

The Ontario Securities Commission

# Trade-through Protection, Best Execution, Access to Marketplaces and the Consolidation of Data

## Supplement to the OSC Bulletin

April 20, 2007

Volume 30, Issue 16 (Supp-3)

(2007), 30 OSCB

The Ontario Securities Commission Administers the  
Securities Act of Ontario (R.S.O. 1990, c. S.5) and the  
Commodity Futures Act of Ontario (R.S.O. 1990, c. C.20)

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Published under the authority of the Commission by:

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The OSC Bulletin is published weekly by Carswell, under the authority of the Ontario Securities Commission.

Subscriptions are available from Carswell at the price of \$549 per year.

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|                       |       |
|-----------------------|-------|
| U.S.                  | \$175 |
| Outside North America | \$400 |

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# Trade-through Protection, Best Execution, Access to Marketplaces and the Consolidation of Data

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**Trade-through Protection,  
Best Execution, Access to Marketplaces  
and the Consolidation of Data**

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**JOINT CANADIAN SECURITIES ADMINISTRATORS/  
MARKET REGULATION SERVICES INC.**

**NOTICE ON TRADE-THROUGH PROTECTION,  
BEST EXECUTION  
AND  
ACCESS TO MARKETPLACES**

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**JOINT CANADIAN SECURITIES ADMINISTRATORS/  
MARKET REGULATION SERVICES INC. NOTICE ON TRADE-THROUGH PROTECTION, BEST EXECUTION AND ACCESS  
TO MARKETPLACES**

**PROPOSED AMENDMENTS TO  
NATIONAL INSTRUMENT 21-101 MARKETPLACE OPERATION  
AND NATIONAL INSTRUMENT 23-101 TRADING RULES AND RELATED UNIVERSAL MARKET INTEGRITY RULES**

**I. INTRODUCTION**

The Canadian Securities Administrators (CSA) and Market Regulation Services Inc. (RS) have prepared this joint notice. As changes to the regulatory framework will result in amendments to CSA national instruments and consequential amendments to RS's Universal Market Integrity Rules (UMIR), the CSA and RS believe that it is important to publish a joint notice to ensure consistency and assist in communication to market participants. Although both the CSA and RS have agreed to the contents of this notice, certain aspects are being proposed by the CSA and others by RS. We have specifically noted whether the CSA or RS is proposing a specific amendment. Where not specifically noted, references to "we" in this notice refer to both the CSA and RS.

The CSA are publishing proposals for comment that would amend National Instrument 21-101 *Marketplace Operation* (NI 21-101), National Instrument 23-101 *Trading Rules* (NI 23-101) (together, the ATS Rules) and the related companion policies. The purpose of the ATS Rules, which were put into place in December, 2001, was to respond to developments in the markets by establishing a framework that permits competition between traditional exchanges and other marketplaces while ensuring that trading is fair and efficient.<sup>1</sup>

Recent market developments have led to a review of the current rules. As a result, the CSA have concluded that changes should be made to the ATS Rules to reflect the current environment.<sup>2</sup> The CSA have focused on the following three key initiatives:

- (1) a "trade-through" discussion, which describes a flexible framework for promoting the value in our markets that all marketplace participants should be treated fairly by requiring all immediately accessible, better-priced visible limit orders, regardless of the marketplaces on which they are entered, to be filled before other limit orders at an inferior price;
- (2) proposed amendments to the best execution requirements, which currently limit best execution to achieving best price, to more broadly describe the factors to be considered in seeking best execution, including price, speed of execution, certainty of execution and overall cost of the transaction;<sup>3</sup> and
- (3) proposed amendments that would establish requirements that must be met by non-dealers to gain access to a marketplace, including that a non-dealer must enter into an agreement with an exchange or a regulation services provider.<sup>4</sup>

At the same time, RS is publishing proposed consequential amendments to UMIR that are necessary as a result of the proposed CSA amendments. RS is recognized as a self-regulatory entity and a regulation services provider for the purposes of the ATS Rules. RS has adopted UMIR as a common set of market integrity principles that apply to all regulated persons in respect of the marketplaces for which RS is the regulation services provider. A regulation services provider provides regulatory services to its members (ATSs) as well as contracts to provide regulatory services on behalf of exchanges. As such, UMIR allows for the competitive operation of equity marketplaces in Canada under a common set of trading rules regulating various trading practices including: manipulative or deceptive methods of trading; short selling; frontrunning; best execution and best price obligations; order entry and order exposure; and client priority and client-principal trading. As the rules of a self-regulatory entity, the requirements under UMIR must be consistent with applicable securities legislation including the ATS Rules.

Part II of this notice reviews recent developments in the equity markets and theories on market structure as well as changes in trading behavior to evaluate whether the current market structure and/or objective should be changed. For background, Appendix A discusses the historical and current theories about how markets should be structured and the regulations that were introduced to promote the objectives that underlie those theories.

<sup>1</sup> See Notices for background at (1999), 22 OSCB (ATS Supp), (2001), 24 OSCB (Supp) and (2003), 26 OSCB 4377.

<sup>2</sup> Amendments to certain other provisions in the ATS Rules were finalized at the end of December, 2006. These amendments extended the exemptions related to government bond transparency and electronic audit trail requirements and re-emphasized the CSA's position on best execution responsibilities in a multiple marketplace environment.

<sup>3</sup> Proposed amendments to National Instrument 23-101, Part 4.

<sup>4</sup> Proposed amendments to National Instrument 23-101, Parts 7 and 8.

Part III considers the proposed regulatory responses and how they are intended to achieve the preferred market structure and objectives (and includes the alternatives that were considered and why they have been rejected). This part includes a discussion of both proposed amendments to the ATS Rules and consequential amendments to UMIR.

## II. RECENT DEVELOPMENTS AND CONTEXT FOR PROPOSED AMENDMENTS

The purpose of the discussion in this part is to review the changes in the equity markets and theories on market structures to consider whether the integrated market structure is still preferred.

### A. The new developments

1. ATSs trading Canadian listed equity securities. Until 2005, ATSs that operated in Canada under the ATS Rules were foreign-based and they did not execute trades in Canadian exchange-traded securities. Trading in Canadian exchange-traded securities only occurred on the TSX, TSX Venture Exchange and, more recently, the Canadian Trading and Quotation System (CNQ).<sup>5</sup> As there are now multiple marketplaces operating in Canada using different execution methodologies to trade the same securities, there are a number of issues to be reconsidered, including whether the objectives and tools<sup>6</sup> regarding competing marketplaces are still relevant. Currently BlockBook, CNQ's Pure Trading, Bloomberg, Shorcan and Liquidnet trade TSX-listed securities and TriAct intends to trade TSX-listed securities upon launch of its operations. Liquidnet also trades TSX Venture securities. The rest of these marketplaces have also indicated that they may extend trading to securities listed on TSX Venture Exchange at a future date.

2. Theories on how markets compete have changed. In the past, the assumption was that the basis of competition for trading was price only. This was supported by rules that stated that best execution is equivalent to best price. We have seen that the introduction of the ATS Rules has facilitated competition and innovation in the Canadian market by accommodating new marketplaces with diverse models of trading. This has included trading facilities which cater to particular niches, such as block transactions and specialized marketplaces where only a subset of participants can gain access (e.g. institutional investors only or dealers only). New trading technologies are being established to enable dealers and non-dealers alike to trade directly on a marketplace.

Marketplaces can now compete by trying to improve upon existing trading alternatives by differentiating on price, cost of execution, liquidity and speed of execution, among others.<sup>7</sup> Regulators have acknowledged this through their reconsideration of issues around best execution to take into account factors other than price.<sup>8</sup>

3. Decimalization. Decimal pricing was introduced in the U.S. in 2001. Although Canada introduced decimalization prior to this date, it moved to penny increments in 2001. The U.S. GAO study on decimal pricing indicated that although the trading costs measured in terms of spreads decreased as a result of decimalization, trading strategies also adapted. Traders adapted by using smaller orders and increasing their use of ATSs because decimalization reduced the minimum tick and lowered the risk for other traders to trade ahead of the larger orders.<sup>9</sup> However, the decrease in the size of limit orders can lead to a less efficient market from the perspective that there is less displayed interest in a security in terms of size and depth of the market.

4. Increasing use of marketplaces with no pre-trade transparency and matching facilities. Uninformed traders value transparency.<sup>10</sup> There is evidence that institutional investors use ATSs when they are informed, and use the upstairs market when they are uninformed. This is supported by the evidence that institutional investors have been increasingly using marketplaces that do not have any pre-trade transparency, i.e., no orders or quotes are available. There are other reasons these facilities are gaining in popularity including concerns over information leakage and anonymity.

Some of these systems are crossing networks that provide opportunities for trading at a point between the bid and ask being shown on a transparent market. Others provide for sequential negotiations until there is a matching in interest. Going dark, i.e., removing information from the book, hampers the incorporation of information into prices. The reduction in transparency or migration of order flow away from the dominant transparent marketplace worsens overall price discovery.

<sup>5</sup> In 1999, the Toronto Stock Exchange, Bourse de Montréal, Vancouver Stock Exchange (VSE) and Alberta Stock Exchange (ASE) entered into an agreement where each exchange would specialize and would not compete for 10 years. The Winnipeg Stock Exchange merged with the entity created by the merger of the ASE and VSE.

<sup>6</sup> For example, any technology or other methods to support the objectives.

<sup>7</sup> Current academic literature shows that marketplaces compete on speed, depth, and anonymity as well as price (Conrad, Johnson and Wahal, "Institutional Trading and Alternative Trading Systems").

<sup>8</sup> See, for example, Concept Paper 23-402 *Best execution and soft dollar arrangements* published on February 4, 2005 by staff of the BCSC, ASC, MSC, AMF and the OSC. The purpose of the concept paper was to set out a number of issues related to best execution and soft dollar arrangements to obtain feedback. See Part III.B of this Notice for discussion of proposed changes.

<sup>9</sup> *Decimal pricing has contributed to lower trading costs and more challenging trading environment* (U.S. Government Accountability Office, May 2005).

<sup>10</sup> "Island Goes Dark; Transparency, Fragmentation and Regulation" (2005) 18 Review of Financial Studies 743-793 at 759.



5. More facilities for internalization. In addition, order management systems have increased the ability of the dealers and large institutional investors to consolidate and match their multiple sources of orders. Such orders are required to be printed on a marketplace, but they are matched within the dealer's or institutional investor's system without going into the book.

In Canada, this trend toward identifying internal matches prior to entry onto a marketplace is the extension of existing marketplace technology that allows "in-house" priority at a given price level. For example, the TSX's trading engine seeks out and gives priority to matching trades of a dealer's clients before matching trades between clients of different dealers.

Internalization raises questions about the value of the information in the book and the price discovery process.

6. Removal of requirements for data consolidation and market integration. In 2001, the ATS Rules identified a number of regulatory objectives that include providing investor choice as to execution methodologies or types of marketplaces and improving price discovery and market integrity. The ATS Rules also set out requirements relating to data consolidation and market integration to minimize any negative impact of having multiple markets trading the same securities, and market regulation rules. Due to the uncertainty of how many and which new marketplaces would develop, the requirements relating to data consolidation and market integration were postponed and an industry committee was struck to specifically consider these issues. In 2003, the ATS Rules were amended to delete the concepts of a data consolidator and a market integrator, based on the recommendation of the industry committee that these concepts were not necessary as a result of best execution requirements for dealers and fair access requirements for marketplaces (which would make information available through information vendors). Although the data consolidation requirement was removed, the ATS Rules still required marketplaces to provide data on orders and trades to an information processor or information vendor. Notwithstanding current obligations, some industry members have expressed concern about the inability or difficulty of complying with best execution and other obligations without an official regulated feed that identifies where the best priced order(s) are located. Also, RS may be required to create its own consolidated feed for regulatory purposes.

## **B. Approaches in other jurisdictions**

1. U.S. developments. There have been recent market structure developments in the United States. On April 6, 2005, the Securities and Exchange Commission (SEC) approved, in a 3-2 decision, Regulation (Reg) NMS which will significantly alter the trade-through rules in the United States.

Historically, trade-through rules were established in the U.S. on a marketplace-by-marketplace basis. Until recently, Nasdaq operated without trade-through rules. The New York Stock Exchange (NYSE) adopted a rule for NYSE-listed securities. Due to the fact that the NYSE was not electronic, the ATSS that traded NYSE securities complained that the trade-through rule put them at a significant disadvantage by requiring them to send orders to the NYSE to meet the trade-through obligations, which meant these orders could be held up for significant amounts of time, diminishing the ATSS' main value propositions of fast and certain execution.

Reg NMS requires trading centers<sup>11</sup> to establish, maintain, and enforce written policies and procedures that are reasonably designed to prevent trade-throughs, and, if relying on one of the exceptions, which are reasonably designed to assure compliance with the exception. To be protected, a quotation must be immediately and automatically accessible. Trade-through protection will apply to the best bid and offer from every type of participant on all of the marketplaces. One of the impacts of this order protection is increased linkages between market centers. Reg NMS includes a number of exceptions from "order protection" obligations, including for: opening or closing orders, crossed markets, benchmark orders where the material terms are not known, intermarket sweep orders, delays in responses caused by systems problems, and flickering quotes.

On March 5, 2007, the Trading Phase of Reg NMS began, which required market centers to be capable of routing orders to other systems. The roll-out of Reg NMS will continue on July 9, 2007, when securities firms will be required to comply with the trade-through provisions of Reg NMS for 250 pilot stocks. All stocks will be introduced on August 20, 2007 with a completion date of October 8, 2007.

2. European developments. The European Union (EU) is preparing to implement the Markets in Financial Instruments Directive (MiFID) as part of its Financial Services Action Plan designed to create a single market in financial services for EU member states. MiFID focuses on best execution and will require all EU jurisdictions to adopt the same policy. For most EU member states, price is not the only consideration in determining best execution. In the United Kingdom, the Financial Services Authority does not have a trade-through rule, whereas the London Stock Exchange does.<sup>12</sup>

<sup>11</sup> "Trading Center" under Reg NMS "means a national securities exchange or national securities association that operates an SRO trading facility, an alternative trading system, an exchange market maker, an OTC market maker, or any other broker or dealer that executes orders internally by trading as principal or crossing orders as agent."

<sup>12</sup> London Stock Exchange Rules 4425 and 4426 for SETSmm securities, Rules 5520 and 5521 for SEAQ securities and Rules 6000 and 6225 for SEATS Plus securities.

### C. Current preferred market structure

Through our consultations and review of recent studies, we have noted that most market participants believe that the ideal or preferred equity market structure is to have integrated marketplaces. Although this does not mean that there would be mandatory linkages between marketplaces, the theory is that, to reduce the negative impact of multiple marketplaces trading the same securities, there should be access to information and orders. The reasons or values in determining the preferred market structure (“objectives”) reflect the following: price discovery, liquidity, competition, innovation, market integrity and fairness.

Most market structure specialists think that lack of transparency and integration are the main reasons for imperfect competition among securities markets and that regulatory changes that increase competition and facilitate integration improve market quality.<sup>13</sup>

We think that there continues to be value in a market structure that promotes the interaction of orders, creates incentives to place transparent limit orders and allows participants to identify and execute against the best available limit orders. Market participants and commentators have described the ideal structure as one that brings together all types of participants in a transparent and efficient manner. Access by different types of marketplace participants requires that the rules are appropriately applied to all participants to promote fairness. The objectives set out above are still relevant. Some reduction in transparency and competition among marketplaces based on factors other than prices does not, in our view, undermine the value of the integrated marketplaces.

### III. PROPOSED REGULATORY RESPONSES

As new marketplaces have now emerged trading the same securities, we are considering whether regulatory responses are necessary to continue to meet the objectives set out above (i.e., price discovery, liquidity, competition, innovation, market integrity and fairness). In order to do that, we have focused on trade-through protection, best execution and access.

Within the multiple marketplace environment, we have identified differences in the way the current rules apply to marketplace participants. For example, the existing UMIR trade-through rule (called the “best price” requirement) only applies to dealers. With new marketplaces offering direct access to non-dealer subscribers, not all participants are currently subject to a trade-through rule.

With respect to best execution, there have been innovations and developments in how marketplaces compete. Specifically, marketplaces now compete on factors other than price and as a result, requirements need to be updated to reflect the current environment. In addition, as noted above, direct access to marketplaces has expanded beyond dealers. This results in non-dealer participants being subject to different regimes depending on how they are accessing a marketplace.

Part A below discusses a proposal for trade-through protection (in the boxed portion), the background, the key aspects of the proposal and the alternatives considered. We are not, however, publishing proposed rules at this time on trade-through. Part B discusses best execution including a description of the proposed amendments to the ATS Rules, the background and the key aspects of the amendments, and consequential UMIR amendments. Part C discusses access requirements for non-dealers including a description of the proposed amendments to the ATS Rules, the background and the key aspects of the amendments, as well as consequential amendments to the UMIRs. Part D discusses other proposed amendments to the ATS Rules.

#### A. Trade-through Protection

At this time, we are only publishing a proposal on trade-through to set out the direction currently being considered, though the issue is not yet settled. As reflected in the comments filed in response to the discussion paper, there are different views and, before publishing specific proposed rules, we would like to solicit feedback about the direction of the proposal.

<sup>13</sup> “Island Goes Dark; Transparency, Fragmentation and Regulation” (2005) 18 Review of Financial Studies 743-793.

**Description of trade-through proposal***General Proposal*

- Require each marketplace to establish, maintain and enforce written policies and procedures that are reasonably designed to prevent trade-throughs (this is similar to the general rule set out in Reg NMS)
- Marketplaces would be required to regularly review the effectiveness of the policies and procedures and take prompt action to remedy deficiencies

*Application*

- Trade-through protection would apply to a “protected order”, when purchasing or selling an “exchange-traded security”<sup>14</sup> (other than derivatives)
- We would consider a “protected order” to be a limit order (other than an “excluded order”) that is displayed and can be “immediately and automatically” executed against
- An “excluded order” would be defined as an order that is subject to a term or condition, where the price cannot be determined at the time of order entry or where the price is determined by reference to prices achieved in one or more derivatives transactions (these would be similar to the current exemptions in UMIR)

*Exceptions – when the trade-through obligation would not apply*

- The order was displayed by a marketplace that was experiencing a systems issue (a “failure, material delay or malfunction of its systems or equipment”)
- The order was identified as an “intermarket sweep order” (a new type of order that would facilitate compliance with these new obligations – see below)
- A flickering quote led to the trade-through

**1. Background**

On July 22, 2005, the CSA published Discussion Paper 23-403 *Market Structure Developments and Trade-through Obligations* (discussion paper).<sup>15</sup> The purpose of the discussion paper was to discuss evolving market developments and the consequential implications for our market, in particular the obligation to avoid trade-throughs (trade-through obligation).

The current rules relating to trade-through protection are in the UMIR administered by RS.<sup>16</sup> In particular, the trade-through obligation is referenced as part of the best price obligation under UMIR. Until recently, no issues arose under the rules because

- there had not been multiple marketplaces trading the same securities in Canada<sup>17</sup>,
- the technology systems of existing marketplaces enforced the best price obligation, and
- only dealers had direct access to the existing marketplaces.

With the establishment of new ATs, the existence of multiple marketplaces trading the same security has refocused attention on the current rules relating to trade-through protection.

RS has been monitoring trading on the marketplaces that it regulates for trade-throughs. At this time, we have insufficient data and experience with trading on multiple marketplaces to come to any conclusions. RS will continue to monitor trading as new marketplaces emerge.

<sup>14</sup> “Exchange-traded security” is defined in the ATS Rules as a security that is listed on a recognized exchange or quoted on a recognized quotation and trade reporting system or is listed on an exchange or quoted on a quotation and trade reporting system that is recognized for the purpose of the ATS Rules.

<sup>15</sup> See (2005) 28 OSCB 6333 for background.

<sup>16</sup> See UMIR Rule 5.2.

<sup>17</sup> See footnote 5.

The discussion paper asked a number of questions to get feedback on what values and rules were important to market participants in the Canadian market. Because of the importance of the issues relating to the trade-through obligation and their potential impact on the Canadian capital markets, the CSA held a public forum on October 14, 2005 to permit all interested parties to participate in discussions relating to trade-through protection.<sup>18</sup>

The CSA received 29 comment letters from marketplaces, dealers, and large, buy-side clients and received feedback on a number of issues identified in the discussion paper where there was often no clear majority opinion and the views on either side of a given issue were approximately split. However, the majority of commenters stated that they believed that all visible orders at a better price should trade before inferior-priced orders; it is this value that serves as the policy basis for a trade-through rule.

Many market participants believe that trade-through obligations are key in maintaining investor confidence and fairness in our markets. It can be argued that trade-through obligations create an incentive for investors to place limit orders on a marketplace as they have confidence that if their order is at the best price, it will be protected and filled before orders at inferior prices. This fosters confidence and encourages more liquidity in the market as well as a more efficient price discovery process.

## 2. Key aspects

Based on the analysis above, we considered a framework to protect all visible, better-priced, immediately accessible limit orders across all marketplaces. Set out below is a summary of the key aspects upon which the proposal is premised.

(a) *An obligation to avoid trade-throughs is part of a duty owed by all market participants to the market in general*

The vast majority of commenters believe that a trade-through obligation is a duty owed by all marketplace participants to the capital markets (and is not based on fiduciary duty). The value in having a rule that provides protection for visible limit orders across marketplaces is that it can promote transparency and perceptions of fairness. The trade-through proposal would in its effect extend to all marketplace participants (dealers and non-dealer participants). This approach is intended to promote price discovery, integration and fairness where there are different types of marketplaces and access.

(b) *All marketplaces would be required to establish, maintain and enforce written policies and procedures that are reasonably designed to prevent trades at prices that are inferior to the price of a visible order on any marketplace<sup>19</sup>*

With respect to where the obligation should be placed (i.e., marketplace or marketplace participant), the commenters to the discussion paper were approximately split between those who believed that the marketplace should be responsible for ensuring that trade-throughs do not occur and those who believed the individual participants should have the responsibility.

We are proposing that a general obligation be placed on marketplaces to establish, maintain and enforce written policies and procedures that are reasonably designed to prevent trade-throughs within and across marketplaces. This would allow the industry to determine how best to implement the necessary changes. The purpose would be to promote price discovery, competition and fairness.

Placing this obligation on marketplaces would require effective monitoring and enforcement of a marketplace's policies and procedures and how they are implemented. At this time, it is contemplated that the CSA would be responsible for performing oversight and enforcing an exchange's compliance with the general obligation (based on the lead regulator model) and RS would be responsible for enforcing an ATS' compliance with this obligation. Depending on how a marketplace complies with its obligations, there may also be a need for oversight of dealers and non-dealers in accordance with the access provisions set out in NI 23-101. In order to ensure consistent requirements and oversight, RS will be implementing amendments that parallel the CSA requirements.

It is important to note that placing the obligation on a marketplace to establish, maintain and enforce written policies that are reasonably designed to prevent trade-throughs does not mean that marketplaces would be required to establish linkages with other marketplaces. Many of the comments received assumed that placing the obligation on the marketplaces would mean mandatory linkages.

We think that there are alternative ways a marketplace could choose to implement its policies and procedures obligation without requiring mandatory linkages. Some examples include:

- Preventing orders from being entered into the marketplace when they are not at the best available prices.
- Preventing orders from being executed if not at the best price.

<sup>18</sup> The transcript of the trade-through forum is published on the OSC website at:  
[http://www.osc.gov.on.ca/Regulation/Rulemaking/Current/Part2/rule\\_20051014\\_23-403\\_trade-through-forum.pdf](http://www.osc.gov.on.ca/Regulation/Rulemaking/Current/Part2/rule_20051014_23-403_trade-through-forum.pdf).

<sup>19</sup> The term "marketplace" refers to a Canadian marketplace (either an exchange, quotation and trade reporting system or ATS).

- Providing price improvement so that the transaction is executed at the same or a better price to that available on another marketplace.
- Requiring participants to take certain specified actions or to more generally confirm their own policies and procedures.
- Allowing the entry of “intermarket sweep orders” (as defined below).
- Establishing voluntary linkages (direct or indirect through an entity that has access to other marketplaces) to the other marketplaces to route orders to the best available visible limit orders.

Although the obligation to establish, maintain and enforce written policies to prevent trade-throughs would rest with the individual marketplaces, the decision about how to implement the requirement would be a choice and an opportunity for marketplaces to differentiate themselves and their services. The policies adopted by an individual marketplace may differ; however, the end result is intended to be the same for all marketplaces - the minimization of trade-throughs.

We would like to specifically request comment on the need to also impose an obligation on marketplace participants regarding execution of an order on a foreign marketplace. If the trade-through obligation is imposed at the marketplace level, the requirements of any marketplace would not be effective in preventing a market participant from trading through better-priced orders on a Canadian marketplace by directing its trading activity to markets outside Canada. The protection of better-priced orders on a Canadian marketplace may be necessary given the significance of securities listed on a Canadian exchange that are also inter-listed or traded on an organized regulated market outside of Canada. Trading in such securities represents a much larger percentage of trading on Canadian marketplaces than it does on U.S. markets like the NYSE. The fact that the Reg NMS order protection rule does not address trading on foreign markets in this way might be explained by the much lower significance of foreign trading of U.S.-listed securities for U.S. markets. Furthermore, as noted above, the price discovery function can be argued to be more important on Canadian marketplaces because they are comparatively less deep and liquid than U.S. markets.

The provision for a supplementary obligation on market participants would result in the regulatory burden being imposed at both levels (that is, marketplaces and market participants) in relation to trading on foreign markets. We are therefore specifically requesting comment on the need to impose a supplementary obligation directly on market participants to require them to execute “better-priced” orders on a Canadian marketplace prior to or concurrent with the execution on a foreign market.

**Question 1:** *In addition to imposing a general obligation on marketplaces to establish, maintain and enforce written policies and procedures to prevent trade-throughs, would it also be necessary to place an obligation on marketplace participants to address trade execution on a foreign market?*

We recognize that a trade-through obligation will likely have a cost impact on some market participants. We will be preparing a cost-benefit analysis of the trade-through proposal and will be soliciting input from interested parties.

**Question 2:** *What factors should we consider in developing our cost-benefit analysis for the trade-through proposal?*

**Question 3:** *Would you like to participate in the cost-benefit analysis by providing your input?*

(c) *Trade-through protection would apply to any exchange-traded security (other than derivatives) that is a “protected order” (defined below)*

We propose that trade-through protection would focus on exchange-traded securities (other than derivatives). The majority of commenters thought the initial focus should not be on fixed income and derivatives trading because each has its own unique characteristics. While we propose to limit the scope of the trade-through obligation to exchange-traded securities, other than derivatives, depending on the outcome of implementation, we may also examine the possibility of establishing similar requirements in the fixed-income and derivatives markets at a later date.

We note that, subject to certain exceptions, the order-protection rule in Reg NMS applies during regular trading hours (which are defined as the time between 9:30 a.m. and 4:00 p.m. Eastern time, unless otherwise specified). We are considering defining regular trading hours in a regulatory context, which is relevant for purposes of regulating trade-through. We are specifically requesting comment on whether trade-through protection should be applied (subject to certain exceptions discussed below) only during “regular trading hours”.

**Question 4: Should trade-through protection apply only during “regular trading hours”? If so, what is the appropriate definition of “regular trading hours”?**

- (d) *Trade-through protection would apply to the visible portions of all automatically accessible better-priced orders (“protected orders”) regardless of the marketplace on which they are entered*

The majority of commenters supported trade-through protection that would apply to all visible orders regardless of where they are in the book. In other words, the majority were supportive of a full depth-of-book obligation. As a result, the proposal applies to all protected orders that are visible. This differs from the model adopted in the United States through Reg NMS, which offers order protection to the top of the book of each automated market center whose orders qualify for order protection.

When and if there is an information processor, it is intended that it would provide full depth-of-book information for all visible orders that are equity securities. However, we are specifically requesting comment on whether we should consider limiting the consolidated feed to a certain number of levels, e.g., the top five, and concurrently limit trade-through obligations to that number of levels.

In addition, the proposal would only apply to “protected orders” as described above. We have included this to account for the different trading methodologies used by marketplaces to distinguish between automated marketplaces and marketplaces that require some form of human intervention. The purpose of this distinction is to promote fairness and innovation.

**Question 5: Should the consolidated feed (and, by extension, trade-through obligations) be limited to the top five levels? Would another number of levels (for example, top-of-book) be more appropriate for trade-through purposes? What is the impact of the absence of an information processor to provide centralized order and trade information?**

- (e) *Trade-through proposal would impose a limit on what a marketplace could charge to access a better-priced order*

We think that it is important to establish a maximum amount that a visible marketplace can charge for access to a quote. The purpose is to ensure that the best visible quote will be the best available price after factoring in such access fees, and would not lead to the converse – i.e. that it will appear to be the best price but the up front cost of accessing it will make it actually inferior.

It should be noted that this is only aimed at the marketplace fee to access a quote. Other costs of the transaction may be considered as part of best execution. Our intention in establishing a limitation on access fees is to help ensure that prices are comparable across marketplaces. This is meant to address the extent to which the price, once the order is accessed, could vary from the displayed price. We are specifically requesting comment on the fee limitation.

**Question 6: Should there be a limit on the fees charged on a trade-by-trade basis to access an order on a marketplace for trade-through purposes?**

- (f) *Specialized Marketplaces*

The current ATS Rules impose fair access requirements on an ATS to not unreasonably prohibit, condition or limit access by a person or company to services offered by it. We have interpreted the fair access requirements to allow an ATS to set access criteria that limit access to a specific type of marketplace participant (for example, only institutional subscribers) as long as it is not contrary to the public interest. The result has been an increasing number of ATSS that limit access to a specific group (“specialized marketplaces”). This ability to limit access is constrained by the requirement that if an ATS reaches 20% of the average daily trading volume in a particular security they must notify the securities regulatory authority to discuss whether or not the ATS should be regulated as an exchange (which is subject to a higher degree of regulation). At that time, the CSA would also consider whether continuing to limit access was appropriate.

Recent amendments to UMIR specifically recognize that a dealer may not have a best price obligation to a better-priced order on every marketplace.<sup>20</sup> In order for a Participant (as defined in UMIR) to demonstrate that it had made “reasonable efforts” to execute a client order at the best price, RS expects the Participant will deal with “better-priced” orders that are visible on another marketplace if that marketplace:

- disseminates order data in real-time and electronically through one or more information vendors;
- permits dealers to have access to trading in the capacity as agent;

<sup>20</sup> Reference should be made to Market Integrity Notice 2007-002 - Amendment Approval - Provisions Respecting Competitive Marketplaces (February 26, 2007).

- provides fully-automated electronic order entry; and
- provides fully-automated order matching and trade execution.

**Question 7: Should the CSA establish a threshold that would require an ATS to permit access to all groups of marketplace participants? If so, what is the appropriate threshold?**

Assuming that the trade-through obligation is an obligation owed to the market in general, for purposes of the trade-through rule, all specialized marketplaces with immediately accessible, visible limit orders should not discriminate against non-members. This could require them to allow order execution on behalf of non-members who need access to better-priced quotes. Alternatively, access could be provided through a member (or subscriber). The member (or subscriber) would, in turn, charge a fee to the non-member for providing this service. In other words, a marketplace must not prohibit access to non-members who access the quote through a member (or subscriber) in an attempt to satisfy the trade-through obligation. It is important to note that any separate "order execution" access would be granted for the purposes of satisfying the trade-through obligation and is distinguished from the broader access/membership, which may include the ability to display limit orders and orders with different markers.

**Question 8: Should it be a requirement that specialized marketplaces not prohibit access to non-members so they can access, through a member (or subscriber), immediately accessible, visible limit orders to satisfy the trade-through obligation?**

- **Should an ATS be required to provide direct order execution access if no subscriber will provide this service?**
- **Is this solution practical?**
- **Should there be a certain percentage threshold for specialized marketplaces below which a trade-through obligation would not apply to orders and/or trades on that marketplace?**

(g) *A trade-through obligation does not eliminate or lessen a participant's best execution requirements*

With the trade-through proposal, all trading in exchange-traded securities other than derivatives would be subject to the requirements, described above. This would not eliminate a marketplace participant's best execution obligations. The proposal would require an order to be executed at the best available price, but the dealer or adviser with the best execution obligation would be required to understand the characteristics and quality of the available marketplaces in making the determination when, where and how to route orders. For a more detailed discussion on best execution see below.

(h) *Exceptions*

As previously mentioned, the overall purpose of trade-through protection is to promote a fair marketplace where the visible portions of better-priced limit orders trade ahead of inferior-priced orders. It is important to acknowledge, however, that the issues relating to preventing all trade-throughs in a multiple marketplace setting are very complex. They are further complicated by the speed at which order routing and execution occurs. We think that because competing marketplaces offer different speeds and certainty of execution, offering price protection across marketplaces is a challenging task.

Set out below is a discussion of possible exceptions. The purpose of the exceptions is to promote fairness, innovation and competition. Exceptions from the general obligation should be justified on policy grounds and should not present an opportunity for regulatory arbitrage between marketplaces. For example, participants should not have an incentive to route orders to a particular marketplace to avoid regulatory requirements applicable to others.

We have separated the discussion of exceptions into the following categories: existing exceptions under UMIR, exceptions to facilitate proposed requirements in a multiple marketplace environment and additional exceptions that attempt to balance potentially conflicting needs of participants.

i. Existing Exceptions

Currently, under UMIR, a participant has an obligation to make reasonable efforts to execute against better-priced orders, but would not be required to do so in certain circumstances. The majority of commenters were supportive of maintaining the current exceptions in UMIR, including for special terms orders. In general, there are three broad categories of orders that are excluded from the obligation:

- Where the price of the trade is not known at the time of the entry or the execution of the order (e.g., call market orders, market-on-close orders, opening orders and volume-weighted average price orders);
- Where the price is determined by reference to prices achieved in one or more derivatives transactions (e.g., basis orders); and
- Where certain conditions are attached to the execution (e.g., special terms orders).

We are generally supportive of these broad categories of exemptions. However, currently under UMIR, the exemption for a special terms order does not apply in certain circumstances. There is a concern that a broad exemption for all special terms orders could be open to abuse if the addition of a condition could avoid all trade-through obligations.

**Question 9: *Are there any types of special terms orders that should not be exempt from trade-through obligations?***

ii. Exceptions to facilitate proposed requirements

### Systems Issues

From time to time a marketplace may experience technical difficulties. We think it is necessary to provide an exception from the obligation to access protected orders when a marketplace is experiencing any of the following: a technical failure, a malfunction or a material delay. This exception is intended to provide marketplaces with flexibility when dealing with another marketplace that is experiencing technological systems problems (either of a temporary nature or a longer-term systems issue). It supports fairness to participants by clarifying when a marketplace is not considered to be operating properly.

### Flickering Quotes

As previously discussed, the speed at which trades occur and the difficulties with ensuring trade-through protection across marketplaces create a situation where it is almost impossible to stop every occurrence of trade-throughs. The increase of algorithmic and black box trading, which generate multiple short-term orders (sometimes generated and cancelled within seconds) for every trade executed, have increased the number of times a better-priced order may be displayed. Given the speed with which these quotes change, there may be technical occurrences of trade-throughs, even though all reasonable precautions were taken and there was a legitimate attempt to execute a trade at the best available price.

We are considering an exception to acknowledge that a trade may occur that has the appearance of a trade-through but was the result of a flickering quote. In other words, it was the best available price at the time of order entry, however, due to rapidly moving quotations, it was not the best available price at order execution.

**Question 10: *Are there current technology tools that would allow monitoring and enforcement of a flickering quote exception?***

**Question 11: *Should the exception only apply for a specified period of time (for example, one second)? If so, what is the appropriate period of time?***

### Intermarket Sweep Order

An intermarket sweep order is an order that indicates that the entity responsible for generating the order (participant or marketplace) has performed a check as to the location of the best available visible, better-priced orders and is attempting to execute against these orders. A marketplace that receives a "intermarket sweep order" has no further obligation to ensure that there is no better available price. This exception may also facilitate the immediate execution of large block orders. For example, if a market participant would like to execute an order that would trade through one or more better-priced orders on other marketplaces, the market participant will be able to do so if it simultaneously routes one or more intermarket sweep orders to execute against the full displayed size of each better-priced order. This is intended to simplify compliance with the trade-through obligation.

iii. Additional exceptions

### After-hours Trading Session

Although we are requesting comment on whether trade-through protection should apply during "regular trading hours", marketplaces may set different hours of operation. Some marketplaces provide an after-hours trading session at a price established by that marketplace during its regular trading hours. This is important for market participants, such as mutual funds, who are required to benchmark to a certain closing price. We are considering an exception from the trade-through obligation for



trades in such a facility.<sup>21</sup> The exception would allow trades to occur in an after-hours trading session at a specific marketplace's closing price without having to execute against better-priced orders on other marketplaces. This promotes fairness to those who must achieve a certain price. RS has amended UMIR to provide for a "Closing Price Order" to facilitate trading after regular trading hours on any marketplace at the closing sale price of a particular security on that marketplace.<sup>22</sup>

**Question 12:** *Should this exception only be applicable for trades that must occur at a specific marketplace's closing price? Are there any issues of fairness if there is no reciprocal treatment for orders on another marketplace exempting them from having to execute at the closing price in a special facility if that price is better?*

### Last Sale Price Order Facility Exception

In addition, we are considering an exception from trade-through requirements for the two original parties of a trade on a visible block trading facility for any residual trading that may occur within a specified timeframe as long as the original trade was at the best available price and of a minimum order size. The rationale for permitting the last sale price order facility is to help facilitate the execution of any volume remaining after the execution of a large block trade (which has been executed at the best price). Several marketplaces have indicated they would like to offer a facility that would allow their participants to trade residual volume of orders without a resulting trade-through obligation. They argue that the original trade was subject to the trade-through rule, and that opportunistic traders may take advantage of the information and attempt to profit from it. The last sale order price facility exception would allow the original parties to the block trade to complete any remaining volume of their trade without any resulting trade being subject to the trade-through obligation for a limited amount of time. After this time, all new trades would be subject to the trade-through obligation.

**Question 13:** *Should a last sale price order facility exception be limited to any residual volume of a trade or should it apply for any amount between the two original parties to a trade? What is the appropriate time limit?*

### Other Exceptions

There may be other types or characteristics of orders that should appropriately be subject to an exception from the trade-through obligation.

**Question 14:** *Should trade-throughs be allowed in any other circumstances? For example, are there specific types or characteristics of orders that should be subject to an exemption from the trade-through obligation?*

## 3. Consequential UMIR amendments

### Current Requirements

Under Rule 5.2 of UMIR, a Participant has an obligation to make reasonable efforts to fill better-priced orders on a marketplace before executing a trade at an inferior price on another marketplace or a foreign market. In Policy 5.2, RS indicated that it would consider whether the Participant is a member, user or subscriber of the marketplace with the best price when determining whether a Participant has made "reasonable efforts" to obtain the best price on the execution of the client order. The "best price" obligation under Rule 5.2 and Policy 5.2 applies to trading undertaken by a Participant as principal or as agent for a client. Access Persons trading on a marketplace are not subject to the "best price" obligation.

### Proposed Amendments

Prior to the issuance by the CSA of Discussion Paper 23-403 – *Developments in Market Structure and Trade-Through Obligations*, RS published Market Integrity Notice 2005-016 – *Request for Comments – Interim Provisions Respecting Trade-Through Obligations* (May 12, 2005). RS had proposed certain interim amendments to UMIR pending the completion of the study arising out of the Discussion Paper. RS has not pursued the approval of these amendments and RS would intend to withdraw those proposed amendments upon implementation by the CSA of a trade-through obligation in the ATS Rules. RS will propose to make consequential amendments to UMIR to conform with the requirements on the trade-through obligation proposed by the CSA following consideration of comments received as a result of this joint notice. Any consequential amendments proposed by RS will be issued in a Market Integrity Notice and open for comment during the same period as any amendments regarding trade-through proposed by the CSA for the ATS Rules.

<sup>21</sup> UMIR amendments in force as of March 9, 2007 include an exemption from the best price obligation for closing price orders. See reference in note 20.

<sup>22</sup> Ibid, note 20.

#### 4. Alternatives considered

Set out below is a brief summary of alternatives considered and reasons for not proposing to adopt these alternatives.

(a) *Maintain status quo and introduce order execution reporting obligations*

One alternative would be to maintain the status quo with respect to trade-through. The current rules place the obligation not to trade-through better-priced orders only on dealers. Non-dealer participants have no obligation to trade at the best available price. This option would impose a reporting obligation on dealers to provide details as to where they are routing and executing orders and require each marketplace to provide information about the trading occurring on that marketplace. The reports would be made publicly available and all marketplace participants could use the information to help inform routing decisions. This would also be a tool to assist dealers and advisers in achieving best execution.

Our main concern with this alternative is that the current rules place different requirements on dealer and non-dealer participants of a marketplace. In addition, the current trade through requirements are tied to best execution rules in the UMIR. While trade-through obligations and best execution are related, we think they are two separate obligations. We also think that placing a general obligation on marketplaces to establish, maintain and enforce written policies and procedures that are reasonably designed to prevent trade-throughs is more flexible to allow industry to determine how best to implement changes.

Further, while the reporting obligations on marketplaces and dealers could provide useful information about order routing and execution, it would still be the case that different requirements would apply to dealer and non-dealer participants of a marketplace.

(b) *Exclusion for highly liquid securities*

Another alternative considered was to exempt highly liquid securities or securities with minimal spreads while imposing a trade-through requirement on less liquid securities. The rationale behind this approach is that limit orders are more likely used by retail clients in smaller, less liquid stocks and trade-through protection is needed to encourage participants to continue to use limit orders. If participants placing limit orders in an illiquid stock continually see their limit orders bypassed they may stop placing these types of orders.<sup>23</sup> For trading in highly liquid securities, it is generally assumed that the spread and arbitrage across marketplaces will keep the prices on different marketplace in a tight range and therefore a trade-through rule may not be needed.

This approach is not consistent with the view that the prevention of trade-throughs is a duty owed to the market. Another issue with this alternative would be defining what would be considered "highly liquid" and how this would be monitored in the event trading patterns changed. In addition, it may be difficult for participants to know whether a security is exempt.

(c) *Mandatory linkages for marketplaces with greater than a certain percentage of trading*

Another alternative considered was to impose the obligation that, when a marketplace reaches a "critical mass" in trading (for example, 10% of market share in trading), it must integrate with other marketplaces that have achieved the critical mass. There would be no obligation to integrate with a marketplace that has not done so. Prior to a marketplace reaching this threshold, there would only be a trade-through obligation if a participant chose to access that marketplace.

Although we considered this alternative, we had concerns that this would favour incumbent marketplaces. In addition, it is not consistent with the view that trade-through protection is an obligation to the markets as a whole. Further, this alternative would require mandatory market integration (at 10%) as opposed to a more flexible solution that allows marketplaces to decide how to implement trade-through protection.

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<sup>23</sup> Kiem, Madhavan, "Transaction costs and investment style: An inter-exchange analysis of institutional equity trades".

**B. Best Execution Requirements****Description of proposed best execution amendments***Definition*

- “Best execution” is defined as trading at the “most advantageous execution terms reasonably available under the circumstances”

*General rule*

- Requires dealers and advisers to obtain “best execution” (and expands reference beyond “best execution price”)

*Additional guidance*

- Number of factors that may be considered in seeking “best execution” – extending beyond price to include speed, certainty of execution and overall cost of the transaction

**1. Background**

On February 4, 2005, staff of the British Columbia Securities Commission, the Alberta Securities Commission, the Manitoba Securities Commission, the Autorité des Marchés financiers and the Ontario Securities Commission published Concept Paper 23-402 *Best execution and soft dollar arrangements* (concept paper).<sup>24</sup> The purpose of the concept paper was to set out a number of issues related to best execution and soft dollar arrangements<sup>25</sup> to obtain feedback.

In the concept paper, the CSA reflected the commonly held view that there is no simple, purely objective definition of best execution. The CSA emphasized that it is difficult to define best execution because there are many factors that may be relevant in assessing what constitutes best execution in any particular circumstance. It had been equated with achieving the best price but has more recently been acknowledged as having broader considerations and that it requires greater focus on the process. The CSA suggested some key elements of best execution: 1) price; 2) speed of execution; 3) certainty of execution; and 4) total transaction cost. We also raised the issue of measurement as this is critical to any meaningful analysis of best execution.

Based on the feedback obtained through the consultation process<sup>26</sup>, we are proposing changes to the current best execution requirements in NI 23-101, which reflect existing obligations in UMIR. The consequential amendments being made to UMIR by RS harmonize UMIR wording to the CSA rule and policy proposals.

**2. Key aspects**

We are proposing the following amendments to update and clarify the best execution provisions in NI 23-101<sup>27</sup>:

*(a) Definition of best execution and obligation to provide best execution*

To reflect the breadth of considerations for best execution, the CSA are proposing to amend the provisions to include factors other than price. Currently, there is no definition of “best execution”. Instead, section 4.2 of NI 23-101 refers to “best execution price” when describing the obligation applicable to a dealer. In addition, requirements in UMIR begin with a general obligation and then focus more specifically on price. In response to questions raised in the concept paper, many commenters stated that the current best execution requirements are too narrow and that the focus of best execution should be on the process and not an absolute standard to be applied on a trade-by-trade basis.

In light of the comments received on the concept paper, the CSA are proposing the following definition of best execution: the most advantageous execution terms reasonably available under the circumstances.<sup>28</sup> The Companion Policy clarifies that the application of the definition will vary depending on the specific circumstances, and also, on who is responsible for obtaining best execution.<sup>29</sup> In assessing the most advantageous execution terms reasonably available under the circumstances, the key

<sup>24</sup> (2005) 28 OSCB 1362.

<sup>25</sup> Amendments to current provisions relating to soft dollar arrangements are being dealt with in a separate proposal.

<sup>26</sup> Summary of comments received published at (2005) 28 OSCB 10065.

<sup>27</sup> It should be noted that the proposals are in addition to any applicable common law requirements.

<sup>28</sup> Proposed amendments to NI 23-101, s. 1.1.

<sup>29</sup> Proposed amendments to 23-101CP, s. 1.1.1.

elements identified (i.e., price, speed of execution, certainty of execution and overall cost of the transaction) are relevant. These key elements encompass more specific considerations such as liquidity, market impact or opportunity costs.

**Question 15:** *Are there other considerations that are relevant?*

**Question 16:** *How does the multiple marketplace environment and broadening the description of best execution impact small dealers?*

(b) *Application of best execution to dealers*

The best execution obligation would require that a dealer use reasonable efforts to achieve best execution. Where a security trades on multiple marketplaces, it does not necessarily require dealers to maintain access to all marketplaces. To achieve best execution, a dealer should assess whether it is appropriate to consider all marketplaces, both within and outside of Canada, upon which a security is traded. The CSA also propose to clarify that "best execution" will vary depending on the particular circumstances and that a dealer should be able to demonstrate that it has a process and has relied on that process in seeking the desired outcome.<sup>30</sup>

(c) *Application of best execution to advisers*

Current securities law requirements provide that advisers have a general responsibility to act in the best interests of their clients. This has been codified in certain instruments, for example, OSC Rule 31-505 *Conditions of Registration* (section 2.1), which sets out the general requirement for advisers to deal fairly, honestly and in good faith with their clients. There are also some specific obligations set out in securities legislation (for example, fair allocation of trades among client accounts).

In updating the best execution requirements, the CSA have acknowledged their application to advisers.<sup>31</sup> The CSA recognize that an adviser's obligations (generally assessed on a portfolio basis) often differ from a dealer's obligations (generally related to specific trades). The CSA have also sought to ensure that these best execution obligations are not inconsistent with standards set by professional organizations (such as the CFA Institute). However, where an adviser chooses to retain control of all trading decisions, including via direct access, the obligations will be similar to a dealer's. Therefore, the CSA have clarified the application of the best execution obligation to an adviser.<sup>32</sup>

**Question 17:** *Should the best execution obligation be the same for an adviser as a dealer where the adviser retains control over trading decisions or should the focus remain on the performance of the portfolio? Under what circumstances should the best execution obligation be different?*

(d) *Reporting of order execution and market quality information*

In the concept paper, the CSA referred to SEC rules on disclosure of order routing and execution practices. One rule (Rule 605 under Reg NMS, formerly rule 11Ac1-5) requires market centers (defined to mean any exchange market maker, OTC market maker, alternative trading system, national securities exchange or national securities association) to make monthly, electronic disclosure of information concerning quality of execution. A second rule (Rule 606, formerly rule 11Ac1-6) requires brokers that route orders on behalf of customers to disclose on a quarterly basis the identity of the market centers to which they route a significant percentage of their orders. In addition, brokers are required to disclose the nature of their relationships with such market centers, including any internalization or payment for order flow arrangements that could represent a conflict of interest between the brokers and their customers. Brokers are also required to respond to the requests of customers interested in learning where their individual orders were routed for execution during the previous six months.

The CSA received mixed feedback. Some suggested that similar rules may be advantageous in Canada, but some raised questions regarding the value of the information received. As a result of the comments, the CSA have tailored the information to focus only on areas that we think would provide important information to assess quality of execution.

The CSA are of the view that transparency of certain information is important to provide tools for assessing and complying with the best execution obligation. Therefore, the proposal includes requirements both on a marketplace<sup>33</sup> and on a dealer<sup>34</sup>. With respect to a marketplace, the CSA are proposing that certain information be reported on a monthly basis, including: the number of orders, the number of trades executed and speed of execution. The CSA are of the view that this information would be relevant for a dealer or adviser to assess best execution based on marketplace quality (for example, speed and certainty of execution). This information could be used by technology providers for order routing purposes as well as for establishing

<sup>30</sup> Proposed amendments to 23-101CP, s. 4.1.

<sup>31</sup> Proposed amendments to NI 23-101, s. 4.2.

<sup>32</sup> Proposed amendments to 23-101CP, s. 4.1.

<sup>33</sup> Proposed amendments to NI 21-101, Part 14.1.

<sup>34</sup> Proposed amendments to NI 23-101, Part 11.1.

compliance. The CSA think the reports would provide information for clients to use to question and understand the best execution practices of their intermediaries.

In addition, the CSA are proposing the following information be reported by dealers on a quarterly basis: percentage of orders executed at a location determined by the dealer; identity of marketplaces and percentage of orders routed to each marketplace; disclosure of any material arrangements with a marketplace.

For the CSA's cost-benefit analysis of these proposed reporting requirements, please see the document entitled "Cost Benefit Analysis – Proposed Amendments to National Instrument 21-101 *Marketplace Operation* and National Instrument 23-101 *Trading Rules*" (the CBA).

**Question 18:** *Are there any other areas of cost or benefit not covered by the CBA?*

The CSA specifically request comment on the proposed reporting for marketplaces and dealers.

**Question 19:** *Please comment on whether the proposed reporting requirements for marketplaces and dealers would provide useful information. Is there other information that would be useful? Are there differences between the U.S. and Canadian markets that make this information less useful in Canada?*

**Question 20:** *Should trades executed on a foreign market or over-the-counter be included in the data reported by dealers?*

**Question 21:** *Should dealers report information about orders that are routed due to trade-through obligations?*

**Question 22:** *Should information reported by a marketplace include spread-based statistics?*

**Question 23:** *If securities are traded on only one marketplace, would the information included in the proposed reporting requirements be useful? Is it practical for the requirement to be triggered only once securities are also traded on other marketplaces? Would marketplaces always be in a position to know when this has occurred?*

### 3. Consequential UMIR amendments

#### Current UMIR Requirements

Rule 5.1 of UMIR requires a Participant to diligently pursue the execution of each client order on the most advantageous terms for the client as expeditiously as practicable under prevailing market conditions.

#### Proposed UMIR Amendments

Concurrent with the publication of this joint notice, RS has issued Market Integrity Notice 2007-008 - *Request for Comments – Provisions Respecting Best Execution* (April 20, 2007), that proposes additional changes to the rules and policies under UMIR respecting "best execution" to parallel the proposed provisions of the ATS Rules and the companion policy with respect to "best execution" obligations of a dealer when handling a client order.

The provisions dealing with "best execution" proposed for NI 23-101 will apply to both dealers and advisers. The amendments to UMIR will adopt the language proposed for the "best execution" obligation for NI 23-101. However, the UMIR obligation will only be applicable to Participants and will not apply to an adviser even if the adviser is trading on a marketplace in the capacity of an "Access Person".

## C. Direct Access Issues

### Description of proposed direct access amendments

#### *Who is a dealer-sponsored participant?*

- A person or company that has dealer-sponsored access to a marketplace, and is an “Institutional Customer” as defined by IDA Policy No. 4 *Minimum Standards for Institutional Account Opening, Operation and Supervision*, as amended, and includes the representatives of the person or company

#### *Compliance and monitoring requirements*

- Requires exchanges to set requirements for dealer-sponsored participants and the dealers who provide such access and to monitor trading activities and enforce requirements either directly, or retain a regulation services provider to do so
- Requires a regulation services provider to set requirements for an ATS, its subscribers and the dealer-sponsored participants, and to monitor trading activities and enforce its requirements
- In addition to required agreements between the ATS and its subscribers and the exchange and its members, requires an agreement between each subscriber and the regulation services provider and each dealer-sponsored participant and the entity responsible for monitoring (either the exchange or regulation services provider)
- Imposes an obligation on dealers that provide dealer-sponsored access to maintain a list of dealer-sponsored participants and supervise trading

#### *Training*

- Trader Training Course examination (currently, a requirement for dealers trading on a marketplace) or another examination relating to an approved course or training
- Understanding of the applicable system requirements

## 1. Background

Currently, there is a different regulatory regime applicable to non-dealer “direct” participants (these are generally buy-side institutions but in the future could be retail) depending on how they are accessing a marketplace. The difference is between “direct” intermediated access (i.e., through or “sponsored by” a dealer) to an exchange or ATS, and direct access to an ATS (by a subscriber). In Canada, access sponsored by a dealer is often referred to as “DMA”.

UMIR impose compliance obligations on dealers and subscribers of an ATS (included in the UMIR definition of “access person”). The obligations of a subscriber of an ATS under the current obligations are limited to a small subset of UMIR provisions including: the requirement to use open and fair practices; the prohibition on the use of manipulative or deceptive methods of trade; and the restrictions on short selling (as well as some order marking requirements).

If a non-dealer that is an “eligible client” has entered an order through an interconnect agreement with a dealer to trade on a marketplace (for example, using TSX Rule and Policy 2-501 access), that client would not be subject to any of the provisions of UMIR and would not be subject to disciplinary or enforcement action under UMIR. On the other hand, if that same non-dealer is a subscriber to an ATS and enters orders directly on the ATS, the limited subset of UMIR provisions set out above would apply.<sup>35</sup>

The distinction between trading as an eligible client and trading as a subscriber to an ATS leads to different regulatory treatment that does not reflect essentially equivalent trading activity:

- ATS subscribers are subject to RS’s jurisdiction; eligible clients are subject to CSA jurisdiction. This division of jurisdiction between RS and CSA in relation to direct access trading may lead to different enforcement outcomes because a dealer who sponsors direct access trading is subject to RS’s jurisdiction, while that dealer’s eligible clients are subject to CSA jurisdiction. In addition, not all UMIR provisions are mirrored by provisions in the statutes, regulations and rules administered by the CSA (including those relating to improper

<sup>35</sup> The UMIRs that would apply are Rule 2.1 Just and Equitable Principles, Rule 2.2 Manipulative and Deceptive Activities, Rule 3.1 Restrictions on Short Selling, and Rule 6.2 Designations and Identifiers.

orders and trades, short sales and order marking), meaning that such provisions apply to trading by ATS subscribers but do not apply to trading by eligible clients.

- Eligible clients trading through a dealer are currently subject to certain rules that do not apply to ATS subscribers, including the existing trade-through rule in UMIR (as these clients access a marketplace through a dealer who has these obligations).
- Dealers have monitoring and compliance responsibilities for trading by their eligible clients under Part 7 of UMIR; ATSs do not presently have the same responsibilities under UMIR for trading by their subscribers.

We are therefore including amendments to deal with the differing requirements that exist between a subscriber of an ATS and a client that enters an order electronically after having signed an agreement with a dealer for DMA.

## 2. Key aspects

In order to address the issue of differing requirements and ensure that participants that are not dealers are subject to the same rules whether they enter an order directly on an ATS (as a subscriber) or through DMA, we are proposing amendments dealing generally with access.

The CSA are proposing a new definition of “dealer-sponsored participant” which is a person or company whose “direct” access to a marketplace is through a dealer (this would only apply to institutional customers). The CSA think it is important to clarify the obligations for all parties: marketplaces, dealers (whether as members of an exchange or subscribers to an ATS), and dealer-sponsored participants, whether foreign or domestic.

Both the exchange and ATS are responsible for ensuring compliance with their rules or contractual requirements regarding who may be granted “dealer-sponsored access”. As well, an exchange would be required to monitor and enforce requirements regarding the trading of dealer-sponsored participants and would have the choice of doing so directly or indirectly through a regulation services provider. The exchange would also be required to set requirements for its members to review and report activity of the dealer-sponsored participants who access the exchange through such members.<sup>36</sup> An ATS would be required to retain a regulation services provider for monitoring the trades on the ATS and the conduct of the subscribers and dealer-sponsored participants.<sup>37</sup> It is also important to clarify that an ATS does retain some compliance responsibility for its marketplace. This applies to situations where the ATS may be a better position than a regulation services provider to obtain information. For example:

- An ATS may have information about relationships between different subscriber accounts, which may be required to detect patterns of activity across subscriber accounts; and
- An ATS may have information about failed trades involving subscribers which is relevant for monitoring short sales.

The CSA acknowledge that an ATS may not be in a position to perform real-time compliance; however, we think that post-trade review may be appropriate, depending on the circumstances. The regulation services provider should identify (subject to public comment and regulatory approval), the responsibilities of the ATS for activities of subscribers and dealer-sponsored participants and for monitoring those activities.

As set out above, there are currently certain limited market integrity rules that apply to ATS subscribers. The CSA expect that these requirements will continue to apply to subscribers of an ATS and would be applied to dealer-sponsored participants, whether foreign or domestic, that have direct access to an ATS through a dealer subscriber or to an exchange through a member. An exchange or a regulation services provider would be able to impose additional requirements applicable to dealer-sponsored participants, subject to public comment and approval by the applicable securities regulatory authorities.<sup>38</sup>

The CSA are also proposing that there be certain training requirements applicable to dealer-sponsored participants (either the Trader Training Course examination, which is currently a requirement applicable to dealers trading exchange-traded securities (other than derivatives), or another examination relating to a course or training that is acceptable to the applicable regulatory securities authority, exchange or regulation services provider).<sup>39</sup>

<sup>36</sup> Proposed amendments to NI 23-101, s. 7.1.

<sup>37</sup> Proposed amendments to NI 23-101, ss. 8.1 and 8.2.

<sup>38</sup> Proposed amendments to 23-101CP, s. Part 7.

<sup>39</sup> Proposed amendments to NI 23-101, s.s 7.6 and 8.4.

- Question 24:** *Should DMA clients be subject to the same requirements as subscribers before being permitted access to a marketplace?*
- Question 25:** *Should the requirements regarding dealer-sponsored participants apply when the products traded are fixed income securities? Derivatives? Why or why not?*
- Question 26:** *Would your view about the jurisdiction of a regulation services provider (such as RS for ATS subscribers or an exchange for DMA clients) depend on whether it was limited to certain circumstances? For example, if for violations relating to manipulation and fraud, the securities commissions would be the applicable regulatory authorities for enforcement purposes?*
- Question 27:** *Could the proposed amendments lead dealer-sponsored participants to choose alternative ways to access the market such as using more traditional access (for example, by telephone), using foreign markets (for inter-listed securities) or creating multiple levels of DMA (for example, a DMA client providing access to other persons)?*
- Question 28:** *Should there be an exemption for foreign clients who are dealer-sponsored participants from the requirements to enter into an agreement with the exchange or regulations services provider? If so, why and under what circumstances?*
- Question 29:** *Please provide the advantages and disadvantages of a new category of member of an exchange that would have direct access to exchanges without the involvement of a dealer (assuming clearing and settlement could continue to be through a participant of the clearing agency).*

### 3. Consequential UMIR amendments

#### Current UMIR Requirements

UMIR presently applies to and imposes obligations on persons who are either a "Participant" or an "Access Person". Generally speaking, UMIR defines a "Participant" as a dealer that is a member of an exchange, user of a quotation and trade reporting system (QTRS) or subscriber to an ATS. Presently, UMIR defines an "Access Person" as a person, other than a Participant, who is a subscriber to an ATS or a user of a QTRS. Since an Access Person is not handling "client orders", an Access Person is subject to a limited subset of UMIR provisions (as noted above, these are principally related to open and fair practices, manipulative or deceptive methods of trade, improper orders and trades and short selling together with general trading requirements such as provisions related to order marking and order entry). If a Participant has provided certain of its clients with DMA or "dealer-sponsored access" to the trading system of a particular marketplace, the Participant must supervise and monitor the trading activity by such clients as the Participant is technically responsible for any breaches of UMIR as a result of this trading activity.

#### Proposed UMIR Amendments

Concurrent with the publication of this joint notice, RS has issued Market Integrity Notice 2007-009 - *Request for Comments – Provisions Respecting Access to Marketplaces* (April 20, 2007) that proposes amendments to the rules and policies under UMIR as a consequence of the proposed changes to NI 23-101 respecting "dealer-sponsored access" to a marketplace and the obligations of ATSS to monitor trading by subscribers and persons with "dealer-sponsored access". In particular, amendments to UMIR are being proposed to:

- provide a definition of "Dealer-Sponsored Access";
- establish requirements for a Participant to provide information to RS with respect to each person granted Dealer-Sponsored Access;
- extend the definition of:
  - "Access Person" to include any person (other than a dealer) to whom a Participant has granted Dealer-Sponsored Access, and
  - "Participant" to include a dealer to whom Dealer-Sponsored Access has been granted;
- require each Access Person to enter into an agreement with RS as a precondition to obtaining access to a marketplace;



- require each person entitled to enter orders on behalf of an Access Person on a marketplace to have met certain minimum proficiency standards respecting UMIR and other regulatory requirements governing the trading of securities on marketplaces; and
- establish certain trading supervision obligations for an ATS in respect of orders entered by a subscriber that is not a dealer.

#### D. Other Amendments

Other amendments that we have proposed to the ATS Rules and companion policies are summarized below:

##### 1. NI 21-101

- drafting clarification regarding the definition of “foreign exchange-traded security”<sup>40</sup>
- amendments that include “representatives” in the definitions of “member”, “user” and “subscriber”<sup>41</sup>
- drafting clarification regarding the record-keeping requirements for marketplaces (no change to the requirements in Part 11)<sup>42</sup>
- a requirement that a marketplace report material systems failures<sup>43</sup>
- non-material housekeeping changes<sup>44</sup>

##### 2. NI 23-101

- amendments that clarify that trading halts referred to are those imposed for a regulatory purpose<sup>45</sup>
- amendments to clarify that the jurisdiction of a regulation services provider extends to ATSs that cease to carry on business, and their former subscribers and dealer-sponsored participants with respect to conduct that occurred while the ATS, its subscribers or dealer-sponsored participants were subject to the requirements of the regulation services provider<sup>46</sup>
- drafting clarification for the record-keeping requirements for dealers and inter-dealer bond brokers (no change to the requirements implemented in December, 2006)<sup>47</sup>

#### IV. AUTHORITY FOR THE PROPOSED AMENDMENTS

In those jurisdictions in which the amendments to the ATS Rules are to be adopted, the securities legislation provides the securities regulatory authority with rule-making or regulation-making authority in respect of the subject matter of the amendments.

In Ontario, the proposed amendments to NI 21-101 and the Forms are being made under the following provisions of the *Securities Act* (Ontario) (Act):

- Paragraph 143(1)7 authorizes the Commission to make rules prescribing requirements in respect of the disclosure or furnishing of information to the public or the Commission by registrants.
- Paragraph 143(1)10 authorizes the Commission to make rules prescribing requirements in respect of the books, records and other documents required by subsection 19(1) of the Act to be kept by market participants (as defined in the Act), including the form in which and the period for which the books, records and other documents are to be kept.

<sup>40</sup> Proposed amendments to NI 21-101, s. 1.1.

<sup>41</sup> Proposed amendments to NI 21-101, s. 1.1.

<sup>42</sup> Proposed amendments to NI 21-101, s. 11.2.1.

<sup>43</sup> Proposed amendments to NI 21-101, s. 12.2.

<sup>44</sup> Proposed amendments to NI 21-101, s. 1.1, Parts 7 and 8, s. 11.1 and s. 11.2.

<sup>45</sup> Proposed amendments to NI 23-101, s. 5.1.

<sup>46</sup> Proposed amendments to NI 23-101, s. 8.1(3).

<sup>47</sup> Proposed amendments to NI 23-101, section 11.2.1.

- Paragraph 143(1)11 authorizes the Commission to make rules regulating the listing or trading of publicly traded securities including requiring reporting of trades and quotations.
- Paragraph 143(1)12 authorizes the Commission to make rules regulating recognized stock exchanges, recognized self-regulatory organizations, and recognized quotation and trade reporting systems including prescribing requirements in respect of the review or approval by the Commission of any by-law, rule, regulation, policy, procedure, interpretation or practice.
- Paragraph 143(1)13 authorizes the Commission to make rules regulating trading or advising in securities to prevent trading or advising that it is fraudulent, manipulative, deceptive or unfairly detrimental to investors.
- Paragraph 143(1)39 authorizes the Commission to make rules requiring or respecting the media, format, preparation, form, content, execution, certification, dissemination and other use, filing and review of all documents required under or governed by the Act, the regulation or the rules and all documents determined by the regulations or the rules to be ancillary to the documents.

In Ontario, the proposed amendments to NI 23-101 are being made under the following provisions of the Act:

- Paragraph 143(1)10 authorizes the Commission to make rules prescribing requirements in respect of the books, records and other documents required by subsection 19(1) of the Act to be kept by market participants (as defined in the Act), including the form in which and the period for which the books, records and other documents are to be kept.
- Paragraph 143(1)12 authorizes the Commission to make rules regulating recognized stock exchanges, recognized self-regulatory organizations, and recognized quotation and trade reporting systems including prescribing requirements in respect of the review or approval by the Commission of any by-law, rule, regulation, policy, procedure, interpretation or practice.
- Paragraph 143(1)13 authorizes the Commission to make rules regulating trading or advising in securities to prevent trading or advising that it is fraudulent, manipulative, deceptive or unfairly detrimental to investors.

## V. COMMENTS AND QUESTIONS

We invite all interested parties to make written submissions with respect to the concepts described in this Joint Notice and amendments to the ATS Rules. Submissions received by July 19, 2007 will be considered.

You should send submissions to all of the CSA and to Market Regulation Services Inc.

Submissions to the CSA should be addressed in care of the OSC, in duplicate, as indicated below:

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

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

Submissions should also be addressed to the Autorité des marchés financiers (Québec) as follows:

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

Submissions to Market Regulation Services Inc. should be addressed to:

James E. Twiss  
Market Regulation Services Inc.  
Suite 900  
145 King Street West  
Toronto, Ontario  
M5H 1J8  
e-mail: [jim.twiss@rs.ca](mailto:jim.twiss@rs.ca)

A diskette containing the submissions should also be submitted. As securities legislation in certain provinces requires a summary of written comments received during the comment period be published, confidentiality of submissions cannot be maintained.

Questions may be referred to any of:

Randee Pavalow  
Ontario Securities Commission  
(416) 593-8257

Cindy Petlock  
Ontario Securities Commission  
(416) 593-2351

Susan Greenglass  
Ontario Securities Commission  
(416) 593-8140

Tracey Stern  
Ontario Securities Commission  
(416) 593-8167

Tony Wong  
British Columbia Securities Commission  
(604) 899-6764

Shaun Fluker  
Alberta Securities Commission  
(403) 297-3308

Serge Boisvert  
Autorité des marchés financiers  
(514) 395-0558 X 4358

Doug Brown  
Manitoba Securities Commission  
(204) 945-0605

James E. Twiss  
Market Regulation Services Inc.  
(416) 646-7277

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**Appendix A to the Notice**

**Historical Market Structure Developments**  
**and**  
**Regulatory Responses**

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## APPENDIX A

HISTORICAL MARKET STRUCTURE DEVELOPMENTS  
AND REGULATORY RESPONSES

This section sets out the historical and current theories about how markets should be structured and the regulations that were introduced to promote the objectives that underlie those theories. As part of our analysis we have included changes in the U.S. that have influenced regulatory developments in Canada.

Each part in this section begins with an identification of:

- what was generally considered to be the ideal or preferred market structure (the “preferred market structure”) which would achieve the desired values or objectives;
- the reasons or values determining the preferred market structure (the “objectives”); and
- any regulations that were implemented to support each objective (“how achieved”).

We discuss the developments in market structure and regulatory responses as background to the changes being proposed. More specifically, the following sections will consider the evolution of market structure through changes brought about by industry and regulatory initiatives.

**A. Historical perspective in Canada and the U.S., prior to 1970s**

- Preferred market structure: single centralized marketplaces
- Objectives: price discovery and liquidity
- How achieved? via natural monopolies with restrictions in rules

Centralized exchanges for the trading of securities were seen as the most efficient type of marketplace. The reason was that bringing interested parties together both physically and temporally facilitated price discovery and liquidity (two important features of markets). These marketplaces were considered to be “natural monopolies” because the nature of listing and the limited access generally meant that trading in a security only took place at one venue. The fact that exchanges had listing rules and rules placing restrictions on where their participants could trade meant that trading remained centralized.

**B. U.S. market developments - 1970s (National Market System)**

- Preferred market structure: integrated marketplaces
- Objectives: price discovery, liquidity, competition and innovation
- How achieved? regulatory requirements including transparency and access; the creation of a National Market System (NMS) infrastructure for consolidation of market information and access between marketplaces (Consolidated Tape System, Consolidated Quotation System and Intermarket Trading System)

In early 1975, the U.S. Congress adopted the Securities Act Amendments (1975 Amendments) to deal with issues concerning the regional exchanges, significant growth in institutional trading and the impact of technology. The principal objective of the 1975 Amendments was to provide for “equally regulated, individual markets which are linked together to make their best price known and accessible.”<sup>48</sup> The SEC believed that competition among marketplaces would allow greater investor choice and would encourage innovation. The NMS infrastructure ensured that all participants would have access to information regarding best bids and offers, that the national best bid and offer (NBBO) would be published, and all participants would have access to the NBBO for execution. The 1975 Amendments also provided the SEC with the authority to regulate and oversee information processors such as the Securities Industry Automation Corporation (SIAC). In addition, it required exchanges to remove rules which restricted their participants from trading on other marketplaces.

<sup>48</sup> Securities and Exchange Commission Release No. 34-40760, “Regulation of Exchanges and Alternative Trading Systems”, p.8.

**C. Development of ATSS and order handling rules**

- Preferred market structure: integrated marketplaces
- Objectives: price discovery, liquidity, competition, innovation and market integrity
- How achieved? regulatory requirements regarding transparency (e.g. order handling rules), access with an additional focus on best execution but rejection of mandated consolidation and linkages in Canada

Developments of ATSS in the U.S. and market integrity issues on NASDAQ. From 1979 until the early 1990s, ATSS were developing in the U.S. and targeting institutional investors primarily for NASDAQ issues. In addition, there had been some studies and enforcement actions regarding the market makers on NASDAQ.<sup>49</sup> In 1996, the SEC announced new rules regarding the handling of retail orders in U.S. markets which required that dealers display all client limit orders better than the NBBO as part of their quote or through electronic communication networks (ECNs or ATSS). This requirement facilitated price discovery through greater transparency of orders. In 1998, the SEC published its final rules regarding the regulation of ATSS and set transparency and integration requirements for ATSS trading greater than 5% of the volume of an NMS security.

Instinet Hearings in Canada. The discussion of market structure issues began in Canada in 1989. They were first addressed by the OSC in the hearings on Instinet, an ATS, when the Commission decided Instinet should be admitted to TSE membership instead of allowing it to trade TSE securities outside of the TSE, and that the TSE should appoint a rule review committee to examine changes required to improve market quality and limit market fragmentation due to Instinet's inclusion. Instinet was restricted from installing terminals in Canada.

TSE Fragmentation Report and policy discussions. In January 1997, the TSE published a Report of the Special Committee on Fragmentation (Fragmentation Report). The Fragmentation Report concluded that consolidated markets provide the highest quality markets, but that it is not always possible to satisfy the needs of different participants with one market structure.

The public policy discussions considered the benefits and concerns brought about by having multiple marketplaces. The discussions also examined how new marketplaces provide competition and choice for investors regarding where to execute trades and how to execute them, while at the same time the development of multiple marketplaces can cause fragmentation of the price discovery process and market surveillance.

The CSA considered the recommendations made in the Fragmentation Report, recognizing that regulators should continue to promote innovation and competition while establishing fair and equitable practices, when contemplating a solution to market structure issues. The issue was addressed in 1999, as part of the Proposals on Alternative Trading Systems.<sup>50</sup>

Exchange Restructuring. Also in 1999, the existing exchanges (TSE, ME, VSE and ASE<sup>51</sup>) entered into an agreement whereby each exchange would specialize and none would compete for a period of ten years. Specifically, the TSE became the senior equities exchange, the VSE and ASE merged to form CDNX for junior equities and the ME became the derivatives exchange.

2001 ATS Rules transparency, data consolidation and market integration requirements. As noted above, the purpose of the ATS Rules adopted in December, 2001, was to create a framework that permits competition between traditional exchanges and other marketplaces, while ensuring that trading is fair and efficient. This was to be achieved by:

- Providing investor choice as to execution methodologies or types of marketplaces;
- Improving price discovery;
- Decreasing execution costs; and
- Improving market integrity.

This was especially important given the restructuring of the exchanges and the result that there would be no interlisting of securities.

<sup>49</sup> Christie and Schultz, *The Journal of Finance* (1994).

<sup>50</sup> The original rules set out requirements for market integration as well as data transparency.

<sup>51</sup> The WSE did not participate in the agreement, but later became part of the entity formed by the merger of the VSE and ASE – CDNX.



The ATS Rules imposed transparency, consolidation and integration requirements for orders and trades of exchange-traded securities and unlisted debt securities. In addition, the rules contained provisions on best execution, fair access, and prohibition against manipulation and fraud to strengthen market integrity across all marketplaces.

2003 Amendments – removal of consolidation and integration requirements. In 2003 the ATS Rules were amended to delete the concept of a data consolidator and market integrator for equity securities to promote a market-driven solution to consolidation in the equity markets. This was based on the theory that best execution would require market participants to generally trade at the best prices – whether directly or through another market participant – and that access to data, which was supported by the transparency requirements, would facilitate market-driven consolidation. At the time, there were no ATSs trading in Canadian-only listed securities and the CSA agreed with the views of an industry committee that we should wait and monitor developments in the marketplace before imposing the costs of creating a consolidator.

2005 Amendments – re-emergence of multiple marketplaces in Canada. With the first ATS trading Canadian listed securities, it was time to revisit the market structure issues and solutions.

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**PROPOSED AMENDMENTS TO  
NATIONAL INSTRUMENT 21-101  
*MARKETPLACE OPERATION*  
AND COMPANION POLICY 21-101CP**

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**AMENDMENTS TO NATIONAL INSTRUMENT 21-101  
MARKETPLACE OPERATION**

**PART 1 AMENDMENT**

1.1 Amendment

- (1) This Instrument amends National Instrument 21-101 *Marketplace Operation*.
- (2) Section 1.1 is amended:
  - (a) in the definition of “foreign exchange-traded security” by
    - (i) striking out “only” wherever it appears; and
    - (ii) by adding “and is not listed on an exchange or quoted on a quotation and trade reporting system in Canada” after “International Organization of Securities Commissions”;
  - (b) in the definition of “IDA” by adding “, or its successor” after “Canada”;
  - (c) by repealing the definition of “member” and substituting the following:

“member” means, for a recognized exchange, a person or company

    - (a) holding at least one seat on the exchange, or
    - (b) that has been granted direct trading access rights by the exchange and is subject to regulatory oversight by the exchange,

and the person or company’s representatives;”;
  - (d) in the definition of “recognized exchange” by adding in paragraph (b) “or authorized by the securities regulatory authority” after “as a self-regulatory organization”;
  - (e) in the definition of “subscriber” by adding “, and the person or company’s representatives” after “orders on the ATS”; and
  - (f) in the definition of “user” by adding “, and the person or company’s representatives” after “on the recognized quotation and trade reporting system”.
- (3) Part 7 is amended:
  - (a) in subsection 7.1(1) and section 7.2 by striking out “that meets the standards set by a regulation services provider”; and
  - (b) in section 7.5 by striking out “and timely” and by adding “in real-time” after “consolidated feed”.
- (4) Part 8 is amended:
  - (a) in subsections 8.2(1), 8.2(3), 8.2(4) and 8.2(5) by striking out “that meets the standards set by a regulation services provider, as required by the regulation services provider”;
  - (b) in section 8.3 by striking out “a” after “produce” and substituting “an accurate”;
  - (c) in section 8.5 by striking out “report” wherever it appears and by substituting “file”; and
  - (d) in subsection 8.5(1) by adding “the” before “selection”.
- (5) Part 10 is amended by deleting all references to “transaction fees” and substituting “trading fees”.

- (6) Part 11 is amended:
- (a) in section 11.1 by adding “in electronic form” after “business”;
  - (b) in subsection 11.2(1),
    - (i) by striking out “In addition to” and substituting “As part of”;
    - (ii) by striking out “keep” and substituting “include”; and
    - (iii) by adding “in electronic form” after “information”;
  - (c) in paragraph 11.2(1)(b) by striking out “, in electronic form,”;
  - (d) by repealing subsections 11.2(2) and 11.2(3); and
  - (e) by adding the following section after section 11.2:

“11.2.1 Transmission in Electronic Form - A marketplace shall transmit

    - (a) to a regulation services provider, if it has entered into an agreement with a regulation services provider in accordance with NI 23-101, the information required by the regulation services provider, within ten business days, in electronic form; and
    - (b) to the securities regulatory authority the information required by the securities regulatory authority under securities legislation, within ten business days, in electronic form.”.

- (7) Section 12.2 is amended by:
- (a) striking out the “s” at the end of “Paragraphs”; and
  - (b) striking out “and 12.1(c) do” and substituting “does”.

- (8) The following Part is added after Part 14:

**“Part 14.1 – Reporting of Order Execution Information by Marketplaces**

14.1.1 (1) Reporting of order execution information by marketplaces – A marketplace must make publicly available a monthly report, in electronic form, on the orders, not including any excluded orders as defined in NI 23-101, that it received for execution from any marketplace participant that were not immediately routed to another marketplace and shall include the following information in the report:

*Liquidity Measures:*

- (a) the number of orders that the marketplace received;
- (b) the number of orders that were cancelled;
- (c) the number of orders that were executed on the marketplace;
- (d) the average volume of all orders received on the marketplace;

*Trading Statistics:*

- (e) the number of trades executed on the marketplace;
- (f) the volume of all trades executed on the marketplace;
- (g) the value of all trades executed on the marketplace;
- (h) the arithmetic mean and median size of trades executed on the marketplace;

- (i) the number of trades that were executed on the marketplace with a volume of:
  - (i) for securities other than options,
    - 1. over 5,000 shares, and
    - 2. over 10,000 shares, and
  - (ii) for options,
    - 1. over 100 options contracts; and
    - 2. over 250 options contracts.

*Speed and Certainty of Execution Measures:*

- (j) the number of orders at the best bid price and best ask price of the marketplace executed
  - (i) from 0 to 9 seconds after the time of their receipt;
  - (ii) from 10 to 59 seconds after the time of their receipt;
  - (iii) from 60 seconds to 5 minutes after the time of their receipt;
  - (iv) over 5 minutes after the time of their receipt.

(2) The reporting required in paragraphs (1)(a) through (j) shall be categorized by security and by order type.”.

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**AMENDMENTS TO COMPANION POLICY 21-101CP – TO NATIONAL INSTRUMENT 21-101  
MARKETPLACE OPERATION**

**PART 1 AMENDMENT**

1.1 Amendment

- (1) This amends Companion Policy 21-101CP – to National Instrument 21-101 *Marketplace Operation*.
- (2) Section 1.2 is amended by striking out the last sentence and substituting “A security that is listed on a foreign exchange or quoted on a foreign quotation and trade reporting system, and is not listed or quoted on a domestic exchange or quotation and trade reporting system, falls within the definition of “foreign exchange-traded security”.”.
- (3) Subsection 5.1(3) is amended by striking out the last sentence and substituting the following:

“For the purpose of sections 7.1, 7.3, 8.1 and 8.2 of the Instrument, the Canadian securities regulatory authorities do not consider special terms orders that are not immediately executable or that trade in special terms books, such as all-or-none, minimum fill or cash or delayed delivery, to be orders that must be provided to an information processor or, if there is no information processor, to an information vendor for consolidation.”.
- (4) Part 9 is amended by:
  - (a) repealing subsection 9.1(1) and substituting the following:

“9.1 Information Transparency Requirements for Exchange-Traded Securities - (1) Subsection 7.1(1) of the Instrument requires a marketplace that displays orders of exchange-traded securities to any person or company to provide information to an information processor or, if there is no information processor, to an information vendor. Section 7.2 requires the marketplace to provide information regarding trades of exchange-traded securities to an information processor or, if there is no information processor, an information vendor.”;
  - (b) adding the following at the end of subsection 9.1(2):

“The Canadian securities regulatory authorities expect that information required to be provided to the information processor or information vendor under the Instrument will be provided in real time or as close to real time as possible.”; and
  - (c) repealing subsections 9.1(3) and 9.1(4).
- (5) Paragraph 10.1(3)(c) is amended by deleting “that meets the standards set by the regulation services provider”.
- (6) Section 12.1 is amended by:
  - (a) striking out all references to “transaction fees” and substituting “trading fees”;
  - (b) adding after the first sentence “The schedule should include all trading fees and provide the minimum and maximum fees payable for certain representative transactions.”; and
  - (c) striking out “Each marketplace is required to publicly post a schedule of all trading fees that are applicable to outside marketplace participants that are accessing an order and executing a trade displayed through an information processor or information vendor.”.
- (7) The Policy is amended by adding the following Part after Part 16:

**“Part 17 – Reporting of Order Execution Information by Marketplaces**

17.1 (1) Reporting of Order Execution Information by Marketplaces – Section 14.1.1 of the Instrument requires a marketplace to make available standardized, monthly reports of statistical information concerning order executions. It is expected that this information would provide a starting point to promote visibility and best execution, in particular, relating to the factors of execution price and speed. It is also expected that this information would provide a tool for dealers and advisers to evaluate the quality of executions among marketplaces and aid in fulfilling their duty of best execution.



(2) Section 14.1.1 of the Instrument refers to "order type". An order type is established by each marketplace and it includes an intentional cross, internal cross, market-on-close order, basis order, call market order, opening order, closing order, market order, limit order and special terms order."

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**PROPOSED AMENDMENTS TO  
NATIONAL INSTRUMENT 23-101  
*TRADING RULES*  
AND COMPANION POLICY 23-101CP**

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**AMENDMENTS TO NATIONAL INSTRUMENT 23-101  
TRADING RULES**

**PART 1 AMENDMENT**

1.1 Amendment

(1) This Instrument amends National Instrument 23-101 *Trading Rules*.

(2) Section 1.1 is amended by adding the following definitions:

“best execution” means the most advantageous execution terms reasonably available under the circumstances;

“dealer-sponsored participant” means a person or company who has dealer-sponsored access to a marketplace and is an “Institutional Customer” as defined by IDA Policy No. 4 *Minimum Standards for Institutional Account Opening, Operation and Supervision*, as amended, and includes the representatives of the person or company;

“dealer-sponsored access” means access to the trading system of a marketplace granted by a dealer who is a member, user or subscriber to a client that is either direct or by means of an electronic connection through the order routing system of the dealer;

“excluded order” means an order

(a) that is subject to a term or condition other than on price;

(b) where the price cannot be determined at the time of order entry; or

(c) where the price is determined by reference to prices achieved in one or more derivatives transactions;”.

(3) Section 4.2 is repealed and the following is substituted:

“4.2 Best Execution – A dealer and an adviser must make reasonable efforts to achieve best execution when acting for a client.”

4.3 Order Information – To satisfy the requirements in section 4.2, a dealer or adviser shall make reasonable efforts to use facilities providing information regarding orders.”.

(4) Section 5.1 is amended by adding “for a regulatory purpose” after “trading in a particular security”.

(5) Part 7 is amended by:

(a) repealing subsection 7.1(1) and substituting the following:

“7.1 Requirements for a Recognized Exchange - (1) A recognized exchange shall

(a) set requirements governing the conduct of its members and dealer-sponsored participants, including

(i) requirements that the members and dealer-sponsored participants will conduct trading activities in compliance with this Instrument; and

(ii) requirements governing the responsibilities of the members that provide access to dealer-sponsored participants to maintain a list of dealer-sponsored participants and to review and report to the recognized exchange or, if applicable, to the regulation services provider, on conduct of dealer-sponsored participants that is or appears to be inconsistent with the requirements set under this subsection;

(b) monitor the conduct of its members and dealer-sponsored participants and enforce the requirements set under paragraph (a); and

(c) maintain a list of all dealer-sponsored participants of the recognized exchange.”;

- (b) adding in subsection 7.1(2) and section 7.2 “and dealer-sponsored participants” after each reference to “members”;
- (c) repealing subsection 7.3(1) and substituting the following:

“7.3 Requirements for a Recognized Quotation and Trade Reporting System - (1) A recognized quotation and trade reporting system shall

- (a) set requirements governing the conduct of its users and dealer-sponsored participants, including
  - (i) requirements that the users and dealer-sponsored participants will conduct trading activities in compliance with this Instrument; and
  - (ii) requirements governing the responsibilities of the users that provide access to dealer-sponsored participants to maintain a list of dealer-sponsored participants and to review and report to the recognized quotation and trade reporting system or, if applicable, the regulation services provider on conduct of dealer-sponsored participants that is or appears to be inconsistent with the requirements set under this subsection;
- (b) monitor the conduct of its users and dealer-sponsored participants and enforce the requirements set under paragraph (a); and
- (c) maintain a list of all dealer-sponsored participants of the recognized quotation and trade reporting system.”;
- (d) adding in section 7.4 “and dealer-sponsored participants” after each reference to “users”;
- (e) adding the following sections after section 7.5:

“7.6 Agreement between a Recognized Exchange, Recognized Quotation and Trade Reporting System or Regulation Services Provider and a Dealer-Sponsored Participant – (1) A recognized exchange, recognized quotation and trade reporting system or regulation services provider that monitors the conduct of a dealer-sponsored participant on behalf of a recognized exchange or recognized quotation and trade reporting system shall enter into a written agreement with the dealer-sponsored participant that provides

- (a) that the dealer-sponsored participant will conduct its trading activities in compliance with the requirements set under subsection 7.1(1) or 7.3(1), as applicable;
- (b) that the dealer-sponsored participant acknowledges that the recognized exchange, recognized quotation and trade reporting system or regulation services provider will monitor the conduct of the dealer-sponsored participant and enforce the requirements set under subsection 7.1(1) or 7.3(1), as applicable;
- (c) that the dealer-sponsored participant will comply with all orders or directions made by the recognized exchange, recognized quotation and trade reporting system or regulation services provider, including orders excluding the dealer-sponsored participant from trading on any marketplace; and
- (d) that a representative of the dealer-sponsored participant entering orders on the recognized exchange or recognized quotation and trade reporting system has successfully completed:
  - (i) the Trader Training Course examination of the Canadian Securities Institute; or
  - (ii) such other examinations relating to courses or training as is acceptable to the securities regulatory authority and the recognized exchange, recognized quotation and trade reporting system, regulation services provider or self-regulatory entity.

(2) Paragraph (1)(d) does not apply until [insert date - one year from the effective date of the amendment].

7.7 Requirements for Members and Users with respect to Dealer-Sponsored Participants – Members of a recognized exchange or users of a quotation and trade reporting system that provide access to dealer-sponsored participants shall:

- (a) maintain a list of dealer-sponsored participants to whom they have provided access; and
- (b) review and report to the recognized exchange, recognized quotation and trade reporting system or, where applicable, the regulation services provider, conduct of dealer-sponsored participants that is or appears to be inconsistent with the requirements set in subsection 7.1(1) or 7.3(1), as applicable.

7.8 Training Requirements – A recognized exchange or recognized quotation and trade reporting system shall ensure that a dealer-sponsored participant granted access by a member or user is trained in the requirements set by the recognized exchange, recognized quotation and trade reporting system or regulation services provider.

7.9 Pre-condition to trading on a Recognized Exchange or Recognized Quotation and Trade Reporting System - (1) A recognized exchange or recognized quotation and trade reporting system shall not execute an order by a member or user for a dealer-sponsored participant unless the dealer-sponsored participant has executed the written agreement required by section 7.6.

(2) Subsection (1) does not apply until [insert date – six months from the effective date of the amendment].

7.10 Restriction on Dealer-Sponsored Access – A dealer-sponsored participant to a recognized exchange or a recognized quotation and trade reporting system shall not provide dealer-sponsored access to that exchange or quotation and trade reporting system.”.

(6) Part 8 is amended by:

- (a) repealing the title and substituting “Monitoring and Enforcement Requirements for an ATS, its Subscribers and Dealer-Sponsored Participants”; and
- (b) repealing sections 8.1 to 8.4 and substituting the following:

“8.1 Requirements Set by a Regulation Services Provider for an ATS - (1) A regulation services provider shall set requirements governing an ATS, its subscribers and dealer-sponsored participants, including,

- (a) requirements that the ATS, its subscribers and dealer-sponsored participants will conduct trading activities in compliance with this Instrument, and
- (b) requirements regarding the ATS’ responsibilities to maintain a list of dealer-sponsored participants and to review and report to the regulation services provider on conduct of its subscribers and its dealer-sponsored participants that is or appears to be inconsistent with the requirements set in this subsection.

(2) A regulation services provider shall monitor the conduct of an ATS, its subscribers, and its dealer-sponsored participants and shall enforce the requirements set under subsection (1).

(3) Subsection (2) applies to an ATS that ceases to carry on business as an ATS and its representatives, its subscribers, its dealer-sponsored participants and its former subscribers and its former dealer-sponsored participants with respect to conduct that occurred while that ATS, its representatives, its subscribers or its dealer-sponsored participants were subject to the requirements set by a regulation services provider.

8.2 Agreement between an ATS and a Regulation Services Provider -- An ATS and a regulation services provider shall enter into a written agreement that provides

- (a) that the ATS will conduct its activities in compliance with the requirements set under subsection 8.1(1);
- (b) that the regulation services provider will monitor the conduct of the ATS, its subscribers and its dealer-sponsored participants;
- (c) that the regulation services provider will enforce the requirements set under subsection 8.1(1);
- (d) that the ATS will transmit the information required by Part 11 of NI 21-101 to the regulation services provider; and
- (e) that the ATS will comply with all orders or directions made by the regulation services provider.

8.3 Agreement between an ATS and its Subscriber -- An ATS and its subscriber shall enter into a written agreement that provides

- (a) that the subscriber will conduct trading activities in compliance with the requirements set under subsection 8.1(1);
- (b) that the subscriber acknowledges that the regulation services provider will monitor the conduct of the subscriber and any dealer-sponsored participant to whom the subscriber has granted dealer-sponsored access and enforce the requirements set under subsection 8.1(1); and
- (c) that the subscriber will comply with all orders or directions made by the regulation services provider, including orders excluding the subscriber or dealer-sponsored participant from trading on any marketplace.

8.4 Agreement between a Regulation Services Provider and an ATS Subscriber or Dealer-Sponsored Participant – (1) A regulation services provider and a subscriber to an ATS or a dealer-sponsored participant to an ATS shall enter into a written agreement that provides

- (a) that the subscriber or dealer-sponsored participant will conduct trading activities in compliance with the requirements set under subsection 8.1(1);
- (b) that the subscriber or dealer-sponsored participant acknowledges that the regulation services provider will monitor the conduct of the subscriber or dealer-sponsored participant and enforce the requirements set under subsection 8.1(1);
- (c) that the subscriber or dealer-sponsored participant will comply with all orders or directions made by the regulation services provider, including orders excluding the subscriber or dealer-sponsored participant from trading on any marketplace; and
- (d) that any representative of the subscriber or dealer-sponsored participant entering orders has successfully completed:
  - (i) the Trader Training Course examination of the Canadian Securities Institute; or
  - (ii) such other examinations relating to courses or training as is acceptable to the securities regulatory authority and the regulation services provider or self-regulatory entity.

(2) Paragraph (1)(d) does not apply until [insert date – one year from the effective date of the amendment].

8.5 Training Requirements – An ATS shall ensure that its subscribers and its dealer-sponsored participants are trained in the requirements set by the regulation services provider.

8.6 Requirements for Subscribers with respect to Dealer-Sponsored Participants – Subscribers to an ATS that provide access to dealer-sponsored participants shall:

- (a) maintain a list of dealer-sponsored participants to whom they have provided access; and
- (b) review and report to the regulation services provider conduct of dealer-sponsored participants that is or appears to be inconsistent with the requirements set in subsection 8.1(1).

8.7 Pre-condition to trading on an ATS – (1) An ATS shall not execute an order for a subscriber unless,

- (a) the ATS has executed the written agreements required by sections 8.2 and 8.3; and
- (b) its subscribers or dealer-sponsored participants have entered into the written agreement required by section 8.4.

(2) Paragraph (1)(b) does not apply until [insert date – six months from the effective date of the amendment].

8.8 Restriction on Dealer-Sponsored Access – A dealer-sponsored participant to an ATS shall not provide dealer-sponsored access to that ATS.”.



- (7) Section 9.1 is amended by adding “and that the inter-dealer bond broker has the responsibility to review and report to the regulation services provider on conduct of its customers that is or appears to be inconsistent with these requirements” after “with this Instrument”.
- (8) Part 11 is amended by:
- (a) repealing subsections 11.2(5) and (6);
  - (b) adding the following after section 11.2:
    - “11.2.1 Transmission in Electronic Form – (1) A dealer and inter-dealer bond broker shall transmit
      - (a) to a regulation services provider the information required by the regulation services provider, within ten business days, in electronic form; and
      - (b) to the securities regulatory authority the information required by the securities regulatory authority under securities legislation, within ten business days, in electronic form.
    - (2) The record kept by the dealer and inter-dealer bond broker under subsections 11.2(1) through 11.2(4) and the transmission of that information to a securities regulatory authority or to a regulation services provider under subsection (1) shall be in the electronic form specified in a rule by the securities regulatory authority, a regulation services provider or a self-regulatory entity by January 1, 2010.”

- (9) The following Part is added after Part 11:

**“Part 11.1 -- Reporting Requirements Applicable to Dealers**

11.1.1 Reporting of order routing by dealer – (1) Each dealer shall make publicly available each calendar quarter a report on its routing of orders when acting as agent during that quarter and shall include the following information reported as a monthly average, where applicable, where securities are traded on multiple marketplaces

- (a) the percentage of total client orders and the percentages that were market orders, limit orders and other order types;
  - (b) the identity of marketplaces where orders are routed for execution, including the percentages of orders routed to each marketplace; and
  - (c) a discussion of any material aspects of a dealer’s relationship with a marketplace including a description of any arrangements.
- (2) Each dealer shall, on request, disclose to its client the identity of the marketplaces where the client’s orders were routed for execution in the six months prior to the request, whether the dealer was specifically instructed to route to a particular marketplace for execution, and the time of the transactions, if any, that resulted from such orders.
- (3) Subsection (1) does not apply
- (a) to orders entered by a dealer-sponsored participant, or
  - (b) where the client has directed that the dealer route the order to a specific marketplace.”.

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**AMENDMENTS TO COMPANION POLICY 23-101CP – TO NATIONAL INSTRUMENT 23-101  
TRADING RULES**

**PART 1 AMENDMENT**

1.1 Amendment

- (1) This amends Companion Policy 23-101CP – to National Instrument 23-101 *Trading Rules*.
- (2) The Policy is amended by adding the following Part after Part 1:

**“Part 1.1 - Definitions**

“ 1.1.1 Definition of best execution – (1) In the Instrument, best execution is defined as the “most advantageous execution terms reasonably available under the circumstances”. In determining best execution, a dealer or adviser may consider a number of elements, including:

- a. price;
- b. speed of execution;
- c. certainty of execution; and
- d. the overall cost of the transaction.

We are of the view that these four broad elements encompass more specific considerations, such as order size, reliability of quotes, liquidity, market impact (the price movement that occurs when executing an order) and opportunity cost (the missed opportunity to obtain a better price when an order is not completed at the most advantageous time). The overall cost of the transaction is meant to include, where appropriate, all costs associated with accessing an order and/or executing a trade that are passed on to a client, including fees arising from trading on a particular marketplace, jitney fees (i.e. any fees charged between dealers to provide trading access) and settlement costs. Also, for advisers, the commission fees charged by a dealer would be a cost of the transaction.

(2) The specific application of the definition of “best execution” will vary depending on the instructions and needs of the client, the particular security, prevailing market conditions and whether the dealer or adviser is responsible for best execution under the circumstances. Please see a detailed discussion below in Part 4.

1.1.2 Definitions of dealer-sponsored participant and dealer-sponsored access – (1) Section 1.1 of the Instrument defines a “dealer-sponsored participant” as a person or company, other than a dealer, that has dealer-sponsored access to a marketplace and is an “Institutional Customer” as defined by IDA Policy No. 4 *Minimum Standards for Institutional Account Opening, Operation and Supervision*, as amended, and includes its representatives. The requirement that the person or company be an “Institutional Customer” as defined by IDA Policy 4, has been included to make it clear that the requirements in the Instrument relating to “dealer-sponsored participants” apply only to institutional clients of a dealer who sponsors marketplace access and not to any retail clients with execution-only accounts at discount brokers that are subject to alternative requirements.”.

- (3) Part 4 is amended by repealing subsections 4.1(1) to 4.1(8) and substituting the following:

“4.1 Best Execution -- (1) The best execution obligation in Part 4 of the Instrument does not apply to an ATS that is registered as a dealer provided that it is carrying on business as a marketplace and is not handling any client orders other than accepting them to allow them to execute on the system. However, the best execution obligation does otherwise apply to an ATS acting as an agent for a client.

(2) Section 4.2 of the Instrument requires a dealer or adviser to make reasonable efforts to achieve best execution (the most advantageous execution terms reasonably available in the circumstances) when acting for a client. The obligation applies to all securities.

(3) Although what constitutes “best execution” varies depending on the particular circumstances, a dealer or adviser should be able to demonstrate that it has a process in place designed to achieve best execution, including how to evaluate whether it was obtained, and that dealer or adviser has taken all reasonable steps, including relying on that process. This process should be reflected in the policies and procedures of the dealer or adviser, which should be regularly reviewed. The obligations of the dealer or adviser will be dependent on the role it is playing in an execution.

For example, in making reasonable efforts to achieve best execution, the dealer should consider a number of factors, including client instructions, the client's investment objectives and the dealer's knowledge of markets and trading patterns. An advisor should consider a number of factors, including assessing a particular client's requirements or portfolio objectives, selecting appropriate dealers and marketplaces and monitoring the results on a regular basis. In addition, if an advisor is directly accessing a marketplace, the factors considered by dealers may also be applicable.

(4) Where securities listed on a Canadian exchange or quoted on a Canadian quotation and trade reporting system are inter-listed either within Canada or on a foreign exchange or quotation and trade reporting system, the Canadian securities regulatory authorities are of the view that in making reasonable efforts to achieve best execution, the dealer should assess whether it is appropriate to consider all marketplaces upon which the security is listed or quoted and where the security is traded, both within and outside of Canada.

(5) For foreign exchange-traded securities, if they are traded on an ATS in Canada, dealers should assess whether it is appropriate to consider the ATS as well as the foreign markets upon which the securities trade.

(6) In order to meet best execution obligations where securities trade on multiple marketplaces in Canada, a dealer should consider information from all marketplaces (not just marketplaces where the dealer is a participant). This does not necessarily mean that a dealer must have access to real-time data feeds from each marketplace but that it should establish reasonable policies and procedures for best execution that include taking into account order and/or trade information from all appropriate marketplaces in the particular circumstances. The policies and procedures should be monitored on a regular basis. A dealer should also take steps, where appropriate, to access orders which may include making arrangements with another dealer who is a participant of a particular marketplace or routing an order to a particular marketplace.

(7) Section 4.2 of the Instrument applies to registered advisers as well as registered dealers that carry out advisory functions but are exempt from registration as advisers.

(8) Section 4.3 of the Instrument requires that a dealer or adviser make reasonable efforts to use facilities providing information regarding orders. These reasonable efforts refer to the use of the information displayed by the information processor or, if there is no information processor, an information vendor.”.

(4) Section 5.1 is amended by adding the following sentences before the first sentence:

“Section 5.1 of the Instrument applies when a regulatory halt has been imposed by a regulation services provider, a recognized exchange, recognized quotation and trade reporting system or an exchange or quotation and trade reporting system that has been recognized for the purposes of the Instrument and NI 21-101. A regulatory halt, as referred to in section 5.1 of the Instrument, is one that is imposed to maintain a fair and orderly market, including halts related to a timely disclosure policy, or because there has been a violation of regulatory requirements.”.

(5) Part 7 is amended by:

(a) repealing section 7.1 and substituting the following:

“7.1 Monitoring and Enforcement of Requirements Set By a Recognized Exchange or Recognized Quotation and Trade Reporting System - (1) Under section 7.1 of the Instrument, a recognized exchange will set its own requirements governing the conduct of its members and dealer-sponsored participants. Under section 7.3 of the Instrument, a recognized quotation and trade reporting system will set its own requirements governing the conduct of its users and dealer-sponsored participants. The recognized exchange or recognized quotation and trade reporting system can monitor and enforce these requirements either directly or indirectly through a regulation services provider. A regulation services provider is a person or company that provides regulation services and is either a recognized exchange, recognized quotation and trade reporting system or a recognized self-regulatory entity.

(2) Sections 7.2 and 7.4 of the Instrument require the recognized exchange or recognized quotation and trade reporting system that chooses to have the monitoring and enforcement performed by a regulation services provider to enter into an agreement with the regulation services provider in which the regulation services provider agrees to enforce the requirements of the recognized exchange or recognized quotation and trade reporting system. Section 7.6 of the Instrument requires a dealer-sponsored participant to enter into an agreement with either the recognized exchange, recognized quotation and trade reporting system, or if monitoring and enforcement is conducted by a regulation services provider, with the regulation services provider. A recognized exchange or recognized quotation and trade reporting system is required under section 7.8 of the Instrument to ensure that dealer-sponsored participants are trained in the requirements of the exchange, quotation and trade reporting system, or if applicable, the regulation services provider.

(3) Section 7.7 of the Instrument requires members of a recognized exchange or users of a recognized quotation and trade reporting system to maintain a list of the dealer-sponsored participants to whom they have given access, and to review and report the conduct of those dealer-sponsored participants to the recognized exchange, recognized quotation and trade reporting system or, if applicable, the regulation services provider. In addition, paragraphs 7.1(1)(c) and 7.3(1)(c) require recognized exchanges and recognized quotation and trade reporting systems to maintain a list of all dealer-sponsored participants accessing their marketplace.

(4) Sections 7.10 and 8.8 of the Instrument restrict a dealer-sponsored participant from providing dealer-sponsored access to a recognized exchange, recognized quotation and trade reporting system or an ATS. This restriction is included in the Instrument to prevent clients of a dealer from providing dealer-sponsored access to their clients.”; and

(b) repealing section 7.2 and substituting the following:

“7.2 Monitoring and Enforcement Requirements for an ATS – (1) Section 8.1 of the Instrument requires the regulation services provider to set requirements that govern an ATS, its subscribers and dealer-sponsored participants. Paragraph 8.1(1)(b) of the Instrument reinforces that an ATS has responsibilities to review and report on conduct of its subscribers and dealer-sponsored participants that is or appears to be inconsistent with the requirements set by the regulation services provider. This is intended to apply in circumstances where an ATS may be in a better position than a regulation services provider to obtain information. For example, an ATS may have information about relationships between different ATS subscriber accounts, which may be required to detect patterns of activity across subscriber accounts, or an ATS may have information about failed trades involving subscribers which is relevant for monitoring short sales. It is expected that an ATS will notify a regulation services provider when it has knowledge of any relevant information.

(2) Before executing an order for a subscriber (including an order for a dealer-sponsored participant), the ATS must enter into an agreement with a regulation services provider and an agreement with each subscriber. In addition, the subscribers and dealer-sponsored participants must enter into agreements with the regulation services provider. These agreements form the basis upon which a regulation services provider will monitor the trading activities of the ATS, its subscribers and dealer-sponsored participants and enforce its requirements. The requirements set by a regulation services provider must include requirements that the ATS, its subscribers and dealer-sponsored participants will conduct trading activities in compliance with the Instrument. The ATS, its subscribers and dealer-sponsored participants are considered to be in compliance with the Instrument and are exempt from the application of most of its provisions if the ATS, the subscriber and the dealer-sponsored participant are in compliance with the requirements set by a regulation services provider.

(3) Under subsection 8.4(d) of the Instrument, a representative of a subscriber or dealer-sponsored participant entering orders is required to successfully complete either the Trader Training Course examination of the Canadian Securities Institute (which is currently a requirement for dealers trading on an equity marketplace) or another examination relating to courses or training that is acceptable to the securities regulatory authority and a regulation services provider or recognized self-regulatory entity. The ATS is required under section 8.5 of the Instrument to ensure that subscribers and dealer-sponsored participants are trained in the requirements of the regulation services provider.

(4) Section 8.6 of the Instrument requires subscribers to an ATS to maintain a list of the dealer-sponsored participants to whom they have given access, and to review and report the conduct of those dealer-sponsored participants to the regulation services provider. In addition, paragraph 8.1(1)(b) of the Instrument requires a regulation services provider to set requirements regarding the responsibilities of an ATS to maintain a list of dealer-sponsored participants accessing the ATS and to review and report conduct that is or appears to be inconsistent with the requirements of the regulation services provider.”.

(6) Part 8 is amended by:

(a) repealing section 8.2 and substituting the following:

“8.2 Transmission of Information to a Regulation Services Provider -- Section 11.3 of the Instrument requires that a dealer and an inter-dealer bond broker provide to the regulation services provider information required by the regulation services provider, within 10 business days, in electronic form. This requirement is triggered only when the regulation services provider sets requirements to transmit information.”; and

(b) repealing section 8.3 and substituting the following:

“8.3 Electronic Form - Subsection 11.2.1(1) of the Instrument requires any information required to be transmitted to the regulation services provider and securities regulatory authority in electronic form. Dealers and inter-dealer bond

brokers are required to provide information in a form that is accessible to the securities regulatory authorities and the regulation services provider (for example, in SELECTR format). The Canadian securities regulatory authorities and the self-regulatory entities are working with the industry to develop uniform standards for the electronic audit trail requirements to be implemented by January 1, 2010, which is reflected in subsection 11.2.1(2).”

- (7) The Policy is amended by adding the following Part after Part 8:

**“Part 9 – Reporting Requirements Applicable to Dealers**

9.1 Reporting Requirements Applicable to Dealers - Section 11.1.1 of the Instrument requires disclosure of the order routing practices of dealers that route orders for clients. As dealers owe a duty of best execution to their clients, dealers should review their order routing practices periodically to assure they are meeting this responsibility. It is expected that the information required by section 11.1.1 of the Instrument would bring transparency to this process and provide clients with the opportunity to monitor a dealer’s order routing activity. On request by a client, a dealer also would be required to disclose where an individual client’s orders were routed.”.

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**COST-BENEFIT ANALYSIS**

**PROPOSED AMENDMENTS TO NATIONAL INSTRUMENT 21-101**  
***MARKETPLACE OPERATION***  
**AND**  
**NATIONAL INSTRUMENT 23-101 *TRADING RULES***

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**Cost-Benefit Analysis****Proposed Amendments to National Instrument 21-101  
Marketplace Operation and National Instrument 23-101 Trading Rules****1) Introduction**

The Canadian Securities Administrators (CSA) are proposing amendments to National Instrument 21-101 *Marketplace Operation* (NI 21-101) and National Instrument 23-101 *Trading Rules* (NI 23-101). The proposed amendments cover two areas:

- a) Best execution
  - i) Acknowledging in the rule that advisers managing a client's portfolio have a best execution obligation to their clients. When acting for their client, advisers must make reasonable efforts to achieve best execution.
  - ii) Broadening best execution beyond "best execution price" in NI 23-101. Best execution would be defined as "the most advantageous execution terms reasonably available under the circumstances".
  - iii) Dealers would be required to report order execution statistics and marketplaces would report market quality information. Additionally, dealers would be required to disclose any material aspects of a dealer's relationship with a particular marketplace.

- b) Non-dealer market access

Currently non-dealer ATS subscribers are subject to a subset of Universal Market Integrity Rules (UMIR) provisions while direct market access (DMA)<sup>1</sup> clients are not subject to UMIR<sup>2</sup>. Non-dealer participants would be subject to UMIR provisions regardless of whether they are an ATS subscriber or a DMA client of an investment dealer. Additionally, it is proposed that DMA clients and ATS subscribers sign an agreement with the applicable regulation service provider to ensure compliance with the rules. To ensure that representatives of these market participants are knowledgeable about the rules, they would be required to first successfully complete an examination relating to an industry-approved training course (e.g. Canadian Securities Institute's Trader Training course).

This cost-benefit analysis (CBA) will focus on the proposed introduction of market quality and execution statistics as it would involve technology and infrastructure costs for investment dealers and marketplaces. The other changes in the proposed amendments would cause participants to make changes to their policies and procedure but these are unlikely to involve significant costs and are likely to be predominantly one-time costs.

**2) The Issue**

The CSA are updating the requirements in NI 21-101 and NI 23-101 to reflect market structure developments. Although these National Instruments have allowed for a security to be traded on more than one marketplace, that situation has only recently become a reality. This leads to a number of issues:

- a) Dealers are required to reasonably provide best execution. In the absence of marketplace statistics, dealers are missing an important tool for determining the most suitable marketplace for their client.
- b) Investors may be constrained in their ability to monitor how trades are executed. A standardized set of execution statistics would allow investors to make comparisons and more informed investing decisions.
- c) All marketplaces have an incentive to maintain or improve their market share. In the absence of standardized disclosure, marketplaces may make available the most favourable statistics and so comparisons between marketplaces may be difficult if not impossible. A standardized set of statistics will enable participants to compare the quality of individual marketplaces and make more informed order routing decisions.

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<sup>1</sup> "Direct market access" are clients with direct intermediated access (i.e., through or "sponsored by" a dealer) to an exchange or ATS. Subscribers have direct access to an ATS.

<sup>2</sup> The dealer must monitor and supervise the trading of their DMA accounts as they are still technically responsible for any UMIR breaches.

In effect, there is an information asymmetry<sup>3</sup> issue; intermediaries are unable to comprehensively evaluate the service they receive from a marketplace and investors are limited in their ability to evaluate their intermediaries. As a result, regulation may be required to address the issue.

### 3) Outcome

The market quality and order execution statistics in the proposed amendments should help:

- a) Foster a competitive environment for marketplaces;
- b) Promote better informed trading and compliance with fiduciary obligations and rule requirements through order execution and marketplace quality statistics; and
- c) Investors determine which dealer would best suit their needs given order routing dealer statistics.

### 4) Background

The December 2001 adoption of NI 21-101 and NI 23-101 established a framework for competition between traditional exchanges and other marketplaces while ensuring that trading is fair and efficient. Obtaining the best terms available is rarely an issue for investors when a security trades on a single marketplace. That single marketplace structure guarantees best price, which for most retail investors is the best terms available.

In a multiple marketplace environment, providing clients with the most advantageous execution terms reasonably available under the circumstances becomes more complicated. Dealers may also need to consider execution speed, price, overall transaction cost, and order fill certainty<sup>4</sup>.

#### Evaluating best execution

In order for market participants to ensure they are achieving the most advantageous execution terms available, they need to be able to make informed choices about how well their dealer meets its best execution obligation and which marketplaces are used to execute their transactions. In a multiple marketplace environment, most retail investors are unlikely to have the sophistication or infrastructure available to determine whether their dealer is providing them with best execution. They are also unable to determine which dealer(s) suit their needs. To help investors make better decisions, dealers should provide investors with accessible data on their order routing decisions. The CSA propose that such information would include the percentage of orders that were directed to a marketplace without specific routing instructions, whether there are any material agreements between the dealer and marketplace, and the marketplaces available.

In order for a dealer to provide best execution to clients, it must have a process for analysing the marketplaces where a security trades and data upon which to base execution decisions. This information is more consistent and measurable if marketplaces provide standardized periodic and timely order execution quality statistics.

### 5) Alternatives

Given the above identified issues, we have identified three alternative policy responses: (a) implement the CSA's proposed order execution and market quality statistics; (b) proceed with no reporting requirements (status quo); or (c) implement proposed order execution and market quality statistics as specified in a) and also include marketplace spread statistics, as required in SEC Rule 605.

#### a. Implement the CSA's proposed order execution and market quality statistics

As proposed, marketplaces would be required to provide, on a monthly basis, market quality statistics which would include:

- i) Liquidity measures (e.g. the number of orders that the marketplace received, cancelled, and executed)
- ii) Trading statistics (e.g. the volume and value of all trades on marketplace, average trade size, and the number of trades of a given size)

<sup>3</sup> Information asymmetry occurs when relevant information is known to some but not all market participants. This prevents markets from operating efficiently as some market participants are unable to make fully-informed decisions.

<sup>4</sup> As discussed in the introduction, the proposal would amend the "best execution price" since in today's environment, investors may demand speed, order execution certain, and transaction cost, in addition to price.

- iii) Speed and certainty of execution measures (e.g. the number of orders at the best bid price and best ask price of the marketplace executed within certain time ranges)

The information in i) to iii) would be categorized by security and, order type. For more detailed information on these statistics, refer to Part 14.1 of the proposed amendments to NI 21-101.

Dealers would be required to provide quarterly statistics on order routing. The proposed CSA reporting requirements for dealers are similar to the SEC rule. These include the percentage executed at a location determined by the dealer, the identity of marketplaces and the percentage of orders routed to each marketplace, and the disclosure of material arrangements with any marketplace. Also, upon request, a dealer would be required to disclose to its client the identity of the marketplace where the client's orders were routed for execution in the six months prior to the request, whether the dealer was specifically instructed to route to a particular marketplace for execution and the time of the transactions, if any, that resulted from such orders.

#### Costs

- Although marketplaces already maintain records of orders received and trades executed, they would realize incremental costs associated with manipulating the raw data into the required statistics. This would include software and systems costs associated with the manipulation and resources devoted to ensuring the integrity of the marketplace statistics. Alternatively, service providers may emerge to generate and report these statistics on behalf of a marketplace for a fee, as has occurred in the U.S.
- Dealers are already likely to keep track of the client orders, the associated routing instructions, and the details of how the order was routed and so there should be limited data acquisition costs. However, that information will have to be stored in a way that is accessible on-demand, and can be manipulated into aggregate reports or reports for an individual client. As a result dealers may incur costs associated with changing how this information is stored and implementing reporting tools.
- A new marketplace's ability to attract liquidity may be hampered by published marketplace statistics. The statistics may reinforce that new entrants often have a limited ability to attract liquidity.
- Dealers would also incur costs related to ensuring the integrity of published execution statistics. The publication of incorrect information could pose a risk to a firm's reputation.
- Misinterpreted order routing statistics may result in frivolous lawsuits; clients might claim their dealer is not meeting their best execution requirement<sup>5</sup>. This may be compounded by the fact that dealers cannot always execute trades exactly as the client would like.

#### Benefits

- Marketplace quality statistics provide guidance to dealers to help meet their best execution obligation<sup>6</sup>.
- Increased information about marketplace quality enables traders to develop more advanced routing algorithms with the aim of decreasing trading costs for clients.
- The combination of dealer order routing information and marketplace quality statistics would allow investors to become more informed about execution options.
- A uniform set of marketplace quality statistics would enable participants to objectively compare marketplaces. Participants would be able to determine if a marketplace has a comparative advantage in a specific area (e.g. speed, order fill rates, etc) and this would encourage competition between marketplaces. The statistics could also help new marketplaces identify underserved segments of the market.
- Order routing decisions and client trade data might help investors determine whether their dealer is obtaining best execution<sup>7</sup>. Investors would also be in a better position to be able to compare the order routing practices

<sup>5</sup> See Morgan Stanley Dean Witter & Co's comment letter to SEC regarding the proposed disclosure of order-routing and execution practices rule. September 25, 2000. Source: <http://www.sec.gov/rules/proposed/s71600/roger1.htm>

<sup>6</sup> In a recent study of the US market, it was found that marketplace statistics influence a dealer's order routing decisions. The marketplaces that provided fast execution and lower execution costs received more order flow. This paper also provided anecdotal evidence of companies claiming to use the dealer statistics. Source: Boehmer, E., and Jennings, R, and Wei, L, "Public Disclosure and Private Decisions: Equity Market Execution Quality and Order Routing" (2006), Review of Financial Studies (forthcoming).

<sup>7</sup> Investors would also have to consider brokerage fees, service requirements, and other features which are not captured in these statistics.

of different dealers. Some investors may lack the knowledge to be able to interpret the order routing and marketplace quality statistics. However, other stakeholders may interpret and communicate the relevant facts to such individuals<sup>8</sup>.

**b. Proceed with no reporting requirements (status quo)**

Under the status quo, the market would continue to develop and securities would trade on multiple marketplaces while there would be no order execution and market quality statistics requirements.

Costs

- As the number of marketplaces grows, investors and intermediaries would find it increasingly difficult to evaluate the different execution options.
- Without greater knowledge, investors would not be able to meaningfully measure the execution achieved by their dealer.
- Although some dealers and marketplaces may choose to report certain information there would be no requirement for standardized statistics. Market quality information is only beneficial if all marketplaces provide it and participants are able to make better informed decisions. Investors can only use order execution information to make informed decisions if it is available from all dealers and is comparable.

Benefits

- There would be no additional costs to dealers or marketplaces.
- There is little additional benefit for investors.

**c. Implement proposed order execution and market quality statistics as specified in a) and also include marketplace spread statistics, as required in SEC Rule 605.**

The SEC's marketplace statistics also include measure of the average effective and average realized spreads which are reported on a monthly basis<sup>9</sup>. These spread statistics are intended to provide an estimate of how well a marketplace offers price improvement and liquidity, respectively, on a given security<sup>10</sup>. Since the CSA are soliciting feedback on whether these spread statistics should be included, this section examines the potential costs and benefits of these figures.

In order to calculate the average effective and realized spread, a marketplace would need to compare the transaction price with the best bid and offer across all marketplaces. Each individual marketplace could calculate the best bid and offer across all marketplaces or, if commercially viable, a single information processor may provide this service.

Alternatively, the effective and realized spread could be calculated using the individual marketplace's best quoted bid and ask. These statistics would be considerably less informative and some marketplaces would be unable to produce usable statistics because limited liquidity can mean that there is no two-sided market for a security.

Costs

- Costs associated with alternative (a) also apply to (c)
- Given the complexity of effective and realised spread statistics, marketplaces would likely incur higher costs than the current proposed amendments

<sup>8</sup> This was a criticism of the SEC's proposal but the SEC anticipated that this would not be an issue since "independent analysts, consultants, broker-dealers, the financial press, and market centers would analyze the information and produce summaries that respond to the needs of investors". Source: <http://www.sec.gov/rules/final/34-43590.htm>

<sup>9</sup> The US requires spread calculations for each security by order size (ranges) and order type. The average effective spread measures the distance between the midpoint of the market at the time an order is entered and the execution price received. This value is then doubled to incorporate the whole bid/ask spread.

The average realized spread measures the execution price to the midpoint of the national best bid and ask 5 minutes after the order is entered.

<sup>10</sup> Aggregated marketplace statistics may be subject to selection bias for markets that specialize in smaller stocks, trade more volatile stocks, or trade difficult order flow (e.g. knowledgeable investors that trade large blocks). See Bessembinder H, "Selection Biases and Cross-Market Trading Cost Comparisons" (2003), Working Paper.

- In order to calculate the spread, marketplaces would have to get data from an information processor (if available) or directly from other marketplaces. Some marketplaces may, as part of their business model, need access to the best bid and offer across all marketplaces.

#### Benefits

- The benefits of alternative (a) also apply to (c)
- If marketplace spread statistics are introduced, they can be used to conduct transaction cost analysis (difference between bid/ask spread on round-trip trade, etc).
- Although more costly to implement, marketplaces could offset some of the cost by selling transaction cost analysis tools back to the marketplace participants
- Participants would be better able to assess the liquidity risk of a particular security.
- The addition of marketplace spread statistics would further improve a dealer's ability to make trading decisions that would be most beneficial to their clients.

#### **6) Conclusions**

More informed industry participants would improve the efficiency and fairness of Canada's capital markets. On that basis, the introduction of order routing and market quality statistics is more desirable than continuing with the status quo.

On a qualitative basis there is reason to believe that the introduction of order execution and market quality statistics would be beneficial. At this stage there is very little available information about how these statistics may be used in the Canadian market and the likely cost of producing them. Without that data it is difficult to make assess the relative costs and benefits of options (a) and (c) above.

As such, the OSC will survey investment dealers, marketplaces, and other market participants to collect quantitative estimates of the cost and benefits of order execution and market quality statistics. We will begin surveying during the spring of 2007. The results of that survey will be published in a revised CBA.

#### **7) Additional request for comments**

Do you believe there are any other costs to implement best execution reporting that are not covered by this CBA?

If you wish to participate in CBA discussions on the best execution reporting requirements, please contact:

Michael Bordynuik  
Economist  
Ontario Securities Commission  
20 Queen Street West  
19th Floor, Box 55  
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M5H 3S8  
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**RS MARKET INTEGRITY NOTICE 2007-008  
REQUEST FOR COMMENTS  
PROVISIONS RESPECTING BEST EXECUTION**

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April 20, 2007

No. 2007-008

**RS MARKET INTEGRITY NOTICE**  
**REQUEST FOR COMMENTS**  
**PROVISIONS RESPECTING BEST EXECUTION**

**Summary**

This Market Integrity Notice provides notice that, on January 30, 2007, the Board of Directors of Market Regulation Services Inc. approved for publication proposed amendments to the Universal Market Integrity Rules respecting various aspects of best execution. In particular, the amendments would:

- conform the requirements under the Universal Market Integrity Rules to be consistent with proposed changes by the Canadian Securities Administrators to National Instrument 23-101;
- clarify the circumstances when a Participant should consider order and trade information from an organized regulated market outside of Canada; and
- clarify that obtaining “best execution” remains subject to “best price” obligations.

**Questions / Further Information**

For further information or questions concerning this notice contact:

James E. Twiss  
Chief Policy Counsel  
Telephone: 416.646.7277  
Fax: 416.646.7265  
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**PROVISIONS RESPECTING BEST EXECUTION****Summary**

This Market Integrity Notice provides notice that, on January 30, 2007, the Board of Directors of Market Regulation Services Inc. (“RS”) approved for publication proposed amendments to the Universal Market Integrity Rules (“UMIR”) respecting various aspects of best execution (“Proposed Amendments”). In particular, the Proposed Amendments would:

- conform the requirements under UMIR to be consistent with proposed changes (the “CSA Best Execution Proposal”)<sup>1</sup> by the Canadian Securities Administrators (“CSA”) to National Instrument 23-101 (“CSA Trading Rules”); and
- clarify the circumstances when a Participant should consider order and trade information from an organized regulated market<sup>2</sup> outside of Canada; and

<sup>1</sup> See “CSA Best Execution Proposal” on page 64 of this Market Integrity Notice. Reference should be made to Market Integrity Notice 2007-007 – *Request for Comments - Joint Canadian Securities Administrators/Market Regulation Services Inc. Notice on Trade-Through Protection, Best Execution and Access to Marketplaces – Proposed Amendments to National Instrument 21-101 Marketplace Operation and National Instrument 23-101 Trading Rules and Related Universal Market Integrity Rules* (April 20, 2007).

<sup>2</sup> RS has proposed an amendment to UMIR to formally adopt a definition of an “organized regulated market” and such proposal is presently being reviewed by the Recognizing Regulators. Reference should be made to Market Integrity Notice 2005-012 – *Request for Comments – Provisions Respecting “Off-Marketplace” Trades* (April 29, 2005) that proposes that the term “organized regulated market” mean a market outside of Canada:

- (a) that is an exchange, quotation or trade reporting system, alternative trading system or similar facility recognized by or registered with a securities regulatory authority that is an ordinary member of the International Organization of Securities Commissions;
- (b) on which the entry of orders and the execution of trades is monitored for compliance with regulatory requirements at the time of entry and execution by a self-regulatory organization recognized by the securities regulatory authority or by the market if the market has been empowered by the securities regulatory authority to monitor the entry of orders and the execution of trades on that market for compliance with regulatory requirements; and
- (c) that displays and provides timely information to data vendors, information processors or persons providing similar functions respecting the dissemination of data to market participants for that market of at least the price, volume and security identifier of each order at the

- clarify that obtaining “best execution” remains subject to “best price” obligations.

### Rule-Making Process

RS has been recognized as a self-regulatory organization by the Alberta Securities Commission, British Columbia Securities Commission, Manitoba Securities Commission, Ontario Securities Commission and, in Quebec, by the Autorité des marchés financiers (the “Recognizing Regulators”) and, as such, is authorized to be a regulation services provider for the purposes of National Instrument 21-101 (the “Marketplace Operation Instrument”) and the CSA Trading Rules.

As a regulation services provider, RS administers and enforces trading rules for the marketplaces that retain the services of RS. RS has adopted, and the Recognizing Regulators have approved, UMIR as the integrity trading rules that will apply in any marketplace that retains RS as its regulation services provider. Presently, RS has been retained to be the regulation services provider for: the Toronto Stock Exchange (“TSX”), TSX Venture Exchange and Canadian Trading and Quotation System (“CNQ”), each as an Exchange; and for Bloomberg Tradebook Canada Company, Liquidnet Canada Inc, Perimeter Markets Inc. (the operator of “BlockBook”), Shorcan ATS Limited and TriAct Canada Marketplace LP, each as an ATS. CNQ presently operates an “alternative market” known as “Pure Trading” that is entitled to trade securities that are listed on other Exchanges and that presently trades securities listed on the TSX.

The Rules Advisory Committee of RS (“RAC”) reviewed the Proposed Amendments. RAC is an advisory committee comprised of representatives of each of: the marketplaces for which RS acts as a regulation services provider; Participants; institutional investors and subscribers; and the legal and compliance community.

The amendments to UMIR will be effective upon approval of the changes by the Recognizing Regulators following public notice and comment and ratification of the changes by the Board. Certain of the Proposed Amendments will be consequential to the adoption of the CSA Best Execution Proposal which is part of proposed amendments to the CSA Trading Rules and Marketplace Operation Instrument that are being proposed concurrently by the CSA. The Recognizing Regulators will consider the Proposed Amendments in the context of any changes approved to the CSA Trading Rules.

The text of the Proposed Amendments is set out in Appendix “A”. Comments on the Proposed Amendments should be in writing and delivered by **July 19, 2007** to:

James E. Twiss,  
Chief Policy Counsel,  
Market Policy and General Counsel’s Office,  
Market Regulation Services Inc.,  
Suite 900,  
145 King Street West,  
Toronto, Ontario. M5H 1J8

Fax: 416.646.7265  
e-mail: james.twiss@rs.ca

A copy should also be provided to Recognizing Regulators by forwarding a copy to:

Cindy Petlock  
Manager, Market Regulation  
Capital Markets Branch  
Ontario Securities Commission  
Suite 1903, Box 55,  
20 Queen Street West  
Toronto, Ontario. M5H 3S8

Fax: (416) 595-8940  
e-mail: cpetlock@osc.gov.on.ca

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- time of entry of the order on that market and at least the price, volume and security identifier of each trade at the time of execution or reporting of the trade on that market,
- but, for greater certainty, does not include a facility of a market to which trades executed over-the-counter are reported unless:
- (d) the trade is required to be reported and is reported to the market forthwith following execution;
  - (e) at the time of the report, the trade is monitored for compliance with securities regulatory requirements; and
  - (f) at the time of the report, timely information respecting the trade is provided to data vendors, information processors or persons providing similar functions respecting the dissemination of data to market participants for that market.

**Commentators should be aware that a copy of their comment letter will be publicly available on the RS website ([www.rs.ca](http://www.rs.ca) under the heading “Market Policy” and sub-heading “Universal Market Integrity Rules”) after the comment period has ended. A summary of the comments contained in each submission will also be included in a future Market Integrity Notice dealing with the revision or the approval of the Proposed Amendments.**

## Background to the Proposed Amendments

### Current Provisions

Rule 5.1 of UMIR presently requires that a Participant “diligently pursue the execution of each client order on the most advantageous terms for the client as expeditiously as practicable under prevailing market conditions”. In addition to this “best execution” requirement, Rule 5.2 of UMIR presently requires that a Participant make reasonable efforts prior to the execution of a client order to ensure that the client order is executed at the best available price.<sup>3</sup> As such, UMIR recognizes that “best execution” and “best price” are separate but related obligations imposed on a Participant when handling a client order.

Currently, the CSA Trading Rules provide that “a dealer acting as agent for a client shall make reasonable efforts to ensure that the client receives the best execution price on a purchase or sale of securities by the client”.<sup>4</sup> For the purposes of the CSA Trading Rules, the focus of “best execution” has been on providing “best price”. In accordance with the CSA Trading Rules, a Participant is exempt from the “best execution” provisions under Part 4 of the CSA Trading Rules if the Participant complies with the requirements of UMIR when handling a client order that is subject to UMIR.<sup>5</sup>

RS issued Market Integrity Notice 2006-017 - *Guidance – Trading Securities on Multiple Marketplaces* (September 1, 2006) and Market Integrity Notice 2006-020 - *Guidance – Compliance Requirements for Trading on Multiple Marketplaces* (October 30, 2006) to provide additional guidance on the application and interpretation of various UMIR provisions in the current multiple marketplace environment. In Market Integrity Notice 2007-002 – *Notice of Approval – Provisions Respecting Competitive Marketplaces* (February 26, 2007), RS provided notice that the Recognizing Regulators had approved amendments (the “Competitive Marketplaces Amendments”) that, among other things, incorporated into Part 2 of Policy 5.1 aspects of the guidance provided in Market Integrity Notice 2006-017 and conform to a comparable requirement on best execution recently added to the Companion Policy of the CSA Trading Rules.<sup>6</sup> The changes to the “best execution” provisions of UMIR under the Competitive Marketplaces Amendments were intended as an “interim step” to facilitate the introduction of multiple competitive marketplaces (particularly setting out when a Participant should consider various visible and non-transparent marketplaces) and that additional changes would be proposed to conform UMIR with future amendments to the CSA Trading Rules. Proposed amendments to the CSA Trading Rules related to “best execution” are now being proposed under the CSA Best Execution Proposal.

The obligation to monitor information on orders entered on and trades executed on marketplaces trading the same security falls to the Participant handling the client order. UMIR does not require that a Participant necessarily to maintain trading access to every Canadian marketplace on which a security may trade. Under the Competitive Marketplaces Amendments, a Participant is expected to make arrangements with another dealer who is a participant of a particular marketplace or will route an order to a particular marketplace if the particular marketplace had demonstrated that there is a reasonable likelihood that the marketplace

<sup>3</sup> The “best price” obligation under Rule 5.2 of UMIR will be repealed or significantly amended dependent upon the provisions governing “trade-through” that are adopted by the CSA. Any consequential amendments proposed by RS will be issued in a Market Integrity Notice and be open for comment during the same period as any amendments regarding trade-through proposed by the CSA for the CSA Trading Rules and the Marketplace Operation Instrument. For a discussion of the concepts that may be included in the trade-through proposal reference should be made to “Trade-through” in Market Integrity Notice 2007-007 - Joint Canadian Securities Administrators/Market Regulation Services Inc. Notice, op. cit., 8.

<sup>4</sup> National Instrument 23-101, ss. 4.2(1).

<sup>5</sup> Ibid, s. 2.1. The text of that section provides:

A person or company is exempt from subsection 3.1(1) and Parts 4 and 5 if the person or company complies with similar requirements established by

- (a) a recognized exchange that monitors and enforces the requirements set under section 7.1(1) directly;
- (b) a recognized quotation and trade reporting system that monitors and enforces requirements set under subsection 7.3(1) directly; or
- (c) a regulation services provider.

<sup>6</sup> Canadian Securities Administrators. *Notice of Amendments to National Instrument 21-101 Marketplace Operation* and Companion Policy 21-101CP and National Instrument 23-101 – *Trading Rules* and Companion Policy 23-101CP, (2006) 29 OSCB 9731. The amendments added the following subsection 4.1(8) to Companion Policy 23-101CP:

In order to meet best execution obligations where securities trade on multiple marketplaces in Canada, a dealer should consider information from all marketplaces (not just marketplaces where a dealer is a participant). This does not necessarily mean that a dealer must have access to real-time data feeds from each marketplace but that it should establish reasonable policies and procedures for best execution that include taking into account order and/or trade information from all appropriate marketplaces in the particular circumstances. The policies and procedures should be monitored on a regular basis. A dealer should also take steps, where appropriate, to access orders which may include making arrangements with another dealer who is a participant of a particular marketplace or routing an order to a particular marketplace.

will have liquidity for a specific security relative to the size of the client order. Under the Competitive Marketplaces Amendments a Participant, in discharging its best execution obligation, must consider possible liquidity on marketplaces that do not provide transparency of orders in a consolidated market display if:

- the displayed volume in the consolidated market display is not adequate to fully execute the client order on advantageous terms for the client; and
- the non-transparent marketplace has demonstrated that there is a reasonable likelihood that the marketplace will have liquidity for the specific security.

In addition, the Competitive Marketplaces Amendments expanded the Policy to indicate that RS would consider two additional factors when determining whether a Participant has diligently pursued the best execution of a client order, namely:

- any specific client instructions regarding the timeliness of the execution of the order; and
- whether organized regulated markets outside of Canada have been considered (particularly if the principal market for the security is outside of Canada).

The Competitive Marketplaces Amendments moved the consideration of specific client instructions on timeliness of execution from Policy 5.2 as one of the factors to be taken into account in determining whether a Participant has fulfilled its “best price obligation” to be a factor in the determination of “best execution”. The Competitive Marketplaces Amendments also clarified when the consideration of organized regulated markets outside of Canada should be undertaken as part of best execution of a client order in order to parallel a provision on best execution contained in the Companion Policy to the CSA Trading Rules.<sup>7</sup>

### ***CSA Best Execution Proposal***

Concurrent with the issuance of this Request for Comments, the CSA has published proposed amendments to the Marketplace Operation Instrument and CSA Trading Rules dealing with a number of matters including best execution.<sup>8</sup> The following is the text of the key aspects of CSA Best Execution Proposal that are directly relevant to the current or proposed provisions under UMIR related to best execution<sup>9</sup>:

#### *Definition of best execution and obligation to provide best execution*

To reflect the breadth of considerations for best execution, the CSA are proposing to amend the provisions to include factors other than price. Currently, there is no definition of “best execution”. Instead, section 4.2 of NI 23-101 [CSA Trading Rules] refers to “best execution price” when describing the obligation applicable to a dealer. In addition, requirements in UMIR begin with a general obligation and then focus more specifically on price. In response to questions raised in the concept paper [Concept Paper 23-402], many commenters stated that the current best execution requirements are too narrow and that the focus of best execution should be on the process and not an absolute standard to be applied on a trade-by-trade basis.

In light of the comments received on the concept paper, the CSA are proposing the following definition of best execution: the most advantageous execution terms reasonably available under the circumstances.<sup>10</sup> The Companion Policy clarifies that the application of the definition will vary depending on the specific circumstances, and also, on who is responsible for obtaining best execution.<sup>11</sup> In assessing the most advantageous execution terms reasonably available under the circumstances, the key elements identified (i.e., price, speed of execution, certainty of execution and overall cost of the transaction) are relevant. These key elements encompass more specific considerations such as liquidity, market impact or opportunity costs.

<sup>7</sup> Companion Policy 23-101CP, ss 4.1(3). The text of that subsection provides:  
For inter-listed securities, the Canadian securities regulatory authorities are of the view that in making reasonable efforts, a dealer should also consider whether it would be appropriate in the particular circumstances to look at markets outside of Canada.

<sup>8</sup> See “Best Execution Requirements”, Market Integrity Notice 2007-007 - Joint Canadian Securities Administrators/Market Regulation Services Inc. Notice, op. cit., 21. The proposals related to best execution follow the publication of Concept Paper 23-402 *Best Execution and Soft Dollar Arrangements* (2005) 28 OSCB 1362. Proposals relating to soft dollar arrangements will be dealt with in a separate CSA proposal.

<sup>9</sup> The “CSA Best Execution Proposal” also deals with the application of the requirements to advisers and the introduction of reporting of order execution and market quality information that will not have comparable provisions in UMIR.

<sup>10</sup> Proposed amendments to NI 23-101, s. 1.1.

<sup>11</sup> Proposed amendments to 23-101CP, s. 1.1.1.

*Application of best execution to dealers*

The best execution obligation would require that a dealer use reasonable efforts to achieve best execution. Where a security trades on multiple marketplaces, it does not necessarily require dealers to maintain access to all marketplaces. To achieve best execution, a dealer should assess whether it is appropriate to consider all marketplaces, both within and outside of Canada, upon which a security is traded. The CSA also propose to clarify that “best execution” will vary depending on the particular circumstances and that a dealer should be able to demonstrate that it has a process and has relied on that process in seeking the desired outcome.<sup>12</sup>

**Harmonization of the Proposed Amendments and the CSA Best Execution Proposal**

Concurrent with the publication of this Market Integrity Notice requesting comment on the Proposed Amendments, the CSA published a Notice and Request for Comments containing the CSA Best Execution Proposal.

It is intended that the provisions adopted under the UMIR will parallel the provisions adopted in the CSA Trading Rules. There will be differences in language and structure that reflect:

- the use of different defined terms and drafting protocols;
- the proposed introduction under the CSA Best Execution Proposal of requirements for reporting of order execution and market quality information will not have comparable provision under UMIR;
- the application of the UMIR provisions to orders for securities eligible to be traded on a marketplace that has retained RS as its regulation services provider as compared to the application of CSA Best Execution Proposal to all client orders; and
- the application of the UMIR provisions to Participants as compared to the application of CSA Best Execution Proposal to all dealers and advisers that may owe a best execution to clients when handling a client order or dealing on behalf of a portfolio.

In the view of RS, there are no substantive differences between the Proposed Amendments and the CSA Best Execution Proposal other than as a result of these four factors.<sup>13</sup> If revisions are made to the CSA Best Execution Proposal, it is intended that necessary consequential revisions will be made to Proposed Amendments such that the UMIR provisions will parallel the provisions of the CSA Trading Rules.

If there are continuing differences between the “best execution” provisions under UMIR and the CSA Trading Rules, a Participant would, in accordance with section 2.1 of the CSA Trading Rules, be exempt from the “best execution” provisions under Part 4 of the CSA Trading Rules if the Participant complies with the requirements of UMIR. However, the provisions of the CSA Trading Rules would apply to:

- a dealer or adviser who is not a “Participant” for the purposes of UMIR; and
- a Participant when trading a client order for a security that is not eligible to be traded on a marketplace regulated by RS.

**Summary of the Proposed Amendments**

The Proposed Amendments would vary Rule 5.1 by replacing certain of the language to more closely parallel the terms used in the CSA Best Execution Proposal. The Rule would be amended to refer to “the most advantageous execution terms reasonably available under the circumstances”. Currently, the Rule requires a Participant to diligently pursue the execution of each client order on the “most advantageous terms for the client as expeditiously as practicable under prevailing market conditions”. The phrase “expeditiously as practicable under prevailing market conditions” has been deleted from the Rule as the Policy will be amended to set out the four general factors (price, speed of execution, certainty of execution and the overall transaction cost) that are encompassed by concept of “expeditiously as practicable” and to indicate that in considering the “circumstances” the Participant should take into account “prevailing market conditions”.

<sup>12</sup> Proposed amendments to 23-101CP, s. 4.1.

<sup>13</sup> Under the CSA Best Execution Proposal, the term “best execution” is defined to mean “the most advantageous execution terms reasonably available under the circumstances”. Under Policy 5.1 of UMIR of the Proposed Amendments, the UMIR provision will refer specifically to “prevailing market conditions” and set out the factors to be taken into account in determining “prevailing market conditions”.

The Proposed Amendments would change various parts of Policy 5.1 to provide clarification of:

- the general factors to be considered in providing best execution, namely: price; speed of execution; certainty of execution; and the overall cost of the transaction;
- the specific factors to be considered in providing best execution, namely: client instructions; consideration of marketplaces that have demonstrated a reasonable likelihood of liquidity relative to the size of the client order; and consideration of non-transparent marketplaces if the displayed volume is inadequate and the non-transparent marketplace has demonstrated a reasonable likelihood of liquidity for the specific security;
- the additional factors that may be considered by a Participant when determining whether to execute on a market outside of Canada including: available liquidity displayed on a marketplace; the proportion of trading in the security accounted for by the foreign market; exposure to settlement risk and fluctuations in foreign currency exchange;
- the requirement to comply with the “best price” obligation under Rule 5.2 notwithstanding any client instruction or consent with respect to the “best execution” obligation; and
- the requirement that the written policies and procedures of a Participant should outline the process used by the Participant to obtain best execution and permit an evaluation of whether best execution was obtained on the execution of a particular client order.

As a result of the changes proposed for Rule 5.1 and Policy 5.1, the Proposed Amendments would move the factors to be taken into account when determining whether a principal trade with a client is undertaken at the “best available price” from Policy 5.1 and add them to Policy 8.1. In addition, the Proposed Amendments would make an editorial change to Rule 8.1 by replacing the phrase “taking into account the condition of the market at that time” with the phrase “under prevailing market conditions”. This change would standardize the use of terminology between Policy 5.1 and Rule 8.1 with respect to the factors to be taken into account. In the view of RS, this amendment simply standardizes the language used and does not represent a substantive change in requirements.

### **Summary of Changes from the Competitive Marketplaces Amendments**

The Proposed Amendments would specifically vary two aspects of Part 2 of Policy 5.1 as adopted by the Competitive Marketplaces Amendments:

#### ***Client Instructions***

The policies under the Competitive Marketplaces Amendments permit a Participant to take into consideration specific client instructions regarding “the timeliness of” the execution of the client order. The Proposed Amendments would remove the restriction on the client instructions to the speed of execution. However, the Proposed Amendments would also clarify that a Participant would remain subject to the “best price” obligation under Rule 5.2 notwithstanding any client instruction or consent.

#### ***Consideration of Organized Regulated Markets***

One of the factors a Participant can take into account under the Competitive Marketplaces Amendments is “whether organized regulated markets outside of Canada have been considered (particularly if the principal market for the security is outside of Canada).” Certain commentators construed this factor as requiring the consideration of foreign markets when trading any security that was traded on both a marketplace and a foreign market. The Proposed Amendments would set out the additional factors that may be considered by a Participant when determining whether to execute on a market outside of Canada including: available liquidity displayed on a marketplace; the proportion of trading in the security accounted for by the foreign market; exposure to settlement risk and fluctuations in foreign currency exchange.

### **Appendices**

- Appendix “A” sets out the text of the Proposed Amendments to the Rules and Policies respecting best execution; and
- Appendix “B” contains the text of the relevant provisions of the Rules and Policies as they would read on the adoption of the Proposed Amendments. Appendix “B” also contains a marked version of the current provisions highlighting the changes introduced by the Proposed Amendments.

**Questions / Further Information**

For further information or questions concerning this notice contact:

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ROSEMARY CHAN,  
VICE PRESIDENT, MARKET POLICY AND GENERAL COUNSEL

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**Appendix "A"****Amendments Respecting Best Execution**

The Universal Market Integrity Rules are amended as follows:

1. Rule 5.1 is deleted and the following substituted.

A Participant shall diligently pursue the execution of each client order on the most advantageous execution terms reasonably available under the circumstances.

2. Rule 8.1 is amended by deleting the phrase "taking into account the condition of the market at that time" and substituting the phrase "under prevailing market conditions".

The Policies to the Universal Market Integrity Rules are amended as follows:

1. Policy 5.1 is deleted and the following substituted:

**Part 1 – General Factors to be Considered**

In seeking the "most advantageous execution terms reasonably available under prevailing market conditions", the Market Regulator would expect that the Participant would take into account a number of general factors, including:

- the price at which the trade would occur;
- the speed of execution;
- the certainty of execution; and
- the overall cost of the transaction.

*These four broad factors encompass more specific considerations, such as order size, reliability of quotes, liquidity, market impact (the price movement that occurs when executing an order) and opportunity cost (the missed opportunity to obtain a better price when an order is not completed at the most advantageous time). The overall cost of the transaction is meant to include, where appropriate, all costs associated with accessing an order and/or executing a trade that are passed onto a client, including fees arising from trading on a particular marketplace, jitney fees (ie. any fees charged between dealers to provide trading access) and settlement costs.*

In considering the circumstances, Participants should take into account "prevailing market conditions" and consider such factors as:

- prices and volumes of the last sale and previous trades;
- direction of the market for the security;
- posted size on the bid and offer;
- the size of the spread; and
- liquidity of the security.

**Part 2 – Specific Factors to be Considered**

In determining whether a Participant has diligently pursued the best execution of a client order, the Market Regulator will consider a number of specific factors including:

- any specific client instructions regarding the execution of the order;



- whether the Participant has considered orders on a marketplace that has demonstrated a reasonable likelihood of liquidity for a specific security relative to the size of the client order; and
- whether the Participant has considered possible liquidity on marketplaces that do not provide transparency of orders in a consolidated market display if:
  - the displayed volume in the consolidated market display is not adequate to fully execute the client order on advantageous terms for the client, and
  - the non-transparent marketplace has demonstrated that there is a reasonable likelihood that the marketplace will have liquidity for the specific security.

### **Part 3 – Consideration of Organized Regulated Markets**

In determining whether to consider the execution of a client order on an organized regulated market outside of Canada, the Participant may consider, in addition to the factors set out in Parts 1 and 2:

- available liquidity displayed on a marketplace relative to the size of the client order;
- the extent of trading in the particular security on the organized regulated market relative to the volume of trading on marketplaces;
- the extent of exposure to settlement risk in a foreign jurisdiction; and
- *the extent of exposure to fluctuations in foreign currency exchange.*

### **Part 4 – Subject to Best Price Obligation**

Notwithstanding any instruction or consent of the client, the provision of “best execution” for a client order is subject to compliance with the “best price” obligation under Rule 5.2. Similarly, if an organized regulated market outside of Canada is considered in order to provide a client with “best execution”, the Participant has an obligation to better-priced orders on marketplaces that may be required for compliance with the “best price” obligation under Rule 5.2.

2. Part 4 of Policy 7.1 is amended by adding the following after the first sentence:

A Participant should have a process in place to “diligently pursue the execution of each client order on the most advantageous execution terms reasonably available under the circumstances”. The process should allow the Participant to evaluate whether “best execution” was obtained and whether the Participant has “diligently pursued” the best execution of a particular client order, including relying on that process.

3. The following is added as Part 3 of Policy 8.1:

#### **Part 3 – Factors in Determining “Best Available Price”**

The price of the principal transaction must also be justified by prevailing market conditions. Participants should consider such factors as:

- prices and volumes of the last sale and previous trades;
- direction of the market for the security;
- posted size on the bid and offer;
- the size of the spread; and
- liquidity of the security.

For example, if the market is \$10 bid and \$10.50 asked and a client wants to sell 1,000 shares, it would be inappropriate for a Participant to do a principal trade at \$10.05 if the security has been trading heavily at \$10.50 and there is strong bidding for the security at \$10 compared to the number of securities being offered

at \$10.50. The condition of the market suggests that the client should be able to sell at a better price than \$10.05. Accordingly, the Participant as agent for the client should post an offer at \$10.45 or even \$10.50, depending on the circumstances. The desire of the client to obtain a fill quickly is always a consideration.

Of course, if a client expressly consents to a principal trade on a fully-informed basis, following the client's instructions will be reasonable.

Appendix “B”

Universal Market Integrity Rules

Text of Rules and Policies to Reflect Proposed Amendments  
Respecting Best Execution

| Text of Provisions of Following Adoption of Proposed Amendments  | Text of Current Provisions Marked to Reflect Adoption of Proposed Amendments  |
|--|---|
| <p><b>5.1 Best Execution of Client Orders</b></p> <p>A Participant shall diligently pursue the execution of each client order on the most advantageous execution terms reasonably available under the circumstances.</p>   | <p><b>5.1 Best Execution of Client Orders</b></p> <p>A Participant shall diligently pursue the execution of each client order on the most advantageous <u>execution terms reasonably available</u> for the client as <u>expeditiously as practicable</u> under <u>the circumstances</u>, <del>prevailing market conditions.</del></p>   |
| <p><b>8.1 Client-Principal Trading</b></p> <p>(1) A Participant that receives a client order for 50 standard trading units or less of a security with a value of \$100,000 or less may execute the client order against a principal order or non-client order at a better price provided the Participant has taken reasonable steps to ensure that the price is the best available price for the client under prevailing market conditions.</p>  | <p><b>8.1 Client-Principal Trading</b></p> <p>(1) A Participant that receives a client order for 50 standard trading units or less of a security with a value of \$100,000 or less may execute the client order against a principal order or non-client order at a better price provided the Participant has taken reasonable steps to ensure that the price is the best available price for the client <u>under prevailing market conditions</u> <del>taking into account the condition of the market at that time.</del></p>  |
| <p><b>Policy 5.1 – Best Execution of Client Orders</b></p> <p><b>Part 1 – General Factors to be Considered</b></p> <p>In seeking the “most advantageous execution terms reasonably available under the circumstances”, the Market Regulator would expect that the Participant would take into account a number of general factors, including:</p> <ul style="list-style-type: none"> <li>• the price at which the trade would occur;</li> <li>• the speed of execution;</li> <li>• the certainty of execution; and</li> <li>• the overall cost of the transaction.</li> </ul> <p>These four broad factors encompass more specific considerations, such as order size, reliability of quotes, liquidity, market impact (the price movement that occurs when executing an order) and opportunity cost (the missed opportunity to obtain a better price when an order is not completed at the most advantageous time). The overall cost of the transaction is meant to include, where appropriate, all costs associated with accessing an order and/or executing a trade that are passed onto a client, including fees arising from trading on a particular marketplace, jitney fees (ie. any fees charged between dealers to provide trading access) and settlement costs.</p> | <p><b>Policy 5.1 – Best Execution of Client Orders</b></p> <p><b>Part 1 – General Factors to be Considered</b></p> <p>In seeking the “most advantageous execution terms <u>reasonably available under the circumstances</u>”, <u>the Market Regulator would expect that the Participant would take into account a number of general factors, including:</u></p> <ul style="list-style-type: none"> <li>• <u>the price at which the trade would occur;</u></li> <li>• <u>the speed of execution;</u></li> <li>• <u>the certainty of execution; and</u></li> <li>• <u>the overall cost of the transaction.</u></li> </ul> <p><u>These four broad factors encompass more specific considerations, such as order size, reliability of quotes, liquidity, market impact (the price movement that occurs when executing an order) and opportunity cost (the missed opportunity to obtain a better price when an order is not completed at the most advantageous time). The overall cost of the transaction is meant to include, where appropriate, all costs associated with accessing an order and/or executing a trade that are passed onto a client, including fees arising from trading on a particular marketplace, jitney fees (ie. any fees charged between dealers to provide trading access) and settlement costs.</u></p> |

| Text of Provisions of Following Adoption of Proposed Amendments   | Text of Current Provisions Marked to Reflect Adoption of Proposed Amendments   |
|---|--|
| <p>In considering the circumstances, Participants should take into account “prevailing market conditions” and consider such factors as:</p> <ul style="list-style-type: none"> <li>• prices and volumes of the last sale and previous trades;</li> <li>• direction of the market for the security;</li> <li>• posted size on the bid and offer;</li> <li>• the size of the spread; and</li> <li>• liquidity of the security.</li> </ul>   | <p><del>“Best execution” refers to a reasonable period of time during which the order is handled, not merely the precise moment in time that it is executed. The price of the principal transaction must also be justified by the condition of the market. In considering the circumstances, Participants should take into account “prevailing market conditions” and consider such factors as:</del></p> <ul style="list-style-type: none"> <li>• prices and volumes of the last sale and previous trades;</li> <li>• direction of the market for the security;</li> <li>• posted size on the bid and offer;</li> <li>• the size of the spread; and</li> <li>• liquidity of the security.</li> </ul> <p><del>For example, if the market is \$10 bid and \$10.50 asked and a client wants to sell 1000 shares, it would be inappropriate for a Participant to do a principal trade at \$10.05 if the security has been trading heavily at \$10.50 and there is strong bidding for the security “at \$10 compared to the number of securities being offered at \$10.50. The condition of the market suggests that the client should be able to sell at a better price than \$10.05. Accordingly, the Participant as agent for the client should post an offer at \$10.45 or even \$10.50, depending on the circumstances. The desire of the client to obtain a fill quickly is always a consideration.</del></p> <p><del>Of course, if a client expressly consents to a principal trade a fully informed basis, following the client’s instructions will be reasonable.</del></p> |
| <p><b>Policy 5.1 – Best Execution of Client Orders</b></p> <p><b>Part 2 – Specific Factors to be Considered</b></p> <p>In determining whether a Participant has diligently pursued the best execution of a client order, the Market Regulator will consider a number of specific factors including:</p> <ul style="list-style-type: none"> <li>• any specific client instructions regarding the execution of the order;</li> <li>• whether the Participant has considered orders on a marketplace that has demonstrated a reasonable likelihood of liquidity for a specific security relative to the size of the client order; and</li> <li>• whether the Participant has considered possible liquidity on marketplaces that do not provide transparency of orders in a consolidated market display if:             <ul style="list-style-type: none"> <li>○ the displayed volume in the consolidated market display is not adequate to fully execute the client order on advantageous terms for the client, and</li> </ul> </li> </ul> | <p><b>Policy 5.1 – Best Execution of Client Orders</b></p> <p><b>Part 2 – <u>Specific</u> Factors to be Considered</b></p> <p>In determining whether a Participant has diligently pursued the best execution of a client order, the Market Regulator will consider a number of <u>specific</u> factors including:</p> <ul style="list-style-type: none"> <li>• any specific client instructions regarding the <del>timeliness of the</del> execution of the order;</li> <li>• <del>whether organized regulated markets outside of Canada have been considered (particularly if the principal market for the security is outside of Canada);</del></li> <li>• whether the Participant has considered orders on a marketplace that has demonstrated a reasonable likelihood of liquidity for a specific security relative to the size of the client order; and</li> <li>• whether the Participant has considered possible liquidity on marketplaces that do not provide transparency of orders in a consolidated market display if:</li> </ul>   |

| Text of Provisions of Following Adoption of Proposed Amendments   | Text of Current Provisions Marked to Reflect Adoption of Proposed Amendments   |
|---|--|
| <ul style="list-style-type: none"> <li>○ the non-transparent marketplace has demonstrated that there is a reasonable likelihood that the marketplace will have liquidity for the specific security.</li> </ul>  | <ul style="list-style-type: none"> <li>○ the displayed volume in the consolidated market display is not adequate to fully execute the client order on advantageous terms for the client, and</li> <li>○ the non-transparent marketplace has demonstrated that there is a reasonable likelihood that the marketplace will have liquidity for the specific security.</li> </ul>  |
| <p><b><i>Policy 5.1 – Best Execution of Client Orders</i></b></p> <p><b>Part 3 – Consideration of Organized Regulated Markets</b></p> <p>In determining whether to consider the execution of a client order on an organized regulated market outside of Canada, the Participant may consider, in addition to the factors set out in Parts 1 and 2:</p> <ul style="list-style-type: none"> <li>• available liquidity displayed on a marketplace relative to the size of the client order;</li> <li>• the extent of trading in the particular security on the organized regulated market relative to the volume of trading on marketplaces;</li> <li>• the extent of exposure to settlement risk in a foreign jurisdiction; and</li> <li>• <i>the extent of exposure to fluctuations in foreign currency exchange.</i></li> </ul> | <p><b><u>Policy 5.1 – Best Execution of Client Orders</u></b></p> <p><b><u>Part 3 – Consideration of Organized Regulated Markets</u></b></p> <p><u>In determining whether to consider the execution of a client order on an organized regulated market outside of Canada, the Participant may consider, in addition to the factors set out in Parts 1 and 2:</u></p> <ul style="list-style-type: none"> <li>• <u>available liquidity displayed on a marketplace relative to the size of the client order;</u></li> <li>• <u>the extent of trading in the particular security on the organized regulated market relative to the volume of trading on marketplaces;</u></li> <li>• <u>the extent of exposure to settlement risk in a foreign jurisdiction; and</u></li> <li>• <u>the extent of exposure to fluctuations in foreign currency exchange.</u></li> </ul> |
| <p><b><i>Policy 5.1 – Best Execution of Client Orders</i></b></p> <p><b>Part 4 – Subject to Best Price Obligation</b></p> <p><i>Notwithstanding any instruction or consent of the client, the provision of “best execution” for a client order is subject to compliance with the “best price” obligation under Rule 5.2. Similarly, if an organized regulated market outside of Canada is considered in order to provide a client with “best execution”, the Participant has an obligation to better-priced orders on marketplaces that may be required for compliance with the “best price” obligation under Rule 5.2.</i></p>   | <p><b><u>Policy 5.1 – Best Execution of Client Orders</u></b></p> <p><b><u>Part 4 – Subject to Best Price Obligation</u></b></p> <p><u>Notwithstanding any instruction or consent of the client, the provision of “best execution” for a client order is subject to compliance with the “best price” obligation under Rule 5.2. Similarly, if an organized regulated market outside of Canada is considered in order to provide a client with “best execution”, the Participant has an obligation to better-priced orders on marketplaces that may be required for compliance with the “best price” obligation under Rule 5.2.</u></p>   |
| <p><b>Policy 7.1 – Trading Supervision Obligations</b></p> <p><b>Part 4 – Specific Procedures Respecting Client Priority and Best Execution</b></p> <p>Participants must have written compliance procedures reasonably designed to ensure that their trading does not violate Rule 5.3 or 5.1. A Participant should have a process in place to “diligently pursue the execution of each client order on the most advantageous execution terms reasonably available under the circumstances”. The process</p>  | <p><b>Policy 7.1 – Trading Supervision Obligations</b></p> <p><b>Part 4 – Specific Procedures Respecting Client Priority and Best Execution</b></p> <p>Participants must have written compliance procedures reasonably designed to ensure that their trading does not violate Rule 5.3 or 5.1. <u>A Participant should have a process in place to “diligently pursue the execution of each client order on the most advantageous execution terms reasonably available under the circumstances”. The process</u></p>  |

| Text of Provisions of Following Adoption of Proposed Amendments  | Text of Current Provisions Marked to Reflect Adoption of Proposed Amendments   |
|--|--|
| <p>should allow the Participant to evaluate whether “best execution” was obtained and whether the Participant has “diligently pursued” the best execution of a particular client order, including relying on that process. At a minimum, the written compliance procedures must address employee education and post-trade monitoring.</p> <p>The purpose of the Participant’s compliance procedures is to ensure that pro traders do not knowingly trade ahead of client orders. This would occur if a client order is withheld from entry into the market and a person with knowledge of that client order enters another order that will trade ahead of it. Doing so could take a trading opportunity away from the first client. Withholding an order for normal review and order handling is allowed under Rules 5.3 and 5.1, as this is done to ensure that the client gets a good execution. To ensure that the Participants’ written compliance procedures are effective they must address the potential problem situations where trading opportunities may be taken away from clients.<br/>...</p>   | <p><u>should allow the Participant to evaluate whether “best execution” was obtained and whether the Participant has “diligently pursued” the best execution of a particular client order, including relying on that process.</u> At a minimum, the written compliance procedures must address employee education and post-trade monitoring.</p> <p>The purpose of the Participant’s compliance procedures is to ensure that pro traders do not knowingly trade ahead of client orders. This would occur if a client order is withheld from entry into the market and a person with knowledge of that client order enters another order that will trade ahead of it. Doing so could take a trading opportunity away from the first client. Withholding an order for normal review and order handling is allowed under Rules 5.3 and 5.1, as this is done to ensure that the client gets a good execution. To ensure that the Participants’ written compliance procedures are effective they must address the potential problem situations where trading opportunities may be taken away from clients.<br/>...</p>  |
| <p><b>Policy 8.1 – Client-Principal Trading</b></p> <p><b>Part 3 – Factors in Determining “Best Available Price”</b></p> <p>The price of the principal transaction must also be justified by prevailing market conditions. Participants should consider such factors as:</p> <ul style="list-style-type: none"> <li>• prices and volumes of the last sale and previous trades;</li> <li>• direction of the market for the security;</li> <li>• posted size on the bid and offer;</li> <li>• the size of the spread; and</li> <li>• liquidity of the security.</li> </ul> <p>For example, if the market is \$10 bid and \$10.50 asked and a client wants to sell 1,000 shares, it would be inappropriate for a Participant to do a principal trade at \$10.05 if the security has been trading heavily at \$10.50 and there is strong bidding for the security at \$10 compared to the number of securities being offered at \$10.50. The condition of the market suggests that the client should be able to sell at a better price than \$10.05. Accordingly, the Participant as agent for the client should post an offer at \$10.45 or even \$10.50, depending on the circumstances. The desire of the client to obtain a fill quickly is always a consideration.</p> <p>Of course, if a client expressly consents to a principal trade on a fully-informed basis, following the client’s instructions will be reasonable.</p> | <p><b><u>Policy 8.1 – Client-Principal Trading</u></b></p> <p><b><u>Part 3 – Factors in Determining “Best Available Price”</u></b></p> <p><u>The price of the principal transaction must also be justified by prevailing market conditions. Participants should consider such factors as:</u></p> <ul style="list-style-type: none"> <li>• <u>prices and volumes of the last sale and previous trades;</u></li> <li>• <u>direction of the market for the security;</u></li> <li>• <u>posted size on the bid and offer;</u></li> <li>• <u>the size of the spread; and</u></li> <li>• <u>liquidity of the security.</u></li> </ul> <p><u>For example, if the market is \$10 bid and \$10.50 asked and a client wants to sell 1,000 shares, it would be inappropriate for a Participant to do a principal trade at \$10.05 if the security has been trading heavily at \$10.50 and there is strong bidding for the security at \$10 compared to the number of securities being offered at \$10.50. The condition of the market suggests that the client should be able to sell at a better price than \$10.05. Accordingly, the Participant as agent for the client should post an offer at \$10.45 or even \$10.50, depending on the circumstances. The desire of the client to obtain a fill quickly is always a consideration.</u></p> <p><u>Of course, if a client expressly consents to a principal trade on a fully-informed basis, following the client’s instructions will be reasonable.</u></p> |

**RS MARKET INTEGRITY NOTICE 2007-009  
REQUEST FOR COMMENTS  
PROVISIONS RESPECTING ACCESS TO MARKETPLACES**

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April 20, 2007

No. 2007-009

**RS MARKET INTEGRITY NOTICE****REQUEST FOR COMMENTS****PROVISIONS RESPECTING ACCESS TO MARKETPLACES****Summary**

This Market Integrity Notice provides notice that, on January 30, 2007, the Board of Directors of Market Regulation Services Inc. approved for publication proposed amendments to the Universal Market Integrity Rules respecting various aspects of access to marketplaces. In particular, the amendments would:

- conform the requirements under the Universal Market Integrity Rules to be consistent with proposed changes by the Canadian Securities Administrators to National Instrument 23-101;
- provide a definition of “Dealer-Sponsored Access” (generally being what is known as “direct market access”);
- establish requirements for a Participant to provide information to Market Regulation Services Inc. with respect to each person granted Dealer-Sponsored Access;
- extend the definition of:
  - “Access Person” to include any person (other than a Participant) to whom a Participant has granted Dealer-Sponsored Access, and
  - “Participant” to include certain dealers to whom Dealer-Sponsored Access has been granted;
- require each Access Person to enter into an agreement with Market Regulation Services Inc. as a precondition to obtaining access to a marketplace;
- require each person entitled to enter orders on behalf of an Access Person on a marketplace to have met certain minimum training standards respecting the Universal Market Integrity Rules and other regulatory requirements governing the trading of securities on marketplaces; and
- establish certain trading supervision obligations for an alternative trading system in respect of orders entered by a subscriber that is not an investment dealer.

**Questions / Further Information**

For further information or questions concerning this notice contact:

James E. Twiss  
Chief Policy Counsel

Telephone: 416.646.7277  
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e-mail: james.twiss@rs.ca

**PROVISIONS RESPECTING ACCESS TO MARKETPLACES****Summary**

This Market Integrity Notice provides notice that, on January 30, 2007, the Board of Directors of Market Regulation Services Inc. (“RS”) approved for publication proposed amendments to the Universal Market Integrity Rules (“UMIR”) respecting various aspects of access to marketplaces (“Proposed Amendments”). Certain of the Proposed Amendments are consequential to changes to National Instrument 21-101 (the “Marketplace Operation Instrument”) and National Instrument 23-101 (“CSA Trading Rules”) which are being proposed (the “CSA Direct Access Proposal”)<sup>1</sup> concurrently by the Canadian Securities Administrators (“CSA”). In particular, the Proposed Amendments would:

<sup>1</sup> See “CSA Direct Access Proposal” on page 83 of this Market Integrity Notice. Reference should be made to Market Integrity Notice 2007-007 – *Request for Comments* - Joint Canadian Securities Administrators/Market Regulation Services Inc. Notice on Trade-Through

- provide a definition of “Dealer-Sponsored Access” (“DSA”) (generally being what is known as “direct market access”);
- establish requirements for a Participant to provide information to RS with respect to each person granted DSA;
- extend the definition of:
  - “Access Person” to include any person (other than a Participant) to whom a Participant has granted DSA, and
  - “Participant” to include certain dealers to whom DSA has been granted;
- require each Access Person to enter into an agreement with RS. as a precondition to obtaining access to a marketplace;
- require each person entitled to enter orders on behalf of an Access Person on a marketplace to have met certain minimum training standards respecting UMIR and other regulatory requirements governing the trading of securities on marketplaces; and
- establish certain trading supervision obligations for an alternative trading system (“ATS”) in respect of orders entered by a subscriber that is not an investment dealer.

With the expansion of the definition of:

- “Access Person”, a client with DSA other than a Participant (a “DSA Client”) would be required to comply with certain provisions of UMIR (principally related to open and fair practices, manipulative or deceptive methods of trade, improper orders and trades and short selling) and would be subject to disciplinary proceedings for any breach of these UMIR provisions; and
- “Participant”, a dealer with DSA that is not otherwise a member of an exchange (“Exchange”), a user of a quotation and trade reporting system (“QTRS”) or a subscriber to an ATS and that is able to act as an intermediary on behalf of clients with respect to securities traded on a marketplace would become subject to UMIR.

### Rule-Making Process

RS has been recognized as a self-regulatory organization by the Alberta Securities Commission, British Columbia Securities Commission, Manitoba Securities Commission, Ontario Securities Commission and, in Quebec, by the Autorité des marchés financiers (the “Recognizing Regulators”) and, as such, is authorized to be a regulation services provider for the purposes of the Marketplace Operation Instrument and the CSA Trading Rules.

As a regulation services provider, RS administers and enforces trading rules for the marketplaces that retain the services of RS. RS has adopted, and the Recognizing Regulators have approved, UMIR as the integrity trading rules that will apply in any marketplace that retains RS as its regulation services provider. Presently, RS has been retained to be the regulation services provider for: the Toronto Stock Exchange (“TSX”), TSX Venture Exchange (“TSXV”) and Canadian Trading and Quotation System (“CNQ”), each as an Exchange; and for Bloomberg Tradebook Canada Company (“Bloomberg”), Liquidnet Canada Inc. (“Liquidnet”), Perimeter Markets Inc. (“BlockBook”), Shorcan ATS Limited (“Shorcan”) and TriAct Canada Marketplace LP (“TriAct”), each as an ATS. CNQ presently operates an “alternative market” known as “Pure Trading” that is entitled to trade securities that are listed on other Exchanges and that presently trades securities listed on the TSX.

The Rules Advisory Committee of RS (“RAC”) reviewed the Proposed Amendments. RAC is an advisory committee comprised of representatives of each of: the marketplaces for which RS acts as a regulation services provider; Participants; institutional investors and subscribers; and the legal and compliance community.

The amendments to UMIR will be effective upon approval of the changes by the Recognizing Regulators following public notice and comment and ratification of the changes by the Board. Certain of the Proposed Amendments are consequential to CSA

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Protection, Best Execution and Access to Marketplaces – *Proposed Amendments to National Instrument 21-101 Marketplace Operation and National Instrument 23-101 Trading Rules and Related Universal Market Integrity Rules*, (April 20, 2007).

Direct Access Proposal. The Recognizing Regulators will consider the Proposed Amendments in the context of any changes approved to the Marketplace Operation Instrument and the CSA Trading Rules as a result of the CSA Direct Access Proposal.

The text of the Proposed Amendments is set out in Appendix "A". Comments on the Proposed Amendments should be in writing and delivered by **July 19, 2007** to:

James E. Twiss,  
Chief Policy Counsel,  
Market Policy and General Counsel's Office,  
Market Regulation Services Inc.,  
Suite 900,  
145 King Street West,  
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***Commentators should be aware that a copy of their comment letter will be publicly available on the RS website (www.rs.ca under the heading "Market Policy") after the comment period has ended. A summary of the comments contained in each submission will also be included in a future Market Integrity Notice dealing with the revision or the approval of the Proposed Amendments.***

## Background to the Proposed Amendments

### ***Application of UMIR to Members, Users and Subscribers***

Presently, UMIR imposes compliance obligations on Participants and Access Persons. A summary of the obligations imposed by UMIR on the various market players is set out in Appendix "B". Basically, Rule 1.1 of UMIR defines a Participant as a securities dealer in a Canadian jurisdiction that is a member of an Exchange, a user of a QTRS or a subscriber to an ATS. Rule 1.1 of UMIR also defines an "Access Person" as a person, other than a Participant, who is a user of a QTRS or a subscriber to an ATS. The Marketplace Operation Instrument does not require that subscribers to an ATS be limited to persons who are registered dealers under securities legislation. When an ATS applies for registration with a securities commission, the ATS must indicate the "classes of subscribers (e.g. dealer, institution or retail)"<sup>2</sup>.

*The Toronto Stock Exchange Act* permits the TSX to establish categories of persons other than dealers that are permitted to trade on the TSX.<sup>3</sup> Presently, the TSX provides access to "independent traders", essentially derivatives market makers on the Bourse de Montréal that are not registered as dealers for the purposes of securities legislation but who are considered to be "Participants" for the purposes of UMIR. TSX Policy 2-501 allows a Participant to grant access to its order routing system to various domestic and foreign institutional clients and to retail clients through Order-Execution Accounts (essentially accounts in respect of which the Participant is not required to review orders for suitability).

In accordance with the recognition order of CNQ as an Exchange, persons who may be granted access to CNQ are limited to registered dealers that are members of a recognized self-regulatory organization. Both Shorcan and TriAct permit only registered dealers to become subscribers to their marketplace (and Shorcan imposes the additional condition that the dealer may only enter principal orders on Shorcan). As such, each member of CNQ and each subscriber to Shorcan or TriAct will qualify as a "Participant" for the purposes of UMIR.

<sup>2</sup> Form 21-101F2 – Initial Operation Report Alternative Trading System.

<sup>3</sup> *Toronto Stock Exchange Act*, RSO 1990, c. T.15, s 13.0.8(1)(c).

Presently, each of Bloomberg, Liquidnet and BlockBook have established criteria for access to their marketplace such that each subscriber would qualify as an “institutional customer” for the purposes of Policy 4 – *Minimum Standards for Institutional Account Opening, Operation and Supervision* of the Investment Dealers Association (“IDA Policy 4”).<sup>4</sup> Each of these subscribers would be an “Access Person” for the purposes of UMIR. In addition, BlockBook permits registered dealers to be subscribers to its marketplace and any dealer subscribing to BlockBook would be considered a “Participant” for the purposes of UMIR.

### ***Direct Market Access on Various Marketplaces***

Currently, the TSX and the TSXV provide for “direct access” by certain clients of Participants that are members of the exchanges. Both the TSX and TSXV have proposed to amend their applicable rules and policies governing “direct access”. CNQ has adopted rules that allow “direct access” to the “Pure Trading” alternative market that are based on the current requirements of the TSX. The current requirements of each of the Exchanges for providing direct access are described below.

#### *Toronto Stock Exchange*

On January 13, 2006, the TSX published a Request for Comments on proposed changes to TSX Policy 2-501 and 2-502 regarding the eligibility of clients to be granted direct access and the conditions established for the provision of such access.<sup>5</sup> Under the proposal, the TSX would to expand the class of clients that would be eligible to have direct access to include any person that would be an “institutional customer” for the purposes of IDA Policy 4. To ensure that non-individuals with total securities under administration or management exceeding \$10 million (“Other Institutional Customers”) were subject to adequate regulatory oversight, the TSX proposed to limit the grant of Direct Market Access to those persons domiciled in one of the Basle Accord Countries. Under the TSX proposal, a securities dealer that is not a Participating Organization of the TSX would qualify as an “eligible client” and would be able to obtain DSA to the TSX. The TSX proposal remains subject to the approval of the Ontario Securities Commission.

#### *TSX Venture Exchange*

Effective May 31, 2004, the TSXV adopted the “Direct Access Rules” (identified as TSXV Rules C.2.51 to C.2.53) that parallel the comparable provisions on the TSX. The only significant variation from the TSX provisions was a requirement imposed by the securities regulatory authorities on the approval of the Direct Access Rules that a Participant assign a unique identifier to each client that had been granted Direct Market Access and that this identifier be included on each order transmitted to the TSXV. If the amendments proposed in January of 2006 by the TSX to TSX Policy 2-501 and 2-502 regarding the eligibility of clients are approved, it is anticipated that corresponding changes will be made to the Direct Access Rules of the TSXV.

#### *CNQ*

Recently CNQ introduced rules related to DSA that provides access to the “CNQ Alternative Market”, a facility of CNQ known as “Pure Trading” that presently trades all securities listed on the TSX and, which in accordance with the recognition order of CNQ as an Exchange, may trade securities listed on any Exchange. The CNQ rules closely paralleled the existing provisions of the TSX but did not take into account the changes proposed by the TSX in its publication of January 13, 2006.<sup>6</sup>

When CNQ proposed its rules on DSA, RS suggested, in a comment letter dated November 7, 2005, that it would be appropriate to allow an “eligible client” of a CNQ Dealer that has direct access to the TSX to have direct access to the CNQ Alternative Market to trade in securities listed on the TSX. Similarly, a client with direct access to the TSXV should have direct access to the CNQ Alternative Market to trade in securities listed on the TSXV. Under this formulation, it would not matter whether there were slight variations in the requirements of the TSX and the TSXV or any other recognized exchange and changes in direct access rules to a particular exchange would be “automatically” adopted by CNQ (and the rules of CNQ would not have to be updated to track every change in the “direct access” rules of other exchanges).

<sup>4</sup> IDA Policy 4 – *Minimum Standards for Institutional Account Opening, Operation and Supervision* provides five broad categories of persons that would be considered “institutional customers” including:

- acceptable counterparties as defined in IDA Form 1 - Joint Regulatory Financial Questionnaire and Report (“JRFQ”);
- acceptable institutions as defined in the JRFQ;
- regulated entities as defined in the JRFQ;
- registrants (other than individual registrants) under securities legislation; and
- a non-individual with total securities under administration or management exceeding \$10 million.

In connection with these requirements, the IDA publishes annually a non-exhaustive list of entities which are “acceptable counterparties” and “acceptable institutions”. The most recent listing was contained in Member Regulation Notice 417 issued on August 10, 2006 that identified 3,598 entities that qualified as either an “acceptable counterparty” or “acceptable institution”. Member Regulation Notice 417 also identified the 17 countries that then qualified as “Basle Accord Countries” and 22 exchanges and associations the members of which would qualify as “regulated entities”.

<sup>5</sup> OSC Bulletin, (2006) 29 OSCB 471.

<sup>6</sup> (2006), 29 OSCB 6084, 6092.

### *Alternative Trading Systems*

RS is aware that certain prospective ATSS intend to permit their subscribers who are Participants to provide “direct access” to their clients. In accordance with the Marketplace Operation Instrument, an ATS is not able to establish “rules”. Instead, the provisions which would govern the grant of direct access by a subscriber would be included as a contractual term in the subscription agreement between the ATS and the subscriber. The conditions established by any particular ATS would be subject to review by the securities regulatory authority in each of the jurisdictions in which the ATS operates.<sup>7</sup>

#### ***Development of the Proposed Amendments***

On June 27, 2003, RS proposed amendment to UMIR to expand the definition of “Access Person” such that persons with “direct access” to the trading system of an Exchange or QTRS would have been required to comply with certain of the integrity rules contained in UMIR (principally related to open and fair practices, manipulative or deceptive methods of trade and short selling) and would have been subject to disciplinary proceedings for any breach of these UMIR provisions.<sup>8</sup> Based on comments received, the Board of Directors of RS approved the withdrawal of the proposed amendment from consideration by the Recognizing Regulators.<sup>9</sup>

With the withdrawal of the original amendment proposal, RS established a “Working Group on Access Persons” comprised of members of the Board, the RAC and management of RS to review various questions regarding the application of UMIR to “Access Persons”. The Working Group on Access Persons was concerned that there should be a “level playfield” between marketplaces and the persons who have access to those marketplaces. The Working Group on Access Persons and the Board concluded that the current UMIR provisions could create an un-level playing field in three respects:

- *Un-level Jurisdiction* – A subscriber to an ATS is included in the definition of “Access Person” and is therefore subject to RS’s jurisdiction while a client of a Participant with DSA is not currently included in the definition of Access Person and so is not subject to RS jurisdiction. For example, if a client of a Participant that is a TSX member enters orders to the TSX trading system under a Policy 2-501 inter-connection agreement, that client is not subject to the provisions of UMIR and, in particular, is not subject to disciplinary or enforcement action under UMIR. On the other hand, if the institution or person is a subscriber to an ATS, the institution or person would be considered an “Access Person” under the current definition in UMIR and would be subject to a limited subset of UMIR provisions including:
  - the requirement to use open and fair practices;
  - the prohibition on use of manipulative or deceptive methods of trade;
  - prohibition on entering an order which the Access Person knows or ought reasonably to know does not comply with securities legislation, requirements of the marketplaces or UMIR; and
  - the restrictions on short selling.

Some ATSS and their subscribers believe that this difference in regulatory jurisdiction represents an advantage for clients with DSA.
- *Un-level Application of Rules to Orders* – If an order is entered on a marketplace by a client with DSA that order is currently subject to a variety of UMIR provisions that would not apply if the order had been entered by the same person as a subscriber to an ATS. For example, currently a Participant has an obligation under Rule 5.2 of UMIR to fill “better-priced” orders on other marketplaces when executing an order on a particular marketplace including an order entered by a client with DSA. If the client was not a Participant and the client entered the same order on an ATS that order would not currently have an obligation to the better-priced orders on other marketplaces. Some Participants and clients with DSA believe that this difference in the application of rules represents an advantage for ATS subscribers.
- *Un-level Compliance Obligations* - Under Part 7 of UMIR, a Participant has monitoring and compliance responsibilities for trading by their clients with DSA while an ATS does not have monitoring or compliance responsibilities under UMIR for trading by their subscribers notwithstanding that each ATS must be registered as a dealer. Some Participants believe this represents an advantage for ATSS.

<sup>7</sup> The conditions established by a particular ATS would be subject to review and approval by the applicable securities regulatory authority in the context of the review of the Form 21-101F2 of the ATS.

<sup>8</sup> Market Integrity Notice 2003-014 – *Request for Comments – Definition of “Access Person”* (June 27, 2003).

<sup>9</sup> Market Integrity Notice 2005-005 – *Notice of Amendment Withdrawal – Definition of “Access Person”* (March 4, 2005).

RS therefore adopted levelling the playing field – between ATSS and Participants, and between ATS subscribers and clients with DSA – as its primary objective. RS adopted the following criteria to assess alternative methods to level the playing field:

- *avoiding regulatory gaps:* any UMIR provision that addresses a relevant risk should apply to all relevant transactions and to at least one party in relation to each order;
- *minimizing unnecessary regulatory duplication:* UMIR provisions should apply to only one party in relation to each order, unless there is a good reason for that provision to apply to more than one party;
- *enabling RS to get information from the best possible source to investigate potential violations:* RS's investigations will be more effective to the extent that the parties with relevant information are subject to RS's direct jurisdiction and must cooperate with RS investigations;
- *imposing liability on the party who is able to ensure compliance at the lowest cost:* one party may be able to take the steps necessary to ensure UMIR compliance at a lower cost than other parties (for example, ATSS and Participants may be able to benefit from economies of scale by developing internal processes or systems that can then be applied to all of their subscribers' or clients' activities, as opposed to requiring subscribers or clients with DSA to develop those processes or systems individually); and
- *imposing liability where it is most likely to change behaviour:* RS's enforcement activity will be more effective to the extent that the party who is in the best position to detect and prevent violations is subject to RS's direct jurisdiction.

At its meeting on April 24, 2006, the Board approved as a concept the following package of provisions to regulate “direct access trading” and trading on ATSS:

1. Expand the definition of “Access Person” to include “direct access clients” (other than order execution accounts) and, for this purpose, a client who is provided with direct access to an ATS through a Participant-subscriber would also be an Access Person;
2. Assign each Access Person a unique identifier to be attached to all orders entered on a marketplace by that Access Person which identifier will be transmitted only to RS for regulatory purposes;
3. Propose that the CSA amend the Marketplace Operation Instrument and the CSA Trading Rules to make ATSS and Participants equally responsible, where they have access to the same information, for monitoring the trading activities of their Access Persons, and to give RS specific jurisdiction to:
  - monitor and enforce Access Persons' compliance with UMIR, and
  - monitor and enforce ATSS' compliance with their responsibilities;
4. Consider whether the rules and policies governing direct access trading, including eligibility and training requirements, should be administered by RS as part of UMIR so that they are consistent for all marketplaces that RS regulates;
5. Consider whether a mandatory training/accreditation program for personnel of “direct access” clients should be introduced; and
6. Ensure that each possible method of electronic order submission (i.e., “direct access” trading, “order execution account” trading, and anything in between) is appropriately supervised and regulated.

After consultation with the Recognizing Regulators and the other members of the CSA regarding the concept proposal, the Board addressed items 1 and 2 with the adoption of the Proposed Amendments. Concurrent with the issuance of this Request for Comments, the CSA has issued the CSA Direct Access Proposal that, among other initiatives, addresses the issues in items 3 and 5.<sup>10</sup> Parts of the Proposed Amendments would be consequential to the adoption of the CSA Direct Access Proposal and would set out the specific requirements to be established by a regulation services provider.

As part of this Request for Comments, RS is soliciting specific input on questions related to item 4. (Reference is made to “Specific Matters on Which Comment is Requested” on page 92.) Concurrent with the issuance for this Request for Comments, RS is addressing item 6 with the issuance of two Market Integrity Notices regarding the compliance obligations of a Participant

<sup>10</sup> Reference is made to “CSA Direct Access Proposal” on page 83.

in connection with trading by clients with DSA and the provision by a Participant of order-execution services only. Reference should be made to:

- Market Integrity Notice 2007-010 - *Guidance – Compliance Requirements for Dealer-Sponsored Access Trading* (April 20, 2007); and
- Market Integrity Notice 2007-011 - *Guidance – Compliance Requirements for Order- Execution Services* (April 20, 2007).

The Board believes that the six elements of the concept proposal offer the following advantages and disadvantages compared to the status quo:

| Advantages vs. Status Quo   | Disadvantages vs. Status Quo   |
|---|--|
| <ul style="list-style-type: none"> <li>• “levels the playing field” between ATSS and Participants by subjecting them to identical UMIR responsibility in relation to trading by their “clients” where they have access to the same information</li> </ul> | <ul style="list-style-type: none"> <li>• creates regulatory overlap (i.e., potential liability at both the Participant-ATS level and the Access Person level) to the extent that ATSS and Participants will be subject to certain obligations in respect of their Access Persons’ trading</li> </ul> |
| <ul style="list-style-type: none"> <li>• avoids regulatory gaps by assigning specific UMIR obligations to all relevant parties (ATSS, Participants and Access Persons)</li> </ul>   | <ul style="list-style-type: none"> <li>• imposing UMIR responsibility on direct access clients may have an adverse effect on the amount of foreign direct access business Participants receive</li> </ul>  |
| <ul style="list-style-type: none"> <li>• enables RS to seek regulatory information directly from the best possible source (i.e., the “directing mind” of the trade – the Access Person)</li> </ul>  |  |
| <ul style="list-style-type: none"> <li>• imposes UMIR responsibility on the “directing mind” of the trade, where it is most likely to change behaviour</li> </ul>   |  |

On balance, the Board concluded that the advantages of the proposed model – as compared to the status quo – outweighed the disadvantages.

With respect to regulatory duplication, it is the nature and scope of the ATSS’ and Participants’ specific obligations that will determine the extent of the duplication. This can therefore be managed by fine-tuning the responsibilities of ATSS and Participants to reduce to the extent feasible any duplication between their responsibilities and those risks that can be satisfactorily addressed by RS’s real-time surveillance and post-trade review. However, the proposed responsibilities for Participants and ATSS do involve some duplication with the oversight provided by RS, principally with respect to interactions between “direct access” and non-direct access accounts and trading.

**CSA Direct Access Proposal**

Concurrent with the issuance of this Request for Comments, the CSA has published proposed amendments to the Marketplace Operation Instrument and the CSA Trading Rules dealing generally with best execution and access.<sup>11</sup> The following is the text of the key aspects of CSA Direct Access Proposal:

In order to address the issue of differing requirements and ensure that participants that are not dealers are subject to the same rules whether they enter an order directly on an ATS (as a subscriber) or through DMA, we [the CSA] are proposing amendments dealing generally with access.

The CSA are proposing a new definition of “dealer-sponsored participant” which is a person or company whose “direct” access to a marketplace is through a dealer (this would only apply to institutional customers). The CSA think it is important to clarify the obligations for all parties: marketplaces, dealers (whether as members of an exchange or subscribers to an ATS), and dealer-sponsored participants, whether foreign or domestic.

Both the exchange and ATS are responsible for ensuring compliance with their rules or contractual requirements regarding who may be granted “dealer-sponsored access” As well, an exchange would be required to monitor and enforce requirements regarding the trading of dealer-sponsored participants and would have the choice of doing so

<sup>11</sup> See “Direct Access Issues”, Market Integrity Notice 2007-007, op. cit., 21.

directly or indirectly through a regulation services provider. The exchange would also be required to set requirements for its members to review and report activity of the dealer-sponsored participants who access the exchange through such members.<sup>12</sup> An ATS would be required to retain a regulation services provider for monitoring the trades on the ATS and the conduct of the subscribers and dealer-sponsored participants.<sup>13</sup> It is also important to clarify that an ATS does retain some compliance responsibility for its marketplace. This applies to situations where the ATS may be a better position than a regulation services provider to obtain information. For example:

- An ATS may have information about relationships between different subscriber accounts, which may be required to detect patterns of activity across subscriber accounts; and
- An ATS may have information about failed trades involving subscribers which is relevant for monitoring short sales.

The CSA acknowledge that an ATS may not be in a position to perform real-time compliance; however, we [the CSA] think that post-trade review may be appropriate, depending on the circumstances. The regulation services provider should identify (subject to public comment and regulatory approval), the responsibilities of the ATS for activities of subscribers and dealer-sponsored participants and for monitoring those activities.

As set out above, there are currently certain limited market integrity rules that apply to ATS subscribers. The CSA expect that these requirements will continue to apply to subscribers of an ATS and would be applied to dealer-sponsored participants, whether foreign or domestic, that have direct access to an ATS through a dealer subscriber or to an exchange through a member. An exchange or a regulation services provider would be able to impose additional requirements applicable to dealer-sponsored participants, subject to public comment and approval by the applicable securities regulatory authorities.<sup>14</sup>

The CSA are also proposing that there be certain training requirements applicable to dealer-sponsored participants (either the Trader Training Course examination, which is currently a requirement applicable to dealers trading exchange-traded securities (other than derivatives), or another examination relating to a course or training that is acceptable to the applicable regulatory securities authority, exchange or regulation services provider).<sup>15</sup>

## Summary of the Proposed Amendments

### *Definition of “Dealer-Sponsored Access”*

Under the Proposed Amendments, the term “Dealer-Sponsored Access” would be defined as the right to access to the trading system of a marketplace either directly or by means of an electronic connection to the order routing system of a Participant that has been granted by the Participant to a client that is an “institutional customer” for the purposes of IDA Policy 4<sup>16</sup>.

In the view of RS, the definition of “Dealer-Sponsored Access” excludes the handling of an order by a Participant in respect of which:

- the client is not an “institutional customer” for the purposes of IDA Policy 4; and
- the Participant provides only an “order-execution service”<sup>17</sup>, which for this purpose is considered as the handling, in accordance with the requirements of a securities regulatory authority or a self-regulatory entity, of a client order which:
  - the Participant has not recommended, and
  - the Participant has no responsibility as to the appropriateness or suitability of the order to the financial situation, investment knowledge, investment objectives and risk tolerance of the client.

<sup>12</sup> Proposed amendments to NI 23-101, s. 7.1.

<sup>13</sup> Proposed amendments to NI 23-101, ss. 8.1 and 8.2.

<sup>14</sup> Proposed amendments to 23-101CP, s. Part 7.

<sup>15</sup> Proposed amendments to NI 23-101, s.s 7.5 and 8.4.

<sup>16</sup> Reference is made to footnote 3 for the definition of “institutional customer” for the purposes of IDA Policy 4.

<sup>17</sup> The term “order-execution service” is defined in IDA Policy 9 – *Minimum Requirements for Members Seeking Approval Under Regulation 1300.1(E) for Suitability Relief for Trades not Recommended by the Member* as “the acceptance and execution of orders from customers for trades that the Member has not recommended and for which the Member takes no responsibility as to the appropriateness or suitability of the trades to the customers’ financial situation, investment knowledge, investment objectives and risk tolerance.”



Under the Proposed Amendments, a Participant that offers “discount brokerage” services to clients will not be considered to be providing Dealer-Sponsored Access. As such, not every person who is granted access to a marketplace in accordance with Marketplace Rules or the contractual provisions of a subscription agreement to an ATS will be considered to have DSA. For example, while a client with an “order-execution account” is an “eligible client” for the purposes of TSX Rule and TSX Policy 2-501, such a client of a Participant would not be considered to have been granted DSA under the definition of “Dealer-Sponsored Access” provided in the Proposed Amendments.

### ***Extension of the Definition of “Access Person” and “Participant”***

Under the Proposed Amendments, the definition of:

- “Participant” would be expanded to include a dealer registered in accordance with securities legislation of any jurisdiction that is able to act as an intermediary on behalf of clients with respect to securities traded on a marketplace with DSA that is not otherwise a member of an Exchange, a user of a QTRS or a subscriber to an ATS; and
- “Access Person” would be expanded to include client of a Participant to whom the Participant has granted DSA.

Under the current TSX proposal for changes to TSX Policy 2-501 and 2-502, a securities dealer that is not a Participating Organization of the TSX would qualify as an “eligible client” and would be able to obtain DSA to the TSX. Implementation of this proposal would represent the first time that a dealer registered in Canada would be able to obtain direct access to a marketplace without becoming a member, user or subscriber to that marketplace. At the time of the development of UMIR, RS did not anticipate that a marketplace would permit a Canadian dealer to have DSA to that marketplace and that each marketplace would continue to require a Canadian dealer wishing direct access to become a member, user or subscriber as appropriate. In the view of RS, a dealer with DSA to a particular marketplace should be subject to the same integrity rules as a dealer that is a member, user or subscriber to that marketplace. In the view of RS, there is no policy reason that would exempt a dealer with DSA from various obligations to clients including exposure of client orders, client priority and client-principal trading requirements simply because the dealer has chosen to avail itself of one type of access to a marketplace over the more traditional access as a member, user or subscriber. The current definition of “Participant” refers merely to a “dealer”. The Proposed Amendments would limit the application of the term “Participant” to a dealer that is a “dealer registered in accordance with securities legislation of any jurisdiction that is able to act as an intermediary on behalf of clients with respect to securities traded on a marketplace”.

### ***Consequential Definitions***

As a result of the introduction of a definition of “Dealer-Sponsored Access” and the extension of the definitions of “Access Person” and “Participant”, the Proposed Amendments would also introduce several additional definitions to be used in outlining the various obligations of Participants, Access Persons and marketplaces. In particular, the Proposed Amendments would add definitions of “Designated Marketplace”, “Marketplace Eligible Client” and “Representative”:

“Designated Marketplace” means any marketplace for which the Market Regulator has been retained as the Regulation Services Provider and to which the Access Person has access by means of being:

- (a) a member
- (b) a subscriber;
- (c) a user; or
- (d) provided Dealer-Sponsored Access.

“Marketplace Eligible Client” means a client of a Participant that is eligible to obtain Dealer-Sponsored Access to a particular marketplace in accordance with:

- (a) in the case of an Exchange or QTRS, the Marketplace Rules of that marketplace; or
- (b) in the case of an ATS, the subscription agreement between the Participant and that marketplace.

“Representative” means each director, officer or employee of the Access Person who on behalf of the Access Person:

- (a) may enter an order on a Designated Marketplace; or

- (b) is responsible for the immediate supervision of any order entered by a director, officer or employee of the Access Person on a Designated Marketplace.

#### ***Order Marking by Clients with Dealer-Sponsored Access***

The Proposed Amendments would require each order entered by a “Marketplace Eligible Client” by means of Dealer-Sponsored Access to contain the unique identifier assigned by the Participant to the client.

#### ***Compliance Obligations of an Alternative Trading System***

In the CSA Direct Access Proposal, the CSA noted: an “ATS does retain some compliance responsibility for its marketplace”<sup>18</sup> and that the “regulation services provider should identify (subject to public comment and regulatory approval), the responsibilities of the ATS for activities of subscribers and dealer-sponsored participants and for monitoring those activities”.<sup>19</sup>

The Proposed Amendments would introduce a requirement that an ATS adopt compliance procedures to review orders entered by Subscribers (other than a Participant) for compliance with those UMIR provisions which are applicable to an Access Person, including:

- prohibition on manipulative and deceptive activities;
- requirement to conduct trading openly and fairly;
- prohibition on entering an order which the Access Person knows or ought reasonably to know does not comply with securities legislation, requirements of the marketplace or UMIR;
- restrictions on short selling; and
- order marking requirements.

Orders entered on an ATS by a Participant either by the Participant directly or by a DSA Client will be subject to supervision and compliance procedures undertaken by the Participant. In Market Integrity Notice 2007-010 - *Guidance – Compliance Requirements for Dealer-Sponsored Access Trading* (April 20, 2007), RS set out its expectations regarding compliance procedures to be adopted by a Participant that permits Dealer-Sponsored Access. In accordance with the Marketplace Operation Instrument, every ATS must be registered as a dealer and be a member of a self-regulatory entity (such as the IDA). As such, the Proposed Amendments would impose on an ATS supervisory and compliance obligations for orders entered on the ATS that are not already subject to supervision and compliance procedures undertaken by a Participant. The Proposed Amendments recognize that an ATS may not be in a position to perform real-time compliance and that post-trade review may be appropriate in the circumstances.

#### ***Training Requirements for Representatives***

Rule 7.2 of UMIR currently requires that each director, officer, partner or employee of a Participant that enters orders has:

- completed the Trader Training Course of the Canadian Securities Institute or can otherwise demonstrate proficiency in the provisions of UMIR that is acceptable to RS; or
- received approval of the Exchange or QTRS for the entry of orders to the trading system of that Exchange or QTRS.

In addition, each Participant and each of its trading employees are subject to continuing education requirements in accordance with the rules of the applicable self-regulatory entity of which the Participant is a member.<sup>20</sup>

Under the Proposed Amendments any “Representative” (being each director, officer or employee of the client who will be responsible for the entry or supervision over any order entered by DSA) would be required to complete training courses prior to entering orders on a marketplace or acting as supervisor in respect of the entry of such orders. The Proposed Amendments have suggested that the training requirements could be met by:

<sup>18</sup> Market Integrity Notice 2007-007 - Joint Canadian Securities Administrators/Market Regulation Services Inc. Notice, op. cit., 28.

<sup>19</sup> Ibid.

<sup>20</sup> For example, see Part III – The Continuing Education Program of IDA Policy 6 – *Proficiency and Education*.

- the completion of the Trader Training Course of the Canadian Securities Institute; or
- the completion of such course, examination or other means of demonstrating training in these Rules and Policies as may be acceptable to the Market Regulator of the marketplace on which the order is entered or the applicable securities regulatory authority.

This requirement would become effective one year following approval of the Proposed Amendments. RS is presently participating with the various marketplaces and the Canadian Securities Institute in a revision of the Trader Training Course. As part of the review of the course material undertaken by RS, RS identified those parts of the course which may have limited application to an Access Person. If a training obligation is imposed on "Representatives", RS would intend to pursue with the Canadian Securities Institute whether a course specifically focused on trading by an Access Person would be practicable.

#### ***Requirements for a Participant Granting Dealer-Sponsored Access***

Under the Proposed Amendments, a Participant that grants DSA to a client would be required to provide certain information concerning the Participant and the client to RS. In particular, the Participant would be obligated to provide to RS the name and contact information of the director, officer or employee of the Participant responsible for any order entered by Dealer-Sponsored Access. The Participant would also be obligated to provide to RS the following information with respect to each client the Participant grants DSA:

- the name and contact information of each "Representative";
- the marketplace to which the client has been granted DSA; and
- the unique identifier that will be attached to each order entered by the client by means of DSA.

#### ***Agreement between a Market Regulator and an Access Person***

The CSA Direct Access Proposal would have the effect of requiring each Access Person (be they a subscriber to an ATS or a client with Dealer-Sponsored Access) to enter into an agreement with RS (as RS is currently the regulation services provider for each marketplace that permits or proposes to permit Dealer-Sponsored Access). The Proposed Amendment would adopt a standard form of agreement applicable to each Access Person. Under the standard form of agreement, each Access Person and each Representative would agree:

- to conduct trading activities in accordance with UMIR and the requirements of the marketplace on which an order is entered; and
- to comply with all decisions, determination or directions made by RS in its capacity as a regulation services provider.

In addition, each Access Person would agree:

- not to enter an order on a particular Designated Marketplace until information respecting the Access Person's access to that marketplace had been provided to RS;
- not to enter an order without the identifier assigned to the Access Person by the Designated Marketplace or Participant;
- no person other than a Representative shall enter an order on a Designated Marketplace by means of the access provided to the Access Person as a Subscriber or as a person with Dealer-Sponsored Access; and
- not to permit any Representative to enter an order on a Designated Marketplace until:
  - information respecting the Representative (including the Representative's acknowledgement of their obligations under the agreement and UMIR) had been provided to RS, and
  - the Representative has completed any training requirements that may be applicable.

(See "Specific Matters on Which Comment is Requested" on page 92 for additional discussion of whether foreign clients should be exempt from the requirement to enter into an agreement with a regulation services provider.)

### ***Gatekeeper Obligations with Respect to an Access Person***

Under the Proposed Amendments, a Designated Marketplace that has provided access to an Access Person or a Participant that has provided Dealer-Sponsored Access to an Access Person would be under an obligation to notify RS if the Designated Marketplace or Participant knows or has reason to believe that the Access Person has or may have:

- failed to comply with the provisions of the standard agreement entered into between the Market Regulator and the Access Person; or
- violated the requirements of UMIR: to conduct business openly and fairly; respecting manipulative and deceptive activities; improper orders or trades; or any requirement of UMIR designated by RS for the purpose of the gatekeeper requirements.

### **Summary of the Impact of the Proposed Amendments**

The following is a summary of the most significant impacts of the adoption of the Proposed Amendments:

#### ***Extension of the Definition of "Access Person"***

With the expansion of the definition of "Access Person", a client of Participant that has been granted DSA by the Participant would be required to comply with certain provisions of UMIR (principally related to open and fair practices, manipulative or deceptive methods of trade, improper orders and trades and short selling) and would be subject to disciplinary proceedings for any breach of these UMIR provisions.

The extension of the definition of Access Person to include clients given access to a marketplace by means of DSA provided by the Participant would result in such clients being subject to the same obligations under UMIR as they would have if they subscribed to an ATS. (For a more detailed discussion of the obligations of an Access Person under UMIR, reference should be made to the heading "Summary of the Application of UMIR to an Access Person" and the "Summary of Obligations under the Universal Market Integrity Rules" included as Appendix "B".)

The extension of the definition of Access Person would have the effect of making UMIR applicable to various persons connected to the Access Person. Under Rule 10.4 of UMIR, a related entity of an Access Person (being a Canadian dealer that is not a member of Exchange, user of a QTRS or subscriber to an ATS) or a director, officers, partner or employee of the Access Person or the related entity is subject to the UMIR provisions requiring the use open and fair practices, prohibiting the use of manipulative or deceptive methods of trade and restricting short selling. Rule 10.3 of UMIR has the effect of extending responsibility for conduct. In particular, any officer or employee who supervises or is responsible for an employee may be liable for the conduct of the supervised employee. Similarly, a partner or director of an Access Person may be liable for the conduct of the Access Person. These various persons would currently be covered by UMIR if the access to the market was obtained as a result of the Access Person being a subscriber to an ATS or a user of a QTRS.

The fact that persons with "direct access" to an Exchange or QTRS will be subject to UMIR does not relieve Participants from any of their obligations with respect to supervision of trading activities. A Participant will retain full responsibility for any order entered by an Access Person on a marketplace by means of an electronic connection to the order routing system of the Participant. The supervision policies and procedures of a Participant should continue to adequately address the additional exposure which the Participant has for orders that are not directly handled by staff of the Participant. The adoption of an expanded definition of "Access Person" will not have an effect on Participants or their compliance functions or costs. However, the Participant that has granted access would have the obligation to ensure that the DSA Client and its staff are trained in the applicable UMIR provisions. Currently, the Participant has such training obligations under the requirements for direct access under the TSX Policy 2-501 and 2-502 and the TSXV Direct Access Rules.

#### ***Extension of the Definition of "Participant"***

With the expansion of the definition of "Participant", a dealer registered in accordance with securities legislation of any jurisdiction that is able to act as an intermediary on behalf of clients with respect to securities traded on a marketplace that has been granted DSA and is not otherwise a member of an Exchange, a user of a QTRS or a subscriber to an ATS would become subject to UMIR.

#### ***Requirements for a Participant Granting Dealer-Sponsored Access***

RS expects that the unique identifier assigned by a Participant to a client granted DSA will be added to the existing "Trader ID" field on order entry. Since the existing "Trader ID" field would be used to include the unique identifier assigned to the DSA Client, no new marker would be required to implement this aspect of the Proposed Amendments. Each Participant that provides DSA should be able to implement the requirement without systems changes. In accordance with Rule 6.2(6), the designation

included in the "Trader ID" field will not be disclosed for inclusion in a consolidated market display. The marketplace will provide this information to RS as part of its "regulatory feed" and will be used by RS as part of its trade monitoring activity.

The information provided to RS will permit RS to enhance its monitoring of trading activity (including the monitoring of trading activity by a person who has obtained DSA through more than one Participant). Since the DSA Client has entered the orders directly, the Participant through which the order is routed may have limited knowledge of the order or overall activity by the DSA Client. If a potential problem is detected with any trading activity by a DSA Client, RS will be able to use the unique identifier to identify the client and will then be able to contact the DSA Client directly. In this way, RS should be able to provide a more timely and efficient resolution of any potential problem.

### ***Obligations of Alternative Trading Systems***

An ATS would be required to undertake compliance reviews of certain of the trading activity on their markets. Gatekeeper obligations would be imposed on ATSS and other Designated Marketplaces to provide notice to RS of suspected violations of UMIR or the agreements entered into between RS and the Access Person.

### **Summary of the Application of UMIR to an Access Person**

The following is a summary description of the significant provisions of UMIR that apply to an Access Person. Appendix "B" contains a more detailed listing of the application of each provision of UMIR that is imposed on marketplaces, Participants, Access Persons and various officers, directors, employees and related parties. Appendix "B" also highlights the changes in obligations that would be introduced as a result of the adoption of the Proposed Amendments.

#### ***Applicable UMIR Provisions***

- Under UMIR, an Access Person must comply with a limited subset of integrity rules, including:
  - prohibition on manipulative and deceptive activities;
  - requirement to conduct trading openly and fairly;
  - prohibition on entering an order which the Access Person knows or ought reasonably to know does not comply with securities legislation, requirements of the marketplace or UMIR; and
  - restrictions on short selling.
- Every investor is already subject to the basic substance of these requirements through applicable securities legislation.
- The distinction for a prospective Access Person is more who undertakes the monitoring for compliance with the requirements rather than substantial differences in the requirements themselves.

#### ***Manipulative and Deceptive Activities***

- Presently, every person who trades in a security is subject to Part 3 of the CSA Trading Rules, which prohibit manipulation and fraud.
- Part 3 of the CSA Trading Rules do not apply to anyone subject to rules established by a regulation services provider, such as UMIR as adopted by RS.
- Rule 2.2 of UMIR prohibiting manipulative and deceptive activities deals with substantially the same subject matter as provisions dealing with manipulation and fraud contained in the CSA Trading Rules.

#### ***Openly and Fairly***

- UMIR requires that an Access Person conduct trading activity "openly and fairly".
- The requirement is essentially an anti-avoidance rule applied when a person attempts to sidestep a specific prohibition or restriction.
- In many ways, the ability of RS to require an Access Person to trade "openly and fairly" is akin to the power of the securities commissions to take various actions in order to protect the "public interest".

*Improper Orders*

- If an Access Person knowingly enters an order or executes a trade that does not comply with a regulatory requirement this will constitute a violation of UMIR.
- For example, an Access Person who knowingly enters an order for sale on the open market of securities which are subject to a statutory hold period would be in violation of Rule 2.3 of UMIR and subject to disciplinary action by RS. In the absence of the jurisdiction of RS, the disciplinary action would be undertaken by the securities commission.

*Short Sales*

- Applicable securities legislation generally requires investors to declare any order that would be a short sale.
- Rule 3.1 of UMIR precludes, subject to certain exceptions, a short sale below the last sale price.
- If the Access Person does not undertake short sales except through transactions handled by a securities dealer, then on a practical basis the requirements to file a short position report will also not be applicable.

***Non-Applicable Provisions***

- There are a number of provisions of UMIR which do not apply to an Access Person, including:
  - frontrunning;
  - best execution obligation;
  - best price obligation;
  - client priority;
  - order exposure;
  - requirement to trade on a marketplace;
  - trading supervision; and
  - client-principal trading.

***Administrative Provisions***

- In addition to the four “integrity” rules to which an Access Person is subject under UMIR, there are a number of “administrative” rules that each Access Person must comply with.
- For example, if RS imposes a “regulatory halt” on trading of a particular security the Access Person will not be able to trade the security during the period of the regulatory halt except on a market outside of Canada if permitted by applicable securities legislation. (The comparable provision under the CSA Trading Rules which applies to a person who is not subject to the rules of a regulation services provider precludes the execution of any trade.)
- An Access Person must comply with the order marking requirements under Rule 6.2.
- There are other provisions in UMIR related to record keeping, audit trail requirements and provision of information.

***General Requirements Related to Proficiency, Supervision and Compliance***

- Questions have been raised as to the expectations that RS has of Access Persons in three specific areas:
  - proficiency and training requirements;
  - supervision requirements; and

- compliance procedures.

#### *Proficiency and Training Requirements*

- UMIR sets out certain specific proficiency requirements which are expected of employees of a Participant who enter orders on a marketplace.
- UMIR does not establish specific standards for employees of an Access Person.
- The Proposed Amendments would introduce training requirements for directors, officers and employees who are involved in trading by an Access Person.
- An ATS or QTRS has the obligation to ensure that each Access Person who is a subscriber of an ATS or a user of a QTRS is trained in those parts of UMIR that are applicable to the Access Person.
- This provision recognizes the wide diversity of persons who may subscribe to an ATS ranging from retail investors to the most sophisticated institutions and requires the ATS to have a training programme which is appropriate for the type of subscribers that will access their marketplace.
- If the definition of Access Person is expanded to include a DSA Client, the Participant that has granted the Dealer-Sponsored Access will have the obligation to ensure that each DSA Client and Authorized Person is trained in those parts of UMIR that are applicable to them.

#### *Supervision Requirements*

- UMIR specifically requires that each Participant adopt written policies and procedures to govern trading activity by the Participant.
- UMIR does not establish similar minimum standards for an Access Person due to the diversity of persons who may be a subscriber to an ATS or a user of a QTRS.
- Each Access Person must determine whether their policies and procedures are “reasonably” designed to ensure compliance with the requirements of the Marketplace Operations Instrument, the CSA Trading Rules and UMIR.
- Since an investor must comply with the CSA Trading Rules unless the requirements of a regulation services provider are applicable, each institutional investor (whether a subscriber to an ATS or a DSA Client) should have already addressed policies and procedures to ensure compliance with the manipulation and fraud provisions of the CSA Trading Rules.

#### *Compliance Procedures*

- UMIR specifically requires that each Participant adopt written policies and procedures to govern compliance activity by the Participant.
- UMIR does not establish similar minimum standards for an Access Person due to the diversity of persons who may be a subscriber to an ATS.
- Each Access Person must determine whether their compliance procedures are adequate with respect to compliance with the limited subset of UMIR requirements that apply to an Access Person.
- If the definition of “Access Person” is expanded to include DSA Clients, these persons (given their institutional character) may already have adopted compliance procedures to limit reputational risk and to address existing obligations under the CSA Trading Rules and securities legislation.
- The only specific compliance procedures that must be addressed by an Access Person are procedures to comply with their “gatekeeper” obligations. If one of their employees believes that a requirement of UMIR has been breached it must be reported to their supervisor or compliance department. The supervisor or compliance department must review the report and if it appears that further investigation is required must diligently pursue the matter and report violations to RS.

### Specific Matters on Which Comment is Requested

Comment is requested on all aspects of the Proposed Amendments. However, comment is specifically requested on the following matters:

#### ***Marketplace Rules on Direct Market Access***

The Proposed Amendments contemplate that an Exchange or QTRS will be able to establish its own Marketplace Rules with respect to the ability of a Participant to grant “direct market access” to that marketplace. RS is concerned that each marketplace, including an ATS, may adopt different criteria for direct access by an “eligible client”.<sup>21</sup> Such a situation may become practically unworkable in a variety of circumstances. For example, if marketplaces are required to route orders to other marketplaces in order to comply with any trade-through obligations that may be imposed,<sup>22</sup> the effect is for each marketplace to effectively adopt the eligibility criteria of the marketplace with the lowest standard (as the requirements of the more restrictive marketplaces would be “sidestepped” by the entry of an order through DSA to the marketplace with the least or lowest requirements). Similarly, the entry of an order directly by a client to a particular marketplace does not relieve a Participant of its obligations to ensure “best price” and “best execution” to the client and, as a result, different rules on DSA between marketplaces trading the same security could frustrate efforts by a Participant to route orders to the best marketplace in order to comply with the “best price” and “best execution” obligations under UMIR in circumstances when the obligation to route orders to the “best” marketplace is imposed on the Participant entering the order rather than on the marketplace which receives the order.

From the perspective of UMIR, the Participant through which the order is entered on a marketplace has “full” responsibility for each order entered by an “eligible client” and UMIR sets out supervision and compliance requirements in respect of such orders. As such, in the view of RS, there may not be any business reason to establish differing requirements for each marketplace.

1. *Should UMIR establish uniform criteria for the granting of access to any marketplace subject to UMIR or should an Exchange or QTRS be able to continue to establish rules regarding the grant of Direct Market Access?*
2. *Should an ATS be able to establish criteria for the granting of access to its marketplace in the contract between the ATS and any Participant that is a subscriber to the ATS?*

#### ***Training Obligations of Marketplaces***

The Proposed Amendments would extend the training requirements to each Representative of an Access Person (defined as a director, officer, partner or employee of an Access Person may enter an order on a Designated Marketplace or is responsible for the supervision of any order entered by a director, officer or employee of the Access Person on a Designated Marketplace). Presently, Rule 7.2 of UMIR requires that a marketplace ensure that each Access Person with access to the marketplace is trained in such of the provisions of UMIR as may be applicable to an Access Person. Appendix “B” sets out the provisions of UMIR which are applicable to an Access Person. If the definition of “Access Person” is expanded to include clients of a Participant that have been granted DSA, the existing provision of UMIR would impose the obligation on the marketplace to which DSA has been granted to ensure that the client with DSA is knowledgeable and trained in the applicable UMIR provisions. RS would expect that each marketplace would discharge this obligation by requiring the Participant to provide the necessary training (as is presently the case in the rules of the TSX, TSXV and CNQ governing the grant of DSA).

3. *If training requirements are adopted for each Representative of an Access Person should marketplaces be relieved on any further training obligations in respect of Access Persons or should the requirement be continued in lieu of “continuing education requirements” for Representatives?*

#### ***Requirement for Regulatory Agreement with Foreign DSA Client***

Presently, each foreign person that becomes an Access Person by subscribing to an ATS must execute an agreement with RS or, based on orders of various securities regulatory authorities, a release in favour of RS that supplements provisions in that person’s subscriber agreement with the ATS to be subject to the jurisdiction of RS as the regulation services provider for the ATS. As noted under the heading “Development of the Proposed Amendments”, RS recognizes that the imposition of a requirement for a foreign client to execute an agreement with RS as a condition of being provided DSA through a Participant to a marketplace may have an adverse effect on the amount of foreign direct

<sup>21</sup> If an ATS were to propose to permit “direct market access”, the CSA would review and approve the access requirements proposed by the ATS in the context of reviewing the Form 21-101F2 of that marketplace.

<sup>22</sup> Market Integrity Notice 2007-007 - Joint Canadian Securities Administrators/Market Regulation Services Inc. Notice, op. cit., 10.



access business Participants receive. Providing an exemption from the agreement requirement for a foreign DSA client would not only create an “unlevel playing field” in comparison with a foreign subscriber but would also create a two-tiered system between domestic and foreign DSA clients.

4. *Should there be an exemption from the requirement for a foreign DSA Client to enter into an agreement directly with RS? If so, why and under what circumstances should such an exemption be available?*
5. *If a DSA Client is exempted from executing an agreement with RS, should the Participant accept a higher level of responsibility for the conduct of the foreign DSA client?<sup>23</sup>*

#### Appendices

- Appendix “A” sets out the text of the Proposed Amendments to the Rules and Policies respecting the grant of access to marketplaces; and
- Appendix “B” sets out a summary of the obligations under UMIR imposed on marketplaces, Participants, Access Persons and various officers, directors, employees and related parties (and assumes the Proposed Amendments have been approved by the Recognizing Regulators).

#### Questions / Further Information

For further information or questions concerning this notice contact:

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<sup>23</sup> For example, in Interpretative Material 4611-1, NASDAQ deals with the obligations of “Sponsoring Members” (being the equivalent of the Participant granting DSA) and the “Sponsored Firm” (being the equivalent of the DSA Client). IM 4611-1 states: “Sponsoring Members have responsibility for the conduct of their Sponsored Firms as if the conduct were their own.”

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**Appendix "A"****Amendments Respecting Access to Marketplaces**

The Universal Market Integrity Rules are amended as follows:

1. Rule 1.1 is amended by deleting the definitions of "Access Person" and "Participant" and substituting the following:

**"Access Person"** means a person, other than a Participant, who:

- (a) is a member;
- (b) is a subscriber;
- (c) is a user; or
- (d) has Dealer-Sponsored Access.

**"Participant"** means:

- (a) a dealer registered in accordance with securities legislation of any jurisdiction that is able to act as an intermediary on behalf of clients with respect to securities traded on a marketplace and who:
  - (i) is a member,
  - (ii) is a user,
  - (iii) is a subscriber, or
  - (iv) has Dealer-Sponsored Access; or
- (b) a person who has been granted trading access to a marketplace and who performs the functions of a derivatives market maker.

2. Rule 1.1 is amended by adding the following definitions of "Dealer-Sponsored Access", "Designated Marketplace", "Marketplace Eligible Client" and "Representative":

**"Dealer-Sponsored Access"** means the right to access to the trading system of a marketplace either directly or by means of an electronic connection to the order routing system of a Participant that has been granted by the Participant to a client that is an "institutional customer" for the purposes of Policy 4 – *Minimum Standards for Institutional Account Opening, Operation and Supervision* of the Investment Dealers Association.

**"Designated Marketplace"** means any marketplace for which the Market Regulator has been retained as the Regulation Services Provider and to which the Access Person has access by means of being:

- (a) a member;
- (b) a subscriber;
- (c) a user; or
- (d) provided Dealer-Sponsored Access.

**"Marketplace Eligible Client"** means a client of a Participant that is eligible to obtain Dealer-Sponsored Access to a particular marketplace in accordance with:

- (a) in the case of an Exchange or QTRS, the Marketplace Rules of that marketplace; or
- (b) in the case of an ATS, the subscription agreement between the Participant and that marketplace.

**“Representative”** means each director, officer or employee of the Access Person who on behalf of the Access Person:

- (a) may enter an order on a Designated Marketplace; or
- (b) is responsible for the immediate supervision of any order entered by a director, officer or employee of the Access Person on a Designated Marketplace.

3. Clause (a) of subsection (1) of Rule 6.2 is amended by:

- (a) deleting the word “and” at the end of subclause (ii);
- (b) inserting the following as subclause (iv):
  - (iv) the Marketplace Eligible Client as assigned by the Participant and submitted to the Market Regulator in accordance with Rule 7.8, if the order is entered by the Marketplace Eligible Client by Dealer-Sponsored Access; and

4. Rule 7.1 is amended by adding the following as subsection (5):

- (5) Each ATS shall adopt written policies and procedures to monitor orders entered by a subscriber who is an Access Person that are adequate, taking into account the business and affairs of the ATS, to ensure compliance with those provisions of the Rules that are applicable to an Access Person.

5. Rule 7.2 is amended by:

- (a) inserting in the title the phrase “and Training” after the word “Proficiency”; and
- (b) adding the following as subsection (3):
  - (3) No order to purchase or sell a security shall be entered by an Access Person on a marketplace, unless the Access Person or the Representative entering the order or responsible for the order has:
    - (a) completed the Trader Training Course of the Canadian Securities Institute; or
    - (b) completed such course, examination or other means of demonstrating training in these Rules and Policies as may be acceptable to the Market Regulator of the marketplace on which the order is entered or the applicable securities regulatory authority.

6. Part 7 of the Rules is amended by:

- (a) renumbering Rule 7.9 as Rule 7.8;
- (b) adding the following as Rule 7.9:

**7.9 Provisions Respecting Dealer-Sponsored Access to Marketplaces**

- (1) A Participant that grants Dealer-Sponsored Access to one or more Marketplace Eligible Clients shall submit the following information to the Market Regulator:
  - (a) the name and contact information of the director, officer or employee of the Participant responsible for any order entered by Dealer-Sponsored Access; and
  - (b) the name of each marketplace to which Dealer-Sponsored Access may be granted to a Marketplace Eligible Client by the Participant.
- (2) Prior to accepting any order entered by Dealer-Sponsored Access granted by a Participant to a particular Marketplace Eligible Client, the Participant shall submit the following information to the Market Regulator:
  - (a) the name and contact information of each director, officer or employee of the Marketplace Eligible Client who may enter an order by Dealer-Sponsored Access on behalf of the Marketplace Eligible Client;

- (b) the name and contact information of each director, officer or employee of the Marketplace Eligible Client who will be responsible for the supervision of any order entered by Dealer-Sponsored Access by the Marketplace Eligible Client;
  - (c) the marketplace or marketplaces to which the Marketplace Eligible Client has been granted Dealer-Sponsored Access; and
  - (d) the unique identifier that will be attached to each order entered by the Marketplace Eligible Client by Dealer-Sponsored Access.
- (3) If after the date of submission of any information under subsection (1) or (2), there is a change in the information the Participant shall immediately submit notice of such change to the Market Regulator.
  - (4) The Market Regulator may require that any information or notice to be submitted to the Market Regulator by a Participant shall be in an electronic form acceptable to the Market Regulator.
- (c) adding the following as Rule 7.10:

**7.10 Agreement between a Market Regulator and an Access Person**

- (1) Each Access Person shall enter into an agreement in such form as may be prescribed in the Policies with the Market Regulator for each Designated Marketplace.
- (2) An Access Person shall not enter an order or execute a trade on a Designated Marketplace unless the Access Person has executed the agreement required by subsection (1) by the later of the date:
  - (a) the person became an Access Person; and
  - (b) six months following the effective date of this provision.
- (3) A Participant or marketplace shall not knowingly accept an order entered by an Access Person unless the Access Person has executed the agreement required by subsection (1) by the later of the date:
  - (a) the person became an Access Person; and
  - (b) six months following the effective date of this provision.

7. Part 10 of the Rules is amended by adding the following as Rule 10.17:

**10.17 Gatekeeper Obligations with Respect to Access Persons**

- (1) A Designated Marketplace that has provided access to an Access Person or a Participant that has provided Dealer-Sponsored Access to an Access Person shall forthwith report to the Market Regulator the fact that the Designated Marketplace or the Participant knows or has reason to believe that the Access Person has or may have:
  - (a) failed to comply with the provisions of the agreement between the Market Regulator and the Access Person required by Rule 7.10, including the failure of the Access Person to file any schedule required by the agreement; or
  - (b) violated:
    - (i) Subsection (2) of Rule 2.1 respecting conduct of business openly and fairly,
    - (ii) Rule 2.2 respecting manipulative and deceptive activities,
    - (iii) Rule 2.3 respecting improper orders or trades, and
    - (iv) any Requirement that has been designated by the Market Regulator for the purposes of this clause.

The Policies to the Universal Market Integrity Rules are amended as follows:

1. Policy 7.1 is amended by adding the following as Part 6:

***Part 6 – Compliance Procedures Applicable to Alternative Trading Systems***

The policies and procedures adopted by an ATS in accordance with Rule 7.1 must be adequate, taking into account the business and affairs of the ATS, to ensure compliance with those provisions of the Rules that are applicable to an Access Person. In accordance with the provisions of the Marketplace Operation Instrument, each ATS may establish criteria and classes of subscribers and provide different access to different groups or classes of subscribers. The policies and procedures adopted by the ATS must be appropriate for the type and extent of trading undertaken through the ATS by its subscribers. An ATS does not have to monitor trading undertaken by a subscriber that is a Participant as such trading activity is already subject to supervision and compliance requirements in accordance with the Rules.

The policies and procedures to monitor orders entered by a subscriber (other than a Participant) should address compliance with those requirements which are applicable to an Access Person, including:

- prohibition on manipulative and deceptive activities;
- requirement to conduct trading openly and fairly;
- prohibition on entering an order which the Access Person knows or ought reasonably to know does not comply with securities legislation, requirements of the marketplace or the Rules;
- restrictions on short selling; and
- order marking requirements.

The policies and procedures should take into account the information which is available to the ATS in its capacity as a dealer that is subject to “know-your-client” requirements under applicable securities legislation and rules of self-regulatory entities. In this regard, the ATS should consider whether similar policies and procedures adopted by a Participant to review trading activity of a client to which the Participant has provided Dealer-Sponsored Access are appropriate for the ATS in the circumstances.

2. The following is added as Part 1 of Policy 7.10:

***Policy 7.10 – Agreement between a Market Regulator and an Access Person***

***Part 1 – Prescribed Form of Access Person and Representative Agreement***

**ACCESS PERSON AND REPRESENTATIVE AGREEMENT**

WHEREAS Market Regulation Services Inc. (“RS”) is recognized as a Self-Regulatory Entity by the applicable Securities Regulatory Authority in various Canadian jurisdictions in which Marketplaces conduct business;

AND WHEREAS RS has been retained as a Regulation Services Provider to provide regulation services to certain Marketplaces in accordance with the Marketplace Operation Instrument and the Trading Rules;

AND WHEREAS the Trading Rules require that a Subscriber to an ATS or a person with Dealer-Sponsored Access to a marketplace must enter into a written agreement with the Regulation Services Provider for each marketplace to which person has access;

AND WHEREAS the Access Person is a Subscriber or has Dealer-Sponsored Access to one or more of the Marketplaces which have retained RS as their Regulation Services Provider;

NOW THEREFORE, in consideration of the premises and the covenants and agreements, RS and the Access Person agree as follows:

**1. Defined Terms**

In this document:

- (a) a capitalized term that is not otherwise defined has the meaning ascribed to it in the Universal Market Integrity Rules ("UMIR") as amended, supplemented and in effect from time to time;
- (b) "Agreement" means this Access Person and Representative Agreement and includes any schedule which is attached or which is submitted at a future date by the Access Person to RS to be attached to this document in accordance with the provisions of this Agreement; and
- (c) "Filing Code" means the password assigned to the Access Person by RS for the purpose of electronically filing Schedules to this Agreement.

**2. Electronic Filing and Delivery**

- (1) RS and the Access Person agree that the Access Person may execute this Agreement, including any schedule or amendment to any schedule to this Agreement, and deliver an electronic copy to RS in the form and manner as RS may permit or require from time to time.
- (2) Upon receipt of an electronic copy of this Agreement, RS shall issue a written or electronic receipt to the Access Person and such receipt shall contain the Filing Code.
- (3) The Access Person agrees that any schedule contemplated by this Agreement which is received by RS and bearing the Filing Code may be considered by RS to be an amendment to this Agreement to be effective upon the issuance of an acknowledgement in accordance with section 10 of this Agreement.

**3. Designated Marketplaces**

- (1) Within five (5) business days following the issuance of the Filing Code by RS, the Access Person shall complete and file with RS a Schedule A that lists each Designated Marketplace as at the date of this Agreement.
- (2) Within five (5) business days following the change of any information contained in Schedule A, the Access Person shall complete and file with RS an amended Schedule A that lists each Designated Marketplace as at the date of the change in information.

**4. Representatives and Training**

- (1) Within five (5) business days following the issuance of the Filing Code by RS, the Access Person shall complete and file with RS a Schedule B for each Representative that may enter an order on a Designated Marketplace or who is responsible for the supervision of any order entered on a Designated Marketplace and such Schedule B shall be executed by the applicable director, officer or employee of the Access Person as at the date of this Agreement.
- (2) Within five (5) business days following the change of any information contained in a Schedule B or in the event a person becomes or ceases to be a Representative, the Access Person shall complete and file with RS a Schedule B or an amended Schedule B, as applicable, as at the date of the change in information.

**5. Compliance Requirement**

The Access Person and each Representative acknowledges and agrees:

- (a) to conduct trading activities on:
  - (i) each Designated Marketplace in compliance with UMIR, and

- (ii) a particular Designated Marketplace in accordance with the requirements of that Designated Marketplace;
- (b) that RS will monitor the conduct of the Access Person and each Representatives and that RS will enforce the requirements of UMIR and the Designated Marketplaces; and
- (c) to comply with all decisions, determinations or directions made by RS in its capacity as a Regulation Services Provider including, but not limited to, any determination to exclude the Access Person and/or any Representative from access to any Designated Marketplace or other marketplace for which RS acts as the Regulation Services Provider.

## 6. Restrictions on the Entry of Orders

The Access Person agrees that:

- (a) the Access Person shall not enter an order on a particular Designated Marketplace:
  - (i) until the Access Person has filed with RS a Schedule A or an amended Schedule A, as applicable, confirming access to the Designated Marketplace and RS has issued an acknowledgement of receipt of such filing, and
  - (ii) unless the order contains the identifier assigned to the Access Person by:
    - (A) the Designated Marketplace, if the Access Person is entering the order on a ATS to which the Access Person is a Subscriber or on a QTRS to which the Access Person is a User, or
    - (B) the Participant, if the Access Person is entering the order on a Designated Marketplace by means of Dealer-Sponsored Access;
- (b) no person other than a Representative shall enter an order on a Designated Marketplace by means of the access provided to the Access Person as a Subscriber or as a person with Dealer-Sponsored Access; and
- (c) no Representative may enter an order on a Designated Marketplace until the Representative has:
  - (i) executed a Schedule B and the Access Person has filed the schedule with RS and RS has issued an acknowledgement of receipt of the Schedule B, and
  - (ii) completed such training requirements as may be required of a Representative in accordance with the requirements of UMIR as may be in force from time to time.

## 7. Limited Liability

RS, its directors, officers, employees, agents and any other person acting under its authority shall not be liable to the Access Person or any Representative or other person for any loss, damage, cost, expense or other liability or claim arising from any act or omission, in good faith, in connection with the performance of services by RS as a Regulation Services Provider.

## 8. Effective Date and Term of Agreement

- (1) This Agreement shall become effective upon the issuance by RS in written or electronic form of an acknowledgement of receipt of a copy of this Agreement as executed and delivered by the Access Person.
- (2) Subject to the provisions of subsection (3) and section 11, this Agreement shall terminate on the date that the Access Person ceases to have access to any Designated Marketplace.
- (3) Notwithstanding the termination of this Agreement, the Access Person and each Representative shall remain subject to UMIR and shall attorn to the jurisdiction of RS in respect of any order entered on any Designated Marketplace by the Access Person and

Representative during the term of this Agreement for a period of seven years following the date of the entry of the order on the Designated Marketplace.

## 9. Notices and Filings

- (1) Unless otherwise provided in a notice given by RS to the Access Person, any filing by the Access Person of this Agreement, including any schedule or any amendment to any schedule to this Agreement, information or documents by the Access Person shall be made electronically through the web site maintained by RS at [ww.rs.ca/](http://ww.rs.ca/).
- (2) Any notice or communication, other than a filing made pursuant to subsection (1), shall be given in writing and may be given by personal delivery or by transmittal by telecopier addressed to the recipient as follows:

To RS:

Market Regulation Services Inc.,  
145 King St. West,  
Suite 900,  
Toronto, Ontario.  
Canada. M5H 1J8

Attention: Vice President Market Policy and General Counsel

Telecopier: (416) 646-7265  
E-Mail: [\\*@rs.ca](mailto:*@rs.ca)

To the Access Person:

Telecopier:  
E-Mail :

Any communication given by personal delivery shall be conclusively deemed to have been given on the day of the actual delivery and, if given by telecopier or e-mail, on the day of transmittal.

## 10. Amendments

- (1) The form of this Agreement is prescribed as Part 1 of Policy 7.10 under UMIR and the terms of this Agreement shall be amended without further action by RS, the Access Person or any Representative upon the effective date of any approval by the applicable securities regulatory authorities of any amendment to Part 1 of Policy 7.10. RS shall provide notice to the Access Person and each Representative of any submission by RS to the applicable securities regulatory authorities to amend Part 1 of Policy 7.10.
- (2) Any change in a schedule to this Agreement shall be effective upon the issuance by RS in written or electronic form of an acknowledgement of receipt of a change in a schedule to this Agreement made in accordance with the terms of this Agreement.

## 11. Retention of Original Copies of Schedules

The Access Person shall retain in its records an original signed copy of this Agreement (including an original copy of each Schedule B to this Agreement that has been manually signed by applicable Representative) until seven years following the termination of this Agreement.

## 12. Assignment

RS may assign this Agreement to an entity that becomes the Regulation Services Provider for a Designated Marketplace.



**13. Applicable Law**

This Agreement shall be interpreted and governed in all respects by the laws of the Province of Ontario and the applicable laws of Canada.

**IN WITNESS WHEREOF**, this Access Person and Representative Agreement is executed as of the \_\_\_\_\_ of \_\_\_\_\_, 200\_\_\_\_.

**[NAME OF ACCESS PERSON]**

By:

\_\_\_\_\_

Name:

Title:

By:

\_\_\_\_\_

Name:

Title:

**SCHEDULE A**

**DESIGNATED MARKETPLACES**

For the purposes of this Schedule to the Access Person and Representative Agreement between Market Regulation Services Inc. ("RS") and the Access Person (the "Agreement"), a "Designated Marketplace" means any marketplace for which RS has been retained as the Regulation Services Provider and to which the Access Person has access by means of being:

- a Subscriber to a marketplace that is an alternative trading system,
- a User of a marketplace that is a quotation or trade reporting system, or
- provided Dealer-Sponsored Access.

| Name of Designated Marketplace | Nature of Access (Subscriber, User or Dealer-Sponsored Access) | Participant Providing Dealer-Sponsored Access |                | Identifier Assigned to Access Person by Marketplace or Participant | Effective Dates of Access to Designated Marketplace |             |
|--------------------------------|--|---|----------------|--|---|-------------|
|                                |  | Name  | Trading Number |  | Commencement  | Termination |
|                                |  |   |                |  |   |             |
|                                |  |   |                |  |   |             |
|                                |  |   |                |  |   |             |
|                                |  |   |                |  |   |             |
|                                |  |   |                |  |   |             |

By inserting the Filing Code assigned by RS, the Access Person certifies that the information contained in this Schedule A is true and accurate as of the date that this Schedule A is filed with RS. Upon filing of this Schedule A with RS, this Schedule A shall become part of the Agreement. An original signed copy of this Schedule must be retained in the records of the Access Person until seven years following the termination of the Agreement.

| Date of Filing | Filing Code | Name of Access Person | Name of Authorized Officer | Signature of Authorized Officer |
|----------------|-------------|-----------------------|----------------------------|---------------------------------|
|                |             |                       |                            |                                 |

**SCHEDULE B**

**REPRESENTATIVES AND TRAINING**

For the purposes of this Schedule to the Access Person and Representative Agreement between Market Regulation Services Inc. ("RS") and the Access Person (the "Agreement"), a "Representative" means each director, officer or employee of the Access Person who on behalf of the Access Person:

- may enter an order on a Designated Marketplace, or
- is responsible for the supervision of any order entered by a director, officer or employee of the Access Person on a Designated Marketplace.

A "Designated Marketplace" means any marketplace for which RS has been retained as the Regulation Services Provider and to which the Access Person has access by means of being:

- a Subscriber to a marketplace that is an alternative trading system,
- a User of a marketplace that is a quotation or trade reporting system, or
- provided Dealer-Sponsored Access.

| Name of Designated Marketplace | Nature of Capacity (Trader or Supervisor) | Participant Providing Dealer-Sponsored Access |                | Identifier Assigned to Access Person by Marketplace or Participant | Training Requirement (if applicable) |                    |
|--------------------------------|---|---|----------------|--|--------------------------------------|--------------------|
|                                |   | Name  | Trading Number |  | Name of Course                       | Date of Completion |
|                                |   |   |                |  |                                      |                    |
|                                |   |   |                |  |                                      |                    |
|                                |   |   |                |  |                                      |                    |
|                                |   |   |                |  |                                      |                    |
|                                |   |   |                |  |                                      |                    |

By inserting the Filing Code assigned by RS, the Access Person certifies that the information contained in this Schedule B is true and accurate as of the date that this Schedule B is filed with RS. Upon filing of this Schedule B with RS, this Schedule B shall become part of the Agreement. A separate Schedule B must be completed for each person who is a "Representative" of the Access Person. An original signed copy of this Schedule must be retained in the records of the Access Person until seven years following the termination of the Agreement. **In executing this Schedule B, the undersigned, in consideration of being able to enter orders on behalf of the Access Person or to supervise the entry of such orders, acknowledges and agrees to the obligations applicable to Representatives set out in the Agreement and in the Universal Market Integrity Rules.**

| Date of Filing | Filing Code | Name of Access Person | Name of Representative | Signature of Representative | Business Telephone Number |
|----------------|-------------|-----------------------|------------------------|-----------------------------|---------------------------|
|                |             |                       |                        |                             |                           |

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**Appendix "B"****Summary of Obligations under the  
Universal Market Integrity Rules**

The following table sets out a summary of the obligations under the Universal Market Integrity Rules that are imposed on marketplaces, Participants, Access Persons and various officers, directors, employees and related parties. The table assumes that the Proposed Amendments have been approved by the Recognizing Regulators. Obligations which will be introduced or significantly impacted by the adoption of the Proposed Amendments have been highlighted.

**Definitions**

If the Proposed Amendments are adopted, the following definitions would be applicable for the purposes of the Universal Market Integrity Rules:

**"Access Person"** means a person, other than a Participant, who:

- (a) is a member;
- (b) is a subscriber;
- (c) is a user; or
- (d) has Dealer-Sponsored Access.

**"Dealer-Sponsored Access"** means the right to access to the trading system of a marketplace either directly or by means of an electronic connection to the order routing system of a Participant that has been granted by the Participant to a client that is an "institutional customer" for the purposes of Policy 4 – *Minimum Standards for Institutional Account Opening, Operation and Supervision* of the Investment Dealers Association.

**"Participant"** means:

- (a) a dealer registered in accordance with securities legislation of any jurisdiction that is able to act as an intermediary on behalf of clients with respect to securities traded on a marketplace and who:
  - (i) is a member,
  - (ii) is a user,
  - (iii) is a subscriber, or
  - (iv) has Dealer-Sponsored Access; or
- (b) a person who has been granted trading access to a marketplace and who performs the functions of a derivatives market maker.

**"Regulated Person"** means, in respect of the jurisdiction of a Market Regulator in connection with the conduct of a person:

- (a) any marketplace for which the Market Regulator is the regulation service provider or was the regulation service provider at the time of the conduct;
- (b) any Participant or Access Person of a marketplace for which the Market Regulator is the regulation service provider or was the regulation service provider at the time of the conduct;
- (c) any person to whom responsibility for compliance with the Rules by other persons are extended in accordance with Rule 10.3 or to whom responsibility had been extended at the time of the conduct;
- (d) any person to whom the application of the Rules are extended in accordance with Rule 10.4 or to whom the Rules had been extended at the time of the conduct; and
- (e) any person subject to a Marketplace Rule of a marketplace for which the Market Regulator is the regulation services provider or was the regulation services provider at the time of the conduct.

| UMIR Section  | Rule Description   | Marketplaces  |            | Regulated Person | Category of Access |               |
|---------------|--|---------------|------------|------------------|--------------------|---------------|
|               |  | Exchange/QTRS | ATS        |                  | Participant        | Access Person |
| <b>Part 1</b> | <b>Definitions and Interpretation</b>  |               |            |                  |                    |               |
| 1.1           | <i>Definitions</i> – definition of terms used in the rules and any policy.   | √             | √          |                  | √                  | √             |
| 1.2           | <i>Interpretation</i> – adoption of definitions used in other applicable instruments and general rules to determining prices.  | √             | √          |                  | √                  | √             |
| <b>Part 2</b> | <b>Abusive Trading</b>   |               |            |                  |                    |               |
| 2.1           | <i>Just and Equitable Principles</i> – requirement to conduct business on a marketplace openly and fairly and in accordance with just and equitable principles of trade.   |               |            |                  | √                  | √ <b>1</b>    |
| 2.2           | <i>Manipulative or Deceptive Method of Trading</i> – prohibition on certain practices when trading on a marketplace.   |               |            |                  | √                  | √             |
| 2.3           | <i>Improper Orders and Trades</i> – prohibition on the entry of an order or execution of a trade that does not comply with regulatory requirements or requirements of the marketplace.   |               |            |                  | √                  | √             |
| <b>Part 3</b> | <b>Short Selling</b>   |               |            |                  |                    |               |
| 3.1           | <i>Restrictions on Short Selling</i> – restrictions on selling securities short at a price below the last sale price.  |               |            |                  | √                  | √             |
| <b>Part 4</b> | <b>Frontrunning</b>  |               |            |                  |                    |               |
| 4.1           | <i>Frontrunning</i> – prohibition on frontrunning client orders.   |               |            |                  | √                  |               |
| <b>Part 5</b> | <b>Best Execution Obligation</b>   |               |            |                  |                    |               |
| 5.1           | <i>Best Execution of Client Orders</i> – general obligation to ensure a client order is executed on most advantageous terms.   |               |            |                  | √                  |               |
| 5.2           | <i>Best Price Obligation</i> – obligation to ensure a client order could not be executed on another marketplace at a better price.   |               |            |                  | √                  |               |
| 5.3           | <i>Client Priority</i> – priority for client orders over principal and non-client orders.  |               |            |                  | √                  |               |
| <b>Part 6</b> | <b>Order Entry and Exposure</b>  |               |            |                  |                    |               |
| 6.1           | <i>Entry of Orders to a Marketplace</i> – establishment of standard trading increments for orders and all orders to be subject to special trading rules issued by an exchange or recognized quotation and trade reporting system.                          | √             | √          |                  | √                  | √             |
| 6.2           | <i>Designations and Identifiers</i> – requirement for standard designations and identifiers to be on each order entered on a marketplace.  | √             | √          |                  | √ <b>2</b>         | √ <b>2</b>    |
| 6.3           | <i>Exposure of Client Orders</i> – requires client orders below specified size to be immediately entered on a marketplace.   |               |            |                  | √                  |               |
| 6.4           | <i>Trades to be on a Marketplace</i> – general requirement that trades by dealers and related entities be on a marketplace.  |               |            |                  | √                  |               |
| <b>Part 7</b> | <b>Trading in a Marketplace</b>  |               |            |                  |                    |               |
| 7.1           | <i>Trading Supervision Obligations</i> – requirement to have written trading policies and procedures, appointment of supervisory staff and review of orders prior to entry to a marketplace.   |               | √ <b>3</b> |                  | √                  |               |
| 7.2           | <i>Proficiency and Training Obligations</i> – requirement that persons entering orders to a marketplace have demonstrated proficiency or training in trading rules and marketplaces have the obligation to ensure Access Persons are trained in the rules. | √ <b>4</b>    | √ <b>4</b> |                  | √                  | √ <b>4</b>    |

| UMIR Section   | Rule Description  | Marketplaces  |     | Regulated Person | Category of Access |               |
|----------------|---|---------------|-----|------------------|--------------------|---------------|
|                |   | Exchange/QTRS | ATS |                  | Participant        | Access Person |
| 7.3            | <i>Liability for Bids, Offers and Trades</i> – provides that all bids and offers accepted on marketplace become binding contracts and the responsibility for the order and contracts by a Participant or ATS where the order has been entered on the ATS by an Access Person.   |               | √ 5 |                  | √                  |               |
| 7.4            | <i>Contract Record and Official Transaction Record</i> – contract record of marketplace to govern settlement and disputes – obligation of marketplace to provide information on trades to the information processor or information vendor.  | √             | √   |                  |                    |               |
| 7.5            | <i>Recorded Prices</i> – limits negative commissions on trades with clients.  |               |     |                  | √                  |               |
| 7.6            | <i>Cancelled Trades</i> – provides that a cancelled trade does not effect validity of subsequent trades.  | √             | √   |                  | √                  | √             |
| 7.7            | <i>Restrictions on Trading During Certain Securities Transactions</i> – restricts trading in a listed security or quoted security on a marketplace by a dealer-restricted person during various securities transactions including distributions, take-over bids, issuer bids, amalgamations, arrangements and similar transactions. |               |     |                  | √                  |               |
| 7.8            | <i>Trading in Listed or Quoted Securities by a Derivative Market Maker</i> – requires compliance with additional requirements of any exchange or recognized quotation and trade reporting system.   |               |     |                  | √                  |               |
| 7.9            | <i>Provisions Respecting Dealer-Sponsored Access to Marketplaces</i> – obligation of a Participant to provide information to a Market Regulator regarding the grant of Dealer-Sponsored Access  |               |     |                  | √ 6                |               |
| 7.10           | <i>Agreement between a Market Regulator and an Access Person</i> – requirement for an Access Person to enter into a standard agreement with a Market Regulator and to preclude the Access Person from entering orders or the marketplace knowingly accepting orders until the agreement has been executed.                          | √ 7           | √ 7 |                  | √ 7                | √ 7           |
| <b>Part 8</b>  | <b>Principal Trading</b>  |               |     |                  |                    |               |
| 8.1            | <i>Client-Principal Trading</i> – general obligation of a dealer when trading a client order against a principal or non-client order.   |               |     |                  | √                  |               |
| <b>Part 9</b>  | <b>Trading Halts, Delays and Suspensions</b>  |               |     |                  |                    |               |
| 9.1            | <i>Regulatory Halts, Delays and Suspensions of Trading</i> – establishes uniform provisions for halts, delays and suspensions to be observed on all marketplaces.   | √             | √   |                  | √                  | √             |
| <b>Part 10</b> | <b>Compliance</b>   |               |     |                  |                    |               |
| 10.1           | <i>Compliance Requirement</i> – general requirement to comply with UMIR and framework for enforcement proceedings.  | √             | √   |                  | √                  | √             |
| 10.2           | <i>Investigations</i> – general power of the Market Regulator to require information in connection with an investigation.   |               |     | √                |                    |               |
| 10.3           | <i>Extension of Responsibility</i> – makes Participants and Access Persons liable for conduct of their directors, officers, partners and employees and supervisors liable for actions of employees that they supervise.   |               |     |                  | √                  | √             |
| 10.4           | <i>Extension of Restrictions</i> – extends the application of certain rules to related entities of persons with market access and to directors, officers, partners and employees of the person with access and related entities.  |               |     |                  | √                  | √             |

| UMIR Section   | Rule Description  | Marketplaces  |      | Regulated Person | Category of Access |               |
|----------------|---|---------------|------|------------------|--------------------|---------------|
|                |   | Exchange/QTRS | ATS  |                  | Participant        | Access Person |
| 10.5           | <i>Powers and Remedies</i> – sets out penalties and remedies which the Market Regulator may impose for a breach of UMIR.  |               |      | √                |                    |               |
| 10.6           | <i>Exercise of Authority</i> – establishes the power of Hearing Panels to impose the remedies and penalties and the ability to appeal orders of Hearing Panels to the applicable securities regulatory authority.   | √             | √    | √                | √                  | √             |
| 10.7           | <i>Assessment of Expenses</i> – power of the Market Regulator to assess expenses in connection with an order.   | √             | √    | √                | √                  | √             |
| 10.8           | <i>Practice and Procedure</i> – provides the ability of the Market Regulator to adopt practice and procedures related to hearings.  | √             | √    | √                | √                  | √             |
| 10.9           | <i>Power of Market Integrity Officials</i> – provides the general power required to administer UMIR and regulate the marketplaces.  | √             | √    |                  | √                  | √             |
| 10.10          | <i>Report of Short Positions</i> – requirement to provide information on short positions to the Market Regulator.   |               |      |                  | √                  | √             |
| 10.11          | <i>Audit Trail Requirements</i> – requirement that each dealer record and provide information on each order entered to a marketplace to the Market Regulator and for each dealer and Access Person to provide such additional information as may be required regarding the trade or prior or subsequent orders for the same security or a related security. |               |      |                  | √                  | √ 8           |
| 10.12          | <i>Retention and Inspection of Records and Instructions</i> – requirement that dealers retain records of orders and that dealers and Access Persons allow an appropriate Market Regulator to inspect the records.   |               |      |                  | √                  | √ 9           |
| 10.13          | <i>Exchange and Provision of Information by Market Regulators</i> – requires Market Regulators to provide information and assistance to other regulatory entities for the administration and enforcement of the rules.  | √             | √    |                  |                    |               |
| 10.14          | <i>Synchronization of Clocks</i> - requires all marketplaces and participants to synchronize clocks for the recording of data.  | √             | √    |                  | √                  |               |
| 10.15          | <i>Assignment of Identifiers and Symbols</i> - provides a mechanism for the assignment of unique identifiers to marketplaces and dealers and for unique symbols to securities which are eligible to trade on a marketplace.   | √             | √    |                  | √                  | √             |
| 10.16          | <i>Gatekeeper Obligations of Directors, Officers and Employees of Participants and Access Persons</i> – obligation to investigate potential violations and to report the findings of violations of certain rules.   |               |      |                  | √                  | √ 10          |
| 10.17          | <i>Gatekeeper Obligations with Respect to Access Persons</i> – obligation to report possible non-compliance with the agreement between the Access Person and the Market Regulator investigate potential violations and to report the findings of violations of certain rules.   | √ 11          | √ 11 |                  | √ 11               |               |
| <b>Part 11</b> | <b>Administration of Rules</b>  |               |      |                  |                    |               |
| 11.1           | <i>General Exemptive Relief</i> - provides each Market Regulator with the power to exempt a particular person or transaction from the application of a rule.  | √             | √    | √                | √                  | √             |
| 11.2           | <i>General Prescriptive Power</i> - provides each Market Regulator with the power to make a policy or a designation to aid in the administration of a rule.   | √             | √    | √                | √                  | √             |

| UMIR Section | Rule Description   | Marketplaces  |     | Regulated Person | Category of Access |               |
|--------------|--|---------------|-----|------------------|--------------------|---------------|
|              |  | Exchange/QTRS | ATS |                  | Participant        | Access Person |
| 11.3         | <i>Review or Appeal of Market Regulator Decisions</i> - any decision of a Market Regulator or Market Integrity Official may be reviewed by or appealed to a securities regulatory authority.   | √             | √   | √                | √                  | √             |
| 11.4         | <i>Method of Giving Notice</i> – general requirement for the provision of notice to any person.  | √             | √   | √                | √                  | √             |
| 11.5         | <i>Computation of Time</i> – general rule respecting the calculation of time periods.  | √             | √   | √                | √                  | √             |
| 11.6         | <i>Waiver of Notice</i> – ability to waive any notice requirement.   | √             | √   | √                | √                  | √             |
| 11.7         | <i>Omissions or Errors in Giving Notice</i> – saving provision when notice is improperly given.  | √             | √   | √                | √                  | √             |
| 11.8         | <i>Transitional Provisions</i> – provides a mechanism for the transition of marketplace rules and disciplinary proceedings to the Market Regulator retained by the marketplace as its regulation service provider.   | √             | √   | √                | √                  | √             |
| 11.9         | <i>Non-Application of Rules</i> – limits the application of UMIR   | √             | √   | √                | √                  | √             |
| 11.10        | <i>Indemnification and Limited Liability of the Market Regulator</i> – provides for the indemnification and limited liability of the Market Regulator and directors, officers and employees of the Market Regulator.   | √             | √   | √                | √                  | √             |
| 11.11        | <i>Status of Rules and Policies</i> – Rules and Policies apply in the event of a conflict with a marketplace rule or the functionality of a trading system of a marketplace unless a specific exemption has been granted by securities regulatory authority. | √             | √   | √                | √                  | √             |

**Notes:** Certain provisions of UMIR have a limited application to either ATSs or Access Persons. In particular:

1. Rule 2.1 – An Access Person is required to transact business “openly and fairly” but will not be subject to the “just and equitable principles of trade” which are generally considered applicable to persons with fiduciary obligations.
2. Rule 6.2 - Certain order designations are applicable to dealers only (such as the requirement to mark a principal order, non-client order, jitney order etc.). Access Persons are required to mark orders as to type, including whether the order is a short sale, and whether the Access Person is an insider or significant shareholder of the security subject to the order. The Proposed Amendments would require orders entered by an Access Person with Dealer-Sponsored Access to contain the identifier assigned by the Participant.
3. Rule 7.1 – The Proposed Amendments would require an ATS to undertake compliance reviews in respect of orders entered on the ATS by a subscriber who is an Access Person.
4. Rule 7.2 – Presently, an ATS is under an obligation to ensure that an Access Person has been trained in the Rules. If the Proposed Amendments are adopted to extend the definition of an Access Person to include a client with Dealer-Sponsored Access, an Exchange or QTRS that permits Dealer-Sponsored Access would also have this obligation. The Proposed Amendments would also require various directors, officers and employees of an Access Person to have completed training courses prior to entering orders on a marketplace. This requirement would become effective one year following approval of the Proposed Amendments.
5. Rule 7.3 - An ATS has responsibility for all trades arising from orders entered through the ATS subject to the obligation of an Access Person for compliance with the requirements of the Rules and each Policy. In marketplaces other than an ATS, this obligation is imposed on Participants, namely the registered intermediaries between the client and the marketplace.
6. Rule 7.9 – The Proposed Amendments would introduce an obligation of a Participant to provide information to a Market Regulator regarding the grant of Dealer-Sponsored Access prior to the Participant accepting orders from the client entered by Dealer-Sponsored Access.
7. Rule 7.10 – The Proposed Amendments would introduce a requirement for an Access Person to enter into a standard agreement with a Market Regulator and to preclude the Access Person from entering orders on the marketplace knowingly accepting orders until the agreement has been executed.



8. Rule 10.11 - An Access Person is not required to maintain or to transmit an electronic record of an order to a Market Regulator. An Access Person is under an obligation to provide to the Market Regulator of the marketplace on which an order was entered or executed certain information respecting that order or trade or other prior or subsequent orders or trades in the same security or a related security.
9. Rule 10.12 - An Access Person is not required to maintain specific records of each order. However, the Market Regulator of the marketplace on which an order was entered or executed may inspect any records that are maintained by the Access Person regarding an order or trade.
10. Rule 10.16 – An Access Person is required to investigate potential violations of: Rule 2.1(2) respecting conduct of business openly and fairly; Rule 2.2 respecting manipulative and deceptive activities and Rule 2.3 respecting improper order or trades. If the investigation determines that a violation has occurred that finding shall be reported to a Market Regulator.
11. Rule 10.17 – The Proposed Amendments would introduce an obligation on a Designated Marketplace or a Participant that has provided Dealer-Sponsored Access an to report possible non-compliance with the agreement between the Access Person and the Market Regulator and to report possible violations of certain rules in respect of orders entered on the Designated Marketplace or through the Participant by an Access Person.

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**CSA STAFF NOTICE 21-306**

**NOTICE OF FILING OF FORMS 21-101F5**  
**INITIAL OPERATION REPORT FOR**  
**INFORMATION PROCESSOR**

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**CSA STAFF NOTICE 21-306**  
**NOTICE OF FILING OF FORMS 21-101F5 INITIAL OPERATION REPORT FOR**  
**INFORMATION PROCESSOR**

## I. INTRODUCTION

The Canadian Securities Administrators (CSA or we) are publishing this notice to seek comments from market participants on the summary of applications for the information processor role, included at Schedule A, and to solicit feedback on a number of specific issues.

## II. BACKGROUND

### 1. Transparency

National Instrument 21-101 *Marketplace Operation* (NI 21-101) imposes transparency requirements onto marketplaces, dealers and inter-dealer bond brokers (IDBs) for exchange-traded securities and fixed income securities. Transparency facilitates the price discovery process and compliance with regulatory requirements, such as best execution and short selling. Transparency also supports competition between marketplaces by enabling market participants to have access to information regarding securities being traded.

Part 7 of NI 21-101 requires that marketplaces that display orders of exchange-traded securities provide information regarding these orders to an information processor or, if there is no information processor, to an information vendor. Part 8 of NI 21-101 requires that marketplaces that display orders of corporate debt securities<sup>1</sup> provide order information for corporate debt securities to an information processor. In addition, marketplaces, IDBs and dealers executing trades of corporate debt securities are required to provide information regarding details of trades to an information processor or, in the absence of an information processor, to an information vendor. Further details on the information to be reported to the information processor are included in Part 10 of Companion Policy 21-101CP to NI 21-101 (21-101CP).

At this time, CanPX Inc. (CanPX) is the approved information processor for corporate debt. There is currently no information processor for the equity securities. However, order and trade information is provided to information vendors.

### 2. Regulatory requirements, multiple marketplaces and information consolidation

The CSA initially proposed the creation of a data consolidator in 1999 with the introduction of the ATS Rules.<sup>2</sup> However, based on recommendations by an industry committee struck to review data consolidation and market integration<sup>3</sup> for the equity markets, we accepted the industry committee's view that a market-based solution would develop to achieve consolidation and removed the requirements for data consolidation and market integration.<sup>4</sup> They also expressed views on market integration.

On July 14, 2006, we proposed several amendments<sup>5</sup> to the ATS Rules and their companion policies (together, the proposed amendments). One of the amendments<sup>6</sup>, which has since been adopted, clarified our expectation that, in order to comply with best execution obligations, dealers should take into account order information from all marketplaces where a security is traded and should not just consider information from marketplaces where a dealer is a participant, as appropriate. Comments received to the proposed amendments indicated that such requirements would be more feasible with a market integrator or data consolidator/information processor. While we disagreed that market integration or data consolidation was necessary in order for dealers to comply with the best execution obligations, we agreed that the existence of an information processor<sup>7</sup> that provides consolidated data could be a helpful tool for meeting best execution and other regulatory requirements. That is, an information processor would ensure the availability of a source of consolidated data that meets regulatory standards and which users, including dealers, could use, at their choice, to demonstrate how they met their best execution obligations. The existence of an information processor would not preclude marketplace participants from using data provided by other information sources such as data vendors or from obtaining direct data feeds from the marketplaces.

<sup>1</sup> Part 8 of NI 21-101 also sets out the transparency requirements applicable to government debt securities, however, these have been postponed until December 31, 2011.

<sup>2</sup> NI 21-101 together with National Instrument 23-101 *Trading Rules* are the ATS Rules. First published at (1999) 22 OSCB ATS Supp (the ATS Supplement). A discussion about the "Consolidated Plan" can be found on page 93.

<sup>3</sup> Market integration enables a buyer or a seller of securities to access any order on any other marketplaces, regardless of whether they are a marketplace participant of that marketplace. See the ATS Supplement for a detailed description of market integration.

<sup>4</sup> See the industry report at (2003) 26 OSCB 4385.

<sup>5</sup> The proposed amendments were published in Ontario on July 14, 2006, at (2006) 29 OSCB 5735.

<sup>6</sup> These amendments have subsequently been implemented in subsection 4.1(8) of Companion Policy to NI 23-101.

<sup>7</sup> An information processor is defined as a company that receives and provides information under NI 21-101 and has filed Form 21-101F5.

As stated above, the purpose of data consolidation is to facilitate the price discovery process and regulatory compliance in a multiple marketplace environment. It enables market participants to use one source to see all prices and trades of a particular security and provides a benchmark for market participants and regulators to evaluate compliance with certain regulatory requirements like best execution, short selling and “best price” obligations, especially in a multiple marketplace environment. An information processor could ensure a central source of consolidated data that is consistent and meets standards approved by regulators.

For these reasons, we invited interested parties to apply for the role of the information processor and published a separate notice of request for this purpose.<sup>8</sup> In response to our request, we received six filings of Form 21-101F5 for the information processor, as follows:

- Bourse de Montréal (MX) for fixed income and equity securities;
- CanPX for fixed income securities;
- CDS Inc. for fixed income and equity securities;
- Gmarkets Inc. (Gmarkets) for fixed income securities;
- TSX Inc. (TSX) in conjunction with CanDeal.ca Inc. (CanDeal) for fixed income securities; and
- TSX for equity securities.

On October 27, 2006, we extended CanPX's approval as the information processor for corporate fixed income securities from December 31, 2006 until December 31, 2007 in order to allow sufficient time for market participants to transition to a new information processor, in case a different entity is selected to perform this role.<sup>9</sup>

### III. CRITERIA AND EVALUATION OF APPLICATIONS

#### 1. Criteria

Section 16.2 of 21-101CP states that the CSA will review Form 21-101F5 to determine whether it is contrary to the public interest for the filer to act as an information processor. We are considering a number of objective factors to evaluate the filings received. Specifically, we are looking for a financially viable entity that meets the following criteria:

- a. *Organization and governance* – the applicant has a strong management team and board of directors with independent representation, if feasible; it has sufficient staff resources with adequate industry knowledge and expertise assigned to run the information processor business; if facing inherent conflicts of interest, such as those associated with the collection, handling and distribution of data provided by competing organizations, it has adequate processes to manage such conflicts.
- b. *Systems*
  - Development and implementation – staff assigned to develop and implement the system necessary to perform the role of the information processor have adequate technical capability; the time required to go live by the system, if not already operational, is reasonable and connectivity is easy, in terms of standards, cost and time; in addition, the system has an adequate Central Processing Unit, network performance and capacity, an adequate testing plan that includes capacity stress tests, as well as adequate customer contract and Service Level Agreements.
  - Operations and data integrity – it has, or can develop, a system that has adequate hardware, software and network redundancy, physical and logical security, customer support activities and data validation processes; it has adequate backup procedures and a disaster recovery plan that ensures that the feed is re-established within a reasonable timeline in the event of a significant disaster; problem resolution and change management are given adequate priority and are handled by staff with the necessary capability.

<sup>8</sup> CSA Notice 21-304 Request for Filing of Form 21-101F5 Initial Operation Report for Information Processor by Interested Information Processors (Request for Filing of Form 21-101F5), published in Ontario on July 14, 2006 at (2006) 29 OSCB 5757.

<sup>9</sup> CSA Staff Notice 21-305 Extension of Approval of Information Processor for Corporate Fixed Income Securities, published in Ontario at (2006) 29 OSCB 8364.

- c. *Commitment to transparency*
- o Fixed income securities – the applicant is committed to receiving data feeds of trade details for designated corporate securities reported by marketplaces, IDBs and dealers in accordance with the requirements of NI 21-101 and 21-101 CP,<sup>10</sup> and to provide a consolidated data feed of such information, as required by NI 21-101; in addition, it has adequate, timely and transparent criteria and processes to select the designated corporate fixed income securities.
  - o Equity securities - it is committed to receiving data feeds for orders and trades in exchange-traded securities reported by marketplaces in accordance with the requirements of NI 21-101 containing, at a minimum, information such as the marketplace, time of entry, price, volume and appropriate regulatory identifiers; it can provide a consolidated feed of the bid and ask prices, as well as trade information transmitted to it.
- d. *Fees and revenue sharing* – the applicant has a competitive fee structure and revenue sharing plan and, if sharing revenue with the data contributors, the allocation is fair.

The summary of the filings received included as Schedule A to this notice is organized under the four general criteria listed above.<sup>11</sup>

## 2. Specific requests for comment

In addition to written submissions with respect to the summary of filings included in Schedule A, we request specific comments in a number of areas, set out below.

### a. *General*

We are requesting feedback on the proposals received and the criteria developed for evaluation.

#### Question #1:

**What are the advantages and disadvantages associated with each proposal summarized in Schedule A?**

#### Question #2:

**Are the criteria used for evaluation of the applications adequate? Should other factors be considered by the CSA in reviewing the applications?**

### b. *Feed versus display*

One issue we considered was whether an information processor should disseminate a standardized display of data that would ensure that all market participants view the same consolidated information in the same way. Discussions with marketplace representatives indicated, however, that the specific information needs of market participants may be better met if the information processor disseminates data feeds that can be acquired by users, directly from the information processor or through information vendors, and can be varied and customized to meet their needs.

#### Question #3:

**Should an information processor be required to create and disseminate a standardized, consolidated display of data? Alternatively, should the information processor disseminate consolidated data feeds that may be accessed by market participants to create their own displays?**

### c. *Multiple information processors*

We note that, while NI 21-101 sets out the process to become an information processor and 21-101CP states that the CSA must make a determination whether it is contrary to the public interest for a filer to act as an information processor, there are no restrictions on the number of entities that may act as information processors, provided they meet the required criteria. Further, in CSA Notice 21-304 Request for Filing of Form 21-101F5, we recognize that an entity may apply to be the information processor for the fixed income market, for the equity market, or for both.

<sup>10</sup> Subsection 10.1(3) of 21-101CP requires marketplaces trading corporate debt securities, IDBs and dealers trading corporate debt securities outside of a marketplace to provide details of trades of all corporate debt securities designated by the information processor, including: the type of counterparty, issuer, type of security, class, series, coupon and maturity, price and time of the trade and, subject to certain volume caps, the volume traded, within one hour from the time of trade.

<sup>11</sup> Note that the summary does not include proprietary and commercial information provided by the applicants.

We acknowledge the synergies and advantages, both in terms of cost savings and ease of connectivity, associated with a single information processor. In addition, a single information processor would ensure the availability of a single source of consolidated information and uniformity of data distributed to the public. However, there may be advantages to having multiple information processors. For example, some believe that having different information processors for the fixed income and equity markets would ensure that the distinct needs of the participants of these two markets are better met. Further, there are views that the availability of multiple information processors may promote competitiveness and create efficiencies, both in terms of fees and operations.

**Question #4:**

**What would be the advantages and disadvantages of having one versus multiple information processors? For example, how would each alternative impact market participants' ability to achieve best execution or comply with trade-through or other obligations? Should the information processors for the fixed income and equity markets be different?**

**IV. COMMENTS AND QUESTIONS**

We are reviewing the filings received based on the criteria specified earlier. Subject to any comments received by *June 4, 2007*, we intend to make a final recommendation regarding the information processor to each Commission in July, 2007 and publish the results shortly thereafter.

You should send submissions to all of the CSA listed below in care of the OSC, in duplicate, as indicated below:

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

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

Submissions should also be addressed to the Autorité des marchés financiers (Québec) as follows:

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

A diskette containing the submissions should also be submitted. As securities legislation in certain provinces requires a summary of written comments during the comment period be published, confidentiality of submissions cannot be maintained.



Questions may be referred to any of:

Shaun Fluker  
Alberta Securities Commission  
(403) 297-3308

Serge Boisvert  
Autorité des marchés financiers  
(514) 395-0558 X 4358

Tony Wong  
British Columbia Securities Commission  
(604) 899-6764

Doug Brown  
Manitoba Securities Commission  
(204) 945-0605

Randee Pavalow  
Ontario Securities Commission  
(416) 593-8257

Tracey Stern  
Ontario Securities Commission  
(416) 593-8167

| SCHEDULE A<br>SUMMARY OF FILINGS RECEIVED |   |  |  |  |  |   |
|---|---|--|--|--|--|---|
| Description                               | CanPX<br>(Fixed Income)   | Gmarkets<br>(Fixed Income)   | TSX/CanDeal<br>(Fixed Income)  | MX<br>(Equity and Fixed Income)  | CDS Inc.<br>(Equity and Fixed<br>Income)   | TSX<br>(Equity)   |
| <b>1. ORGANIZATION AND GOVERNANCE</b>     |   |  |  |  |  |   |
| <b>1. Overview</b>                        | CanPX is a for-profit, privately-held corporation.  | Gmarkets is a for-profit, privately-held corporation.  | The application is made jointly by TSX and CanDeal.<br><br>The vehicle pursuant to which TSX/CanDeal will deliver the functions of the IP (and consequently, the governance structure for the IP) has not been finalized at this time. TSX/CanDeal anticipate that the structure will facilitate the involvement of, and input from, various industry participants including those who are independent of TSX/CanDeal. | MX is a for-profit, privately-held corporation.<br><br>It proposes two alternative structures for the information processor:<br><br>1. The CSA could form a not-for-profit legal entity which would carry on its activities as an IP. The IP would:<br><ul style="list-style-type: none"> <li>contract with MX to provide the technical service through its Information Technology Solutions business unit (MX-ITS); and</li> <li>establish Policy and Technical Committees comprised of industry volunteers for each market (equity and debt) that would make all policy decisions applicable to the IP, as well as decisions on fees and revenue sharing.</li> </ul><br>2. MX could take on direct responsibility to operate as an IP and could establish a separate entity with an independent governance for this purpose. | The IP services would be provided by CDS Inc., a wholly-owned subsidiary of The Canadian Depository for Securities Limited.  | TSX Inc. (TSX) is a for-profit corporation and a wholly-owned subsidiary of TSX Group Inc., a public company. |
| <b>2. Board of Directors<sup>12</sup></b> | The board of directors of CanPX is composed of eight directors. All are related to dealers or IDBs. | There are three shareholders, two of which are also directors of Gmarkets. While no directors are independent of the applicant, they have no | The governance model for the vehicle has not yet been finalized. TSX/CanDeal anticipate facilitating the involvement of, and input   | The composition of the Board will be determined once the optimal governance structure to perform the IP role has been determined between the CSA, the data contributors and the  | The Canadian Depository for Securities Limited has a board of 15 directors; currently, 4 of these directors are independent. | The TSX board of directors has 14 directors, 12 of which are independent.                                     |

<sup>12</sup> For the purposes of this summary, we interpreted independence broadly to mean the lack of a direct or indirect material relationship with an applicant; a material relationship would be reasonably expected to interfere with the exercise of a director's independent judgement.

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| <p><b>3. Key personnel</b></p> <p>An Operating Committee composed of the President (a representative of a dealer), Secretary-Treasurer (from the Investment Industry Association of Canada (IIAC) and one of the Directors (an IDB), is responsible for the ongoing operations of CanPX.</p> <p>4 individuals employed by the IIAC are responsible for ensuring high-level compliance with corporate governance requirements, accounting, the day-to-day operations of CanPX, oversight of the technical facilitator, monitoring timeliness of data reported to and displayed by the system, and other ongoing functions.</p> | <p>relationship with any dealers, IDBs or marketplaces.</p> <p>Key personnel consists of the President and CEO, as well as the Secretary and Director.</p> <p>In addition, there is a Client Services group responsible for data quality assurance, entitlements, administration and first level client support.</p> | <p>from various industry participants, including those independent of TSX/CanDeal.</p> <p>Key personnel responsible for the services of the IP will include:</p> <ul style="list-style-type: none"> <li>Staff of TSX</li> <li>Datalinx, the market data division of TSX, TSX and CanDeal technologies staff;</li> <li>Staff of TSX</li> <li>Markets, the trading division of TSX; and</li> <li>Senior staff from TSX and CanDeal.</li> </ul> <p>The IP will leverage TSX staff in Network Operations/ Support, Vendor Services, Market Services and Product Management.</p> <p>The IP will also leverage TSX staff in Development, Quality Assurance and Project Management on an "as needed" basis.</p> | <p>Key personnel will be comprised of the 120 individuals employed by the MX-ITS and 5 of the Market Data Services divisions of MX.</p> | <p>Selected staff of CDS Inc. will be responsible, among others, for the operations of the IP. Such staff will include:</p> <ul style="list-style-type: none"> <li>The Executive Director, CDS Inc.;</li> <li>The Managing Director, CDS Inc. Business, reporting to the Executive Director; and</li> <li>A Business Manager, IP, reporting to the Managing Director, CDS Inc. Business.</li> </ul> <p>The Business Manager, IP position will be created and dedicated full-time to the operations of the IP. This individual will be charged with recommending and executing strategies for the overall management of the IP operations.</p> <p>At this time, it is anticipated that two business analysts, reporting to the Business Manager, IP, will be dedicated full-time to the operations of the IP.</p> | <p>Personnel will be employed by either TSX or an affiliate, and any personnel employed by an affiliate will be shared with TSX under a service agreement.</p> <p>Core personnel that would be involved in the operations of the IP would be certain staff of TSX Datalinx, Market Services, Technology Operations, Technology Development, Product Management and Market Services.</p> <p>IP products will share dedicated staff in Operations, Network Support, Vendor Services and Product Management and will share staff with other products on an "as needed" basis in Development, Quality Assurance and in the Project Management Office.</p> |                 |

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| <p><b>4. Management of potential conflicts of interest<sup>13</sup></b></p> | <p>As no directors are independent of a dealer or IDB, and some may serve on Board of other parties with an interest in the debt markets, CanPX has a number of measures to help preserve independence, as follows:</p> <ul style="list-style-type: none"> <li>Broad share ownership with provision for others to become shareholders;</li> <li>Secretariat services provided by a third party (the IIAC);</li> <li>Declaration by directors of any known conflicts of interest during Board meetings;</li> <li>Periodic guest participation of a Bank of Canada representative;</li> <li>Shareholders do not acquire data directly from CanPX but from CanPX vendors at the same prices, time and terms as other parties;</li> <li>Quarterly communication to all data contributors of Board meeting minutes;</li> <li>Annual circulation to all contributors of audited financial</li> </ul> | <p>The application indicates that Gmarkets does not have a conflict of interest in pursuing the role of IP for the Canadian debt markets, as it does not derive any income from trading in these markets, and none of its shareholders and directors are employed by a Canadian marketplace, dealer or IDB.</p> | <p>TSX/CanDeal will put into place the necessary policies, procedures and processes (both system and non-system) to manage potential conflicts of interest associated with the receipt of data from competitors of TSX or CanDeal. As a general matter, access to data will be on an "as needed" basis. Specifically:</p> <ul style="list-style-type: none"> <li>Employees of Shortcan Brokers Limited (an IDB subsidiary of TSX) will not be granted access by TSX/CanDeal to competitor IDB data;</li> <li>Employees of Revolution Trading division will not be granted access by TSX/CanDeal to competitor IDB data;</li> <li>Access to the contributed inbound sources will be restricted to those who require access for the purposes of the performing IP functions.</li> </ul> <p>The existing safeguards that are put in place by TSX in order to ensure that the interests of</p> | <p>MX's conflicts of interest are specific to an exchange and relate to the inherent conflicts from ownership of the exchange shares. Such conflicts are managed through restrictions on share ownership.</p> <p>In addition, the technical infrastructure for the consolidated data feeds will be separate from the MX infrastructure.</p> <p>Operational processes are automated, and only operational staff specifically required to maintain the service will be authorized to access the applications.</p> <p>The reception, processing and dissemination of the data takes only a fraction of a second, therefore, potential conflicts of interest from human manipulation is virtually non-existent as the information is made public within milliseconds.</p> <p>All MX employees and consultants sign a code of ethics with sections related to confidential and privileged information.</p> | <p>CDS Inc. does not compete at any level with any of the providers of data to the IP, nor with any of the potential users of such data.</p> <p>However, it has processes to manage potential conflicts of interest that it would face as an IP, due to receipt of data from competitors of its shareholders. For example, data received by CDS Inc. in its capacity as an IP will not be made available to its Board of Directors (or the Board of its parent, CDS Limited), New service strategy papers and business cases are reviewed and approved by the Board of Directors. Similarly, status reports on various lines of business are presented to the Board of Directors from time to time for review and comment.</p> <p>However, management screens such documents for sensitive, competitive or confidential information prior to pre-mailing the documents to the Board members. In the event that such information must be tabled with the Board, the director with a conflict of interest is expected to</p> | <p>Data transmitted to the IP by marketplaces will not be inappropriately manipulated by TSX. That is, data will not be modified, except to reformat it if required, to remove unnecessary data elements and add necessary new data elements. TSX staff who do not require knowledge of or access to competitor data or client information for purposes of operating the IP or carrying out TSX processes will not have access to the data or client information.</p> <p>TSX is able to bill and collect other marketplace fees or coordinate appropriate direct billing administration with them. In the latter case, as an additional control, vendors must report the numbers that access to marketplace subscriptions directly to marketplaces not administered by TSX.</p> <p>The proposed fee schedule for the Consolidated Data Feed does not charge clients a second time for the same data-if they already subscribe to a marketplace's data feed.</p> <p>The fee model levels the playing field such that clients do not have</p> |

<sup>13</sup> While, as an information processor, the main conflict of interest is that related to the handling of data contributed by other entities, some of which may be competitors, this summary considers all potential conflicts of interests identified by applicants.

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|   | <p>statements; and</p> <ul style="list-style-type: none"> <li>Easy access to secretariat staff and access to assistant corporate secretary (from a third-party law firm) for all corporate governance matters.</li> </ul> |   | <p>competing equity marketplaces that provide equity trading data for distribution by the TSX are not compromised will also be put into place by TSX/CanDeal as the IP. In addition, TSX/CanDeal will put into place dispute resolution mechanisms to ensure the independence and fairness of the process for bond selection (described in section 3(a)).</p> |  | <p>declare same and recuse him/herself from that portion of the meeting.</p>  | <p>incentive to unsubscribe from a marketplace's feed when subscribing to the Consolidated Feed, and addition of the Consolidated Feed comes at a nominal price, \$5, which will not be a barrier to access.</p> |
| <b>2. SYSTEMS</b>                         |   |   |   |  |   |  |
| <b>1. Systems overview</b>                | <p>Technical services are currently provided by Reuters Canada Limited (Reuters), which administers the CanPX Transparency System, as instructed by CanPX.</p>  | <p>Bluesky System LLC currently provides the systems and application software, maintenance and upgrades, as well as systems administration and second level client support.</p> | <p>The data will be collected through CanDeal, which has in place a network between itself and 12 primary dealers, and distributed through TSX's market data distribution platform.</p>   | <p>MX will create the SOLA<sup>®</sup> Canadian Consolidated Market Feed Technology Solution to receive, consolidate, disseminate and manage quote and trade information for fixed income and equity securities.</p>                               | <p>CDS Inc. proposes to engage a software development firm (Tata Consultancy Services) to create the required system solution and to use CDS Inc. to operate and maintain the resultant system.</p>                                 | <p>The primary system is TSX's RTMD messaging middleware and distribution platform that manages the input, throughput, processing and distribution of data feeds and their related protocols.</p>                |
| <b>2. Development and Implementation</b>  |   |   |   |  |   |  |
| <b>a. Implementation timeline</b>         | <p>The system is currently live.</p>  | <p>It estimates that it can provide a production-ready system within 60 to 90 days.</p>   | <p>The system is currently "live" in that CanDeal collects data from its dealer contributors and the data is subsequently distributed by TSX.</p>   | <p>While the implementation timeline will depend on the final requirements and scope of the IP (i.e. equity, debt or both), it is currently anticipated that the timeline for development and implementation for the system will be 12 months.</p> | <p>Currently, it is anticipated that the development and implementation timeline will be 13 months, including 12 months for system development work and 6 months for implementation, including community testing and readiness.</p> | <p>A timeline for rolling out the feed will be established once specifications are determined.</p>   |
| <b>3. Connectivity</b>                    |   |   |   |  |   |  |
| <b>a. Connection method</b>               | <p><u>Dealers</u><br/>Dealers report via a page or item-based feed in a</p>   | <p><u>Participating firms reporting trades on an hourly basis</u><br/>The applicant will</p>  | <p>Data files will be collected by CanDeal using a Secured File Transfer Protocol (SFTP) over the</p>   | <p>Physical access to the system will be achieved by making use of the MX data network linking data centres.</p>   | <p>The data transmitted will be in the standard industry protocol FIX format.</p>   | <p>Information from the marketplaces can be transmitted to the IP in any format and will be</p>  |

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|   | <p>proprietary protocol.</p> <p>The proprietary feed is transmitted to the CanPX system using redundant communication facilities including dedicated circuits, hardware and transmission points.</p> <p>Several dealers have chosen a File Transfer Protocol (FTP) to transmit data.</p> <p><u>IDBs</u></p> <p>IDBs transmit proprietary feeds, on a voluntary basis, using redundant communications facilities including dedicated circuits, hardware and termination points.</p> | <p>implement redundant FTP servers to receive hourly Extensible Markup Language (XML) files.</p> <p><u>Participating firms that will voluntarily report orders or trades on a real-time basis</u></p> <p>The applicant will determine the most efficient language protocol in consultation with each participating firm.</p> | <p>Internet.</p>   | <p>numerous points of presence (POP), and through third-party network providers. In addition to direct POP connections and connections through one of several supported third party network providers, connectivity would also be available over the internet, using a VPN connection.</p> <p>The marketplaces providing the source feeds may connect to any of the POPs through direct connections to one of the MX POPs, through third party network providers or over the internet.</p> <p>A single, industry wide protocol is envisaged, but the system can be extended to support additional protocols.</p> | <p>Data will be transmitted via secured Internet transport or SFTP (for smaller firms).</p> <p>CDS Inc. will transform, in real time, the FIX format into a standard format for subsequent processing.</p>   | <p>reformatted if necessary, STAMP is preferred, however TSX can accommodate other formats.</p> <p>Each marketplace will supply data via two identical feeds on dual independent lines to the IP.</p> |
| <p>b. Connectivity costs</p>              | <p>Internal costs to establish a connection to CanPX are borne by the participating firms.</p>   | <p>Each participating firm is responsible for their connectivity costs to transmit data.</p>   | <p>The cost to connect to the IP is the responsibility of the participant, and there will not be a mark-up passed along by CanDeal/TSX. There will be no additional costs attributed to the 12 primary dealers currently connected to CanDeal.</p> | <p>Marketplaces, dealers and IDB providing information will pay their own connectivity fees.</p>   | <p>CDS Inc. already has existing network connection with all stock exchanges and most bond dealers across Canada, therefore, there are unlikely to be any additional connectivity costs for data providers.</p> <p>However, if a data provider does not have an existing network connection to CDS, such connection can be put in place through a service provider such as Allstream, at a monthly connection fee of \$500 plus a hardware fee of \$167 per month.</p> | <p>Each marketplace will be responsible at its own expense for installing, operating and maintaining connectivity lines to the IP.</p>  |

| SCHEDULE A<br>SUMMARY OF FILINGS RECEIVED |  |  |   |   |  |   |
|---|--|--|---|---|--|---|
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| c. Fees to provide data                   | None   | Gmarkets will charge participating firms \$1,500 per month. However, firms currently providing information on a voluntary basis will not pay this fee.   | None.   | None.   | None.  | TSX will charge an inbound connection fee of \$1,600 per month to each marketplace that submits a feed to be included in the consolidated feed to cover costs incurred by TSX such as: ports, routers, processors and network connectivity, as well as upfront development to process feeds that are in the STAMP format. |
| <b>4. Operations and data integrity</b>   |  |  |   |   |  |   |
| a. Training and support                   | <p>The technical facilitator provides online help and learning materials.</p> <p>Client trainers make visits to educate clients on their products.</p> <p>A team of five specialists at Reuters are available to provide customer support.</p> | <p>Gmarkets Client Services provides support and application training to subscribers free of charge. Additional development and technical consulting services from Gmarkets are available at \$150 per hour.</p> <p>In addition, Gmarkets will provide an Extensible Markup Language (XML) Feed Specification Document to participating firms providing trade data on an hourly basis, and will provide a Feed Specification Document detailing required data fields and connection information to firms choosing to report orders or trades in real time.</p> | <p>Training and materials will include:</p> <ul style="list-style-type: none"> <li>• Specifications and examples of inbound and outbound feeds;</li> <li>• Instructions regarding the content and context of the data provided from the IP to ensure that the retail audience and global (non-English native language) institutional participants will have an appropriate level of understanding of the data content;</li> <li>• Support to parties providing and receiving information from the IP;</li> <li>• Online documentation and training materials to help explain the content of the data; and</li> <li>• Educational materials for the investing public and subscriber base.</li> </ul> | <p>Entities that supply the data or receive the consolidated feed will be provided with specifications for the consolidated feed protocol and the required network connectivity.</p> <p>MX will provide connectivity support to these external entities and an environment for testing.</p> <p>In addition, MX-ITS will provide operations support and will make a help desk available for the operation of the SOLA® Canadian Consolidated Market Feed Technological Solution.</p> | <p>CDS currently provides onsite training programs and publishes user manuals on its website to support the customers for existing services.</p> <p>It will use the existing infrastructure to implement user training programs and publish user manuals to support the IP user community in the same manner as the other services.</p> <p>A help-desk program is currently in production.</p> | <p>All external recipients of the consolidated service will receive a functional specification and a Business Design Guide outlining the connectivity requirements as well as the Message Protocol.</p>   |

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| <b>3(a) COMMITMENT TO TRANSPARENCY – FIXED INCOME</b>   |   |  |   |   |   |                 |
| <b>1. Corporate bond information to be provided</b>     | Trade data for designated corporate bonds is transmitted by dealers and marketplaces with a market share in excess of 0.5% within one hour of the trade. The following data fields are transmitted:<br><ul style="list-style-type: none"> <li>• type of counterparty;</li> <li>• issuer;</li> <li>• security type*;</li> <li>• class*;</li> <li>• series*;</li> <li>• coupon;</li> <li>• maturity;</li> <li>• price;</li> <li>• time of the trade; and</li> <li>• volume traded, subject to volume caps.</li> </ul> *Inserted from Reuters master file. | Trade data for designated corporate debt securities will be transmitted by entities required to contribute such data by NI 21-101.   | Trade data for designated corporate debt securities will be reported, as required by 21-101CP:<br><ul style="list-style-type: none"> <li>• type of counterparty;</li> <li>• issuer;</li> <li>• security type;</li> <li>• class;</li> <li>• series;</li> <li>• coupon;</li> <li>• maturity;</li> <li>• price;</li> <li>• time of the trade; and</li> <li>• volume traded, subject to volume caps.</li> </ul> Based on the input from industry participants, other data fields, such as yield and type of trade (buy/sell), will also be transmitted. | Trade data for designated corporate debt securities will be transmitted by entities required to contribute such data by NI 21-101. The following information will be reported, as required by 21-101CP:<br><ul style="list-style-type: none"> <li>• type of counterparty;</li> <li>• issuer;</li> <li>• security type;</li> <li>• class;</li> <li>• series;</li> <li>• coupon;</li> <li>• maturity;</li> <li>• price;</li> <li>• time of the trade; and</li> <li>• volume traded, subject to volume caps.</li> </ul> In addition, the applicant will collect any other information that may be required by NI 21-101. | Trade data for designated corporate debt securities will be transmitted by entities required to contribute such data by NI 21-101. The following information will be reported, as required by 21-101CP:<br><ul style="list-style-type: none"> <li>• type of counterparty;</li> <li>• issuer;</li> <li>• security type;</li> <li>• class;</li> <li>• series;</li> <li>• coupon;</li> <li>• maturity;</li> <li>• price;</li> <li>• time of trade; and</li> <li>• volume traded, subject to volume caps.</li> </ul> In addition, the following information will also be collected:<br><ul style="list-style-type: none"> <li>• type of trade (buy or sell);</li> <li>• yield;</li> <li>• and</li> <li>• security cusip or ISIN.</li> </ul> |                 |
| <b>2. Corporate bond information to be disseminated</b> | Information is displayed through Reuters front-end display products. CanPX data is made available on the internet.<br><br>Data is also redistributed by information vendors as feeds or via internet  | Gmarkets will distribute the fixed income information via a desktop application called Gmarkets Pilot (prefabricated page displays) and through feed products (such as raw data for resellers), specifically: Gmarkets Feed API or | TSX/CanDeal will make the consolidated fixed income information feed initially available through the following distribution channels:<br><ul style="list-style-type: none"> <li>• TSX's website; and</li> <li>• A fully described, logical, record-based</li> </ul>   | MX will make available the consolidated feed with a published protocol for connection.<br><br>Internet access to post-trade data can be incorporated in the solution, if required.  | CDS Inc. will make the consolidated data feed output from the IP available through various distribution channels that will include:<br><ul style="list-style-type: none"> <li>• Access via the Internet; and</li> <li>• Depending on</li> </ul>   |                 |



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|   | <p>access.</p> <p>CanPX benchmark yield data is also available on the CanPX website.</p>  | Gmarkets Feed in XML.  | <p>feed from the existing TSX infrastructure on dedicated circuits.</p> <p>In the future, TSX/CanDeal anticipate utilizing internet protocol to distribute the feed.</p>  |  | <p>requirements, message feeds over various transport mechanisms.</p>  |                 |
| <i>b. Information disseminated</i>  | <p>CanPX consolidates the post-trade bond data and displays it every hour, on the hour.</p> <p>The information published includes:</p> <ul style="list-style-type: none"> <li>• Issuer;</li> <li>• Coupon;</li> <li>• Maturity;</li> <li>• Trade price;</li> <li>• Trade yield;</li> <li>• Volume (subject to volume caps);</li> <li>• Trade date;</li> <li>• Trade time (to the hour); and</li> <li>• Aggregate volume.</li> </ul> | Gmarkets will consolidate the post-trade bond data and display it in real time.                  | Data will be consolidated into the feed and displayed on a trade-by-trade basis.  | <p>Details of trades are required to be reported to the information processor no later than one hour from the time of the trade. The IP will not require a shorter timeframe, unless a future review indicates that this would be beneficial to the marketplace. The trade data will be published by the IP as soon as it is received.</p> | <p>CDS Inc. will provide a consolidated feed in real time of all corporate fixed income trade data received. In addition to the data fields received, it will also display:</p> <ul style="list-style-type: none"> <li>• The moving average price by security; and</li> <li>• A volume analysis by security.</li> </ul>  |                 |
| <b>3. Process for corporate bond selection, selection criteria and method for communication</b> |   |  |   |  |  |                 |
| <i>a. Process</i>   | <p>The selection is done on a quarterly basis.</p> <p>The list of corporate fixed income securities is maintained by the Corporate Bond Working Group of the IIAC's Canada Debt Markets Committee and reviewed and approved quarterly by the CanPX Operating Committee.</p> <p>New issues are added to,</p>   | The corporate bonds will be selected using the same criteria as the S&P/TSX Canadian Bond Index. | <p>The selection will be done in consultation with industry participants, including the Capital Markets Committee of the IDA, buy side customers, issuers and retail participants, and based on the review of the most actively securities list.</p> <p>The selection will be done on a quarterly basis. The final decision on the corporate bond securities to be included will be</p> | <p>The list of designated corporate bonds will be reviewed and updated quarterly.</p> <p>The first review would be done by the IP Policy Committee, based on the criteria described below.</p> <p>A process will be put in place where outside parties can request corporate bond additions to the list for the next quarterly review.</p> | <p>CDS Inc. will analyze the data being gathered and will monitor the market for changes that need to be reflected in the data gathered and distributed.</p> <p>CDS Inc. will meet on a quarterly basis with data providers and regulators to identify new securities that meet the established selection criteria that should be included in the service.</p> |                 |

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|   | <p>and issues may be removed (e.g. if not actively traded and prices are less accurate) from the list, subject to the constraints of the technical facilitator.</p> <p>A proposed revised list is circulated to the Corporate Bond Working Group for comments and further revisions or approval.</p> <p>The list is presented to the CanPX Board for approval by e-mail.</p> <p>Other parties can suggest adding corporate bonds to the list via the internet.</p> <p>Upon CanPX Board approval, the final list is sent to the technical facilitator for implementation and to vendors and to the OSC for information.</p> | <p>As set out above, the corporate bonds will be selected from the S&amp;P/TSX Canadian Bond Index. The S&amp;P/TSX Canadian Bond Index uses the following criteria for bond selection:</p> <ul style="list-style-type: none"> <li>An S&amp;P rating of BBB- or better;</li> <li>Minimum par amount of \$50 million (or \$100 million for Government of Canada or federally-guaranteed);</li> <li>Minimum of two independent dealers</li> </ul> | <p>made by the IP. The IP will put into place appropriate dispute resolution mechanisms.</p> <p>The list of designated bonds will be updated quarterly by the IP using the following process:</p> <ul style="list-style-type: none"> <li>Based on the criteria described below, major dealers will be polled for corporate bonds to be added/deleted; and</li> <li>The list will be consolidated based on consensus (majority of the dealers polled).</li> </ul> | <p>A proposed, revised list will be provided to applicable industry committee(s) for comments, modification and approval.</p> <p>The list will be approved by the IP board, at which time MX-ITS (as the technology provider) would be advised of any changes, as well as the CSA and all affected vendors.</p>  |   |                 |
| <i>b. Criteria</i>                        | <p>Applicable criteria for corporate bonds include:</p> <ul style="list-style-type: none"> <li>Trading volumes;</li> <li>Whether bonds are included in domestic Canadian corporate bond indices;</li> <li>Minimum issue size of \$250 million;</li> <li>Bonds should be issued by issuers among the major industrial groups of issuers;</li> <li>Bonds should be highly liquid;</li> </ul>   | <p>As set out above, the corporate bonds will be selected from the S&amp;P/TSX Canadian Bond Index. The S&amp;P/TSX Canadian Bond Index uses the following criteria for bond selection:</p> <ul style="list-style-type: none"> <li>An S&amp;P rating of BBB- or better;</li> <li>Minimum par amount of \$50 million (or \$100 million for Government of Canada or federally-guaranteed);</li> <li>Minimum of two independent dealers</li> </ul> | <p>Applicable criteria for corporate bonds will include:</p> <ul style="list-style-type: none"> <li>Minimum total issue sizes (including re-openings) of \$250 million;</li> <li>Bonds will be highly liquid;</li> <li>Bonds will represent a majority of trade flow within the corporate bond markets;</li> <li>Bonds will represent a majority of trade flow within the corporate bond markets;</li> </ul>   | <p>Applicable criteria for corporate bonds will include:</p> <ul style="list-style-type: none"> <li>Issue size, with a minimum total issue size of \$250 million;</li> <li>Bonds will be highly liquid;</li> <li>Bonds will represent a majority of trade flow within the corporate bond markets;</li> <li>Bonds will represent major industrial groups of issuers (including, but not limited to: financial, utility, telecom, oil and</li> </ul> | <p>Initially, CDS will follow the selection criteria currently used by CanPX, as follows:</p> <ul style="list-style-type: none"> <li>Minimum total issue sizes (including re-openings) of \$250 million;</li> <li>Bonds will be highly liquid relative to comparables;</li> <li>Bonds will represent a majority of trade flow within the corporate bond markets;</li> </ul> |                 |

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|   | <ul style="list-style-type: none"> <li>Bonds should represent a majority of trade flow within the corporate bond markets;</li> <li>Bonds should, between themselves, include short-term maturities, mid-term maturities and long-term bonds; and</li> <li>Bonds should be from each industry classification (with at least two from each classification).</li> </ul> | <ul style="list-style-type: none"> <li>providing bid prices each day to the TSX (available as a subscription from the TSX);</li> <li>Minimum term of 18 months to maturity at the time of inclusion.</li> </ul> | <ul style="list-style-type: none"> <li>among themselves, all major industrial groups of issuers (including financial, utility, telecom, and oil and gas);</li> <li>TSX/CanDeal will attempt to include at least 2 bonds from each industry classification;</li> <li>Bonds will represent, among themselves, all maturity buckets, including 0-5 years, 5-10 years, and 10 and over years; and</li> <li>Bonds will include debt securities of broad interest to retail investors, including bonds issued by well known corporations, bonds represented in an industry standard corporate bond index, bonds with terms to maturity of less than 5 years and bonds priced at a discount.</li> </ul> | <ul style="list-style-type: none"> <li>Bonds will be from each industry classification;</li> <li>Bonds will include all maturities including 0-5 years, 5-10 years, and 10 years and over; and</li> <li>Bonds will be those of broad interest to retail investors.</li> </ul> | <ul style="list-style-type: none"> <li>Bonds will represent, among themselves, all major industrial groups of issuers (including financial, utility, telecom, and oil and gas); an attempt will be made to include at least 2 bonds from each industry classification;</li> <li>Bonds will represent, among themselves, all maturity buckets, including 0-5 years, 5-10 years, and 10 and over years; and</li> <li>Bonds will include debt securities of broad interest to retail investors, including bonds issued by well known corporations, bonds represented in an industry standard corporate bond index, bonds with terms to maturity of less than 5 years and bonds priced at a discount.</li> </ul> |                 |
| c. Method of communication                | <ul style="list-style-type: none"> <li>Reuters posts the list on the CanPX website;</li> <li>The IIAC website posts a link to the list.</li> </ul>   | The rules for selection of bonds are published on S&P and TSX websites and all changes are published simultaneously to all market   | The list of addition/deletions will be published for all firms providing the information two weeks prior to the  | The information will be published on the IP web site.   | CDS Inc. will report additions, deletions and changes to the bond list through an e-mail notification list that will be  |                 |

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|  | on the CanPX website.  | participants.<br>Gmarkets will also publish the list on its website.  | change taking effect.<br>The new list of corporate bonds will be distributed quarterly via email to designated individuals at each firm. It will be posted on TSX's website.  |   | maintained by it.<br>In addition, CDS Inc. will publish information on the additions, deletions and changes to the bond list in the news section on its website and also incorporate the changes into the complete bond list, which will be permanently displayed on the website.  |                 |
| <b>4. Other bond information that will be reported and disseminated<sup>14</sup></b> | CanPX collects bid/offer prices and trade information for Government bonds and T-bills voluntarily transmitted by IDBs.<br>In addition, it collects and disseminates information relating to certain TSX-listed fixed income securities.<br>It disseminates the following information in real time:<br><br><i>Government bonds</i><br>Bid price; offer price; bid size; offer size; bid yield; offer yield; bid price change from previous day's close; bid yield change from previous day's close; hit or take of last trade; last trade price; last trade size; last trade time or date; and | Some participants currently report, and may continue to do so, government (such as Canadian T-bills or government debt securities) or corporate bond data in real-time. Gmarkets has proposed to support the continued aggregation and dissemination of voluntary products.<br><br>The published fields reported for these securities will include: issuer; coupon; maturity; order price (buy/sell); order size (buy/sell); order yield (buy/sell); bid price (best price, for multiple bids and offers, and where multiple best prices exist, the best price will aggregate volumes); bid yield; bid size; offer price; offer yield; offer size; trade price; trade yield; trade size; net change; and whether a security is benchmark. | The IP may collect and disseminate data that is provided by parties that are not required to contribute or from those parties that contribute in order to supplement or enhance the product. For example, TSX/CanDeal proposes to initially collect, aggregate and disseminate (all in real time) price information for the following securities: all Government of Canada bonds; all Government of Canada T-bills; approximately 130 Provincial Bonds; and 50 corporate bonds. | The infrastructure will be designed to support consolidated pre- and post-trade information on government fixed income securities, and MX would provide the consolidation and dissemination of this information if and when this is made mandatory by the CSA. MX can accept and publish this information if it is provided during the current exemption period from transparency requirements for government bonds.<br><br>The infrastructure will be designed to support consolidated pre-trade information on corporate fixed income securities, if there is a requirement for this. | CDS, through its subsidiary CDS Innovations, offers a number of ancillary services that provide a cross section of information on bonds. These ancillary services include:<br><ul style="list-style-type: none"> <li>• Security Masterfile – which, among other things, provides details on security identification, interest rate, maturity rate, and security features such as interest frequency, early redemption etc.;</li> <li>• Entitlement Products – which provide various degrees of entitlement coverage in different formats and include CDS Entitlement Bulletin (a web-based product), Entitlement Data Feed (an end-</li> </ul> |                 |

<sup>14</sup> Some participating firms are, or may be, providing other fixed income information (such as government fixed income data) to the entities applying for the position of the IP on a voluntary basis. This section describes the type of information that the applicants are or expect to collect and disseminate on a voluntary basis and is included for information purposes.

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|---|--|--|-------------------------------|---|--|---|
| Description                                     | CanPX<br>(Fixed Income)  | Gmarkets<br>(Fixed Income)   | TSX/CanDeal<br>(Fixed Income) | MX<br>(Equity and Fixed Income)   | CDS Inc.<br>(Equity and Fixed<br>Income)   | TSX<br>(Equity)   |
|   | <p>aggregate volume of the day for the instrument.</p> <p><i>Government T-bills</i><br/>Bid yield; offer yield; bid size; offer size; bid yield change from the previous day's close; hit or take of last trade; last trade yield; last trade size; last trade time or date; and aggregate volume of the day for the instrument.</p> <p><i>Provincial bonds</i><br/>Bid yield spread; offer yield spread; bid size; offer size; bid yield spread change from previous day's close; hit or take of last trade; last trade spread; last trade size; last trade time or date; and aggregate volume of the day for the instrument.</p> | <p>The government bonds will be selected from the S&amp;P/TSX Canadian Bond Index. The S&amp;P/TSX Canadian Bond Index uses the following selection criteria: (1) an S&amp;P rating of BBB- or better; (2) minimum par amount of \$50 million (or \$100 million for Government of Canada or federally-guaranteed); (3) minimum of two independent dealers providing bid prices each day; and (4) minimum term of 18 months to maturity at the time of inclusion.</p> |                               |   | <p>of-day batch product) and the ISO 15022 compliant MT564 Entitlement Message (a real time product);</p> <ul style="list-style-type: none"> <li>• SCRIBI – which provides access to document filings made by all issuers across Canada.</li> </ul>                |   |
| <b>3(b) COMMITMENT TO TRANSPARENCY – EQUITY</b> |  |  |                               |   |  |   |
| 1. Pre-trade information to be reported         |  |  |                               | <p>Marketplaces will report the following information in real time:</p> <ul style="list-style-type: none"> <li>• identification of the marketplace;</li> <li>• order type (buy/sell);</li> <li>• volume;</li> <li>• symbol;</li> <li>• price; and</li> <li>• time of the order.</li> </ul> <p>Any additional information that may be required by NI 21-101 will also be reported.</p> | <p>Marketplaces will report the following information in real time:</p> <ul style="list-style-type: none"> <li>• name of marketplace;</li> <li>• time of order entry;</li> <li>• price;</li> <li>• volume;</li> <li>• symbol;</li> <li>• cusip or ISIN.</li> </ul> | <p>Marketplaces will transmit all orders for every security (i.e. full depth of book).</p> <p>Each message will contain one quote/order from a marketplace and will include at least the following information:</p> <ul style="list-style-type: none"> <li>• message type (order);</li> <li>• IP sequence number;</li> <li>• marketplace identifier;</li> <li>• marketplace trading system time stamp;</li> <li>• IP time stamp;</li> <li>• broker number;</li> </ul> |

| SCHEDULE A<br>SUMMARY OF FILINGS RECEIVED       |                         |                            |                               |   |  |  |
|---|-------------------------|----------------------------|-------------------------------|---|--|--|
| Description                                     | CanPX<br>(Fixed Income) | Gmarkets<br>(Fixed Income) | TSX/CanDeal<br>(Fixed Income) | MX<br>(Equity and Fixed Income)   | CDS Inc.<br>(Equity and Fixed Income)  | TSX<br>(Equity)  |
|   |                         |                            |                               | <p>Marketplaces will report the following information in real time:</p> <ul style="list-style-type: none"> <li>• identification of the marketplace;</li> <li>• volume;</li> <li>• symbol;</li> <li>• price and</li> <li>• time of the trade.</li> </ul> <p>Any additional information that may be required by NI 21-101 in the future will be reported.</p> | <p>Marketplaces will report the following information in real time:</p> <ul style="list-style-type: none"> <li>• marketplace;</li> <li>• time of trade;</li> <li>• price;</li> <li>• volume;</li> <li>• security symbol; and</li> <li>• security cusip or ISIN.</li> </ul> | <ul style="list-style-type: none"> <li>• security type;</li> <li>• issuer;</li> <li>• symbol;</li> <li>• series;</li> <li>• class;</li> <li>• price;</li> <li>• volume; and</li> <li>• business action (buy or sell).</li> </ul>   |
| <b>2. Post-trade Information to be reported</b> |                         |                            |                               |   |  | <p>In addition to the data elements included in the order information message (other than 'message type (order)'), each trade message will include at least the following information:</p> <ul style="list-style-type: none"> <li>• message type (trade);</li> <li>• broker number (both sides);</li> <li>• trade number;</li> <li>• type of trade (marketplace, internal trade, etc.); and</li> <li>• business action (trade).</li> </ul> |
| <b>3. Equity Information to be Disseminated</b> |                         |                            |                               |   |  |  |
| <b>a. Method of distribution</b>                |                         |                            |                               | <p>MX will distribute a consolidated data feed with a published protocol for connection.</p>  | <p>The distribution method will be the same as that used for fixed income securities.</p>  | <p>The consolidated data feed will be delivered via an industry approved standard protocol designated by the IP.</p> <p>Network protocol for the consolidated services will be disseminated via Multicast.</p>   |
| <b>b. Information disseminated</b>              |                         |                            |                               | <p><u>Pre-trade</u><br/>Will provide, in real time, a consolidated feed of pre-trade data to five price levels.</p>   | <p><u>Pre-trade</u><br/>Will provide a consolidated feed of the bid and ask prices received.</p>   | <p>Will provide a consolidated feed of pre and post-trade information.<br/><br/>The information</p>  |

| SCHEDULE A<br>SUMMARY OF FILINGS RECEIVED   |  |   |  |  |   |   |
|---|--|---|--|--|---|---|
| Description   | CanPX<br>(Fixed Income)  | Gmarkets<br>(Fixed Income)  | TSX/CanDeal<br>(Fixed Income)                                | MX<br>(Equity and Fixed Income)  | CDS Inc.<br>(Equity and Fixed Income)   | TSX<br>(Equity)   |
|   |  |   |  | <p><i>Post-trade</i><br/>Will provide, in real time, a consolidated feed of post-trade market data.</p>  | <p><i>Post-trade</i><br/>Will provide a consolidated feed of each trade including the following fields:</p> <ul style="list-style-type: none"> <li>marketplace;</li> <li>time of trade;</li> <li>price; and</li> <li>volume.</li> </ul>   | <p>disseminated will have the same data elements as those received from the marketplaces (listed above).<br/><br/>TSX is prepared to offer a display of this information if required by the market.</p> |
| <b>4. FEES AND REVENUE SHARING</b>  |  |   |  |  |   |   |
| <p><b>1. Subscriber<sup>15</sup> fees</b></p> <ul style="list-style-type: none"> <li><b>Corporate bonds</b> <ul style="list-style-type: none"> <li>Reuters fee - \$25/terminal/month in addition to base Reuters service charge;</li> <li>G-Markets - \$50/month;</li> <li>Other vendors - fees to be determined.</li> </ul> </li> <li><b>Government bonds</b> <ul style="list-style-type: none"> <li>Reuters fee - \$25/terminal/month on top of base Reuters service charge;</li> <li>G-Markets - \$50/month;</li> <li>Other vendors - to be determined.</li> </ul> </li> </ul> | <p>Connection fee (per login Gmarkets Pilot) \$50 per month per user, with additional charges for data subscriptions, as follows:</p> <ul style="list-style-type: none"> <li>\$10 for corporate fixed income data;</li> <li>\$10 for government fixed income data.</li> </ul> <p>In addition, the charge for the end-of-day file (including last trade and/or price for each security) is \$1,500 per month.</p> | <p><i>Monthly institutional/professional subscriber<sup>16</sup> access fee</i><br/>\$75-100 per month</p> <p><i>Non-professional<sup>17</sup> usage-based fees</i></p> <ul style="list-style-type: none"> <li>\$0.02 per security instrument quote, capped at \$10 per month; or</li> <li>\$10 per month for data stream.</li> </ul> <p>Snapshot data web access via <a href="http://tsx.com">tsx.com</a><br/>Free</p> | <p>The fees will be determined by the Policy Committees.</p> | <p>Data will be made available on its website at no charge. Users will only be able to view the information on this free website service. CDS will also offer a "security watch" product that would be delivered over the Internet to individual investors at a price of \$35 per month.</p> | <p><i>Monthly professional subscriber fee</i></p> <ul style="list-style-type: none"> <li>If the professional subscriber already subscribes to data feeds from marketplaces<sup>18</sup>, the charge will be a TSX administrative fee of \$5 that will cover the costs of operating, processing and administering the feed;</li> <li>If the professional subscriber does not subscribe to data feeds from marketplaces, the charge will be: the TSX administrative fee of \$5 + the current TSX charge (refer to TSX 2007 pricing</li> </ul> |   |

<sup>15</sup> Generally, a subscriber is an individual or entity that has entered into an agreement to receive information from the information processor (directly or through a vendor).  
<sup>16</sup> A securities professional means any broker, dealer, investment advisor or person employed by an organization conducting professional activities involving the buying and selling of financial instruments.  
<sup>17</sup> A non-professional subscriber means an individual that is not a securities professional, cannot be a consultant, independent contractor, software developer or others that use market data for any purpose other than trading for their personal account.  
<sup>18</sup> Vendors and firms will be allowed to subscribe to marketplace feeds separately.

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| <p>2. <i>Vendor</i><sup>19</sup> fees</p> <ul style="list-style-type: none"> <li>\$2,000 per month for corporate bonds</li> <li>\$4,000 per month for government bonds</li> </ul> | <ul style="list-style-type: none"> <li>\$10 per user for corporate fixed income data</li> <li>\$10 per user for government fixed income data.</li> </ul> | <p>Connection fee: \$1,500 per month per connection per site, with add-on charges as follows:</p> <ul style="list-style-type: none"> <li>\$10 per user for corporate fixed income data</li> <li>\$10 per user for government fixed income data.</li> </ul> | \$500 per month.              | The fees will be determined by the Policy Committees. | An equity product containing all information on a daily, real time or batch basis will be made available at a price of \$25,000 per year. Segmented files by industry group will be made available at a cost of \$5,000 per year. | <p>schedule for all pricing details and tiers<sup>19</sup> + the fee(s) charged by each marketplace.</p> <p><i>Monthly non-professional subscriber fee</i></p> <ul style="list-style-type: none"> <li>If the non-professional subscriber already subscribes to data feeds from marketplaces, the charge will be the TSX administrative fee of \$2.50.</li> <li>If the non-professional subscriber does not subscribe to data feeds from marketplaces, the charge will be: the TSX administrative fee of \$2.50 + the current TSX 2007 pricing schedule for all pricing details and tiers) + the fee(s) charged by each marketplace.</li> </ul> <p>The fees will be indexed to inflation</p> |

<sup>19</sup> Published at [http://www.tsx.com/en/data/product\\_sheets](http://www.tsx.com/en/data/product_sheets)

<sup>20</sup> Generally, a vendor is an individual or entity that enters into agreements to receive information from the IP in connection with the business or distributing this information to others.



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|--|---|--|--|--|---|---|
| Description                                | CanPX<br>(Fixed Income)   | Gmarkets<br>(Fixed Income)   | TSX/CanDeal<br>(Fixed Income)  | MX<br>(Equity and Fixed Income)  | CDS Inc.<br>(Equity and Fixed<br>Income)  | TSX<br>(Equity)   |
| <p><b>3. Costs and Revenue sharing</b></p> | <p>Net revenue will be allocated between shareholders based on the process outlined below:</p> <p>First, the total net revenue is allocated between the IDB Market (defined as total dollar volume of trades in total market issues during a period by all IDBs as a group), Corporate Bond Market (total dollar volume of trades in corporate bonds during a period by all dealers as a group) and ATS Market (total volume of trades during a period by all ATS participants, if any, as a group).</p> <p>This allocation is based on the percentage of trading volume attributable to each of the separate markets.</p> <p>After this initial allocation, the net revenues will be distributed as follows:</p> | <p>In addition, \$1,500 per month will be charged for the end-of-day file (last trade and/or price for each security).</p> | <p>TSX/CanDeal does not anticipate sharing revenues with the dealer participants at this time, as it believes that the IP will carry the cost associated with transparency, and the dealers will benefit from cost efficiencies.</p> | <p>A. Revenue determination<br/>Each market (fixed income and equity) will have its own revenue streams from sales of the consolidated market data specific to that market.</p> <p>B. Cost determination<br/>A. Net Revenue Calculation<br/>The cost to develop, implement, operate and administer the SOLA<sup>®</sup> Canadian Consolidated Market Feed Solution will be a fixed annual cost based on a 5 year contract, CPI indexed. This annual cost will be allocated to each market (fixed income and equity, at the start of the service), based on that market's share of total revenues for both markets for the period (i.e. revenues from data distributors and subscribers for all services).</p> <p>C. Revenue sharing<br/>After deducting costs from revenues associated with each market (A-B), net revenue would then be distributed</p> | <p>A fixed income product containing all fixed income information on a daily, real time or batch basis will also be made available at a price of \$25,000 per year. Segmented files by type of fixed income will be made available at a cost of \$5,000 per year.</p> | <ul style="list-style-type: none"> <li>administrative fee of \$500 per month. If the vendor or PO does not subscribe to data feeds from marketplaces, the charge will be: the TSX administrative fee of \$500 + current TSX charge of \$3,000 (refer to TSX 2007 pricing schedule for all pricing details and tiers) + the fee(s) charged by each marketplace.</li> </ul> <p>TSX currently provides data distribution services for multiple marketplaces and several asset classes. The TSX IP will leverage its established infrastructure including hardware, software, physical premises (raised floor, network services, operations monitoring stations and tools, etc.) resources as well as administration (contractual, billing, reporting, auditing etc.), help desk and vendor services technical support, and legal, product and sales support. There will be additional development, hardware, and support resources required which will depend on the number of marketplaces and the bandwidth and structure of their feeds however, TSX will absorb these costs upfront and expect to recoup them over a period of time from the fees.</p> |

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|---|---|----------------------------|-------------------------------|--|--|---|
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|   | <ul style="list-style-type: none"> <li>IDB market revenue will be split 50/50 between dealers and IDBs</li> <li>Corporate Bond Market revenue will be allocated to dealer market-makers based on proportionate trading share of corporate bonds</li> <li>ATS Market revenue will be allocated to ATS participants based on proportionate trading share of total market issues in the ATS market.</li> </ul> |                            |                               | <p>between the contributors to the service for each market (fixed income and equity). For each market, excess revenues will be allocated based on each contributor's proportion of the total number of trades for that market, and also based on whether the entity contributes to both pre- and post-trade information, or only to post-trade information. Contributors who supply both would receive a higher proportion.</p> <p>In the model, contribution to post-trade information would be worth 50% of the calculation of the revenue share of each entity, while the remaining 50% would be allocated to entities that are also providers of pre-trade information. However, the model could be revised with any weighting that would be reasonable for a specific market.</p> <p>Contributor Proportion of net revenue = ((50% times the contributor's proportion of total trades for the market)+(50% times the contributor's proportion of the total number of trades of all contributors supplying pre-trade information, if this information is also supplied)).</p> <p>Contributor revenue share = net revenue for the market times contributor proportion of net revenue.</p> |  | <p>Revenues will be shared back to the marketplaces in the amount that those marketplace chose to charge vendors and subscribers. The administrative fee and marketplace connection fees will be retained by TSX.</p> |