist. It has to do with competition and where

1 the obligation to monitor would lie.

2 I take it when you say the obligation
3 should be at the participant level, you mean the
4 obligation and the monitoring should be done there as
5 well? In other words, the responsibility to comply with
6 the anti-trade-through rule would be on the market
7 participant?

8 MR. BAIKIE: I think that responsibility to
9 comply should be with the marketplace participant.
10 Obviously that means they have to monitor the prices in
11 different markets.

12 MR. MOORE: They would have to have the
13 systems.

14 MR. BAIKIE: Yes. But consolidated market
15 displays are available.

16 MR. MOORE: I guess my question, though, is
17 you say on page 3 of your submission:

18 "Furthermore trade-through prohibitions
19 will not hinder development of competitive alternative
20 marketplaces."

21 If you are wrong that the cost of
22 compliance, if the obligation is put on the market
23 participant, if you are wrong about that and RBC, BMO and
24 BNS who use the term prohibitive costs, et cetera, et
25 cetera, if they are right, wouldn't the imposition of an

1 anti-trade-through rule on the market participant be
2 anti-competitive because, in effect, no market participant
3 would go to that market place?

4 MR. BAIKIE: Well the way I look at it is
5 if it is prohibitive it is going to end up being
6 prohibitive no matter what. Because if it is too
7 expensive for a dealer to have the responsibility, you
8 make it a responsibility for the market place, presumably
9 it is going to be very expensive for the market place to
10 do it and the participants will end up paying anyway
11 through fees.

12 What I would urge the CSA to do is to look
13 at what somebody suggested earlier, look at what the order
14 entry vendors are offering now. I don't believe, based on
15 my discussion with some order entry vendors and
16 discussions that others have had, that it is prohibitively
17 expensive. So I would urge you to see what is out there
18 now and also take a look at how the US markets solved it
19 when it was their responsibility in the States because I
20 think everybody would agree that that is not -- that is an
21 example of where you you have a group of marketplaces that
22 don't have an economic incentive to build an efficient
23 system, went out and built an efficient system.

24 MR. MOORE: Tim, I realize you come from a
25 very small exchange so this is not meant to be a

1 rhetorical question because I know you were once at the
2 TSE, as it was then called. But if the CSA decided to
3 bring in a trade-through rule and to impose an obligation
4 to monitor and enforce at the marketplace level, would it
5 be appropriate for that to be shared among marketplaces
6 that were going to take it -- that would be subject to
7 that rule so that -- I am just thinking like, your
8 percentage of the total market compared to the TSX will be
9 extremely small. So I am just trying to get in my own
10 mind how we could introduce this on a fair way without
11 shutting out newer and smaller exchanges?

12 MR. BAIKIE: Speaking with my CNQ hat, I
13 would say that that would be the best way to approach it
14 because it would be less onerous for the smaller
15 marketplaces.

16 If I were still at the TSE, I would be
17 saying why should I, in effect, have to subsidize my
18 competitors and allow them to get to the point where they
19 are taking serious chunks of my order flow? Are you going
20 to at that point mandate that they will have to pay me
21 back part of my development fee?

22 CHAIR: The TSE people here are writing
23 that down.

24 MR. BAIKIE: I don't think they need me to
25 prompt me on that one.

1 MR. MOORE: One of the things we are
2 concerned about, though, is competition in the marketplace
3 and one of the driving things behind the ATS rule that we
4 worked on for almost ten years is to foster competition in
5 marketplace and not just competition between orders. So
6 these questions are very important to us, do we just throw
7 the ATS rule out?

8 MR. BAIKIE: No. In fact, we believe that
9 the trade-through rule will foster, promotes the goal of
10 fair competition among markets and at the end of the day
11 you will have a more competitive marketplace. We view the
12 trade-through protection as being entirely consistent with
13 the ATS rules.

14 CHAIR: Paul Bates.

15 MR. BATES: Thanks. Tim, if we accept it
16 as a given that in the end everyone is going to act on
17 their economic self interest. If we had the scenario in
18 place that you have just described, what kind of
19 behavioural changes would you anticipate in the
20 marketplace from both the dealer community and from the
21 buy side?

22 MR. BAIKIE: I don't think you will see too
23 many behavioural changes because, as in the case in the
24 US, whatever solution there is will have to be automated.
25 So I think what will happen is you will probably see

1 dealers at first not joining, not necessarily feeling
2 compelled to join new marketplaces because of the
3 trade-through rule. But as liquidity increases, it is
4 going to be in everybody's interest to be able to get in
5 and out of every marketplace as easily as possible.

6 So if you end up with a situation where all
7 the marketplaces have a decent amount of liquidity, in a
8 sense the problem will revolve itself because everybody
9 will want to be able to get into every market.

10 The struggle is allowing the new
11 marketplaces to get to the point where they have a decent
12 level of liquidity because they won't have it on day one.

13 CHAIR: Just one question. What about this
14 idea of the data consolidator that was originally part of
15 the ATS rule and then was, I won't say abandoned, but we
16 didn't pursue that in favour of let the marketplace kind
17 of, let's focus on transparency and price discovery and
18 hopefully the markets will deal with it. What do you
19 think of that?

20 MR. BAIKIE: We had a consolidated market
21 display in Canada through the TSX. I believe we still do.
22 I don't, I don't think that that needs to be mandated. I
23 think, I think my recommendation is we should take a
24 wait-and-see approach. Again, it would be powerful
25 economic incentives for everybody to get all the data in a

1 format and allow them to comply with the rules and the
2 Commission could just take a light touch approach. I
3 suggest the Commission should only step in if that becomes
4 a problem.

5 CHAIR: And would your view be that we
6 start with equities and don't try to resolve fixed income
7 derivatives for now?

8 MR. BAIKIE: I really don't have enough
9 experience with fixed incomes to say. I think it would be
10 best to take incremental steps. I would just echo the
11 comments that other people have made that you may need to
12 step in if it is apparent that people are using these
13 other markets as a way of getting around the trade-through
14 rule.

15 CHAIR: No other questions, so thank you
16 very much, Tim, Rob.

17 MR. BAIKIE: Thank you.

18 CHAIR: The final presentation before we
19 break for lunch is the TSX group. And appearing for the
20 TSX is Rik Parkhill. Hi, Rik.

21 MR. PARKHILL: Hi.

22 CHAIR: Welcome.

23 SUBMISSIONS BY MR. PARKHILL FOR TSX:

24 MR. PARKHILL: Thank you. I am the
25 president of TSX Markets and I am responsible for the

1 TSX's trading and listings business and I want to thank
2 you for the opportunity to do a short presentation today.
3 In our comment letter on the concept paper,
4 we enunciated three core beliefs rather consistently
5 through the paper. The first one was that trade-throughs
6 are harmful to the Canadian capital markets. The second
7 was that all better priced orders that are visible on any
8 Canadian marketplace should be filled before an inferior
9 priced order is executed. And the third was that
10 trade-through protection should only apply to trading done
11 on marketplaces where the trades are visible and
12 immediately executable. And the theory behind this is
13 that visible orders contribute to price discovery, lower
14 the cost of trading and should be protected.

15 In terms of these three core principles or
16 beliefs what we are not saying is that the rules among
17 markets place should be exactly the same. In fact we
18 think that different rules among marketplaces foster
19 innovation and competition and that is certainly a value
20 that we cherish and that the Commission obviously believes
21 is important.

22 But we think that there should also be some
23 overriding principles that cut across marketplaces. And
24 one of them is trade-through protection. And the argument
25 that has been made that, well, there is a segment of

1 investors that don't want trade-through protection. Well,
2 I mean, we have decided a whole raft of issues in the past
3 on the basis that some practices are harmful to capital
4 markets and prohibited them. For instance, there is still
5 a segment of investors that would like to have insider
6 trading rules dropped, but we decided as a capital market
7 that that is a bad thing and have prohibited them. And
8 this isn't about eliminating investor choice, it is about
9 enshrining some principles in terms of fairness,
10 efficiency and integrity.

11 So why do we think that trade-through
12 protection is important ?

13 The first point is that limit orders play a
14 key role in terms of the price discovery process. And if
15 inferior priced orders can execute before better priced
16 limit orders, fewer investors will enter limit orders. And
17 I think this is really, this is the crux of the matter.
18 And as some of the ATSS present to you that are proponents
19 of trade-throughs later in the day, the question you
20 should ask them is do they actually, do they actually
21 protect better priced orders in their own matching systems
22 ahead of inferior priced orders? And I think the answer
23 you are going to get is, yes, they do. And the reason they
24 do that is because it is good for price discovery, it
25 allows trades to be executed and customers would not use

1 the matching systems unless better priced orders were
2 protected.

3 And there is somewhat of a whiff of
4 hypocrisy by then turning around and saying, okay, well,
5 that is how we operate in our own matching system but when
6 it comes to other marketplaces the segment of customers
7 that we service should be able to trade-through; and we
8 are adamantly opposed to that.

9 We think as less limit orders are entered
10 into the marketplace, there will be a reduction of
11 liquidity and you will see poor price discovery for a
12 given security, and it is going to make our capital
13 markets a lot less attractive to investors not only in
14 Canada but outside of Canada.

15 We think that the lack of trade-through
16 protection also creates different classes of investors
17 with variable rights, which we also think is a bad thing
18 and certainly doesn't contribute to fairness or efficiency
19 in terms of the capital markets. I don't think we want to
20 set institutional investors, in particular, that already
21 have so many advantages in terms of operating in the
22 capital markets and give them even more superior rights to
23 other investors.

24 Institutional investors already have some
25 significant advantages, as I mentioned. They have

1 superior access to information, superior access to
2 management, superior access to technology, and they do not
3 need the ability to trade-through as well.

4 And I think the reason that they don't need
5 the ability to price through and the reason why it could
6 be quite damaging to allow them to do that, is that price
7 discovery is driven primarily at the margin by the
8 quantity and frequency of non-block orders.

9 And we that see all the time in our
10 marketplace but it is interesting, and you see it in the
11 US as well, which, until recently, allowed investors to
12 trade-through where 65 per cent of the trade-throughs that
13 occurred on New York Stock Exchange listed companies were
14 for order sizes of a hundred shares or less and 40 per
15 cent of the trade-throughs that occurred on NASDAQ listed
16 companies were also for order sizes of a hundred shares or
17 less. So you are really disadvantaging small investors.

18 I think the concept paper made a
19 fundamental mistake in terms of equating small order sizes
20 with just retail investors. And we talk about small
21 orders, and this is a huge growth area in terms of the
22 order flow the Toronto Stock Exchange receives. We are
23 talking about portfolio traders as well retail traders,
24 velocity traders, hedgers, pro traders, market makers and
25 algorithmic traders which is the fastest growing type of

1 trading and is really turning the whole structure of
2 trading on its head.

3 And if you look back at the first quarter
4 in terms of the number of trades that were executed on the
5 Toronto Stock Exchange, approximately 78 per cent of the
6 trades that were executed were less than a 1,000 shares in
7 size. And so there is this fallacy, I think, or perhaps
8 misperception that block trading dominates the trading on
9 Canadian marketplaces and that is not, that is not the
10 fact.

11 We also think that the lack of
12 trade-through protection will have a negative impact on
13 market making activities, whether they are registered
14 traders or designated market makers by the exchange or
15 investors that just make two-way markets without other
16 responsibilities. And that is market makers are dependant
17 on price protection for their livelihood and if price
18 protection is not enforced, they lose the incentive to
19 provide narrower spreads. And once the spreads widen you
20 have got more volatility and your cost of capital, as
21 other speakers have indicated this morning, increases
22 substantially.

23 If we look at other marketplaces, I mean
24 the London Stock Exchange may be a good example, it has a
25 similar number of issuers as are on the TSX, it oft

1 affords no price protection and it really has a two-tier
2 market where we often see institutional trades are
3 executed at better prices than retail trades. Retail
4 participation in the market is about half the level of
5 retail participation in Canada and the average trade on
6 the London Stock Exchange is about six times the size of
7 the trades that are executed on the Toronto Stock
8 Exchange. And they actually do half as many trades as the
9 TSX and the TSX Venture Exchange combined, which is not a
10 market that is conducive to high levels of liquidity or
11 overall price discovery. And one of the reasons, not the
12 only reason, but one of the reasons is the lack of
13 trade-through protection.

14 The New York Stock Exchange also did an
15 interesting study on companies that switched in terms of
16 the listing venue from NASDAQ to their Exchange and the
17 New York Stock Exchange does offer price protection. And
18 what they witnessed was a 50 per cent reduction in
19 volatility in terms of the companies that switched from
20 NASDAQ to the New York Stock Exchange and NASDAQ
21 traditionally has not had price protection. Narrower
22 quoted spreads also resulted which were reduced by an
23 average of 33 per cent. And there was a drop in average
24 order cancellation rates from about 35 per cent to 11 per
25 cent. And they estimated that executing at second best

1 price would add about four cents per share executed.
2 So in terms of trade-through protection
3 what we would like to see and we were quite supportive of
4 the RS proposal which I guess is still being considered
5 although somewhat deferred right now is full depth of book
6 protection. We think it is important that the SEC
7 compromise that was developed in the US which just
8 involved the first level does not get adopted in Canada.
9 And we have got some significant advantages over the US in
10 terms of having fully electronic marketplaces which are
11 very conducive to full depth of book protection.
12 We also believe that only better priced
13 visible orders should be honoured in terms of price
14 protection and are certainly willing to adjust the
15 parameters associated with our iceberg orders as soon as
16 the rules are clarified in terms of trade-through
17 protection.
18 And we also believe that there should be
19 exceptions on special terms orders where the price may not
20 -- is not known at the time of entry like market-on-close
21 orders or volume weight average price orders.
22 It is interesting on market-on-close, one
23 of proposals we received when we were developing that
24 system from institutional investors was that we actually
25 just make the market-on-close system or the setting of the

1 closing price an institutional process. And we decided
2 not to do that, we think we would have got quite
3 unfavourable reception from the capital market staff at
4 the Commission as well. And the way it operates is that
5 everyone has an opportunity to set the closing price and
6 that the continuous market is integrated with this
7 market-on-close book which is primarily an institutional
8 book.

9 And we think that principle of fairness
10 should cut across the rules governing capital markets
11 activity and that is another reason that we think that
12 trade-through protection is important.

13 When we come to whether the obligation
14 should be a participant obligation or a marketplace
15 obligation, we are somewhat squishy on this issue and
16 probably could go either way.

17 We think logically the obligation should be
18 at the participant level and that the participant must be
19 responsible for the order and accountable to ensure that
20 the order does not trade-through better priced orders but
21 we realize that that may not be the perfect solution.
22 Although there is, there is a considerable body of
23 precedent to say that that actually should be the solution
24 in terms of the participant obligation.

25 We also think that the obligation should be

1 imposed across the board, that is not only on
2 participating organizations on an exchange but also to
3 subscribers of an ATS and also to subscribers of direct
4 access clients.

5 And I guess we have some problems in terms
6 of actually forcing marketplace participants to trade on
7 marketplaces that they are not connected to.

8 But we could also easily go the other way.
9 I think our main concern about a marketplace obligation is
10 not so much the cost associated with the marketplace as
11 having to perform that obligation. It is that we do not
12 want an inflexible centrally mandated facility that is
13 difficult to change. And technology is changing very
14 rapidly and several of the speakers have pointed out the
15 issue of latency and that speed of execution is becoming
16 of paramount importance to a large segment of traders, and
17 we want to make sure that if there is a centralized system
18 that it is done on a very cost effective basis and that it
19 can be changed quite rapidly.

20 And we favour the approach that was really
21 used in the Reg. NMS debate. And that is that market
22 places, if we are going to go with the market place
23 obligation, should establish policies and procedures that
24 are reasonably designed to prevent trade-throughs rather
25 than to have, you know, a large scale order routing

1 project mandated with associated high cost.

2 We are quite concerned about the cost of
3 trade execution in Canada and the overall cost of doing
4 business in Canada vis-a-vis the US, and we don't want to
5 price ourselves out of the market, so to speak.

6 Just go back and touch on one point.

7 We think that the obligation -- that there
8 is a duty owed to the market by participants and at
9 least -- I mean we can find this in our rules and
10 regulations, it goes back to a TSX Board of Governors
11 decision, which confirmed that a member's client account
12 as well as its principal accounts were covered by this
13 obligation. And one of the comment papers it was argued
14 that we have a rule called 4802, which involves
15 unintentional crosses and this allows basically a bypass
16 to the market which is similar to trade-throughs.

17 But I want to point out that we honour
18 better priced orders and even unintentional crosses have
19 to be done at the best price that is available. What
20 unintentional crosses don't do is they don't enshrine the
21 concept of time priority but they certainly adhere to
22 price priority.

23 And this is a crossing feature that we
24 responded to our customers' request for it and it is part
25 of being, sort of, a responsive commercial entity.

1 The other issue that was raised in some of
2 the comment papers was that a trade-through obligation
3 would actually expose marketplace participants to
4 information leakage. And we actually think that the
5 markets will deal with this issue and have certainly dealt
6 with it in the past. We have introduced a number of
7 products that are designed to stop information leakage.
8 There is anonymous trading, there is iceberg trading,
9 there is the market-on-close system, and a lot of the new
10 crossing systems that are either in operation now or are
11 being developed are opaque or have opaqued books that are
12 also designed to stop information leakage.

13 In terms of the CSA objectives on
14 competition, we think that competition between
15 marketplaces will happen with or without trade-throughs
16 due to international pressures. And a significant part of
17 our business on the trading side is really direct
18 competition with US marketplaces, 60 per cent of our
19 trading revenue is derived from the trading of
20 inter-listed stocks and every day we compete with NASDAQ
21 and the New York and the ECNs. We also think that
22 competition between borders creates the the best results
23 for investors and an uneven playing field interferes with
24 the competition among orders. And we refer to the former
25 SEC Chairman Donaldson who said if competition among

1 orders is impaired, markets experience reduced depth and
2 liquidity and excessive price volatility.

3 And we also believe that marketplaces that
4 trade-through others are free-riding on the price
5 discovery process and they do it at the expense of
6 investors who have taken the time and the effort to place
7 limit orders.

8 And we have talked about how bid offer
9 spreads can widen as people become less secure about
10 having orders executed at the best possible price and how
11 that has a negative impact on our -- it increases
12 volatility and it effectively raises the cost of capital
13 for issuers as well as overall trading costs.

14 There is also the innovation argument which
15 was outlined in the concept paper. And that is that a
16 trade-through obligation will stifle the development of
17 alternative marketplaces. And a market innovation isn't
18 driven by the ability to execute trades at any price. It
19 is driven by a perceived need that isn't being filled by
20 existing marketplaces. That is why new ones start up and
21 that is what drives innovation. And I guess we also have
22 a concern if we have very different rules in terms of
23 trade-through protection from the United States that we
24 will be put at a progressive disadvantage in terms of
25 capturing liquidity on Canadian marketplaces that might

1 migrate south where there are fairer trading rules.

2 So we talked about international
3 competition and the importance that we see in terms of
4 effectively competing against US marketplaces, the problem
5 of liquidity migration and also the, I mean, allorhythmic
6 trading, just to give you an example, I think in 2001 our
7 order to trade ratio was about 3 to 1, that is how many
8 trades are executed for every order -- as relative to how
9 many orders are actually put into the market. Right now
10 on most days it is as high as 20 to 1, which shows you
11 that the whole structure of trading has shifted away from
12 block trading and the importance of a central limit order
13 book or the auction process. It is becoming paramount to
14 price discovery, and we think that since we are just at
15 the cusp of the change in allorhythmic trading in Canada
16 that the lack of trade-through protection is going to
17 interfere with the development and the orders that flow
18 from that activity.

19 And I think, finally, that the Canadian
20 regulatory framework must not penalise Canadian based
21 marketplaces and issuers who are providing an advantage to
22 our US counterparts.

23 So those are the key points that I wanted
24 to address, and I would be happy to answer any questions.

25 CHAIR: Just as part of your presentation,

1 would you be kind enough to, you have given us a handout
2 which I think supplements the written presentation, what
3 you said today.

4 I am just looking at page 2 of that
5 handout, it is the chart that shows distribution of
6 bypassed orders on NYSE and NASDAQ. I am just trying to
7 understand a little bit what time frame is this covering?

8 MR. PARKHILL: I think it is covered in the
9 footnote at the bottom of the chart.

10 CHAIR: It says December 15, 2004, But that
11 is just a date so I wasn't sure what period of time this
12 was covering.

13 MR. PARKHILL: I think it is just that day,
14 it was a snapshot of the market.

15 CHAIR: Oh, it is one day?

16 MR. PARKHILL: Yeah.

17 CHAIR: Then I am really not understanding
18 this.

19 MR. PARKHILL: Well what it shows in terms
20 of trade-throughs that occurred on that day, what
21 percentage of the orders fall into buckets in terms of
22 size. So most of the orders that are being bypassed are
23 very small orders.

24 And I guess the whole point is that if they
25 are very small orders, institutional investors in terms of

1 actually having the displacement obligation, I mean it is
2 not particularly onerous.

3 Although we do admit that there is a
4 problem with icebergs on our market, and we are certainly
5 willing to deal with that and we think it is important to
6 underline that we believe that trade-through protection
7 should only occur with visible orders.

8 CHAIR: Okay, thank you. I am just going
9 to turn it over to Serge.

10 MR. BOISVERT: One thing that is still
11 unclear to me your answer to question ten, you said that
12 the obligation should be imposed on market participants
13 given the complexities of Canadian market.

14 It wasn't clear to me to which complexities
15 you were referring to or what aspect of the Canadian
16 market is maybe that it should be on the market
17 participant as opposed the marketplaces?

18 MR. PARKHILL: We believe that market
19 participants should be able to chose what marketplaces
20 they link up to. That we shouldn't force that through a
21 regulatory mechanism and...

22 CHAIR: But apropos that comment, because I
23 had a similar question to Serge's. But the last
24 presentation I think we had from CNQ suggested that one
25 answer to that, because they also as you did, suggested

1 that the obligation, if there is one, should be imposed on
2 the market participant and not on the marketplace.
3 Although you said you could go other way or a little bit
4 undecided I sense that you were more leaning towards it
5 should be on the market participant for the reasons you
6 gave.

7 So the two marketplaces we have heard from
8 say it should be on the market participant not the
9 marketplace. And the way that CNQ, if I understood them
10 correctly tried to address the issue of access, which you
11 also were concerned about because you say in your
12 submission that you don't think marketplace participants
13 should be forced to trade on marketplaces to which they
14 are not directly connected. CNQ says if you go that route
15 require the marketplace to give limited access to certain
16 participants for purposes only of complying with a
17 trade-through obligation. Would that work?

18 MR. PARKHILL: Yeah, I think it would. I
19 mean there is a variety of ways that you -- I think as CNQ
20 pointed out, that you can trade on the marketplace through
21 intermediaries and third parties without having to
22 directly connect.

23 And I think, you know, the number of
24 participants that actually connect to a marketplace is
25 dependant on the perceived value that the marketplace is

1 actually driving and that's not something that should be
2 left to the market.

3 MR. MOORE: Just to follow up to Susan's
4 question, and I appreciate the hand out you gave us but
5 haven't had a chance to study it yet. I tried to take a
6 quick look and when I go back and study it, I just wonder
7 whether or not -- I noticed the dissent on the US decision
8 said:

9 "Commission staff examined public quotation
10 and the trade data to analyse the instances of
11 trade-throughs for NASDAQ and NYSE stocks. It found that
12 the overall trade-through rates for NASDAQ stocks and NYSE
13 stocks were respectively 7.9 per cent and 7.2 per cent of
14 the total volume of traded shares. When considered as a
15 percentage of number of trades, the overall trade-throughs
16 rate for both NASDAQ and NYSE stocks was 2.5 per cent."

17 And then they also say:

18 "When block trade-throughs and
19 trade-throughs at a hundred share quotations are
20 eliminated, the overall trade-through rate for NYSE stocks
21 is reduced from 7.2 per cent to approximately 2.3 per cent
22 of the total volume."

23 I am just trying to figure out where did
24 you get this table from and --

25 MR. PARKHILL: Well this table doesn't talk

1 about the percentages of trade-throughs relative to the
2 total trading. It just talks about trade-throughs in
3 terms of percentages. Trade-throughs that fall into
4 various share size buckets.

5 MR. MOORE: Oh, share size buckets.

6 MR. PARKHILL: Yeah.

7 MR. MOORE: Okay. I might give you a call
8 once I have had a chance to study this but this looks like
9 it is very interesting information, thank you.

10 MR. PARKHILL: Sorry, I didn't fully answer
11 the question that you asked in terms of the complexity
12 argument.

13 I think that goes back to the fact that the
14 United States and trading in the United States that the
15 additional complexity factor is that for better or worse
16 Canadian participants have fairly liberal access to
17 trading on US markets and they also trade some of the same
18 stocks that are listed in Canada. And so I don't think
19 that we can look at this in sort of a, just in sort of a
20 Canadian-only context, that we have to be aware of the US
21 factor and the importance of the US marketplace on
22 Canadian trading.

23 MR. MOORE: Thank you.

24 The next question. Your submission
25 suggests that trade-through protection should apply to

1 trading of all securities in Canada including derivatives.
2 I think I understand where you are coming from with
3 respect to equity options, derivatives equity options but
4 your submission seems to say that it should apply to
5 all --

6 MR. PARKHILL: No, it was meant to say just
7 equity derivatives because of the arbitrage between the
8 two.

9 MR. MOORE: Yes, okay. Thank you.

10 CHAIR: One thought I wanted to pick up on
11 your submission, and it really goes back to your response
12 to Serge in terms of his question. And you were saying
13 that we really have to look at the Canadian marketplace
14 relative to what is going on in the US. And you have also
15 indicated in your submissions to us that if a
16 trade-through obligation is imposed, we want to make sure
17 that it is flexible enough that we don't mandate all the
18 details. Now, and you want to -- and we also need to be
19 cognizant of the the fact that we want to promote
20 competition not only between marketplaces in Canada but
21 also we need to take into consideration of how anything we
22 impose would effect competitiveness with marketplaces
23 within the US.

24 So if I take that concept and think about
25 it from the perspective of the issue of where we would

1 impose the trade-through obligation were we to go that
2 route, and correct me if I am wrong, but I think in the US
3 they said the obligation rests with the marketplace?

4 MR. PARKHILL: That is correct.

5 CHAIR: So if we were to be influenced,
6 let's say by some of the considerations or at least the
7 input that we have heard today that, no, it makes more
8 sense for it to be on the participants, you will have to
9 work through these details but that is where it ought to
10 be.

11 I guess my question is, wouldn't that
12 effect competition, indirectly couldn't we be impacting by
13 taking a different view and imposing a different solution
14 on what I would say is a very critical aspect of how the
15 trade-through obligation would be inputted in practice,
16 would we not potentially be skewing competition between
17 marketplaces in Canada versus the US where they have gone
18 with the obligation on the marketplace?

19 Rightly or wrongly, they have done that.
20 So to what extent are we free to say it can be on the
21 participant without impacting competition unduly?

22 MR. PARKHILL: Well I think it is an easier
23 decision in Canada to put it on the participant right now
24 just because of the fact that there is a small number of
25 competing marketplaces.

1 In the US, which is a much more fragmented
2 market, you just have far more moving pieces that have to
3 be coordinated. But, I mean, if you want it to be
4 consistent with the rest of our arguments, yes, it
5 probably should be put on the marketplaces but I would, at
6 least for the time being, leave it up to the marketplaces
7 in terms of the most efficient way of linking together
8 rather than to, you know, to have some solution that is
9 mandated.

10 CHAIR: And I understand that, the
11 flexibility point. I guess what I am still struggling
12 with a bit, bear with me. But if we were to say in Canada
13 the obligation should rest with the participant, I mean,
14 my logic tells me that that could hurt order flow in
15 Canada to the extent a market participant might look at
16 this and say well if I had a choice, I can put this order
17 in in Canada or in the US, let's assume that there is that
18 choice available, which there is with respect to many
19 stocks. Why wouldn't they go the route of saying, I will
20 go with the US because there I don't have the obligation
21 in the US to do this, the marketplace will do it for me?
22 That is more where I was going with my question. Tell me,
23 if I am wrong about that just tell me.

24 MR. PARKHILL: I mean, I think there is
25 reasonable level of sophistication among the participants

1 that enter orders and that they have a number of
2 marketplaces that they are constantly monitoring on their
3 screens or they do that in an automated fashion and that
4 there probably is a solution at the participant level that
5 is cost effective for most participants.
6 CHAIR: We hope.
7 MR. PARKHILL: Yeah.
8 CHAIR: Thank you very much.
9 MR. PARKHILL: Thank you.
10 CHAIR: That is it for the morning. We are
11 going to break I guess a bit early for lunch and be back
12 here at 1:45.
13 --- upon luncheon recess at 12:36 p.m.
14 --- Upon resuming at 1:40 p.m.
15 CHAIR: Next up we have Markets Inc.,
16 Judith Robertson. Hi Judith, welcome.
17 SUBMISSIONS BY MS. ROBERTSON FOR MARKETS
18 INC.:
19 MS. ROBERTSON: Thank you. Thank you very
20 much for the invitation to come, and I will try to keep my
21 comments brief partly to compensate for the length of my
22 written comments. I was happy to see I wasn't the longest
23 one, but I do apologize for that.
24 I would like to thank you for showing
25 leadership on this issue and for playing the role in this

1 marketplace of ensuring that all are heard and that time
2 is taken to think carefully about the issues. That is
3 something that that is very important to us and we
4 appreciate the effort that has been put into that.

5 I have really three main areas that I would
6 like to touch on in my comments this morning and then I
7 have given you each a sheet of all of our executions to
8 date; unfortunately they do still fit on one page. And we
9 can talk about maybe some preliminary thoughts that I have
10 about what this even preliminary evidence might show.

11 The first thing is really to try to give
12 you our thoughts on whether trade-through or an enhanced
13 or changed trade-through regime in Canada is necessary at
14 this time; so not to belabour it but to touch on a few
15 things there.

16 Secondly, to identify the key things in any
17 trade-through rule that are important. So the, what of a
18 trade-through rule, as you are well aware, really matters
19 as far as consequences.

20 And the third point is really just to
21 highlight the potential damage that has been -- damage
22 already that has been caused and the potential for further
23 damage by regulatory uncertainty in this area.

24 But to start, I just wanted to give a brief
25 overview of where we fit in because I know we are not well

1 known in the marketplace yet and even some of the
2 commentators this morning, I am sure inadvertently,
3 misrepresented some of the things that we do.

4 Our marketplace is a structured marketplace
5 for large trades. So this is a minimum order size of
6 25,000 shares. That it is a niche market. It is designed
7 to complete not with the TSX marketplace but with the
8 upstairs market currently. That is the niche that we have
9 targeted. And the reason for introducing a new
10 marketplace to address that niche is because we thought
11 that there were weaknesses in the existing upstairs market
12 that could be dramatically improved. The existing
13 upstairs market is a human-intermediary business. It is a
14 phone-based business. We thought putting in a rules-based
15 marketplace with automated execution, with no possibility
16 for pre-trade information leakage or front running and
17 complete anonymity would offer some significant benefits
18 not just to the participants but to the marketplace as a
19 whole.

20 And we have achieved that and I think the
21 usage to date demonstrates that there is some real value
22 there that serious market participants would like to tap
23 into. The benefits are lower implicit costs of execution
24 and just overall, a higher quality of execution for
25 participants.

1 So, you know, if this is such a good thing,
2 which we strongly believe it is, you need to ask the
3 question, well, why has our entry into the market created
4 such a fuss, because it really has.
5 What we are not doing is exploiting any
6 regulatory loophole or encouraging regulatory arbitrage.
7 Our marketplace is in complete compliance, obviously, with
8 existing regulations. We have not gone beyond existing
9 regulations. We have no way, really, of doing that or
10 presuming what they ought to be. But, for the moment, our
11 marketplace supports and our participants are in complete
12 compliance with existing regulations.
13 So to deal with the issue about how we got
14 here and why there is such a fuss, I would like to go back
15 to the idea of 'is enhanced trade-through necessary at
16 this point?'. And it is obvious from our written comments
17 that we are not persuaded by the arguments that
18 trade-through protection is fundamental to market
19 integrity.
20 The two main points that are raised are
21 that there is the encouragement of limit orders, or
22 perhaps the discouragement of limit orders, in the absence
23 of trade-through protection and the perception of
24 fairness. Now obviously those are two good things. The
25 question is 'Is a trade-through protection regime

1 fundamental to achieving those things?', and we just don't
2 think that there is any evidence to demonstrate that that
3 is true.

4 People advertise through limit orders in
5 order to find the other side. That is a very effective
6 way to trade securities if your trade size is within the
7 context of normal market size. It is the worst way to
8 trade securities if you have a large order.

9 The perception of fairness is a woolly
10 concept that I have a very hard time dealing with. I
11 think the notion that someone, you know, a trade-through
12 doesn't guarantee someone a better price. A trade-through
13 protection doesn't guarantee someone a better price, it
14 just guarantees them a fill. And it is this presumption
15 of liquidity in the marketplace that I am not sure is at
16 the foundation of a trading environment.

17 However, if there is any common ground
18 here, I would agree that there is most likely to be those
19 two benefits in markets that are very similar. So if you
20 have orders of a similar size between two markets, and you
21 have market functionality of a similar operation. So
22 essentially like for like. If those two markets were
23 allowed to trade-through each other, I would be more
24 inclined to agree with the fairness perception and the
25 limitation on people posting orders.

1 However, I think that argument gets very
2 strained when you are talking about strong differences in
3 order condition or order size, and we have that imbedded
4 already in our regulations with the exemption for special
5 terms orders. So I would encourage you to look along
6 those lines as you are thinking about crafting a
7 trade-through rule.

8 Looking at the cost side, we -- I have got,
9 you know, a whole list of costs that I don't need to go
10 through. But, fundamentally, a trade-through rule is a
11 barrier to a buyer and a seller otherwise entering into a
12 transaction. So it is, at the very least, a friction cost
13 between that specific transaction. It is an absolute
14 reduction in investor choice because now it is the rule
15 that is dictating where and how they execute as opposed to
16 the investor themselves dictating where and how they
17 execute. And for reasons that I hope I explained
18 adequately in the written presentation, it is a real
19 barrier to the new marketplaces. The linkages required to
20 ensure orders can move around from market to market are
21 not easy, they are not present today and require time and
22 money and motivation to put in place.

23 The same issue with benefits is also
24 present, in my view, on the cost side. That is the -- in
25 the same way that the benefits are clearer to me in

1 like-for-like orders, the costs are less in like-for-like
2 orders. You know, for example, if you look at the
3 investor-choice issue, we could perhaps assume that an
4 investor may be more indifferent between marketplace A and
5 marketplace B if marketplace A and marketplace place B are
6 very similar and the order size is very similar and so on.
7 However, if an order -- investor has made a deliberate
8 choice to go to a substantially different marketplace,
9 then a rule that prevents them from executing in a way
10 that they would choose is more of a burden.

11 Obviously the total costs are very much
12 driven by the content of the rule and what it is designed
13 to protect. And so here I am in agreement with some of
14 the commentary earlier this morning which is in favour of
15 two things. One is to clearly identify what is the heart
16 of the regulatory concern that the rule is designed to
17 address and then craft a rule designed specifically to
18 address those concerns as opposed to some blanket rule
19 that would necessarily carry with it unintended
20 consequences.

21 For example, I am a strong supporter of
22 trying to imbed as much flexibility as possible into the
23 rule and stay away from prescriptive or centralized
24 structures.

25 So the idea of pre-trade versus post trade

1 remedy for a trade-through, post trade allows different
2 matching algorithms or technologies to occur with an
3 after-the-fact remedy, there is more flexibility for
4 market innovation in that type of application.
5 Marketplace level versus participant level.
6 Here I will point out that I am actually going to argue
7 against my self-interest in that I think putting the
8 obligation on a participant level actually allows more
9 flexibility into the marketplace in that the marketplace
10 could offer a service to allow their participants to
11 comply and it doesn't prevent a start up from operating.
12 At the stage that our marketplace is at
13 right now, a marketplace level structure could work for
14 me. But it would be, I believe, a significant impediment
15 to a new start up coming behind me.
16 Top of book versus full depth of book.
17 This is just the quantification of the friction cost that
18 may be incurring. So it is an important distinction and
19 an important factor in the cost and benefits.
20 And I think that there needs to be some
21 real recognition of the constraints of institutional
22 investors. Unlike dealers, institutional investors do not
23 have trading accounts so it is much more difficult for
24 them to buy more or sell more, even more importantly, than
25 the order they have at hand. So the obligation for

1 displacement is of particular concern to an institutional
2 investor and a very stringent rule could have a serious
3 impediment to direct market access.

4 We think that all of these issues were not
5 very well addressed in the RS proposal and, and most
6 importantly, really, the application for immediate
7 implementation of the RS proposal, as we wrote to you last
8 May, was a very serious anti-competitive issue for us in
9 that it would have resulted in a new rule regime being
10 immediately imposed on an entirely new set of market
11 participants who had no tools, experience, or, honestly,
12 understanding about how to comply. And to have that be
13 imposed on the marketplace without any consultation or
14 discussion would have, would have shut down our operation
15 completely.

16 So as far as the, and that leads me to my
17 third point which is really the regulatory uncertainty
18 aspect of the process to date. That there is right now
19 strong market confusion just around where the rules are,
20 who is caught up in them and what expected behaviour is
21 supposed to be. And we have had the difficulty of trying
22 to navigate through this uncertain environment. And so we
23 would ask in this process that you make it clear to the
24 marketplace where the direction is coming from, how it
25 will be effected, what the process is, and what the

1 potential scope of the rule will be.

2 If you want to just turn to the summary
3 page of executions, I could just perhaps walk you through
4 some of the actual experience that we have had.

5 The summary, level we have had 34
6 executions on 15 different securities since our inception
7 up until yesterday. The way the system has operated, our
8 average share size is about 40,000 shares but because it
9 has -- some executions have occurred in the chunks of 25
10 it -- these statistics probably exaggerate the number of
11 real executions, if you like, compared to the previous
12 market structure but under estimate the order size. It is
13 just a little bit of colour. Trade-throughs have occurred
14 on about half of those executions, 20 out of the 34,
15 slightly more than half on 9 different symbols. 11 out of
16 the 20 were within 3 cents of the TSX relevant quote, and
17 8 out of the 20 were between 4 and 9 cents.

18 We have been tracking this obviously
19 because we are very interested in the impact of price
20 discovery and how our marketplace will impact the general
21 marketplace as a whole. And our presumption was, to the
22 extent we had trade-throughs, we would expect that to
23 contribute to the overall price discovery of the
24 marketplace; and we have seen evidence of that happening.
25 In that in all cases but one after our execution was

1 published, and this is even with limited distribution
2 currently, we did see the TSX market quote react to that
3 published price. And in a very short period of time, an
4 average of about a minute, the TSX quote actually moved
5 such that the execution on BlockBook would have now been
6 within the TSX quote.

7 So there is some evidence of a mutual
8 information and benefit, I would say, between a price
9 discovery in one environment under a different set of
10 rules and price discovery on another environment. And
11 seeing that the markets react and seeing that those limit
12 orders on the TSX were in fact taken out as the markets
13 reacted. So that is one thing that I would encourage you
14 to look at because it is not just, I would say that this
15 is supporting the fact that it is perhaps not necessary to
16 have a rule to require these orders be taken out, but
17 perhaps this is going to end up being part of the natural
18 dynamic of the marketplace.

19 I know you probably have a lot of
20 questions, so I am going to pause there and be happy to
21 answer whatever you would like.

22 CHAIR: Thank you. Questions?

23 MR. BATES: Just a technical one. Just
24 take me to this column that talks about market efficiency,
25 I am assuming that relates to what you were just

1 describing?

2 MS. ROBERTSON: That is exactly right.
3 Here let me walk you through the chart perhaps that would
4 help. We have sorted it through trade-through amount, you
5 see sort of in the centre of the column, and that is the
6 cent per share. So lowest to highest. And it is just the
7 top half of the page that showed trade-throughs.

8 And so the market efficiency lag is the
9 time it took for the TSX book, the published quote to move
10 to the price of the BlockBook execution.

11 MR. BATES: I know I am nitpicking, but did
12 you have any sense of why there was literally one trade
13 there that seemed to skew the average completely?

14 MS. ROBERTSON: No, I don't. Well actually
15 I do. It is anecdotal evidence. I believe that it is,
16 people were not watching our marketplace that day and
17 didn't see the execution and, in fact, when we, when we
18 took some steps to notify market participants of the
19 execution, particularly the brokers that we saw active in
20 that stock, then the market did react after the fact.

21 CHAIR: Other questions? No.

22 MR. BATES: I will keep going then, if I
23 may?

24 CHAIR: Absolutely.

25 MR. BATES: Obviously at the heart of your

1 presentation is a very different view on this issue of
2 obligation, and this has to go probably to the heart of
3 the deliberation anyway that we make. Could you give me
4 your sense of how you came to have such a very different
5 perspective on this?

6 MS. ROBERTSON: I think there are a number
7 of elements that contribute to it. And I should start by
8 saying it's not that I don't believe market participants
9 have an obligation to the market as a whole, I am just not
10 sure they have this one.

11 And I think that the position that we hold
12 in the marketplace as setting ourselves the task of
13 examining the existing structure, identifying a weakness
14 and creating a solution to that weakness perhaps allows us
15 to think differently than those who are very much working
16 within the existing structure. And, in fact, it has
17 surprised me how little thinking has been done, generally,
18 until we arrived on the scene about this issue at all. And
19 how little understanding most market participants have
20 about what the rules actually say versus how they are
21 applied because of limitations of the TSX matching engine.

22 So there is a real, I would say, that we
23 have thought more and more deeply about this and have had
24 to as a result of what we have been trying to do in the
25 marketplace. It is not that we are right.

1 MR. MOORE: Judith, could you just expand a
2 bit upon you said that your system was really devised as a
3 competition to the upstairs market?

4 MS. ROBERTSON: Right.

5 MR. MOORE: Could you just describe in what
6 way that works and what makes your system competitive with
7 the upstairs market?

8 MS. ROBERTSON: So the upstairs market, as
9 it works today, is where a buyer and a seller of large
10 sizes of securities are matched, if you like, on the desk
11 of a broker, the block trading desk. So, if you like, the
12 marketplace for those trades is currently on a block desk.
13 And the way that works currently is that I, either the
14 block trader, will call a client with information of
15 interest from another client and trying to find the other
16 side, that is their job or a client will call the block
17 trader and indicate interest in a certain name. And, of
18 course, it is very much a difficult and delicate balance
19 between providing enough information to find the other
20 side and not providing so much information that you can
21 influence the price, because this is the essential
22 conundrum of large trades, is that the presence of the
23 order itself can have a negative market impact. So it is
24 a different trading problem than a more standard market
25 order.

1 Most of the time we would say that that
2 works quite well, that clients are reasonably well served
3 by that, trades get done. However, as more sophistication
4 and more analysis about trading costs, the more demand by
5 clients for more control over their trade executions, and
6 a more critical look at commission dollars and what
7 commission dollars are compensating, and so on all of
8 these things along with a focus on best execution has
9 caused investors to examine whether this is, in fact, the
10 best way to transact these large orders.

11 The risk, of course, when you are using a
12 human intermediary is always that you are giving that
13 human information and you lose control over how that human
14 uses it or releases it to the marketplace. And even
15 without nefarious intentions like front running, it is
16 possible that the human intermediary doesn't control it in
17 the way you would like it and it could have some adverse
18 impact.

19 So the core of our system is really to
20 design a way to allow buyers and sellers to find each
21 other without the two main down sides of the existing
22 upstairs market and that is without revealing too much
23 information, so the delicate problem is enough information
24 to bring a buyer and seller to together to meet on both
25 size and price and without the possibility that that

1 information gets leaked to the marketplace through the
2 human intermediary.

3 The third benefit that we bring, because of
4 the structure, is that it is actually for the first time a
5 consolidated pool of liquidity. If you think about a
6 block trading desk at the different dealers around the
7 Canadian marketplace, each one essentially operates as a
8 silo of liquidity or a separate marketplace, right. It is
9 the dealer in the centre with clients. So if you had
10 client A talking to dealer over here and client B talking
11 to dealer over here, they may never find each other, it is
12 possible.

13 Our system allows all clients, all buy side
14 institutions and all dealers who can represent clients or
15 represent themselves as proprietary traders to meet in a
16 single liquidity pool. So the third main benefit is that
17 it has the potential for truly concentrating liquidity.

18 MR. MOORE: Just another question on the
19 trade-through. You mentioned how if the RS rule had come
20 in as proposed when proposed that would have killed your
21 market.

22 You do have dealer members of your market
23 and you have access person members?

24 MS. ROBERTSON: We do.

25 MR. MOORE: The dealers would be subject to

1 the trade-through rule --

2 MS. ROBERTSON: The dealers are currently
3 subject to the existing trade-through rule. So they
4 essentially have three possibilities for compliance. One
5 is to prevent a trade-through, right, which they can do.
6 One is to utilize one of the existing exemptions such as
7 an all or none order, that is really the only one we
8 currently support on our marketplace. And the third is an
9 after-the-fact remedy which is if an execution occurs on
10 BlockBook that is a trade-through, they are deemed to have
11 satisfied their obligation if they immediately take out
12 the visible better priced orders on the TSX. And those
13 have happened, and they have been able to comply.

14 The key difference, really, is that that is
15 an obligation dealers are familiar with and are
16 comfortable with and have the tools in place to use to
17 comply. It is not an obligation that a buy-side trader
18 has ever faced directly, has ever had to comply with and
19 would not be able to demonstrate to their compliance
20 department that they would have the necessary ability to
21 effect those trades.

22 MR. BATES: Can I jump in with one, sorry.
23 So you have arrived at a threshold of 25,000 shares as
24 being a base. We have heard earlier today that the nature
25 of trading in small lots is changing quite dramatically.

1 If one of the buy-side clients that you have is using your
2 system at the 25,000 threshold comes back and says, you
3 know, I really enjoyed working with you, I like what is
4 going on here, but it would be very helpful to me if I
5 could now go down to 500 share trade, what would your
6 answer be?

7 MS. ROBERTSON: On our system. The answer
8 would be that the value proposition of our system actually
9 doesn't work with the 500 share trade. And the reason for
10 that is that there is just too much opportunity for gaming
11 at that cheap level. The principal constraint against
12 someone putting an order in just to see if there is
13 another order is that if they are just fishing for
14 information they are really at risk for some size, right.
15 So that is why the large order size is really the
16 principal protection which allows other large orders to
17 come in and potentially match.

18 So, so the answer is the limitation on the
19 large order size is fundamental to the value proposition
20 of the way the system has been constructed.

21 Now it doesn't mean to say that we are
22 firmly convinced that 25,000 shares is the right number
23 for all time or for all stocks. In fact, we are
24 anticipating that what the marketplace probably needs is
25 perhaps three tiers. That for the very low priced high

1 volume stocks like a Nortel 25,000 shares is actually
2 quite small. And for the higher priced lower volume
3 stocks that 25,000 shares is too big. So we may end up
4 proposing a 10,000/25,000/100,000 or 50,000 tier depending
5 on the trading characteristics of the individual
6 securities.

7 CHAIR: I am just going to ask one
8 question. You have mentioned in your submission that to
9 require trade-through protection would adversely impact
10 competition in the marketplace because it would impose an
11 obligation on the marketplace where there is no technology
12 currently available to allow the smart order routing to
13 take place.

14 We have heard from others this morning that
15 there is and, you know, we didn't get into a discussion in
16 the context or forum, I am sure that is for another day
17 and another venue. Can you just elaborate a little bit on
18 why some have said there are vendors who are doing this
19 and it is feasible and you are saying it is not feasible
20 and it is not available?

21 MS. ROBERTSON: Well I think the
22 difference, and I sympathize with the confusion. I think
23 the difference is one of timing. So it's not that it is
24 not possible and it is not that they aren't going to be
25 there soon, it is just they are not there now. And it is

1 a bit of a chicken and an egg thing. The reason they are
2 not there now is because they are not mandated and because
3 there, until this moment, has been no commercial reason to
4 create one, right.

5 And so the problem for requiring this type
6 of facility or this type of capability prior to operation
7 is that you never get over the chicken and the egg
8 situation.

9 CHAIR: Okay, thank you.

10 MS. ROBERTSON: I think the US example,
11 perhaps in this case, actually does have some relevance in
12 that the virtual central limit order book that appears to
13 exist now in the US was created only after there were
14 multiple competitive marketplaces and those competitive
15 marketplaces actually decided that it was a feature of
16 their marketplace to offer their clients better execution
17 elsewhere, you know, it is kind of like the electronic
18 sales guy saying we will match any price. And that it is
19 that commercial imperative that has driven the fact that
20 now the penalty on competition and innovation of Reg. NMS
21 is deemed to be less of a concern in that environment
22 because this infrastructure has been allowed to be
23 established.

24 CHAIR: Okay, Judith, thank you very much.

25 MS. ROBERTSON: Thank you.

1 CHAIR: We are pretty much on time here and
2 our next presenter is TriAct Canada Marketplace, Wendy
3 Rudd. We have your handout.

4 MS. RUDD: I did provide a handout, and I
5 will be following the pages on the handout.

6 SUBMISSIONS BY MS. RUDD FOR TRIACT CANADA
7 MARKETPLACE:

8 MS. RUDD: I am CEO of TriAct Canada
9 Marketplace, we are a hopefully soon-to-be-registered ATS
10 in Canada. And prior to this position years ago I spent
11 quite a long tenure at the TSX with Mr. Bates here, mainly
12 focussing on market structure issues, studying market
13 structure developments throughout the world, and working
14 on initiatives and rules related to changes in structure.
15 So I certainly have had plenty of years to develop strong
16 opinions on things like trade-throughs.

17 I am going to take a slightly different
18 approach than most of the other speakers. I am going to
19 look at this from a very pragmatic point of view. I could
20 reiterate a lot of the points that have been made but more
21 of a theoretical point of view. But I think ultimately
22 any rule, any law anywhere in the world in any industry
23 can only work if it can be implemented, if those that must
24 comply with it can do that and can do it economically.

25 So, I am going to take that tact and look

1 at realistically what this would mean.

2 I would like to point out, though, that
3 really TriAct, I believe, will not be affected by the
4 imposition of a trade-through rule or the lack of.
5 Primarily because our model focuses on providing price
6 improvement over the best bid and offer. So our system
7 will always execute within the best price there. So, I
8 believe we are not affected by this, but certainly if
9 trade-throughs were allowed that would open up the door
10 for us to take a look at our model and possibly change it.
11 I certainly don't want to have to do that.

12 Slide number two. If trade-throughs were
13 allowed, I think it is important to consider the
14 down-stream impact on the rules that we have all come to
15 rely on and to believe in. And I have listed here only
16 four of the basic rules in the UMIRs, but they are all
17 based on a fundamental principle implicitly of price
18 priority of the best bid and asked being important and
19 having a right.

20 And so I think allowing trade-throughs
21 would require a re-examination of all of these rules. It
22 would put into question the relevance of the best bid and
23 offer and the meaning behind it. It would put into
24 question why a dealer has to give priority to its clients'
25 orders at the same price if, in fact, there are no rules

1 around price priority. And it would also put into
2 question why certain client orders should be exposed to a
3 public market if there is no -- if price priority is not a
4 principle that is adhered to in those markets.

5 So I think there is more, more than meets
6 the eye and it definitely has to be factored into the
7 decision.

8 On the next slide, I won't go into great
9 detail on this, but I just really have graphically
10 depicted what I think would be an unwanted outcome of
11 trade-throughs being allowed in Canada.

12 I think we are starting, as others have
13 said, at a very high standard. The US started at the
14 other end; they are fixing the mess they are in. Their
15 market is really very difficult to compare to. It has
16 been a real mess of various systems and there hasn't been
17 really any clean regulatory framework, and they are headed
18 in that direction.

19 I think by compromising our current high
20 standards what we end up doing, as an industry as a whole,
21 is compromising our competitiveness, and I know that has
22 been bought up by a few speakers today. Ultimately there
23 is two main outcomes, I think, one is our competitiveness
24 with the US markets. If our market is seen as less
25 efficient and less fair than it is currently, then we are

1 liable to see order flows stay south of the border and not
2 come to this market.

3 But another one that hasn't been brought up
4 is a real, I believe, is a real tangible cost to the
5 dealers, to the dealer community, certainly from retail
6 clients and quite possibly also from their institutional
7 clients in terms of not understanding always why didn't I
8 get a fill on my order, assuming that they, perhaps, are
9 not getting good service if their order is not being
10 filled and the market is trading around it. And that
11 can't be underestimated. I think the cost of dealers of
12 dealing with those situations and the risk of lost
13 business as a result of that has to be factored in as
14 well.

15 The issue of balancing regulation and
16 with -- and allowing competition, I would like to address
17 that for a moment. In our submission we stated very
18 emphatically that we feel that all competition should be
19 based on some strong principles of fairness and efficiency
20 and that, in fact, there is plenty of room even with a
21 trade-through rule, with the rules that we have today for
22 competition to flourish and I believe that TriAct is an
23 example of one of many variations of an alternative
24 trading system that has been designed to work within the
25 rules and not, not to create trade-throughs, in fact, to

1 add value to, add value in terms of price improvement.

2 So I would disagree with the argument that
3 we need to relax the rules in order to invite competition.

4 I don't think that by having these strict
5 rules that all competitors have to have the same model.
6 Again, there are plenty of variations on market models
7 that can work, all based on the same set of principles.
8 And, finally, I think competition, I think the goal of
9 allowing increased competition in our industry should be
10 to raise the bar, to provide value, to fill in where there
11 is a need, as someone has said earlier, and make this
12 market a better one.

13 On the fifth page, I have used some
14 diagrams just to illustrate the points I am getting at
15 here. I will run quickly through this one. It is our
16 view, and I believe most others, that non-transparent
17 orders and non-transparent markets should not receive
18 trade-through protection. And, you know, it all comes
19 down to the basic fact that if you can't see what is
20 there, how can anyone tell whether there is a price that
21 should be adhered to? If there are two non-transparent
22 markets how can a dealer or an investor determine which
23 one is better?

24 If there is no pre-trade transparency then
25 there is no way to know and, again, those orders are not

1 necessarily contributing to the price discovery mechanism.
2 And I say that even though our system will, in fact, be a
3 confidential book with no pre-trade transparency. I
4 believe that market participants should -- they will chose
5 the markets to which they, in which they want to
6 participate based on the value that those markets provide.
7 And if they want to participate in a non-disclosed
8 non-transparent market it will be because there is a value
9 to them. I don't think we need a regulated protection of
10 orders for that -- for markets that choose not to
11 disclose.

12 On the next page, I just lay out some
13 considerations. If the onus were on markets to prevent
14 trade-throughs, I think there are some down-stream
15 implications that would need to be thought out.

16 Fundamentally I believe that dealers and
17 their clients should have the economic right to chose the
18 markets that they would like to access based on cost
19 benefit. You know, there are lots of factors, each of the
20 markets that exist now and will exist in the future, have
21 certain economic proposition, has made decisions on cost
22 of access, transactions fees, et cetera, each of those
23 markets is a business like every other and each of the
24 participants is a business that I think should have the
25 right to chose which markets they believe add value, which

1 ones they want to participate in and which they don't.

2 And so if you subscribe to that belief,
3 then having the market, the onus on the marketplaces to
4 prevent trade-throughs would bring some issues such as,
5 let's use real examples, TSX and CNQ. If TSX sends an
6 order, broker A puts in an order to TSX, TSX sends it to
7 CNQ, who doesn't recognize that broker as a participant;
8 that kind of issue has to be addressed.

9 If Markets Inc. for example has an order
10 from an access person and needs to pass that order over to
11 the TSX to satisfy that visible liquidity, how is that
12 done? Does Markets Inc. have to become a dealer -- sorry a
13 PO of the TSX, for example, and act as agent? There are
14 lots of those mechanical issues that would have to be
15 addressed and it is not as easy and straightforward as it
16 would appear.

17 If the onus were on participants, I believe
18 that is the most efficient way to go. In our work in
19 implementing our new marketplace, it is very clear to us.
20 There are really four to six, what I would call, access
21 vendors that really are the final point after which an
22 order is routed to a market. And those vendors do all the
23 routing for the order flow in Canada today with the
24 exception of a few dealers that do their own routing. So
25 those access vendors are in the business, they are in the

1 business of routing orders and they know by virtue of the
2 way their systems are designed which of their users has
3 access to which markets.

4 So it is an easy extension to, say, allow
5 those access vendors to compete to take advantage of this
6 opportunity to add value for their clients, the dealers
7 and the institutional clients and provide smart routing
8 services.

9 And I think as TD said this morning and
10 others, the dealers that do their own routing already have
11 smart routing systems and can easily customize those for
12 the Canadian context.

13 One of the submissions argued that, and
14 actually I believe it was Judith's, said that it is not
15 done today, that issue just came up at the end of Judith's
16 presentation. I refer here to the sleepy Canadian
17 securities industry, a little bit tongue and cheek, but
18 essentially, as Judith said, those systems providers,
19 those access vendors have had no reason, no compelling
20 requirement to deliver smart routing services in Canada.
21 There has not been two markets that they have had to deal
22 with. And, yes, that it hasn't been done yet, but I can
23 say from our own experience that all of those vendors are
24 currently at some point in the process of preparing for
25 the existence of TriAct and for the existence of CNQ, and,

1 as a result, I would venture to say that before this
2 debate even finishes that smart routing technology will be
3 there. If for no other reason than for economic reasons.
4 The dealers, all the market participants out there, don't
5 need a trade-through rule to, to be motivated to find the
6 best price. They want to find the best price in order to
7 satisfy their best execution obligations, they want to
8 find the best price simply to optimise the results of
9 their trades. No one in their right mind is going to buy
10 high when they can buy low.

11 So there is a natural incentive for that
12 kind of technology to be developed and it is, in fact,
13 well on the way, I can tell you that. And, in fact, a
14 couple of months ago I delivered a presentation to a few
15 of the staff at the OSC to communicate that on behalf of
16 one of the access vendors. And so I think, I think the
17 natural forces of competition will take care of that
18 issue.

19 As others have said, I believe that a light
20 touch should be taken in terms of the mechanisms required
21 to implement the rules, sweep orders, a data consolidator,
22 et cetera, I don't think are necessary partly because
23 every system out there, every automated system works
24 differently. So mandating a particular mechanism isn't
25 necessarily going to work easily, isn't going to fit in

1 with those systems. But mainly because, again, the normal
2 forces of supply and demand, I believe, will take care of
3 the issue.

4 On the issue of consolidation with -- many
5 presenters refer to the central limit order book. Well,
6 it is today a central limit order book; it is the TSX
7 limit order book. But if you think of it as a wider model
8 of an integrated model, there hasn't been a need. There
9 hasn't been more than one marketplace, again. And that is
10 the reason that a data consolidator never arrived. There
11 was never a need to do that.

12 I believe that the data vendors will
13 respond to the needs of their clients and will integrate
14 quotes and data from multiple marketplaces if and when
15 they exist and that data will be available to market
16 participants. I think it is risky the mandate a data
17 consolidator in the absence of more than one viable
18 marketplace. I think you have to have two or more viable
19 marketplaces with pre-trade transparency in order to even
20 need a data consolidator.

21 I won't go into the rest of the details on
22 this slide but there are many, many ways and I have been
23 involved, I have designed systems myself to deal with the
24 smart routing issue. Many ways to do it, it is, I
25 believe, straightforward.

1 I'll wrap up my comments here. But the
2 next slide deals the issue of access persons.
3 Fundamentally I agree with the RS proposal, but I believe
4 that the RS proposal had a teeny bit of loophole in it in
5 that if an access person subscribes to an ATS and
6 otherwise can only access another market by submitting,
7 manually submitting orders to a dealer, i.e. by phone or
8 e-mail et cetera and doesn't have direct market access, I
9 would suggest that that access person should be compelled
10 to use whatever means of access they have to another
11 market, including picking up the phone, if those
12 relationships are, in fact, in place.
13 And then, finally, the opt out alternative.
14 A number of submissions suggested that there should be opt
15 out rights for sophisticated investors. For dealers
16 acting as principal. Those submissions, I believe, are
17 looking at the issue from the point of view of the active
18 order. The order that is deciding it is going to execute.
19 And when, in fact, the issue is one of the rights of the
20 order that is sitting in the book publicly declaring its
21 intention and deserving a fill. And I don't think anyone,
22 whether it is a sophisticated investor or a dealer acting
23 as principal or a retail client, would consciously choose
24 to opt out of their right to trade-through protection. So
25 I think on the issue of opt out, needs to be clarified.

1 You can't opt out of an obligation. An obligation is an
2 obligation; you can opt out of a right. So I will leave
3 it at that.

4 In summary, I believe that trade-throughs
5 would call into question several of the entrenched rules
6 and principles that we all abide by. And they would also
7 negatively impact real and perceived competitiveness of
8 the Canadian market. Integrity of the markets doesn't
9 need to be sacrificed for the sake of competition. There
10 is plenty of room for competition the add value within
11 strict rules of fairness, and I would caution the
12 regulators to consider from whence it came in terms of
13 some submissions that are either subtly or not so subtlety
14 coming from vested interests, I believe.

15 I suggest that only transparent markets and
16 orders can or should have standing. That participants
17 should be responsible for trade-through and prevention and
18 that that can be done through their systems providers,
19 those access vendors. And that practical objectives are
20 already driving the development of smart routing
21 technology and there is no need for regulating mechanisms.
22 Access persons should be expected to honour better prices
23 on other markets either via direct market access or via
24 traditional order placement through a participant. And,
25 finally, I believe that opt out provision won't really

1 solve any problems. Thank you.

2 CHAIR: Thank you, Wendy. I am going to
3 see if anyone has any questions but let me just ask you,
4 in terms of your comment about you want flexibility and
5 don't get in there and mandate certain regulatory
6 mechanisms like mandatory sweep orders or data
7 consolidators.

8 What is your view on why they did mandate
9 mandatory sweep orders in the US? Do you see the
10 differences being because of where they were relative to
11 where we are or do you just think it was ill-conceived
12 that they did that or?

13 MS. RUDD: I guess I would agree with the
14 latter, that it was ill conceived. I have studied the US
15 markets for over 20 years now and I have been fascinated
16 with the degree of complexity that they impose in their
17 rules and systems. You know, we have got a much simpler
18 market here, a much smaller market, so, you know, we
19 haven't had to deal with that so I am not saying that
20 Canada wouldn't be in a same situation, you know,
21 comparing apples to apples. But I think they tend to
22 overthink these issues instead of keeping the principles
23 down to the fundamentals.

24 CHAIR: Thank you. Questions?

25 MR. MOORE: I have one question.

1 I believe in your, I am getting tired, but
2 I believe in your written submission you were in favour of
3 a narrow exemption from trade-through protection from
4 large block trades that would be akin to wide
5 distribution?

6 MS. RUDD: Yes, I think there are certain
7 valid situations, and we failed to mention, you know, some
8 of the other exemptions, you know, for example orders that
9 don't know what price they are going to trade at,
10 market-on-close, there are valid, you know, reasons for
11 exemptions. But in terms of normal day-to-day trading of
12 executable orders in the secondary equity market, I don't
13 see any need for any exemptions.

14 MR. MOORE: I think I can understand the
15 need for exemptions for, you know, certain conditional
16 orders and various things that don't really, where you
17 don't know what the price is going to be, but I wonder
18 about large block trades that would be akin to a wide
19 distribution because that is just a practical exemption,
20 it really goes against the velocity of allowing no
21 trade-throughs?

22 MS. RUDD: Honestly, I don't have a strong
23 opinion on that. It seems to make sense that there are
24 special situations, you know, but I don't have a lot of
25 knowledge on that, that would require certain exemptions.

1 MR. MOORE: Then you get into where do you
2 draw the line? You know, you have got control
3 distributions, like over 20 per cent where you are
4 controlled shareholder and you do have to go to secondary
5 market the wide distributions would be under that to a
6 certain amount and then block trade and how far do you go?
7 I am just wondering whether there is a practical exemption
8 there for block trades and how large?

9 MS. RUDD: There may not be. It is a
10 tricky issue.

11 MR. MOORE: Thank you.

12 CHAIR: Thank you very much, Wendy, that
13 was great.

14 We have one more before the coffee break
15 and that is Shorcan, Joie Watts. Did I pronounce that
16 right?

17 SUBMISSIONS BY MR. WATTS FOR SHORCAN ATS
18 LIMITED:

19 MR. WATTS: Thank you. Well having had the
20 privilege to listen to the first nine speakers, I am
21 comforted in the fact that I think we have one area of
22 common ground and that is vested interest.

23 I am Joie Watts and I am the CEO of Shorcan
24 ATS Limited. Shorcan ATS is seeking regulatory approval
25 to operate a specialised alternative trading system to

1 enable dealers trading as principal to more effectively
2 manage trading risk; that is my vested interest.

3 I would like to commend the CSA on the
4 quality and the comprehensiveness of their discussion
5 paper and secondly I would like to thank you for the
6 opportunity to provide feedback on the issues raised.

7 The previous presentations have tended to
8 focus almost exclusively on trade-through and it's
9 certainly a primary focus of ours as well. We do not
10 support the proposed RS trade-through obligation.

11 Our discussion on trade-through
12 restrictions will address four key areas. One, it does
13 not protect retail investors. In other words, it does not
14 actually accomplish what its supporters say it will do.
15 Secondly, it causes collateral damage. Three, it
16 increases market risk by impeding investors' and traders'
17 ability to achieve best execution. And, four, it
18 undermines innovation by forcing market centralisation and
19 consolidation.

20 Now before we move to discuss these four,
21 what I would refer to as negative externalities, of a
22 universal trade-through rule, it is important to clearly
23 understand the discussion papers about market structure
24 and trade-through. Now the market structure component
25 compels us to look at the big picture.

1 On market structure, two points need to be
2 made. First, the CSA approach to market structure is not
3 a blank slate. There is already a policy built into the
4 national marketplace instrument of competition between
5 marketplaces; and that means multiple marketplaces.
6 It also means different marketplaces
7 because it is clear, or it was clear to me until I heard
8 the CNQ presentation, that Canada does not need multiple
9 Toronto stock exchanges and the exchanges themselves
10 recognized this when they merged and began to practice
11 specialization.
12 Secondly, the competitive multi-marketplace
13 approached envision in the national instrument has been
14 slow to evolve. The regulators should avoid snuffing out
15 competition that has taken over four years to get started.
16 Others have covered this, so I will be very
17 brief. Best execution means different things to different
18 market participants. For example retail investors equate
19 best execution with best price. Also, retail investors do
20 not only trade as individuals but they buy the services of
21 institutional investors and traders when they invest in
22 mutual funds and contribute to company pension plans.
23 Institutional investors are participants with more complex
24 needs such as the need to minimize market impact, the need
25 to avoid information leakage, and the need to complete

1 their orders, size orders in a predictable basis and
2 timely basis. For dealers who risk their capital to
3 supply liquidity to institutional investors and for market
4 making, best execution can be characterized as best risk
5 management. Dealers need to manage trading risk in order
6 to more effectively perform their role as liquidity
7 providers. Therefore, the purpose of competitive
8 marketplaces is to service the specialised needs of
9 different participants. The concept of best execution
10 means different things to different participants hence the
11 need for specialized marketplace to meet different
12 participant's best execution goals.

13 Almost all of the discussion by
14 trade-through advocates is premised on the wrong
15 assumption that if trade-through is rigidly enforced
16 retail investors and limit orders are sure to benefit.
17 Our contention is that retail investors want best price
18 but above all they want their limit orders to be executed
19 and not bypassed.

20 I would like to just look at a couple of
21 things that demonstrate the view that trade-through does
22 not offer comprehensive protection it is, in fact, an
23 illusion. Let's initially take this case of limit orders
24 and what happens to them when trades occur inside the
25 spread. To illustrate, let's say the TSX market is 10.25

1 to 10.30. Under current TSX trading rules, dealers can
2 internalise and cross blocks of stock without
3 interference, 10.26, .27, .28, .29, and the limit orders
4 which have, in essence, performed the price discovery
5 mechanism for those crosses in between are totally left
6 out of the equation; they are not offered the price
7 improvement that those orders that take place within the
8 spread have been given.

9 So the idea that a trade-through rule will
10 actually protect those limit orders or encourage more
11 limit orders because they are offered price improvement,
12 it just doesn't make any sense at all. Now that is how
13 things happen today in the upstairs institutional
14 marketplace and it is also the methodology that will be
15 employed by our last speaker, Wendy at TriAct, which will
16 offer its customers price improvement by benchmarking
17 against the TSX best bid/best offer. Now how does this
18 protect or encourage the placement of retail limit orders?
19 It doesn't but no one seems very fussed about it.

20 Now if we continue with the same example
21 10.25 to 10.30, the inside spread. Of greater concern is
22 actually the impact of a system that is invisible and
23 matching orders inside of the spread and the impact on
24 market orders of other dealers -- that other dealers have,
25 whether they are retail or institutional or dealer. The

1 essence of the TriAct system is that it offers a service
2 for its customers' invisible limit orders to match in
3 between the TSX spread. Essentially TriAct is a market
4 within a marketplace, a two-tiered market not unlike the
5 TSX institutional upstairs marketplace and the TSX
6 marketplace.

7 The TSX, I think, and regulators should be
8 considering the fact that market orders of participating
9 organisations who are not able to access the TriAct system
10 will routinely trade-through better priced orders in
11 TriAct and receive an inferior price. Will RS' interim
12 trade-through proposal protect these market orders from
13 harm? The answer is no.

14 Now let's take a look at the same example,
15 10.25 to 10.30 and examine the situation related to price
16 priority for those limit orders at 10.25 and the limit
17 orders at 10.30. Keep in mind the proponents of
18 trade-through make the argument that trade-through rules
19 are necessary to encourage limit orders. But there is
20 another point besides vested interests we can agree on.
21 It is the case that limit orders are a valuable component
22 and an essential component of the price discovery process.

23 Okay. Current trading rules allow dealers
24 to cross or internalise orders of any nature at 10.25 --
25 in amounts greater than 5,000 shares or at 10.30 and

1 completely bypass those orders that have price priority,
2 those orders of other dealers with price priority in the
3 book. Now, how encouraging is that to those limit orders
4 that have been bypassed? The imposition of trade-through
5 does nothing to protect these orders that contribute to
6 price discovery.

7 And now let's stick with the same example
8 and assuming no other orders in the TSX book, I would like
9 to take a look at the case where there is a trade-through
10 obligation if, in fact, a large block trades below 10.25
11 or above 10.30. So we are going to assume the
12 trade-through obligation exists and we are going to take a
13 look at displacement.

14 Let's assume there is 5,000 shares bidding
15 at 10.25. Let's take dealer ABC, they receive an
16 institutional order to sell 250,000 shares and request a
17 firm bid from their, the upstairs trading desk, the
18 institutional desk at ABC and want an answer in a couple
19 of minutes. Well ABC will quickly assess the market
20 conditions and then they will phone back, and this is just
21 a scenario, and say to the institution we will bid you 14
22 for the 250; the client says sold. Well with a
23 trade-through obligation, dealer ABC will knock out the
24 14-and-a-quarter bid for 5,000 and cross the 245 share
25 balance at 14. Well the result is dealer happy,

1 institution happy, but is the limit order that just got
2 filed 25 cents higher, are they happy? It brings to mind
3 the sign by Meatloaf, Two Out of Three Ain't Bad.

4 What has an imposed trade-through
5 obligation done for the limit orders at 14.25? It has
6 protected them from any possibility of potentially
7 revising their order and achieving a better price.

8 Proponents who suggest that trade-through
9 is some kind of panacea that ensures protection and
10 fairness for retail investors orders or limit orders are
11 misguided. The idea that trade-through protects retail
12 investors is truly an illusion. Shorcan ATS believes that
13 imposing an a requirement for universal post-trade
14 transparency is a much more superior tool than
15 trade-through as a means for promoting efficient price
16 discovery, market integrity and fairness. When all
17 investors have equal access to post-trade information,
18 trade size, price, time, they will be able to make better
19 informed decisions. Post-trade transparency is an
20 essential element of market quality and integrity.

21 I would now like to briefly discuss this
22 idea of owing a duty to the marketplace. Regulation
23 Services and other proponents of universal trade-through
24 argue that participants in markets owe a duty to the
25 marketplace.

1 Existing rules are much more narrowly
2 expressed than this, therefore, without inventing a broad
3 duty owed by everyone to the marketplace, it would be
4 impossible to justify an across-the-board or universal
5 trade-through rule. There is no statutory basis for a
6 duty owed to the marketplace.

7 Participants may owe statutory duties to
8 their customers, institutions may owe fiduciary and
9 statutory duties to their stakeholders, but they do not
10 owe a general duty to the marketplace to do their trading
11 on it. In fact, the only trade-through rule that exists
12 today is one that applies to trading by dealers as agent
13 for their customers. The fact that the trade-through rule
14 in the national instrument is this narrowly expressed, I
15 believe, is no accident. It applies only to agency
16 trading. If it were more broadly worded, competition
17 could not arise among marketplaces. The only duties owed
18 to a marketplace are not to engage in manipulative or
19 deceptive trading.

20 I would now like to analyse the issue of
21 contingent liability, which is related to collateral
22 damage imposed by a trade-through rule. I think the best
23 bet is to use the Shorcan ATS model to illustrate the
24 negative consequences.

25 First I will describe a typical trade

1 negotiation that would take place in Shorcan ATS. First
2 dealers subscribers telephonically convey bids and offers
3 with a minimum size of, say, 10,000 shares. It is
4 actually -- it will be based on what Judith was discussing
5 average daily volume type elements -- anyway a larger size
6 can be shown. And bids and offers are conveyed
7 telephonically to the Shorcan trade facilitation desk.
8 Dealer subscribers are able to view the current top of
9 book, which is best bid/best offer and size on the Shorcan
10 video screen. Only the Shorcan trade desk sees the depth
11 of books. Let's say the current bid for XYZ is 14-25 for
12 10,000 shares by dealer A. Remember that all subscribers
13 of Shorcan ATS are dealers trading as anonymous
14 principals. Dealer B phones in to the Shorcan desk to
15 address or hit the 14-and-a-quarter bid. The Shorcan
16 trade desk, upon confirming that the screen quote is
17 current, verbally confirms a trade for 10,000 XYZ at
18 14-and-a-quarter to the relevant counterparties.
19 Simultaneously the Shorcan video display is flashing trade
20 is occurring at 14-and-a-quarter to all subscribers.
21 Now that might be the end of trade but much
22 more likely a scenario and in fact on the IBB side at
23 Shorcan it happens about 80 per cent of the time, further
24 buy and sell interest is expressed to the Shorcan trade
25 desk and then the initial trade size will work up at

1 14-and-a-quarter to the quantity point where supply and
2 demand meet. This work up process is formally referred
3 to, and I think it might have come from the Bank of
4 Canada, as trade expansion protocol.

5 Now, trade expansion protocol can take ten
6 seconds, a few seconds, 15 seconds, but it also can take
7 in unusual circumstances as much as a minute.

8 Now lets go forward. Suppose dealer A
9 indicate as willingness to buy on at 14-and-a-quarter an
10 additional 30,000 shares. Dealer B, who sold the original
11 ten, indicates -- and they have time priority -- a
12 willingness to sell ten more. And in the same time frame
13 dealer C and dealer D each telephonically enter orders to
14 sell 10,000 and 20,000 shares respectively at
15 14-and-a-quarter. Well in this example, an additional
16 30,000 shares trade at 14-and-a-quarter; A buying from B
17 an additional 10; A buying 10 from C; and A buying ten
18 from D. In all, 40,000 shares have traded at
19 14-and-a-quarter and of course dealer D is left with
20 10,000 shares to sell at 14-and-a-quarter.

21 The trade was stopped by the seller; that
22 is, in this case the buyer couldn't buy any more -- and
23 this is very important information and this information is
24 actually only can be gleaned from trade expansion
25 protocol -- in this case the fact that it was stopped by

1 the seller who had more to go, it gives you an idea in
2 terms of the price discovery mechanism where the market
3 may be going from there.

4 Now if this is a universal trade-through
5 obligation, then a bid at 14.26 in another marketplace
6 would impose a contingent liability during this trade
7 negotiation process that I have described above. You
8 might consider this activity akin to front running because
9 it would be used by adversaries interested in trying to
10 break that larger block trade. That would create
11 uncertainty that would interfere with the trade expansion
12 protocol and the collateral damage results in a case where
13 the price discovery mechanism is compromised and the
14 Shorcan ATS would be less effective at enabling dealers to
15 source bigger liquidity and manage their trading risk. As
16 a result, market risk would increase and market liquidity
17 would suffer.

18 It is the essence that when market
19 participants come to a marketplace they expect to transact
20 in a predictable way without finding they are trading in
21 unanticipated ways in unanticipated venues. They do not
22 want a contingent liability to another marketplace that
23 interferes with trading. This is particularly so with
24 specialized marketplaces with different trading methods
25 and trade-through exceptions currently recognize this.

1 This approach reflects a balancing of competing goods,
2 trade-through, within the limits, is a good. Certainly an
3 execution in a particular marketplace is also a good.

4 Trade-through does not, in any obvious way,
5 transcend the need for certainty of execution which is a
6 precondition to specialized marketplaces getting off the
7 ground.

8 Forcing a trade-through obligation upon
9 institutional investors or all participants in all
10 situations is just anti-competitive and will certainly
11 eliminate the benefits that competition brings to the
12 marketplace.

13 Universal trade-through protection
14 undermines innovation. Proponents of trade-through fail
15 to recognize the disparity and diversity of participants'
16 needs. They are not a homogenous group. Trade-through
17 forces centralisation and favours the status quo. It
18 underestimates the intelligence of the retail investor. It
19 inhibits the development of specialized marketplaces and
20 it assumes that investors act irrationally and require
21 mandated protection. If innovation is undermined,
22 competition will be less, transaction costs will be higher
23 and market quality will suffer.

24 One final point, Shorcan ATS is confident
25 that the CSA will carefully assess and balance the

1 relevance of the written comments received and today's
2 input and we do urge the CSA, as others have, to make
3 final decisions on these important matters as quickly as
4 possible so that marketplace participants and marketplaces
5 can make business decisions with regulatory certainty.
6 Thank you.

7 CHAIR: Thank you. Questions for
8 Mr. Watts?

9 MS. RUDD: I wonder if I might just be able
10 to clarify a point that Joie made about TriAct? Can I
11 just speak from here? I will just do it sitting down.

12 In the example that was given where the
13 markets bid 10.25 and offered 10.30 public bids and
14 offers. If a trade happens in TriAct at let's say 10.27,
15 then I don't believe there is any price improvement to be
16 offered to those bids and offers. The bidder has declared
17 that they are willing to buy up to 10.25. They don't want
18 to buy at 10.27. The offering has declared they are
19 willing to sell as low as 10.30, they are not willing to
20 sell as low as 10.27. So I think the matching and trading
21 of orders inside the spread doesn't at all compromise or
22 ignore those bids and offers. They have declared those
23 prices and those same participants have an option to
24 participate in a market like TriAct if they want to bid
25 higher, they can enter an order.

1 On the other issue of market orders that
2 don't have access to TriAct not being able to benefit from
3 the price improvement. That really harkens back to my
4 earlier argument that economic forces should determine
5 who, where there is access and where there is not. If we
6 are not seen as providing value, then participants won't
7 chose to access us and they will chose to miss out on that
8 price improvement. If they want to access our market and,
9 in effect in our case there are no barriers to entry at
10 all, then they can do that very easily and take advantage
11 of the value that we offer.

12 CHAIR: Mr. Watts, do you want to respond
13 and then we can go to a break?

14 MR. WATTS: Sure. First of, Wendy, it is
15 correct the limit orders are setting the price in the
16 marketplace and what is happening is the systems, as does
17 the upstairs institutional market, their pricing off of
18 that and trading in between. But there is, you know, the
19 retail orders that are supposed, you know, everybody talks
20 about trade-through encouraging retail orders. How are
21 they encouraged? They are not offered any opportunity to
22 participate in that print, they are being parasitically
23 priced off of, used to price. And so this argument that
24 somehow if we don't have trade-through that limit orders
25 will be disadvantaged in some way and people will put in

1 less limit orders is incorrect. Limit orders are already
2 disadvantaged in numerous cases.

3 MR. MOORE: Could I just ask a question to
4 make sure I understand your point. Are you suggesting
5 that maybe someone with a limit order of .25, if they
6 could see the sale at .27 might then revise that limit
7 order. Is what your point is?

8 MR. WATTS: Absolutely correct. That is an
9 option, Paul, that an individual when there is full
10 disclosure in real-time post-trade transparency then those
11 limit orders could potentially kill their order,
12 re-evaluate, end up buying at a better price. And the
13 idea that they have been, they have price protection is
14 silly in that simple example that I gave because they are
15 getting filled at 14-and-a-quarter, they are not being
16 offered an opportunity to participate in the print at 14
17 and buy it cheaper.

18 So this is where I come up to the
19 conclusion that trade-through is a bit of an illusion in
20 terms of encouragement of limit orders. The reality is it
21 won't discourage limit orders from being entered. Limit
22 orders are entered by virtue of the very reason that there
23 is no, there is no other alternative. That is really what
24 it boils down to. Limit orders will not be discouraged.

25 Interestingly enough the, what I consider

1 the most robust vibrant efficient marketplace in the
2 United States has never had and certainly doesn't have now
3 a trade-through obligation and that is NASDAQ.

4 CHAIR: Well I think this is definitely a
5 topic to be continued during the coffee break. So, on
6 that note, I just want to thank you for your presentation
7 and we will resume at 3:30.

8 --- Upon recess at 3:00 p.m.

9 --- Upon resuming at 3:31 p.m.

10 SUBMISSIONS BY MR. MIASNIKOF FOR CPP

11 INVESTMENT BOARD:

12 MR. MIASNIKOF: I would like to begin by
13 thanking you for providing the CPP Investment Board an
14 opportunity to comment on the CSA discussion paper. We
15 think that the trade-through obligation is important, it
16 is an important topic to us in meeting our best execution
17 obligations.

18 I am going to skip over the first few
19 slides and the handout and I am going to take you straight
20 to page 3. The first few pages are descriptive
21 information about the CPP Investment Board.

22 So I am going to begin by giving you a
23 brief overview of our position and then I will go right
24 into the specifics of each topic.

25 We have chosen to focus our response to the

1 CSA's discussion paper on the following topics: The cost
2 of regulation; locked and cross markets; information
3 leakage and best execution; market fairness; and
4 protection of limit orders; and finally we will say a few
5 words about RS's proposal.

6 CPP Investment Board supports initiatives
7 promoting market fairness and transparency. We support
8 the evolution of market structure when it helps us meet
9 our best execution obligations. We also believe that
10 different market participants have different needs. We
11 believe that innovation is the best way to meet the needs
12 of all participants and we also believe that innovation
13 can be hampered by complex regulation.

14 CPP Investment Board does not support the
15 imposition of the trade-through obligation because it will
16 increase the cost of transaction -- the cost of
17 transacting, it may stifle the development of alternate
18 marketplaces, it may expose participants to information
19 leakage, it is a clear obstacle to best execution and it
20 provides no demonstrated investor protection.

21 A few words on the cost of regulation.
22 Regulation always involves costs whether they be
23 operational, legal, technological, compliance and so on.
24 They may stifle the development of alternate marketplaces
25 and future innovation provided by these alternate

1 marketplaces may address problems that are not currently
2 addressed by the market structure or by the current
3 regulatory regime. And, more importantly, in the absence
4 of a well-documented problem authorities should generally
5 avoid regulation unless it is absolutely necessary.

6 Locked and cross markets. Locked markets
7 rarely occur. When they occur it is a temporary
8 situation. We have ample evidence from cross-listed
9 NYSE/TSX stocks. And those stocks are almost never
10 locked, despite the lack of regulation to that effect.

11 Cross markets are even rarer and even
12 shorter lived because arbitrageurs make a living off of
13 taking advantage of cross markets and contributing to
14 market efficiency and market information, information
15 dissemination.

16 Information leakage, I put out an example,
17 it is a hypothetical example. Suppose that I am an
18 investor wishing to buy a 100,000 shares and I am faced
19 with the following order book. I can see 25,500 shares --
20 it is a completely hypothetical example. And now suppose
21 that on an ATS or over the phone on any upstairs market, I
22 find a counterparty that is willing to sell me the shares
23 for 10.31. Now, with the trade-through obligation, I have
24 to transact with all these parties which offer more
25 advantageous prices before I can enter into an agreement

1 with my party upstairs. This delays simple and efficient
2 upstairs or ATS negotiation because of this obligation to
3 take out liquidity on all markets before entering into a
4 price agreement.

5 This obligation to take out all more
6 favourably priced liquidity signals the existence of a big
7 buyer in this case, or a big seller if I was selling, to
8 the rest of the market resulting in higher prices for
9 everyone. And, additionally, the order needs to be broken
10 up. The original counterparty, this is a rare case. But
11 the original counterparty may no longer be there, may no
12 longer be willing to transact because he really wanted to
13 get rid of a 100,000 shares not 75,000.

14 A trade-through obligation is an impediment
15 to best execution. You have heard this a few times today,
16 best price is not best execution. Best execution
17 simultaneously minimizes cost and risk for a given level
18 of risk tolerance over a given trading horizon. Best
19 execution is specific to each investor because each
20 investor has a specific tolerance for risk and each
21 investor is willing to trade off costs for risk at a
22 different rate.

23 Now the set of all best execution
24 strategies, the set of all lowest cost/risk combinations
25 is defined by the efficient trading frontier, this is an

1 idea that was put forward by Neil Chris and Robert Altman.
2 Robert Altman is actually here at the University of
3 Toronto.

4 So if you look at the graph at the bottom
5 of page 7, you have an example of an efficient trading
6 frontier there. The reason why an investor may pick
7 trading strategy A or trading strategy B or any other
8 point along that curve, and all the points along that
9 curve are best execution strategies, depends on the
10 investor's risk aversion, his tolerance and appetite for
11 risk.

12 A risk adverse investor will transact
13 faster, incur more cost and reduce risk exposure. In this
14 case a risk adverse investor would be towards the left
15 side of the curve, the top left-hand side of the curve.

16 A risk tolerant investor will trade slower,
17 will minimize market impact, may take advantage of an
18 expectation of more favourable prices, he may have a view
19 on the stock, but he is exposed to more risk. A more risk
20 tolerant investor would be somewhere, would pick a
21 strategy, if he were completely efficient in his trading,
22 along this curve, along the lower left-hand side of the
23 curve.

24 And where does this, where is this relevant
25 to trade-through? Well investors may wish to trade at a

1 less favourable price in the interest of prompt
2 completion. So somebody would be towards the top
3 left-hand side somewhere around A or maybe higher on that
4 curve.

5 Let's go back to our example. Again, I am
6 an investor who needs to buy a 100,000 shares, and I am
7 looking at the same order book I was looking at a few
8 minutes ago.

9 Now, again, suppose that I find somebody
10 willing to sell me the 100,000 shares at 10.31. It is
11 completely plausible that I may wish to do so and it is
12 not irrational for me to do so because I get order
13 completion. The order is completed sooner and I have
14 reduced my price impact because the cost of actually
15 transacting a 100,000 shares on the market, regardless of
16 how I break it up, will most likely be higher than one
17 penny, and I have locked in my price, I haven't moved the
18 market. Now in this case, we can say that I bought
19 immediacy for one penny. And a trade-through obligation
20 would destroy this market for immediacy and, therefore, be
21 a clear impediment to best execution.

22 It is important to remember that in the
23 case of a rational investor, trade-through will only occur
24 in the event that parties seek to complete a large order
25 very quickly. In this case there is no reason why I would

1 trade, trade-through if my order was below 25,500 because
2 I could get a much better price, so there is no reason for
3 that. And, in general, I know the gentleman from the TSX
4 earlier today said that there were examples of this, but
5 in general, a rational investor would not trade-through if
6 he could get a better price elsewhere.

7 The incentive to place limit orders. As
8 illustrated in our previous example, the trade-through
9 only occurs when the order exceeds all visible liquidity.
10 The limit orders that were traded through in our
11 hypothetical example did not offer the necessary liquidity
12 to attract the liquidity that -- to attract the parties in
13 this transaction. And the trade-throughs, in fact, do
14 contribute to price formation in same way as do limit
15 orders or market orders.

16 Trade-throughs are not given preferential
17 treatment. They demand liquidity and liquidity has a
18 price. Large orders allow the true price to be discovered
19 because large amounts are transacted at a price that is
20 away from the prevailing price. Basically people are
21 willing to put their money where their mouth is and
22 because of this trade-through benefits all parties on the
23 other side. So if I am buying or if I am selling -- if I
24 am buying at a price that is above the most favourable
25 price on the TSX, for example, well I will end up pushing

1 up the market most probably; we would expect to see that.

2 And especially in the case of illiquid
3 stocks, large trades contribute to the long-term price
4 formation and often become reference points many days
5 after the trade occurred simply because those stocks are
6 illiquid and the price formation mechanism doesn't work
7 very well.

8 Let's look at a hypothetical example of
9 trade-through on page 11 in the bottom slide. Suppose
10 that, again, we are looking at the same, same hypothetical
11 order book and suppose that a trade-through occurs for a
12 100,000 shares at \$10.35. Now we would expect that once
13 this trade-through occurs the price is reported, we would
14 expect all sellers to discover the true price because,
15 again, a large amount of stock was transacted at that
16 price so it helps us discover the true price, and adjust
17 their limit orders and eventually potentially get better
18 prices on their sells. And the same argument could be
19 made for a buyer, but...

20 Now I have given you hypothetical examples,
21 and I have two examples of real-life trade-throughs in
22 which CPP Investment Board was involved, and I will show
23 you that what I have shown so far in the hypothetical
24 examples is not that farfetched.

25 On September 21st, 2005 at 12:06 and nine

1 seconds, we sold 25,000 shares at 15.62, an order that
2 represented roughly 20 per cent of the average daily
3 volume in that stock. At the time there were 1,300 shares
4 that were priced at more favourably. And in this case the
5 buyer was willing to transact with us because he got 20
6 per cent, roughly 20 per cent of the average daily volume,
7 which is a huge amount. And what happened? At 12:08:12,
8 500 shares were transacted at 15.59. So, in fact, we did
9 push up the market by revealing what the true price -- or
10 what the true price may be.

11 Again, in the same vein, same amount again
12 roughly 20 per cent of the average daily volume was
13 transacted roughly three minutes later. At the time there
14 were 1,100 shares that were more favourably priced. What
15 happens to the TSX order book? Well 700 shares get
16 transacted between 15.60 and 15.61 at 12:37. So again we
17 see that the two successive trade-throughs pushed up the
18 price, at 12:08 it was 15.59 then it went to somewhere
19 between 15.60 and 61. So in the case it would be fair to
20 say or fair to assume that true economic price was above
21 what was quoted on the TSX. And the trade-through did
22 contribute to this true price discovery.

23 Now a few words on RS's trade-through
24 proposal and I will wrap up. RS's trade-through proposal
25 leaves many unanswered question. There doesn't seem to be

1 any cost benefit analysis of the proposed regulation. The
2 practical implications are not addressed and, most
3 importantly, it addresses a problem that we don't even
4 know exists; it is a completely undocumented and
5 hypothetical problem.

6 So, in summary, we believe that no
7 regulation should be imposed without a well documented
8 problem. Trade-through regulation would impose unnecessary
9 costs, stifle innovation without enhancing investor
10 protection. Trade-through obligation is an impediment to
11 best execution. The trade-throughs enhance the price
12 discovery mechanism and trade-throughs are not unfair and
13 do not free-ride and, on the contrary, they benefit all
14 opposite side liquidity.

15 CHAIR: Thank you. Does anybody have
16 questions? I think we are petering out at the end of the
17 day here.

18 MR. BATES: I will ask.

19 So, Peter, what would you have done if this
20 facility had not been available to you?

21 MR. MIASNIKOF: Well if we hadn't traded
22 those shares in this case, it would have taken more time
23 to execute. Most probably would have ended up paying more
24 because, A, being exposed to more risk because the trade
25 would have taken longer and, B, because this trade was

1 done outside of the market, relatively low market impact.
2 The market, we would have ended up displacing prices by
3 our size.

4 In one of the slides that I skipped, I give
5 you an example on page 3 of the size of the CPPIB's
6 trades. 13 per cent of our trades in Canada, and this is
7 a typical month, exceeded 500 per cent of the daily
8 volume. So it would have taken a long, long time to
9 complete -- a much longer time to complete this trade,
10 this particular trade.

11 CHAIR: Any other questions?

12 MR. BOISVERT: Just a quick one. You said
13 a problem that you had if you had to displace the market
14 that it would be information leakage and the market would
15 move probably by the time you execute your full size --

16 MR. MIASNIKOF: Not only that. It is that
17 when you sell large amounts or buy large amounts, there
18 are two components. First of all, you reveal information
19 so people know that there is a big player and they will
20 try to take advantage of you. The other point is that
21 you, even without this dynamic, the fact that you demand
22 or glut the market with additional liquidity pushes the
23 price up or down.

24 MR. BOISVERT: But solving the -- if the,
25 if you did the transaction at the price you wanted and

1 then the obligation was to clear out the book ex post,
2 would that solve that issue or basically --

3 MR. MIASNIKOF: -- well in this case, in
4 this case we were the seller so it was actually the other
5 side that was in a rush to get this trade done.

6 In the case of this other side, well, in
7 both cases, in one case he only had or she only had 1,100
8 shares visible and 1,300 that were at a better price. And
9 and in one day this party traded, just with us, 40 per
10 cent of the average daily volume. So I don't think that
11 having a more visible, like for instance, I am assuming
12 you are saying if we didn't allow stuff like icebergs, I
13 am not sure that 40 per cent of average daily volume would
14 be visible at any given time.

15 MR. MOORE: I am just curious. We have
16 heard a lot today about the US market being very imperfect
17 because they allow trade-throughs and Canada's such a
18 terrific market because it didn't allow trade-throughs up
19 until very recently. What is your experience in the
20 United States? I presume you a big player in the United
21 States as well.

22 MR. MIASNIKOF: Yes. The US market, in
23 general, is more liquid. I think that it's, it is a very
24 common theme in Canada where we always think we are better
25 than the big bad Americans; I am not so sure that is true.

1 CHAIR: Well thank you very much.
2 MR. MIASNIKOF: Thank you very much for
3 your time.
4 CHAIR: Our next presenter is on the screen
5 with Doug Steiner with Perimeter.
6 SUBMISSIONS BY MR. STEINER FOR PERIMETER
7 FINANCIAL CORP. VIA VIDEO-LINK.
8 MR. STEINER: Thanks. Can you hear me
9 okay? Thank you very much for letting me speak to this
10 group today on the CSA discussion paper.
11 The company I represent, Perimeter
12 Financial, has a clear and well-defined mandate to build
13 and offer financial infrastructure that makes the
14 securities market more efficient for investors. Our
15 shareholders represent a cross section of diverse and
16 significant capital market participants. We started with
17 a clean slate of paper and are not trying to protect an
18 existing business. We think this is unique amongst the
19 intermediaries that were represented at your conference
20 today.
21 My comments today will focus not only on
22 the discussion of the efficacy of trade-through but its
23 use and context and the general lack of focus by industry
24 participants and in particular the dealers and the
25 regulatory infrastructure in dealing with the first

1 principles of investor fairness. In short, we believe
2 trade-through rules are simply a diversion and an excuse
3 not to focus on larger issue in investor fairness.

4 Markets for commodities evolve and grow
5 because users are satisfied with their characteristics.
6 The most primitive markets around the world offer and sell
7 market-based commodity products daily and exist in every
8 single country in world.

9 I have visited these markets in many places
10 as diverse as Mexico, Africa, Vietnam, China, Canada and
11 many countries in Europe. In all you will notice all
12 similar characteristics. The users of these markets,
13 primarily daily shoppers for food, know that by and large
14 prices are close to or equal for items of equal value.
15 There is haggling allowed to a greater and lesser extent
16 and there are always discounts based on volumes.

17 There is no law that says you have to take
18 the lowest priced product; there simply is no need for
19 this law. Most of the people using these markets don't
20 know the first thing in economics and in many parts of the
21 world most are illiterate. Buyers in these markets are
22 well aware of price discrepancies because all sellers
23 state their prices. Sellers respect the privacy of
24 transactions by not jumping over their food stalls to
25 offer a similar priced good at a better price and,

1 conversely, when they see a transaction complete at a
2 price that is significantly different from their own, they
3 don't seek legal remedies; they adjust their prices to
4 compete. And the commodity they are selling is perishable
5 unlike a security.

6 What lets them do this without rules? It
7 is very simple: Customers have full transparency of
8 pricing and transaction information. Markets all over the
9 world respect this dictum, however, for them to work you
10 need accurate data. In the case of the market we are
11 trading in, this is the case.

12 So what does this have to do with
13 trade-through? My belief is that trade-through issue,
14 which was caused by an introduction of a service that our
15 company funded, is an attempt to use the window dressing
16 of public good to protect an existing transaction
17 infrastructure.

18 The reasons for keeping trade-through have
19 all been heard about today. Protection of investors,
20 market integrity, the danger of the public order display
21 disappearing without rules. But behind this lurks a
22 dealing community which has failed in many respects to
23 keep up with client wishes; they are protecting their own
24 interest first.

25 The trade-through issue is a simple

1 economic equation. It focuses on the economic symmetry or
2 rent that can be achieved between the common good in the
3 case the value of the order in a market to buy or sell a
4 security compared with the private value that traders can
5 give their clients by completing a trade away from the
6 market.

7 In the used security world that we live in
8 and we are talking about, the dealers' real reason, in my
9 belief, is they would like to keep an enforced
10 trade-through as simple and can be proven by exception,
11 which I will do.

12 The existence of a market-enforced
13 trade-through rule basis its success on no competitive
14 advantage being given to one player; full stop. Investor
15 interest is a smoke screen. Dealers who support this rule
16 want to make sure that everyone has to play by the same
17 rule. But everyone agrees from an economic standpoint
18 that if there is a dominant player in this arena, this
19 makes innovation practically impossible; and I am sure you
20 have heard this already today.

21 This is because no new entrants with new
22 methods of transacting securities cannot exist until they
23 play by the existing and present security auction rules,
24 they have to play by the existing price display rules, the
25 existing order entry rules and the existing transaction

1 rules. In short, all the rules that exist in the market
2 before they are entrants. A trade-through rule might seem
3 good in sound bites but I believe it does absolutely
4 nothing for clients.

5 Let me go through my reasoning about the
6 speciousness of the trade-through arguments that have been
7 presented you today by telling you not what was mentioned
8 to you but what should have been mentioned to you.

9 We all know dealers overwhelmingly want
10 trade-through for publically or private traded secondary
11 equity transactions, but that's it. They don't want it
12 for anything else. You have to ask yourself the question
13 why that is the case.

14 As well, for their wish itself, their
15 calculation of what constitutes trade-through is missing a
16 very important transaction cost ingredient, probably the
17 single most important transaction cost ingredient for
18 retail investors; the commission that the broker charges
19 the client.

20 If we are going to talk of lower
21 transaction costs, why has there been no mention in any
22 submissions of including the cost of the commission in the
23 trade-through calculation? Why? The answer is simple,
24 including the cost of the broker's commission on the trade
25 forces competition; let me explain.

1 In order to have a trade taken up in a
2 trade-through with the commission included scenario, a
3 high-commission-charging dealer will be forced to tell the
4 client, "the commission made the difference on whether the
5 trade could have been completed, perhaps if the commission
6 had been lower." Do you think dealers want to have that
7 conversation with a client?

8 And if trade-through is so important for
9 dealers, why haven't they filled their own client orders
10 on new issues of the same securities that clients are
11 bidding for on an exchange. Trade-throughs are sanctioned
12 for new issues.

13 If we are going to have trade-through rule,
14 isn't it fair to fill all existing orders on trade
15 relations from exchange limit orders first before dealer
16 gets to sell stock to investors with a 5 per cent
17 commission and a discounted price? If you want
18 trade-through protection add new issues to this process.

19 What about bonds and other savings
20 products? Dealers trade-through clients' orders dozens of
21 times a day. They argue there is no public market for
22 fixed income and they help their cause by not contributing
23 trade prices to any publically available feed. There is
24 no mark-up rules for bonds in Canada and dealers accept
25 bids on bonds made by clients and simply do not reflect

1 them to any other dealers, except through inter-dealer
2 relationships and need never include retail orders.

3 The cost of these trade-throughs of savings
4 products to retail client we estimate at millions of
5 dollars a week, perhaps more than ten million dollars a
6 week. The potential cost of trade-throughs that we are
7 talking about today, may be one-hundredth of that. I
8 could go on.

9 Dealers will counter there is no organized
10 market for these products to offer investor protection for
11 trade-through. But it is the same dealers who have
12 refused to contribute to organized markets currently, who
13 refuse to post quotes publically, who refuse to report
14 trades; now all of a sudden seem to think that the public
15 would be better served if all investors were treated
16 equally in only one market where some competition has
17 surfaced with potentially better mousetraps. This
18 shouldn't be the reason we have new rules.

19 We at Perimeter believe in three basic
20 principles in the market. Number one, fiduciary
21 responsibility to clients' best interest. Two,
22 transparency of quotes and pricing. Three, the ability
23 for investors to choose a venue and a structure that most
24 efficiently serves their needs.

25 Adding rules that force clients in a

1 certain country to trade a certain way while dealers trade
2 cross market for their own account is not being
3 responsible as a fiduciary. Not accessing better market
4 for bonds or selling or buying them because the customer
5 is ignorant about the level of pricing of an instrument is
6 something currently sanctioned and endorsed in the market
7 today; this is wrong and violates the first principles we
8 have made to our clients as dealers.

9 And adding a rule that forces clients to
10 trade up at a price that is "superior" while conveniently
11 ignoring key trading cost, a client commission charge
12 which could be more than 5 per cent of the order value
13 slams at economic dishonesty. Where the real costs are
14 made up or ignored in order to serve their interest before
15 their clients.

16 In conclusion, I believe that if the
17 fiduciary responsibility and duty of a dealer is actually
18 enforced rather than paid lip service to, that before we
19 start laying out rules in engagement in a market that we
20 believe already is fair, securities markets traders will
21 instantly commit hundreds of millions of dollars keeping
22 markets within one cent of each other, then we will have a
23 fair market for investors without a rule needed, just like
24 other markets that work so well around the world.

25 Why do we need a trade-through rule? Is it

1 because my mother-in-law missed a fill on a hundred shares
2 of Dell because of a trade-through of five cents or a
3 five-dollar disadvantage? Or is it really because the
4 dealer doesn't want to tell will her why she has to pay a
5 minimum commission a \$110 on that exact same trade when
6 she can do it for \$9 somewhere else? This is
7 trade-through rule as proposed. This is wrong, it is
8 dishonest and it not in the investors' best interest.

9 The Commissioners and the market regulators
10 listening at this conference have to tease out self
11 interest from market good. They have to decide what the
12 real problems are from the scaremongering and making a
13 rule that will scare investors from dealing in any other
14 way except what dealers think is good for their clients
15 and that is not the way to do it.

16 And if you really believe that fiduciary
17 duty should be held up as a first principle and that
18 trade-through is the best way to enforce this
19 responsibility because you think that dealers are
20 incapable of thinking about themselves before their
21 clients, then I recommend and suggest that you enforce the
22 strictest trade-through rules in the world. And you must
23 do it for new issues, you must do it for bonds, you must
24 enforce trade-throughs for savings products, for insurance
25 products, for foreign exchange transactions, you must

1 enforce trade-throughs for service charges, for interest
2 charges and for management fees; in fact, for everything
3 that dealers offer their clients. Because to do anything
4 else means it is okay to maximize intermediation profit at
5 the expense of clients' interest and it is okay for us to
6 use the cloak of public good to hide the true intention of
7 dealers to keep everything exactly as they want it. Thank
8 you.

9 CHAIR: Well thank you, Doug.
10 One thing is clear in the written
11 submissions, they begin by saying they have strong beliefs
12 on many aspects of this debate. And I think that Doug's
13 impassioned remarks underscore that. Does anybody have
14 questions for Doug?

15 MR. MOORE: Doug, you are at the end of the
16 day. We have asked our questions, I have no further
17 questions but thank you for the presentation. We have had
18 many questions. I found your presentation intriguing,
19 interesting, provocative and perhaps when we study it
20 further we might agree with all or part of it.

21 MR. STEINER: Thank you.

22 CHAIR: Thanks, Doug. Did you want to stay
23 on for the next presentation?

24 MR. STEINER: You talking to me?

25 CHAIR: Yes. There is another presentation

1 to come and it is Regulation Services, so I didn't know if
2 you wanted to stay.

3 MR. STEINER: I would like to listen to it.

4 CHAIR: I didn't want to cut you off if you
5 wanted to stay on.

6 MR. STEINER: Thank you.

7 CHAIR: You are more than welcome. I guess
8 last up we have Market Regulation Service Inc.. And
9 appearing for them we have Tom Atkinson, Rosemary Chan,
10 James Twiss and Doug Harris. So welcome to all of you.

11 SUBMISSIONS BY MR. ATKINSON, MS. CHAN, MR.
12 TWISS & MR. HARRIS FOR MARKET REGULATION SERVICES INC.:

13 MR. ATKINSON: I knew I was following Doug
14 so I needed to bring some firepower with me.

15 Well I know it is late in the day and we
16 will try and be as quick as we can. Thank you Susan, good
17 afternoon everybody. I am pleased to have this
18 opportunity to speak to you today as part of RS'
19 participation in the Canadian debate on trade-through
20 obligations. So with me this afternoon is: Rosemary
21 Chan, Vice-President of Market Policy and General Counsel;
22 James Twiss, Chief Policy Counsel; and Doug Harris, who is
23 Director of Policy, Research and Strategy. We have all
24 been working on our background work for trade-throughs, so
25 I thought they could answer some questions. They have

1 done some detailed analysis on the trading that has
2 occurred if we need some questions on that.

3 At RS, as you know, our mandate is to
4 foster investor confidence in market integrity through the
5 administration, interpretation and enforcement of the
6 universal market integrity rules. We consider the
7 trade-through obligation to be a central component to this
8 mandate.

9 When this debate started, trade-throughs
10 were a theoretical possibility. Many predicted that they
11 may not happen -- that they would not happen. Now we have
12 some facts. Since the launch of BlockBook ATS in August,
13 trade-throughs by institutional investors are happening
14 and happening frequently. As of yesterday's close more
15 than half of all trades on BlockBook, as Judith has told
16 us, were trade-throughs and over 48 per cent of the
17 trading by volume and value on BlockBook has been
18 trade-throughs.

19 Almost overnight trade-through has become a
20 reality in the Canadian equity market. It is within this
21 context that I will address four key aspects of the
22 trade-through debate in my presentation today. First, I
23 will explain why RS believes that investor protection
24 especially for retail investors who provide liquidity by
25 placing limit orders should be the primary concern of

1 regulators. Also, we believe that we need trade-through
2 obligations that benefit investors on Canadian
3 marketplaces.
4 Second, I will give you some data about the
5 trading on BlockBook and its impact on the limit orders on
6 the TSX.
7 Third, I will comment on the question how
8 to implement trade-through protection. RS believes that
9 the decision between the two alternatives should be made
10 with the benefit of concrete independent data on the
11 direct and indirect cost and benefits associated with each
12 alternative. This data should be collected as part of the
13 present CSA review.
14 The market-level solution does appear to be
15 attractively straightforward. But RS has identified a
16 significant qualification to the way it has been proposed
17 in the discussion paper; that is, that any
18 marketplace-level obligation would have to be supplemented
19 -- and Susan you eluded to this earlier -- with a parallel
20 obligation on market participants for their trading
21 outside of Canada. This will result in regulatory
22 duplication and additional costs. There are also real
23 concerns about whether the marketplace-level solution
24 would create a barrier to entry for new marketplaces.
25 Finally, I will argue that there is a

1 continued need for interim trade-through protection while
2 you consider these important issues. We remain convinced
3 some form of interim trade-through protection is required
4 to prevent harm to investors and market integrity.
5 Now the CSA discussion paper proposes a
6 number of regulatory objectives relating to competition,
7 retail participation in the market, order interaction, and
8 displayed depth and innovation. While these matters are
9 of concern to all market participants, RS believes that
10 the first priority of market structure regulation is to
11 protect investors by promoting market integrity. In this
12 case, market structure regulation should protect investors
13 and markets from the adverse effects of trade-throughs.
14 We are strongly in favour of competition
15 and innovation in the Canadian market. However, we
16 believe that competition and innovation should be pursued
17 only to the extent that they are compatible with the goals
18 of investor protection and market integrity. As one
19 commentator put it, competition must be based on robust
20 standards of fairness and market integrity and innovation
21 should not be bought at the expense of fairness.
22 In fact, of the comments you received seven
23 argue that trade-through obligations promote fairness and
24 market integrity. So what are the implications for
25 investors if trade-through is permitted? Trading-through

1 is unfair to investors and it is bad for markets. It
2 hurts investors who place limit orders. Limit orders are
3 a necessary component of efficient liquid markets. They
4 provide liquidity and depth to a market which improves
5 market quality for all investors.

6 Investors who place limit orders provide
7 what some call a "free option" to other market
8 participants who may elect to trade with the displayed
9 limit orders or at any time to exploit the liquidity that
10 those limit orders offer. If the limit order is traded
11 through, the investor who placed the order loses that
12 opportunity to trade and so may gain nothing from placing
13 the order and bears increased risk that the order may not
14 get filled.

15 The risk is to the market that investors
16 who find their limit orders being regularly traded through
17 may be less likely to place them in the future. As fewer
18 limit orders are placed by investors, market quality
19 declines for all investors.

20 Investors placing market orders and
21 negotiating block trades will be less confident that the
22 market price represents an accurate benchmark.
23 Furthermore, trade-through obligations best protect those
24 aggressive limit orders that narrow the spread for
25 particular security. And tighter spreads benefit all

1 investors.
2
3 Canada's smaller markets which face
4 constant competition from the US can't afford the loss
5 of this important source of liquidity. Particularly at a
6 time when the US is moving to enhance the protection of
7 limit orders under Regulation NMS.
8 Efficient and effective price discovery is
9 particularly important in Canadian markets which are
10 comparatively less deep and liquid than US markets. So
11 trading through increases the risk to individual investors
12 and deteriorates the price discovery mechanism. Is that
13 what we thought would be a consequence of competition and
14 innovation in the market?
15 There are other important values at stake
16 in this debate. First, RS believes that regulation should
17 be marketplace neutral. That means that trade-through
18 obligations and the investor protection they provide
19 should apply equally to trading on all marketplaces.
20 Second, RS believes that regulation should
21 create a level playing field among market participants.
22 This means that dealers and investors, including access
23 persons, should be subject to the same trade-through
24 obligations when trading the same securities.
25 In other words, those who have access to
both retail and wholesale markets for securities should

1 not be permitted to decide on a trade-by-trade basis,
2 whether to trade with or to trade-through public limit
3 orders.

4 Our current rules do not achieve either of
5 these objectives. As it stands now, only the dealers are
6 subject to trade-through obligations. Institutional
7 investors trading on their own behalf using ATSS are not
8 subject to these obligations. This creates an obvious
9 opportunity for regulatory arbitrage. A buy-side firm can
10 avoid trade-through obligations simply by trading on an
11 ATS. Whereas if the same order was placed on either the
12 regular or upstairs market through a dealer, there would
13 be trade-through obligations; this is not marketplace
14 neutral regulation. Instead it results in regulation
15 driving trading behaviour.

16 In addition, dealers trading as principals
17 are subject to trade-through obligations while
18 institutional investors trading on their own behalf are
19 not. This doesn't represent a level playing field for
20 market participants. That is why we believe that each
21 person with access to the Canadian equity markets should
22 be subject to the same trade-through obligations
23 protecting investors in a way that is marketplace neutral
24 and that creates a level playing field among market
25 participants.

1 So what has been our experience with
2 trading-through in Canada? Previously it wasn't possible
3 to trade-through on Canadian marketplaces because there
4 weren't multiple marketplaces trading the same security
5 and the marketplaces themselves prevented intra-market
6 trade-throughs.

7 That changed, first of all, when two
8 securities began trading on the TSX venture exchange as
9 well as CNQ and again when BlockBook began trading all TSX
10 listed securities. Since then, there have been instances
11 of trading-through on TSX venture and CNQ. Now this is a
12 result of having one stock with two different symbols; it
13 is a technical glitch, we can fix this over time. We are
14 not so concerned about that.

15 We are much more concerned about the
16 experience on BlockBook over the last several months
17 because this has significant implications for market
18 structure. Respective ATSS told us that based on various
19 studies undertaken in the United States -- and I know they
20 told you this too -- that between 90 and 98 per cent of
21 the trading on ATSS would take place within the context of
22 the prevailing market prices in which case no
23 trade-through obligations would arise. Even in its
24 comments CPP Investment Board stated, trading-through the
25 market will only occur in rare cases of large and urgent

1 institutional trades. I think the facts so far speak
2 otherwise.

3 Between the launch of BlockBook in August
4 and the close yesterday, there were 34 trades on
5 BlockBook; more than half these trades traded through
6 better priced orders on the TSX. Since BlockBook launched
7 48 per cent of its trading by volume trade-through better
8 priced orders on the TSX and 49 per cent of its trading by
9 value traded-through the TSX. Those trades resulted in
10 102 better priced orders being traded through, an average
11 of more than five better priced orders for each
12 trade-through. I think there was four trade-throughs
13 alone yesterday, one of them at 28 cents off the bid. The
14 implications are that BlockBook activity are serious.
15 BlockBook has a minimum trade size of 25,000 shares. It
16 is a marketplace for large block trades.

17 So let's look at the TSX. In last week
18 there was over 6,600 trades of 25,000 or more shares on
19 the TSX. That is over 582 million shares with a value of
20 over ten million. So I don't want to be alarmist, but
21 what do you think would happen if we say, let's say, a
22 quarter of that trading was allowed to trade-through
23 better priced orders? How can we say that trading-through
24 on BlockBook is acceptable if we aren't prepared to say
25 the same thing for other market places and accept the

1 consequences of that decision?

2 The majority of the orders that were traded
3 through were client orders and the average size of those
4 orders is smaller than the TSX average, which would
5 include retail orders. Who is responsible for this
6 activity? Clearly institutional investors are taking
7 advantage of a regulatory gap that allows them to
8 trade-through on BlockBook. All but one of the
9 trade-throughs were by institutional investors. This is
10 regulatory arbitrage and it is happening despite the
11 heightened scrutiny that trade-through issue has attracted
12 in connection with the BlockBook launch.

13 The trading activity on BlockBook has shown
14 that institutional investors will engage in regulatory
15 arbitrage and will take advantage of the regulatory gap.
16 And we have heard from more than one buy-side firm that
17 they will have no choice but to take advantage of the
18 opportunity to trade-through if its competitors are doing
19 so. Meaning that trading-through will only increase as
20 time passes without a regulatory response. RS, therefore,
21 supports trade-through obligations that are marketplace
22 neutral, ensure a level playing field for all market
23 participants and that above all protect investors and
24 market integrity.

25 Against this backdrop, I would like to turn

1 now to alternatives for implementing trade-through
2 obligations at the level of market participants versus
3 marketplaces.

4 The comments today have focussed on two
5 issues related to this decision. They are, the relative
6 impact on the two models on innovation and competition
7 among marketplaces and the relative costs of these two
8 models. I will address each of these in turn.

9 As I said earlier, RS strongly supports
10 innovation and competition in the Canadian market.
11 However, they should not be pursued at the expense of
12 investor protection and market integrity. A recent IOSCO
13 report on market transparency and fragmentation identified
14 several benefits of competition between trading venues but
15 also noted that these benefits may be more than off-set by
16 a number of disadvantages including market fragmentation.
17 Based on the analysis that will be set out in its second
18 comment, RS believes that valid arguments relating to
19 competition and innovation do not conclusively decide the
20 issue of whether trade-through obligations themselves
21 represent an unjustified impediment to innovation or
22 competition. Given the other values that are at stake in
23 this debate such as investor protection and the adverse
24 effects of trade-through and market qualify, RS supports
25 the continued need for trade-through obligations.

1 RS believes that the arguments based on
2 competition and innovation are also not conclusive with
3 respect to choice between two alternative methods of
4 implementing trade-through obligations. For example, a
5 requirement to connect to other marketplaces under the
6 market-level solution would impose a cost on new
7 marketplaces that could represent a barrier to entry.
8 On the other hand, that connection would
9 also enable a new marketplace to receive order flow from
10 investors on other marketplaces before it has established
11 critical mass of its own subscribers possibly reducing an
12 obstacle to entry.

13 These are complex issues and there are many
14 trade-offs that have to be considered before the benefits
15 of competition and the negative impact of market
16 fragmentation. That is why we believe a comprehensive
17 cost/benefit analysis should be part of the information on
18 which you base your decision.

19 Turning to the relevant costs of the two
20 models. Many commentators are saying that smart order
21 routing technology is readily available to market
22 participants, and we have heard this today. The
23 technology would result in lower overall implementation
24 costs when compared to requiring marketplaces to develop
25 the necessary infrastructure. Others argue that

1 implementation costs would be minimized if they were borne
2 by a small number of marketplaces. That would be better
3 able to coordinate their efforts as opposed to the cost
4 that would be incurred by a large number of market
5 participants with unavoidable duplication efforts.

6 Finally, while marketplace-level solution
7 is appealing simple, we cannot have a pure marketplace
8 obligation. Instead the marketplace-level obligation
9 would have to be supplemented by a parallel obligation on
10 market participants in connection with their trading
11 outside of Canada. A trading obligation that is
12 implemented at the level of Canadian marketplaces would
13 not affect such trading since there would be no mandatory
14 connection between Canadian marketplaces and foreign
15 markets. RS believes that such an obligation is necessary
16 in Canada given the significance of trading in
17 inter-listed securities on Canadian marketplaces. Trading
18 in US inter-listed securities represented approximately 60
19 per cent of the total trading by value and approximately
20 30 per cent of its total trading by volume on the TSX in
21 '05 to the end of July.

22 Market participants must not be permitted
23 to avoid trade-through obligations by diverting this trade
24 in this US markets. It is, however, unavoidable that the
25 supplementary obligation on market participants would

1 result in that regulatory burden being imposed at both
2 levels under the marketplace-level solution with a
3 resulting increase in the cost associated with that
4 option. That is an aspect of the market-level solution
5 that we cannot overlook.

6 To conclude, RS fully supports the current
7 CSA process. It is critical that the CSA address the
8 trade-through issue in a thorough and thoughtful manner.
9 Let's face it, trade-throughs are happening on Canadian
10 marketplaces. They are no longer a theoretical
11 possibility; today they are a reality. It is going to
12 take six months to a year to fully assess the important
13 market structure issues; let's have some form of interim
14 trade-through protection in the meantime. Whether it is
15 the interim solution we proposed earlier this year or
16 another solution the CSA prefers, it will enable us to
17 help protect investors while we take the time to get the
18 solution right.

19 As I said, RS fully supports the process
20 the CSA has established to examine these issues and we
21 look forward to working with you constructively and
22 cooperatively to address them.

23 Thank you very much for your attention and
24 we would be happy to answer any questions you have.

25 CHAIR: Tom, just before you sit down.

1 Could you just walk us through the interim solution, the
2 overview?
3 MR. ATKINSON: I will let Rosemary answer
4 that one.
5 MS. CHAN: The interim solution would level
6 the playing field --
7 CHAIR: Do you want to come up to the mic.
8 MS. CHAN: The interim solution would have
9 leveled the playing field, currently the obligation to
10 take out better priced orders on a Canadian marketplace
11 before that trade is executed on another Canadian
12 marketplace or off-marketplace only applies to dealers
13 whether acting as principal or as agents. That obligation
14 would have extended to access persons as subscribers on an
15 ATS.
16 The interim solution, as the title infers,
17 was interim. Dealers are able to able to comply with that
18 obligation on BlockBook several ways, as Judith explained
19 earlier. One of those ways is to use a facility in
20 BlockBook itself that would peg the order so that the
21 order would not match if it was to violate the
22 trade-through obligation.
23 So our view was that an access person would
24 be able to utilize that feature of that marketplace in
25 order to comply and there would be minimal costs to doing

1 that. Again, this was an interim solution given the facts
2 of the case and we are obviously willing to look at the
3 long-term solution further with a cost/benefit analysis
4 and other considerations on whether the obligation should
5 continue to apply to access persons or be placed on the
6 marketplace.

7 CHAIR: Okay, thank you. Any questions?

8 MR. MOORE: I have four questions. Tom,
9 I -- we were all handed, I don't know if you were handed
10 it or not but I presume you have this, we were handed by
11 Judith a table showing BlockBook execution summary showing
12 the 34 trades.

13 MR. ATKINSON: Yeah, we have the summary as
14 well.

15 MR. MOORE: And when I look at this I see
16 there were, of the 34 trades, seven were trade-throughs at
17 1 cent from the limit order and some for 2. And 33 of the
18 34 were under 10 cents.

19 I also see that in most cases, I haven't
20 really had a chance to analyse this. But in most cases
21 the market moved within a matter of minutes so that the
22 limit orders that were technically traded-through would
23 have been able to have been satisfied by the other market.

24 So I am saying to myself, where is the
25 harm? Where the harm in this?

1 And I guess, I guess what I really want to
2 be clear about, we did ask you to monitor and we said we
3 would monitor BlockBook to understand what was happening.
4 So although there have been trade-throughs, 34 trades and
5 that is the majority of the trades, more than 50 per cent,
6 I still think that an interim solution may be required if
7 we see real harm happening. And I am just wondering
8 whether you consider that there has been real actual harm?

9 MR. ATKINSON: You know, when I look back
10 on our decision to ask you to implement that. I mean, we
11 didn't have any trading facts. We were just thinking it
12 is a harm that, a potential harm that could be prevented
13 and there was no reason to take that risk.

14 I tell you the way I see it, you know, the
15 view it on a trade-by-trade basis trade-throughs do not
16 involve large dollar amounts. For example, if a better
17 priced order for 1,000 shares is traded-through by 5 cents
18 the amount of the trade-through is \$50. From the
19 perception of the party who traded-through this is the
20 amount that he or she lost by trading at an inferior
21 price. This is the side of the transaction that duty of
22 best execution addresses.

23 The trade-through obligation protects the
24 investor who placed the limit order that was traded
25 through. The harm to the investor is a lost opportunity

1 to trade at the time the trade-through occurred and the
2 increased risk that the investor bears while his order is
3 unfilled. So the question is some of their orders were
4 filled eventually, did that necessarily have to happen?
5 You know, I don't think so.

6 MR. MOORE: No, but we should analyse this
7 to see because if, in fact, on BlockBook -- if, in fact,
8 rather than being taken out by the person doing the
9 trade-through, the limit orders are being filled by the
10 marketplace within a matter of minutes. Then I think we
11 would all say that that probably isn't a terrible case of
12 real harm?

13 MR. ATKINSON: Right. You know, I guess,
14 too what concerns me, I guess, is this is at the time
15 when, you know, there is heightened regulatory scrutiny on
16 what is going on. As you said, CPP told us these things
17 would not happen, you know, everybody else told us it
18 would be 98 per cent in between the spread. We have seen
19 quite a radical divergence from this within the first 34
20 trades. So what is going to happen by the end of next
21 week, I don't know? So it is still that concern about
22 future harm; but I take your point.

23 MR. MOORE: We will continue to monitor.
24 This all goes to the urgency of an interim solution and
25 the urgency to monitor.

1 MR. ATKINSON: Yes, yes.

2 MR. MOORE: My second question is if your
3 proposed interim solution was put in place, how would you
4 monitor trade-throughs as it was based only on those
5 markets to which each participant has access? Wouldn't
6 that present a monitoring question?

7 MR. ATKINSON: Well we're I guess, no,
8 because I think we are regulating all the markets now that
9 are trading equities in Canada. So we could monitor, you
10 know, we could have a monitor between the two. Am I
11 missing something, or?

12 MR. MOORE: Well I guess maybe I am missing
13 something. I was just wondering how you would monitor it
14 if it was only based on marketplace -- I am maybe being a
15 little theoretical here because there are only two
16 marketplaces right now.

17 MR. ATKINSON: Right.

18 MR. MOORE: But if you have to have a
19 monitoring system in place, and I guess you are saying
20 that you would only require the trade-through obligation
21 to apply where a market participant had access to the
22 market --

23 MR. ATKINSON: Right.

24 MR. MOORE: -- not to all markets. The
25 whole market would be --

1 MR. ATKINSON: Yeah, yeah. And please
2 understand, that interim solution is sort of the best we
3 had with the tools we had. You know, our suggestion
4 wasn't -- that was our second choice, right. So, you
5 know, if there is better way like the point Rosemary made,
6 you know, BlockBook has indicated it is going to be so
7 difficult for the buy side to comply when, really, they
8 pull down a window on the screen like the dealers do,
9 press pegged order and and they are inside the spread.

10 MR. MOORE: The third question is, how
11 would you deal with trade-throughs involving foreign
12 markets?

13 MR. ATKINSON: Well I -- you know, that's
14 the problem we mentioned is that, you know, if it is a
15 marketplace solution we are going to have, to also have a
16 participant solution because we don't think you should be
17 able to divert your order to a foreign market to avoid
18 trade-through obligations which was the case in Credit
19 Swiss.

20 MR. MOORE: Okay. And my final question
21 is, as you know in -- it took us about, I don't know how
22 long -- 10 years to come up with our ATS rules and we did
23 specify three or four -- four criteria that we thought was
24 important. I know your submission said that we really
25 were too broad in that focus and you thought we should

1 focus more on the trade-through. But do you believe we
2 can come up with a permanent solution that won't kill the
3 emerging ATS potential?

4 MR. ATKINSON: Yeah, I don't -- to tell you
5 the truth -- I want, I was hoping the ATSS would compete
6 purely on a business model. The fact that they have got
7 an opaque market that they can control market impact. I
8 really didn't think the competition would be in the market
9 integrity rules; that is my concern here. I want them to
10 to compete among, you know, the way orders are filled,
11 quicker markets, you know, different trading modalities, I
12 don't want them to compete on the basis of regulatory
13 arbitrage; and that is the concern.

14 And that's why, I think, innovation, we
15 should be all pushing for this and, you know, I know
16 you've pushed very hard to bring it in and I think you are
17 right on track doing that, we need that competition it is
18 great for our capital markets. But, to me, the basic
19 premise is the investor should be protected first, those
20 are the lines we don't blur but everywhere else is fair
21 game in terms of competition, so...

22 MR. MOORE: This is only a one-day forum
23 and obviously we are going to be continuing this
24 discussion. But one of the things I think we will have to
25 explore is, as I understand it, markets Inc. designed

1 their system to compete with the upstairs market.

2 MR. ATKINSON: Right.

3 MR. MOORE: And so there are considerations
4 we want -- and it is not just Markets Inc. but other ATSS
5 that may come forward -- we want to make sure that any
6 solution we have doesn't, in effect, throw out the
7 possibility of new marketplaces coming forward.

8 We have heard one type of marketplace that
9 is going to come forward that doesn't have a problem. But
10 two others that say they do have a problem, so. Thank you
11 very much, we will be in touch.

12 MR. ATKINSON: And I just want to thank the
13 Commissioners because I think this is great forum. I
14 think the submission by everybody were very good today and
15 we are really looking forward to working with your
16 talented team on a final conclusion to this.

17 CHAIR: Tom, I just had one question for
18 you. You heard what Doug had to say before you made your
19 presentation?

20 MR. ATKINSON: Right, yes.

21 CHAIR: And do you have any reaction to the
22 comment that he makes, I mean it's, you know, you hear so
23 many different perspectives on these issues and obviously
24 the reason it is a such a complicated issue is that there
25 is so many difference angles to it. And someone else

1 referred to it as self interest and maybe there is some of
2 that. But the reality is as long as you are getting all
3 the self-interested points of view on the table; it is
4 only when you are getting one self-interested point of
5 view is when you can get into trouble. So I think the
6 fact that we are hearing all of those points of view is a
7 good thing, regardless of what the motivations might be.

8 But just what occurred to me as I was
9 listening to Doug, is we have been focussed on a fairly
10 narrow -- in the context of we frame this as market
11 structure and the trade-through rule. And I think what
12 Doug is pointing out is that, you know, to really just
13 focus on this trade-through obligation and to be so
14 concerned about the price protection in the context of
15 only the equities market and only in the context of this,
16 you know, very narrow kind of market structure that we
17 have versus what about new issues? What about derivatives?
18 What about fixed income? What about all these situations
19 where trade-through occurs all the time, in fact, a lot
20 worse than trade-through occurs according to what Doug has
21 to say. What do you say to that?

22 MR. ATKINSON: I think we should be
23 exploring these issues for sure. I am glad he raised it.
24 My only concern is, you know, it is a continuing debate
25 with our policy group is, you know, the market is

1 continually changing, the US is changing its rules. We
2 have got to make a decision at certain points in time and,
3 you know, next we will be dealing with best execution and,
4 you know, our decisions are going to be, you know, they
5 may be right for the time but that decision may be wrong
6 at a future date, but we still have to start making some
7 decisions and I don't think we will every get the Utopian
8 answer.

9 But I think these are things we should be
10 looking at as we go down the line. I don't see any
11 problems, I think they should be raised. Again, our
12 premise is we should be rooting out any unfairness to
13 investors.

14 And just going to your comment about Doug's
15 comment about the bias, you know. I, you know, we have
16 fairly thick skins as regulators, but I find when we are
17 dealing with the dealers they always like us until we lay
18 those charges and then we are biased for some reason and
19 we get that whenever we make an unpopular decision. But
20 we trying to do our best. We have buy side, we have
21 markets, we have ATS representation on our board, 50 per
22 cent independent directors, dealers have two seats on our
23 board out of 11.

24 So we have put all those safeguards in
25 place, we do our best, make our best calls and you are

1 going to have to take that for what it is worth.

2 CHAIR: Thank you very much. We would like
3 to thank RS for their contributions which have been many
4 to this debate and will continue to be. Obviously will be
5 talking to you about these issues. I think that pretty
6 much wraps it up for all of us.

7 MR. MOORE: I would just like to say, I
8 would like to thank as well, Susan said this, but I think
9 the quality of the written material was terrific and the
10 quality of the submissions were very, very good as well.

11 We had questions for you, and I think there
12 will be additional questions once we analyse and
13 understand better some of the submissions that have been
14 put in. So thank you very much.

15 And also, I know you are going to be
16 putting in written submission. Many of you have indicated
17 that you will be putting in written submissions by October
18 20th, so I certainly look forward to reading those as
19 well.

20 CHAIR: Well it just remains to wrap it up
21 and I would like to thank you all for coming. Thank you
22 for your contribution. I know it has been a long day but
23 I know that I speak for all of us on this panel by saying
24 we have really benefitted a lot, as I know the staff has.
25 And obviously I also want to thank the staff for what they

1 have done to prepare this day and make this happen, and I
2 think, as I say, we have got a lot to think about and we
3 will be in touch with many of you but thanks again, very
4 useful, and we appreciate it.
5 --- Whereupon matter adjourned at 4:34 p.m.

6
7 I HEREBY CERTIFY THE FOREGOING
8 to be a true and accurate
9 transcription of my shorthand notes
10
11 to the best of my skill and ability.
12

13
14 Lisa Baker
15 Computer-Aided Transcription

