

Notice and Request for Comment

Proposed Regulation to amend Regulation 21-101 respecting Marketplace Operation

Proposed Regulation to amend Regulation 23-101 respecting Trading Rules

I. Introduction

The Canadian Securities Administrators (CSA or we) are publishing for comment proposed amendments (the Proposed Amendments) to *Regulation 21-101 respecting Marketplace Operation* (Regulation 21-101), *Regulation 23-101 respecting Trading Rules* (Regulation 23-101) (together, the ATS Rules) and the related Policy Statements.

The key part of the Proposed Amendments deals with trade-through protection (Proposed Trade-through Protection Rule). It proposes a framework to require all visible, immediately accessible, better-priced limit orders to be filled before other limit orders at inferior prices, regardless of the marketplace where the order is entered. Other parts of the Proposed Amendments include proposals relating to clock synchronization, technology requirements for marketplaces, information processor requirements, and best execution reporting requirements.

II. Background

On July 22, 2005, the CSA published Discussion Paper 23-403 *Market Structure Developments and Trade-through Obligations* (2005 Discussion Paper).¹ The purpose of the Discussion Paper was to discuss evolving market developments and the consequential implications for the Canadian capital market, and in particular the obligation to avoid trade-throughs (trade-through obligation).

The 2005 Discussion Paper asked a number of questions to get feedback on what values and rules were important to Canadian market participants. Because of the importance of the issues relating to the trade-through obligation and their impact on the Canadian capital market, the CSA held a public forum on October 14, 2005 to permit all interested parties to participate in discussions relating to trade-through protection.²

The CSA received feedback on a number of issues identified in the 2005 Discussion Paper where there was often no clear majority opinion and the views on either side of a given issue were split. However, the majority of commenters stated that they believed that all visible orders at a better price should trade before inferior-priced orders.

On April 20, 2007, the CSA along with Market Regulation Services Inc. or RS (now the Investment Industry Regulatory Organization of Canada or IIROC) published the *Joint Notice on Trade-Through, Best Execution and Access to Marketplaces* (Joint Notice).³ The Joint Notice:

- outlined a proposal for a trade-through protection regime,
- proposed rule changes regarding access to marketplaces, and
- proposed rule changes regarding best execution.

The CSA published the amendments to best execution in their final form on June 20, 2008, and again on September 5, 2008, to be effective on September 12, 2008. We intend to re-examine the proposed rule amendments relating to direct market access and republish them for comment in 2009.

¹ See Bulletin de l'Autorité des marchés financiers, Vol. 2, n° 29, 2005-07-22 for background.

² 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.

³ Bulletin de l'Autorité des marchés financiers, Vol. 4, n° 16, 2007-04-20.

The Proposed Trade-through Protection Rule that is being published along with this Notice is based largely on the proposal outlined in the Joint Notice and the responses of the commenters who, for the most part, expressed support for the initiative.

We received nineteen comment letters in response to the request for comments published in April 2007. We have considered the comments received and thank all commenters for their submissions. A list of those who submitted comments, as well as a summary of comments pertaining to the trade-through proposal and our responses, are attached as Appendix A to this Notice.

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

III. Trade-through Protection

1. What is Trade-through Protection?

Trade-through protection ensures that all immediately accessible, visible, better-priced limit orders are executed prior to inferior-priced limit orders. Commenters generally agreed that the obligation not to "trade-through" (i.e. bypass better-priced limit orders in favour of inferior-priced limit orders) is an obligation owed by all marketplace participants to the market as a whole. Unlike the obligation for best execution, the obligation not to trade-through is not a fiduciary duty and cannot be waived.⁴ It is proposed that trade-through protection would apply whenever two or more marketplaces with displayed protected orders are open for trading.

2. Why is Trade-through Protection Important?

Trade-through protection is considered to be important to maintain investor confidence and fairness in the market, especially where there is a high degree of retail participation and a historical expectation of trade-through protection. Without it, it can be argued that there may not be sufficient incentive to contribute to the price discovery process because investors who disclose their intentions will not be assured of the benefit of having their better-priced orders filled while others will be able to use that information to help in determining the prices at which they transact. This confidence encourages more liquidity in the market and a more efficient price discovery process.

3. The Current Regulatory Regime

Currently in Canada, trade-through protection is addressed as part of the best price obligation imposed by IIROC in its Universal Market Integrity Rules (UMIR), Rule 5.2 *Best Price Obligation* (UMIR Best Price Rule). The rule imposes a requirement on dealers that trade on marketplaces that have retained IIROC to use reasonable efforts to obtain the best price available. There are a number of exemptions available and the factors to be considered in determining if reasonable efforts have been used are broadly outlined.⁵

In the past, no issues arose under the UMIR Best Price Rule because:

- there had not been multiple marketplaces trading the same securities in Canada,
- the technology systems of marketplaces enforced the "best price" or trade-through obligation, and
- only dealers had direct access to the existing marketplaces.

The existence of multiple marketplaces trading the same security has refocused attention on the current rules relating to trade-through protection.

⁴ For a discussion about trade-through and best execution please see Part III 4(f) of this Notice.

⁵ See UMIR Rule 5.2 *Best Price Obligation* and the related policy.

The UMIR Best Price Rule currently applies only to dealers, which results in different requirements for dealers and non-dealers who are subscribers of ATSs. In addition, the rule as it exists does not provide the necessary infrastructure to effectively prevent trade-throughs. For example, it does not provide for an inter-market sweep order that would allow marketplace participants to simultaneously route orders to various marketplaces.

When multiple marketplaces began trading TSX-listed securities, the dealers in Canada had difficulty complying with the UMIR Best Price Rule. Technology was not yet at a point where dealers could monitor multiple marketplaces and effectively route orders to where the best price was displayed. In addition, order data was not consolidated. In response, RS at the time, proposed an approach whereby the factors to be considered in determining if a dealer used "reasonable efforts" to obtain the best price were broadened. RS introduced an immediate implementation rule, effective on May 16, 2008⁶, that broadened these factors to include:

- whether the dealer has used an order router offered by it or a marketplace,
- whether the dealer relies on another dealer to route its orders,
- the timing of the launch of the marketplace,
- whether the marketplace has had a material malfunction or interruption of services,
- whether the data being transmitted by the marketplace is easily and readily used by dealers, and
- whether the marketplace executes an inordinate proportion of orders at an inferior price or there is no fill at all.

Under the UMIR Best Price Rule, dealers are required to introduce and comply with policies and procedures outlining how they will meet their best price obligations. It was intended that this solution be an interim solution until the CSA developed and implemented a trade-through protection rule. In the coming weeks, IIROC will publish its proposed amendments to the UMIR Best Price Rule in response to the CSA's proposal of a trade-through protection rule.

4. The Proposed Trade-through Protection Rule

At this time, the CSA are proposing to amend the ATS Rules to create a full depth-of-book trade-through obligation on marketplaces. We have considered the comment letters received in response to the Joint Notice and the 2005 Discussion Paper and have also reviewed international developments in the area of trade-through. Particularly, we have looked at the Order Protection Rule in Regulation NMS developed by the U.S. Securities and Exchange Commission (SEC) and its implementation, and have examined the Markets in Financial Instruments Directive (MiFID) in Europe.

(a) Key Aspects of the Proposed Trade-through Protection Rule

(i) Marketplace Obligation

The Proposed Trade-through Protection Rule would require each marketplace to establish, maintain and enforce written policies and procedures that are reasonably designed to prevent trade-throughs on that marketplace. Marketplaces would be required to regularly review and monitor the effectiveness of these policies and procedures and act promptly to remedy any identified deficiencies. The purpose of this approach is to require marketplaces to eliminate trade-throughs that can reasonably be prevented, but also provide them with flexibility about how to do so. Marketplaces may choose how to implement the obligation in various ways including, for example, voluntarily establishing direct linkages to other marketplaces, or designing specific trade execution algorithms. However,

⁶ The UMIR Best Price Rule was published for comment on May 16, 2008, MIN 2008-009.

marketplaces would not be able to avoid their obligations by establishing policies and procedures that instead require marketplace participants to take steps to reasonably prevent trade-throughs.

Question 1: Should marketplaces be permitted to pass on the trade-through protection obligation to their marketplace participants? If so, in what circumstances? Please provide comment on the practical implications if this were permitted.

Marketplaces would be required to provide their policies and procedures, and any amendments thereto, to the securities regulatory authority and their regulation services provider 45 days prior to implementation. It is expected that marketplaces would also maintain relevant information so that the effectiveness of its policies and procedures could be adequately evaluated by regulatory authorities.⁷

Placing the obligation on marketplaces was supported by a majority of the commenters to the 2005 Discussion Paper and the Joint Notice.

(ii) *Protected Orders*

Trade-through protection would only be applicable to certain orders (“protected orders”). A protected order would be defined as a “protected bid or protected offer.” A “protected bid” or “protected offer” would be an order to buy or sell an exchange-traded security, other than a derivative, that is displayed on a marketplace with automated functionality and about which information is provided to an information processor or information vendor.⁸ The CSA do not consider special terms orders that are not immediately executable or that trade in a special terms book, such as all-or-none, minimum fill, or cash or delayed delivery, to be orders that are protected.⁹ However, those executing against these types of orders are required to execute against all better-priced orders first. A marketplace that is considered to have “automated functionality” would have the ability to immediately and automatically:

- permit an incoming order entered on the marketplace electronically to be marked as fill-or-kill,
- execute a fill-or-kill order,
- cancel unexecuted portions of that order,
- transmit a response to the sender indicating the action taken, and
- display information that updates the displayed order.¹⁰

A marketplace would also be required to have policies and procedures relating to the handling and display of these orders (to be included in their policies and procedures required under section 6.1 of the Regulation) and would be required to immediately inform all regulation services providers and other marketplaces when it experiences a failure, malfunction or material delay of its systems or equipment.¹¹

(iii) *Full Depth-of-book*

The Proposed Trade-through Protection Rule would be applicable to all visible parts of orders entered into the book (i.e. full depth-of-book). This means that in order to execute an order at an inferior price, the marketplace would have to ensure that all protected orders that are visible at price levels better than that price have been executed. This approach is different from the one adopted in Regulation NMS in the United States, which provides protection only to the best bid and offer on each marketplace (top-of-book). In the 2005 Discussion Paper and the Joint Notice, commenters were asked for their views on whether to impose the obligation only at the top-of-book. The majority of commenters responded by

⁷ Proposed section 6.1 of Regulation 23-101.

⁸ Proposed definition in section 1.1 of Regulation 23-101.

⁹ See subsection 5.1(3) of Policy Statement 21-101.

¹⁰ Proposed amendment to section 1.1 of Regulation 23-101.

¹¹ Proposed section 6.4 of Regulation 23-101.

supporting trade-through protection that would apply to all visible orders regardless of where they are in the book, which is consistent with the current UMIR Best Price Rule.

(iv) *Visible Orders*

The Proposed Trade-through Protection Rule would only apply to orders or parts of orders that are visible. In other words, the orders would have to be displayed by the marketplace and information about them would have to have been provided to an information processor or information vendor.

In addition, hidden orders or those parts of iceberg orders that are not visible would not be protected. Currently, the manner by which “dark” portions of orders in an otherwise transparent order book would be avoided is by using the “bypass” marker introduced by IIROC.¹² The bypass marker signals to the marketplace that the order routed to the marketplace should not execute against any hidden liquidity. It is intended that this marker will evolve into the marker used for an inter-market sweep order discussed below.

(b) *“Permitted” Trade-throughs*

The overall purpose of trade-through protection is to promote confidence and fairness in the 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 environment have become highly complex, particularly with the advent of new types of orders and other developments in market structure in Canada.

As a result, we have proposed a number of circumstances where trade-throughs would be permitted.¹³ These “permitted” trade-throughs or “exceptions” are primarily designed to achieve workable inter-market trade-through protection while facilitating the use of trading strategies and order types that are useful to investors. They are intended to promote fairness, innovation and competition.

Although trade-through protection is an obligation owed by all marketplace participants to the market as a whole, in certain circumstances, the marketplace can trade through better-priced orders on other marketplaces where a marketplace participant has taken certain action (for example, routing an inter-market sweep order). In these circumstances, it is important that marketplace participants create policies and procedures that will reasonably prevent trade-throughs and maintain relevant information so that the effectiveness of section 6.1 of Regulation 23-101 can be adequately evaluated by regulatory authorities.¹⁴

(i) *Failure, Malfunction or Material Delay of Systems or Equipment*

We are proposing an exception for any failure or malfunction of a marketplace’s systems as well as any material delay (systems issues).¹⁵ If a marketplace repeatedly fails to respond immediately after receipt of an order, under the Proposed Trade-through Protection Rule, this would constitute a material delay. This is intended to provide marketplaces with flexibility when dealing with another marketplace that is experiencing a systems problem (either of a temporary nature or a longer term issue). The marketplace that is experiencing the failure, malfunction, or delay is responsible for informing all other marketplaces, its marketplace participants, and any regulation services providers when the failure, malfunction or delay occurs. However, if a marketplace fails repeatedly to provide an immediate response to orders received and no notification has been issued by the marketplace that may be experiencing systems issues, a routing marketplace or a marketplace participant may rely on paragraph 6.2(a) of Regulation 23-101, in accordance

¹² Market Integrity Notice 2008-008 approving amendment to UMIR regarding “Provisions Respecting Off Marketplace Transactions” was published on May 16, 2008.

¹³ The list of “permitted” trade-throughs is set out in proposed section 6.2 of Regulation 23-101.

¹⁴ Proposed subsection 6.1(3) of Policy Statement 23-101.

¹⁵ Proposed paragraph 6.2(a) of Regulation 23-101.

with its policies and procedures that outline processes for dealing with these systems issues. The marketplace or marketplace participant must immediately notify the marketplace that may be having systems issues, its own marketplace participants (where applicable) and all regulation services providers. This notification will enable the marketplace that may be experiencing systems issues to assess whether it is in fact experiencing systems issues.

Question 2: What length of time should be considered an “immediate” response by a marketplace to a received order?

(ii) *Inter-market Sweep Order*

We are proposing an exception to allow the execution of inter-market sweep orders. An inter-market sweep order (ISO) is an order that is marked to inform the receiving marketplace that it can be immediately executed without delay or regard to any other better-priced orders displayed by another marketplace.¹⁶ It may be marked “ISO” by a marketplace or a marketplace participant. The definition allows for simultaneous routing of more than one ISO in order to execute against protected orders. In addition, marketplace participants may send a single ISO to execute against the best protected bid or best protected offer. An ISO may enable participants to execute large block orders, provided that they simultaneously route one or more ISO’s to execute against better-priced orders. This would facilitate compliance with the trade-through obligation.

(iii) *Flickering Orders*

With the growth of algorithmic and computer-generated trading, there has been a substantial increase in the number of short term orders generated (often generated and cancelled within seconds) for every trade executed. This has subsequently increased the number of times a better-priced order may be displayed. Given the speed with which orders 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. As a result, we are allowing for a transaction that occurs when the marketplace displaying the best price that was traded through had displayed, immediately prior to execution of a trade that resulted in a trade-through, an order with a price that was equal or inferior to the price of the trade-through transaction.¹⁷

(iv) *Non-Standard Orders*

Non-standard orders have been included on the list of “permitted” trade-throughs. A non-standard order refers to an order for the purchase or sale of a security that is subject to non-standard terms or conditions relating to settlement that have not been set by the marketplace on which the security is listed or quoted.¹⁸ A marketplace participant, however, may not add a special settlement term or condition to an order solely for the purpose that the order becomes a non-standard order so that it qualifies for an exception from the Proposed Trade-through Protection Rule.

(v) *Calculated Price Order*

We are proposing to include an exception for orders where the price is not known at the time of order entry and is to be calculated based on, but will not necessarily be equal to, the price of the security at the time of execution.¹⁹ Orders that would be included under this definition are:

- call market orders – where the price of a trade is calculated by the trading system of a marketplace at a time designated by the marketplace,

¹⁶ Proposed paragraphs 6.2(b) and (c) of Regulation 23-101.

¹⁷ Proposed paragraph 6.2(d) of Regulation 23-101.

¹⁸ Proposed subparagraph 6.2(e)(i) of Regulation 23-101.

¹⁹ Proposed subparagraph 6.2 (e)(ii) of Regulation 23-101.

- volume-weighted average price orders – where the price of a trade is determined by a formula that measures a weighted average price on one or more marketplaces,
- opening orders – where each marketplace may establish its own formula for the determination of opening prices,
- closing orders – where execution occurs at the closing price on a particular marketplace, but at the time of order entry, the price is not known, and
- basis orders – an order that must be approved by a regulation services provider to ensure that the price of the order is based on one or more derivative transactions executed in conjunction with securities where the securities transaction comprises at least 80% of the underlying interest of the derivative instruments.²⁰

(vi) *Closing Price Order*

We are proposing to also include an exception for an order entered on a marketplace for the purchase or sale of an exchange-traded security that would execute at the established closing price on that marketplace for that trading day for that security.²¹ Some marketplaces provide an after-hours trading session at a price established by that marketplace during its regular hours for marketplace participants who are required to benchmark to a certain closing price. Therefore, we propose to allow for trade-throughs resulting from the execution of transactions in these circumstances so that a better-priced order on another marketplace would not need to be accessed.

(vii) *Crossed Market*

We are proposing an exception for a transaction that occurred where the transaction that constituted the trade-through was executed at a time when the best protected bid was higher than the best protected offer (crossed market).²² Without this exception, no marketplace could execute transactions in a crossed market because it would constitute a trade-through. The CSA recognize that crossed markets may occur as a result of trade-through protection only applying to displayed orders or parts of orders, and not to hidden or reserve orders. Intentionally crossing the market to take advantage of this exception would be a violation of proposed section 6.5 of Regulation 23-101.

Question 3: Are any additional exceptions necessary?

(c) *Access to Marketplaces*

The Joint Notice asked a number of questions on the issue of access, including:

- whether there should be a threshold that would require ATSS to permit access to all groups of marketplace participants, and
- whether specialized marketplaces should not prohibit access to non-members/subscribers or should provide direct order access to non-members/subscribers if members/subscribers do not provide this service.

Many commenters were supportive of a threshold that would require marketplaces to provide access. Rather than setting a threshold for ATSS to permit access to all marketplace participants, we have proposed amendments to Policy Statement 21-101 to enhance the fair access provisions in Regulation 21-101.²³ These provisions require marketplaces to provide fair access to all of their services. As well, marketplaces should permit fair and efficient access to their services for the purpose of complying with the proposed trade-through requirements. At this time, we think that the provisions relating to fair access and the proposed amendments to Policy Statement 21-101 are sufficient to address fair access to a marketplace whether directly or indirectly. We will continue to monitor this issue.

²⁰ Proposed section 2.3 of Policy Statement 23-101.

²¹ Proposed subparagraph 6.2(e)(iii) of Regulation 23-101.

²² Proposed paragraph 6.2(f) of Regulation 23-101.

²³ Proposed amendments to sections 7.1 and 8.2 of Policy Statement 21-101.

With respect to issues relating to access to marketplaces by non-members/subscribers to a marketplace, we do not believe that a marketplace should be required to provide direct access to non-members/subscribers. It would be left to the marketplaces to determine how best to meet their trade-through obligations. We intend to further discuss access issues with the industry implementation committee (described below).

Question 4: Please comment on the various alternatives available to a marketplace to route orders to another marketplace.

(d) Trading Fee Limitation

In the Joint Notice, we considered whether there should be a specified limit that a marketplace could charge for trade-through purposes. A number of commenters expressed concern about proposing a specified trading fee limit imposed on a trade-by-trade basis. They preferred a principle-based approach that would require marketplaces to set reasonable trading fees.

The CSA think it is important to prevent marketplaces from raising their fees substantially to try to take advantage of the trade-through protection regime. Consequently, we are proposing a rule that would prohibit a marketplace from imposing (i) a fee charged for the execution of an order to comply with the trade-through requirement that is equal to or greater than the minimum price increment that is described in IROC Universal Market Integrity Rule 6.1, as amended, or (ii) terms that have the effect of discriminating between orders that are routed to that marketplace to prevent trade-throughs and orders that originate on that marketplace.

Question 5: Should the CSA set an upper limit on fees that can be charged to access an order for trade-through purposes? If so, is it appropriate to reference the minimum price increment described in IROC Universal Market Integrity Rule 6.1 as this limit?

(e) Locked and Crossed Markets

A “locked market” occurs when there are multiple marketplaces trading the same security and a bid (offer) on one marketplace is at an identical price level to an offer (bid) on another marketplace. Had both orders been entered onto the same marketplace the bid and the offer would have matched and a trade would have been executed. In a locked market situation, there are two ways to unlock the markets:

- typically, more buyers and sellers appear resulting in subsequent trades and immediate correction; or
- one of the participants involved in the lock removes their order and places the order on another marketplace to immediately execute the trade.

A “crossed market” occurs when one participant’s bid (offer) on one marketplace is higher (lower) than another participant’s offer (bid) on a different marketplace. A crossed market condition between marketplaces usually does not last for a long period of time as someone will usually take advantage of the arbitrage opportunity.

Proposed section 6.5 of Regulation 23-101 prohibits a marketplace participant from intentionally locking or crossing a market by entering a bid at a price that is the same as or higher than the best protected offer or entering an offer at a price that is the same as or lower than the best protected bid. This section is meant to capture the situation where a marketplace participant enters an order intentionally to lock or cross a particular marketplace or the market as a whole. It is not intended to prohibit the use of marketable limit orders. An exception from the Proposed Trade-through Protection Rule has been

provided to allow for the resolution of crossed markets that occur unintentionally. An exception is not necessary to resolve locked markets.

Question 6: Should there be a prohibition against intentionally creating a “locked market”?

(f) Trade-through and Best Execution

There has long been debate about the interplay between the obligations of best execution and “best price” or trade-through protection. In addition, there is some concern that trade-through and best execution obligations may conflict. This section addresses these issues.

The rationale for a dealer’s best execution obligation and the obligation to prevent trade-throughs is different. The obligation of best execution that a dealer or adviser has to its client is based on the common law fiduciary duty and the loyalty obligation under the civil law regime, which can be found in securities laws and UMIR. As discussed above, trade-through protection is based on the obligation of a participant to the market as a whole. It is grounded in the desire to protect visible and accessible limit orders and to ensure that those who decide to display the prices they are willing to pay or receive for a particular security will obtain the benefit of that decision. The requirement to achieve best execution can be waived or overwritten by direction of a client, however the trade-through obligation would always have to be met except in the specific circumstances outlined in Part III 4(b) above.

Having a trade-through obligation does not diminish the obligation to achieve best execution, including having policies and procedures to look at data from multiple marketplaces to determine whether or not to access to those marketplaces. The decision of how and where to trade (best execution) is determined by the particulars of the order and needs of the client. However, all better-priced orders must be honoured at the time of execution (trade-through obligation).

The Proposed Trade-through Protection Rule does not propose to address trading on foreign markets. However, we reiterate that marketplace participants should consider foreign markets when addressing best execution. We have also included an anti-avoidance provision that prohibits a person from routing orders to foreign marketplaces only for the purpose of avoiding the trade-through protection regime in Canada.²⁴

There may be some additional costs associated with trading on multiple marketplaces and dealers may determine to take on those costs or pass them onto their clients as part of their commissions. These commissions are part of the factors considered in obtaining best execution. We think that these costs are balanced against the need to protect displayed limit orders and the need to ensure that the risks taken by those that display those limit orders are rewarded.

(g) Other Jurisdictions

(i) U.S. Approach

On April 6, 2005, the SEC implemented the Order Protection Rule in Regulation NMS.²⁵ It requires trading centers 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, these policies and procedures must be 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 marketplaces. One of the impacts of this order protection is increased linkages between trading centers. Regulation NMS includes a number of

²⁴ Proposed section 6.7 of Regulation 23-101.

²⁵ “SEC Adopts Regulation NMS and Provisions Regarding Investment Advisers Act of 1940”, online: U.S. Securities and Exchange Commission, <http://www.sec.gov/news/press/2005-48.htm> on July 15, 2008.

exceptions from “order protection” obligations, such as exemptions for opening or closing orders, crossed markets, benchmark orders where the material terms are not known, inter-market sweep orders, delays in responses caused by systems problems, and flickering quotes.

(ii) European developments

The European Union (EU) implemented MiFID on November 1, 2007 to replace the existing Investment Services Directive as part of its Financial Services Action Plan designed to create a single market in financial services for EU member states.²⁶ MiFID does not impose a trade-through obligation that prohibits the by-passing of better priced quotes when executing transactions. Instead, MiFID introduces a best execution standard that requires firms to take “all reasonable steps to obtain the best possible result” for their clients, taking into consideration not only execution price, but also the cost, speed, size and nature of the order, the likelihood of execution and settlement when trading and any other factors deemed relevant to the execution of the order.

(h) Next Steps

Upon the publication of this Notice and the Proposed Amendments, we will establish an industry committee to discuss the implementation issues relating to the introduction of the Proposed Trade-through Protection Rule. The role of the committee will be to raise operational issues associated with implementing this rule and develop recommendations to be considered by the CSA and where appropriate, IIROC. The committee will be chaired by an industry representative and facilitated by the Investment Industry Association of Canada. It will be an open committee, made up of interested parties representing marketplaces, dealers, and buy-side investors.

If you are interested in participating on the committee, please send an e-mail to: marketregulation@osc.gov.on.ca.

IV. Additional Amendments

Along with the Proposed Trade-through Protection Rule, we are also proposing some additional amendments to Regulation 21-101 and Regulation 23-101.

1. Reporting Requirements for Marketplaces and Dealers

In April 2007, we proposed reporting requirements for marketplaces and dealers that would require:

- a marketplace to report certain information on a monthly basis, including: number of orders, number of trades, and speed of execution, and
- a dealer to report certain information 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, and disclosure of any material arrangements with a marketplace.

The comments that we received on the proposed requirements published in April 2007 were generally mixed. There was some feedback on specific aspects of the reporting requirements, such as spread-based statistics and securities traded on only one marketplace. A summary of the comments received on the best execution reporting requirements and our responses is included in Appendix A of this Notice.

When finalizing the best execution amendments in June 2008, the CSA decided to postpone the implementation of the proposed best execution reporting requirements for marketplaces and dealers due to intervening market developments. However, we are of the

²⁶ “Markets in Financial Instruments Directive – Background Information”, online: Financial Services Authority, <http://www.fsa.gov.uk/pages/about/what/international/pdf/MiFID.pdf> on July 8, 2008.

view that it is appropriate to republish them for comment with this package of amendments. A cost-benefit analysis of the implementation of reporting requirements for marketplaces and dealers was published with the Joint Notice.

The CSA continue to be of the view that this information is important to provide tools for assessing and complying with the best execution obligation. With respect to the proposed marketplace reporting requirement, we think this information would be useful for a dealer or adviser to assess best execution based on marketplace quality (for example, speed and certainty of execution). For the proposed dealer reporting, we think the reports would provide useful information to clients about order execution.

We have made a number of changes to the best execution reporting requirements from when they were published in April 2007, based on the comments received to further streamline the requirements. Specifically, we have removed the requirement for dealers to provide the percentage of total client orders and percentages that were market orders, limit orders and other order types as part of their report. In addition, we are proposing that marketplaces report by security only and not also by order type.

As the CSA understand that technology changes will be necessary to comply with these requirements, we are proposing that there would be a six month transition period after the regulation becomes effective.

We have set out below some questions on which we are specifically requesting feedback.

Question 7: Should the marketplace statistics focus on units of securities traded instead of orders and number of trades?

Question 8: Should the marketplace statistics require separate reporting on specific order types that would include market orders, intentional crosses, and pre-arranged trades?

Question 9: Should the focus of the liquidity measures be the number of orders or the cumulative number of shares?

Question 10: Would it be useful to have information about partially or fully hidden liquidity that is available on certain marketplaces? If so, what measures of that liquidity would be most informative?

Question 11: Would it be useful to include reporting similar to the near-the-quote orders required by the SEC in the United States?²⁷ What price increment away from the quote would be appropriate to use for the Canadian market?

Question 12: Are statistics regarding average realized and effective spreads useful without a consolidated best bid and offer?

Question 13: Are the time frames used to assess speed and certainty of execution on a marketplace in section 11.1.1 of Regulation 21-101 appropriate? If not, what time frames should be used?

Question 14: In addition to the proposed reporting requirements for marketplaces, would other information, such as the following, be useful to dealers or advisors to assess best execution:

(a) a breakdown of the information by order size (i.e. 100-499 shares, 500-1999 shares, 2000-4999 shares, 5000 or more);

²⁷ A "near-the-quote order" is defined by the SEC as non-marketable buy orders with limit prices that are lower by \$0.10 or less than the consolidated best bid at the time of order receipt, and non-marketable sell orders with limit prices that are higher by \$0.10 or less than the consolidated best offer at the time of order receipt.

(b) the proportion of time that a marketplace had orders that were at the best bid or the best ask;

(c) the proportion of trades (in number of shares or number of trades based on our decision) executed inside the best bid and ask price?

2. Marketplace Systems

A number of changes are proposed to the systems requirements for a marketplace in Part 12 of Regulation 21-101. Most update the technical descriptions of the requirements and modify the requirements to better reflect what is taking place in practice.

Currently, Part 12 of Regulation 21-101 requires a marketplace to address specific issues related to capacity management, system development and testing, system vulnerabilities and business continuity. The defined scope of the annual independent systems review (ISR) is to provide assurance on these same issues. The proposed amendments broaden the requirement for a marketplace to develop and maintain and, for an independent review, assess the more comprehensive and integrated concept of a system of internal control.

Currently, Regulation 21-101 provides for an exemption from the independent review of an ATS that is below a certain trading volume threshold. The proposed amendments remove this threshold. ATSs will now be required to perform an ISR in accordance with established audit standards, unless granted an exemption under Part 15 of Regulation 21-101.

3. Transparency

Amendments are being proposed to Parts 9 and 10 of Policy Statement 21-101 for the purposes of clarifying the requirements under sections 7.1, 7.2, 8.1 and 8.2 of Regulation 21-101 for marketplaces, inter-dealer bond brokers and dealers to provide accurate and timely order and trade information to an information processor, or to an information vendor that meets the standards set by a regulation services provider.

4. Information Processor Requirements and Systems

The CSA are continuing to work toward the selection of an information processor based on the applications received (for equity and debt securities). A summary of these applications was published with the Joint Notice as CSA Staff Notice 21-306. We note that on July 14, 2008, the Bourse de Montréal withdrew its application to be the information processor for debt and equity securities.

It is our view that the information processor for equity securities should disseminate a full depth-of-book market-by-price data feed and consolidated trade information for all marketplaces trading equity securities.

Question 15: Do you agree that an information processor should disseminate consolidated trade information along with a feed that contains the best bid and best offer and all orders at all price levels (along with the marketplace identifier/marker)? For practical reasons, should the price levels be limited? If so, to how many levels?

We are proposing some amendments to Part 16 of Policy Statement 21-101 to clarify the requirements under subsections 14.4(2) and (5) of Regulation 21-101 regarding certain obligations that an information processor has towards its users and providers of order and trade information, in relation to the collection, processing, distribution and publication of that information. In addition, we have proposed changes to the systems requirements applicable to an information processor that are outlined in Part 14 of Regulation 21-101. The changes mirror those described above for a marketplace. However,

an information processor will be required to conduct an annual independent systems review, unless an exemption is sought and granted.

5. Amendments to Sections 7.2, 7.4, and 8.3 of Regulation 23-101 - Agreement Between a Marketplace and a Regulation Services Provider

We have amended subsections 7.2(c), 7.4(c), and 8.3(d) to require that the agreement between a regulation services provider and a marketplace mandates that the marketplace provide the regulation services provider with the information that the regulation services provider considers necessary for the regulation services provider to effectively monitor the conduct of marketplace participants and if applicable, the marketplace. This amendment in no way changes the existing relationship between an exchange or quotation and trade reporting system and the regulation services provider that it has retained. Instead, it clarifies our expectations that the regulation services provider will be provided with the information it needs to effectively monitor trading on multiple marketplaces and to ensure that certain standards, such as clock synchronization, and use of markers, are uniformly met by all marketplaces that the regulation services provider surveils.

V. 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.

VI. Comments and Questions

We invite all interested parties to make written submissions on the Proposed Amendments. We will consider submissions received by January 15, 2009. If you do not submit your comments by email, provide a diskette containing the submissions in Microsoft Word format.

Please address your comments to all of the CSA member commissions, as follows:

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

c/o Me Anne-Marie Beaudoin
 Corporate Secretary
 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

and

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

We cannot keep submissions confidential because securities legislation in certain provinces requires that a summary of the written comments received during the comment period be published.

Questions may be referred to any of:

Serge Boisvert
 Autorité des marchés financiers
 514-395-0337 ext.4358

Sonali GuptaBhaya
 Ontario Securities Commission
 416-593-2331

Tracey Stern
 Ontario Securities Commission
 416-593-8167

Lorenz Berner
 Alberta Securities Commission
 403-355-3889

Meg Tassie
 British Columbia Securities Commission
 604-899-6819

Susan Greenglass
 Ontario Securities Commission
 416-593-8140

Matthew Thompson
 Ontario Securities Commission
 416-593-8223

Doug Brown
 Manitoba Securities Commission
 204-945-0605

Mark Wang
 British Columbia Securities
 Commission
 604-899-6658

Cassie Scanlan
 British Columbia Securities
 Commission
 604-899-6766

Appendix A

Summary of Public Comments on Proposed Amendments to Regulation 21-101 respecting Marketplace Operation and Regulation 23-101 respecting Trading Rules Regarding the Trade-Through Proposal and Canadian Securities Administrators Responses

General Comments

Framework for Trade-Through Proposal

General support was expressed by a number of commenters for the proposal that responsibility for trade-through protection should lie with marketplaces.

Two commenters did not favour a trade-through rule. One of these commenters stated that it did not believe a trade-through rule was necessary, particularly for institutional orders.

A couple of commenters urged Canadian regulators to implement a consistent system with that of the U.S.

Finally, another commenter remarked that marketplaces must be responsible for ensuring accessibility on a consistent and reliable basis prior to launch involving the dealers, the marketplaces and the vendors. This commenter further stated that since the Canadian marketplace relies on third party vendor technology for access to marketplaces and post-trade processing, coordinated and successful industry-wide testing is a critical success factor to the introduction of new marketplaces in Canada.

The Canadian Securities Administrators (CSA or we) believe that a trade-through protection rule will help in maintaining investor confidence and fairness in our markets. In addition, imposing the obligation on marketplaces would allow flexibility in determining how to best implement the trade-through protection rule.

Where appropriate, the CSA have endeavoured to make the proposed trade-through protection regime consistent with the system used in the U.S.

We have updated existing provisions to require a marketplace to publicly make available its technology requirements in their final form for at least three months immediately prior to operations and to provide public testing facilities for interfacing with or accessing the marketplace for at least two months immediately prior to operations. However, industry-wide testing is not being proposed at this time.

<p><i>Need for Data Consolidation and Smart Order Routers</i></p> <p>Some commenters expressed the view that a centralized data consolidator and order routers are necessary to comply with a trade-through rule.</p> <p><i>Requests for Clarification</i></p> <p>One commenter highlighted the lack of guidance for how the specific needs of institutional investors would be addressed in the trade-through proposal. Specifically, this commenter called for accommodation for institutional investors as the proposed system would inhibit the legitimate trading and price discovery activities of this element of the Canadian capital markets.</p>	<p><i>While we are of the view that a centralized data consolidator is not critical for compliance with a trade-through obligation, the CSA are working towards the introduction of an information processor to facilitate data consolidation. In addition, we expect that information vendors will respond to market demand and make consolidated data available. With respect to smart order routers, there are a number of ways in which a marketplace can implement its policies and procedures. Providing a smart order router is one such mechanism. It is the CSA's understanding that many of the marketplaces carrying on business in Canada do or plan to offer routing services to their participants.</i></p> <p><i>The CSA are of the view that all marketplace participants should respect better-priced limit orders already displayed. However, the ability to use an inter-market sweep order has been included to facilitate block trading.</i></p>
<p>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?</p>	
<p><i>Comments</i></p>	<p><i>CSA Responses</i></p>
<p>An overwhelming majority of commenters were not supportive of imposing an</p>	<p><i>The CSA agree that the trade-through obligation should not apply to protect better-</i></p>

obligation on marketplace participants to address trade execution on a foreign market.	<i>priced orders displayed on a foreign market. However, we note that currently, best execution would require marketplace participants to consider foreign markets when executing a trade. We have also proposed an anti-avoidance provision (section 6.7 of Regulation 23-101) to prevent the routing of orders to foreign marketplaces only for the purpose of avoiding the trade-through regime in Canada.</i>
Question 2: What factors should we consider in developing our cost-benefit analysis for the trade-through proposal?	
<i>Comments</i>	<i>CSA Responses</i>
<p>Commenters recommended the following factors should be considered when developing a cost-benefit analysis for the trade-through proposal:</p> <ul style="list-style-type: none"> • Total cost to the marketplace of imposing trade-through obligations on various marketplace participants; • Total industry costs; • Access fees, settlement and clearing fees, cost of surveillance and monitoring of trading on each marketplace; • Costs of a system that is inconsistent with the U.S.; • Benefits of maintaining strict trade-through protection; • Net measurement of the benefit to the client; • Aggregate cost to the industry rather than on a dealer by dealer basis; • Cost of surveillance and monitoring within the dealers' compliance units; • Regulatory costs of the market regulator(s); • Impact of latency – missed opportunities, information leakage and high transaction and clearing costs if orders must travel to many destinations before they are filled; and • Look at the cost-benefits for trade-through on a portfolio or multiple order basis in addition to a single stock basis. <p>One commenter stated that it is important to view all of the limit orders at the bid or</p>	<p><i>The CSA thank all commenters for their input. We are publishing a cost-benefit analysis which examines the anticipated incremental impact of the proposed amendments. The comments received have, where appropriate, informed that analysis. For example the current participant level obligation, removing current requirements and applying the trade-through obligation at the marketplace level were considered in the CBA.</i></p>

ask in the aggregate in order and to consider the contribution made by retail orders.	
Question 3: Would you like to participate in the cost-benefit analysis by providing your input?	
<i>Comments</i>	<i>CSA Responses</i>
Seven commenters expressed an interest in providing input into the cost-benefit analysis.	<i>The CSA thank these commenters for their interest in participating in the cost-benefit analysis. We are publishing a cost-benefit analysis along with the proposed amendments and invite all interested parties to provide comments and estimates of the anticipated costs and benefits of the proposal. We will be considering conducting targeted consultation in the future.</i>
Question 4: Should trade-through protection apply only during “regular trading hours”? If so, what is the appropriate definition of “regular trading hours”?	
<i>Comments</i>	<i>CSA Responses</i>
<p>Ten commenters believe that trade-through protection should only apply during “regular trading hours”. Many of these commenters suggested that 9:30 a.m. to 4 p.m. ET should be the appropriate definition of “regular trading hours”.</p> <p>Some commenters did not believe that trade-through protection should be limited to a portion of a trading day.</p> <p>A few of these commenters cited that trade-through protection should apply when two or more marketplaces are open simultaneously however trade-throughs of marketplaces that are closed should be allowed.</p> <p>Some reasons cited for this stance included:</p>	<i>The CSA are of the view that trade-through protection should apply across markets whenever two or more marketplaces with displayed protected orders are open for trading. Consequently, we have not defined “regular trading hours” but have provided some guidance in Policy Statement 23-101.</i>

<ul style="list-style-type: none"> • Applying trade-through protection at all times would prevent liquidity to migrate to hours when trade-through obligations do not apply; and • Will avoid the confusion that may arise from different interpretations of “regular trading hours”. 	
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?	
<i>Comments</i>	<i>CSA Responses</i>
<p>Most commenters believe that that all visible, better-priced orders should be protected and that the trade-through obligation should extend through the whole depth-of-book.</p> <p>One commenter remarked that trade-through protection for the top five levels would be an onerous requirement and concurs with the U.S. approach that trade-through protection should extend to top-of-book quotations only.</p> <p>Another commenter was of the view that a trade-through rule is only appropriate where a consolidated quote is available.</p>	<p><i>The CSA agree that the trade-through obligation should apply to the full depth-of-book. Under the proposed trade-through protection rule, all visible, better-priced orders displayed on marketplaces with automated functionality would be protected, subject to certain “permitted” trade-throughs as described in our response to comments in Question 9 below.</i></p> <p><i>The CSA agree that a consolidated quote would assist in meeting the trade-through obligation but this is not a necessity to effectively meet this requirement. As stated above, we are currently working towards the introduction of an information processor.</i></p>
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?	
<i>Comments</i>	<i>CSA Responses</i>
<p>The majority of commenters responding to this question indicated that they are not</p>	<p><i>In response to the comments received, we are proposing not to impose a specific</i></p>

<p>supportive of imposing a limit on the fees charged on a trade-by-trade basis to access an order on a marketplace for trade-through purposes. Many of these commenters cited that fees should be determined by competition.</p> <p>Six commenters did favour fee caps. Some reasons for this position included:</p> <ul style="list-style-type: none"> • The playing field for all participants would be level and memberships to an ATS may increase; • Prices would be easily comparable across marketplaces; • Dealers would be protected from becoming captive to unreasonable marketplace fees; and • Investors would not have to indirectly bear a disproportionate amount of the costs for accessing quotes under the trade-through obligations. 	<p><i>limit on the fees charged but to refer to the minimum price increment outlined in IIROC Universal Market Integrity Rule 6.1. We have also prohibited a marketplace from imposing terms that have the effect of discriminating between orders routed to the marketplace to prevent trade-throughs and orders that originate on that marketplace. We have requested further comment as to whether it is appropriate to set a cap with a specified dollar amount.</i></p>
<p>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?</p>	
<p><i>Comments</i></p> <p>Most commenters responding to this question were in favour of establishing a threshold that would require an ATS to permit all groups of marketplace participants. Suggested appropriate thresholds included: 20%, 10%, and 5% of market share. One commenter stated that ATSs should provide access to all groups of market participants when they have been deemed to be a relevant marketplace.</p> <p>Another commenter was of the belief that marketplaces should not unduly restrict access and that all categories of marketplace participants should be allowed to trade.</p> <p>Another commenter was unsure of an appropriate threshold in the absence of a fully competitive environment. This commenter suggested that this concept be revisited after a year of the operation of multiple marketplaces to assess the feasibility of establishing a suitable threshold for Canadian marketplaces.</p>	<p><i>CSA Responses</i></p> <p><i>Rather than requiring that a marketplace provide direct access to all groups of participants when it meets a certain threshold, we have instead provided additional guidance regarding fair access in Policy Statement 21-101. We will continue to monitor this issue.</i></p>

<p>Five commenters did not support a legislated threshold that would require ATSs to allow access to all groups of marketplace participants. Some of these commenters believed that:</p> <ul style="list-style-type: none"> • The CSA practice of looking at this issue on a case by case basis from the broad public interest point of view is appropriate; and • It is unclear whether exchanges are complying with the U.S. fair access rule since only dealers can be members. 	
<p>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?</p> <ul style="list-style-type: none"> • 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? 	
<i>Comments</i>	<i>CSA Responses</i>
<p><i>Access of Non-members to Specialized Marketplaces</i></p> <p>Many commenters responding to this question supported the requirement of specialized marketplaces allowing access to non-members so that they can access immediately accessible, visible limit orders to satisfy the trade-through obligation.</p> <p>Some reasons cited for this position included:</p> <ul style="list-style-type: none"> • the trade-through obligation is a duty owed by all marketplace participants to the capital markets in general and therefore all marketplace participants with such an obligation should have fair access to all better-priced orders; and • such a prohibition creates a powerful disincentive to join new marketplaces as compliance burdens will increase. 	<p><i>With respect to issues relating to access to marketplaces by non-members/subscribers to a marketplace, we are not proposing that a marketplace provide direct access to non-members/subscribers. Under the proposed amendments, marketplaces would be given the discretion to determine how best to meet their trade-through obligations. This issue will be discussed with the industry implementation committee.</i></p>

Other commenters not in favour of this requirement submitted that:

- marketplaces that limit membership contain, by definition, orders that are not immediately accessible, visible limit orders (by virtue of the fact that excluded members cannot see or execute against orders in this type of marketplace) and therefore these orders should be deemed “excluded orders”; and
- it is not appropriate or necessary to force a specialized marketplace to change its technology or by-laws merely to allow the occasional and otherwise non-qualifying market participant to displace a quote for trade-through purposes.

Direct Order Execution Access

The majority of commenters responding to this question did not believe an ATS should be required to provide direct order execution access if no other subscriber would provide this service.

A few commenters, however, were in support of such a requirement.

Practicality of Direct Order Execution Access

Some commenters responding to this question believe that it is practical to require an ATS to provide direct order execution access if no subscriber will provide this service. One of the reasons provided in support of this stance is that ATSs are registered brokers and they should be able to handle inbound order flow as client flow.

Two commenters did not believe this is a practical solution.

Threshold Limits for Trade-Through Obligation

Suggested thresholds for which a trade-through obligation would not apply to orders and/or trades on a marketplace ranged from 5% (after one year of continuous trading) to 10% of trading volume of a Canadian issuer.	<i>The CSA have not set a threshold at which the trade-through obligation would apply and believe that the obligation should apply to all visible limit orders on a marketplace.</i>
Question 9: Are there any types of special terms orders that should not be exempt from trade-through obligations?	
<i>Comments</i>	<i>CSA Responses</i>
<p>Many commenters remarked that the exemption of special terms orders listed in the joint notice is appropriate.</p> <p>One commenter cited that special terms orders that are used to establish the last sale price should not be exempt from the trade-through obligation.</p> <p>Another commenter contended that all special terms orders should be exempted.</p> <p>Another commenter specified that the ability for a “fill” term order (all-or-none, minimum fill) to trade-through a better-priced order on another marketplace should be consistent with how it is treated in a market and any exemptions for marketplaces with larger minimum order sizes. This commenter also added that “settlement” terms such as cash, delayed delivery etc. and odd lots should also be exempt from the trade-through rule.</p> <p>One commenter stated that the exclusion of special terms orders should be consistent with UMIR.</p>	<p><i>We have not proposed a general exemption for all special terms orders. However, subsection 5.1(3) of Policy Statement 21-101 outlines that special terms orders that are not immediately executable or that trade in special terms books, such as all-or-none or minimum fill orders, are not required to be provided to an information processor or an information vendor. Therefore, these types of orders would not fall under the definition of “protected orders” under the proposed rule and hence would not receive trade-through protection. However, those executing against these types of orders are required to execute against all better-priced orders first.</i></p> <p><i>In addition, orders with special settlement terms and “calculated price orders” have been included in the list of “permitted” trade-throughs in paragraph 6.2(e) of Regulation 23-101.</i></p> <p><i>As well, certain marketplaces provide an after-hours trading session at a price established by that marketplace during its regular trading hours for marketplace participants who are required to benchmark to a certain closing price. In these circumstances, a marketplace would not be required to take steps to reasonably prevent trade-throughs of orders on another marketplace.</i></p>

Question 10: Are there current technology tools that would allow monitoring and enforcement of a flickering quote exception?	
<i>Comments</i>	<i>CSA Responses</i>
<p>While commenters responding to this question were not aware of any technology tools available to allow for the monitoring and enforcement of a flickering quote exception, some suggested an “inter-market sweep order” to address this issue.</p> <p>Another commenter stated that it would be possible to develop a non-real time monitor at RS that would compare time stamps of orders and trades.</p> <p>Some commenters stated that it would be impractical to monitor for flickering order exceptions.</p> <p>Commenters offered the following alternative suggestions to a flickering order exception:</p> <ul style="list-style-type: none"> • dealers should demonstrate that their trading policies and procedures are designed to minimize instances of trade-through caused by “flickering orders”; • initially monitor the reality of a multi-market operating environment in order to ascertain if this will actually be a material issue that warrants development work; • dealers to keep a log book that documents the instances and rationale as to why an order was non-executable, and if appropriate, the Participant could send an exception report to RS when this occurs; and • use “pattern” based regulation so that if a participant demonstrates a consistent pattern of abusing the exception it would be dealt with by regulators at that time. 	<p><i>It is expected that a marketplace will conduct periodic reviews to test the effectiveness of its policies and procedures for reasonably preventing trade-throughs and ensuring compliance with Part 6 of Regulation 23-101. We are of the view that a marketplace must retain relevant information so that the effectiveness of its policies and procedures can be adequately evaluated by regulatory authorities. In certain circumstances, such as sending an inter-market sweep order, it may be appropriate for marketplace participants to maintain relevant information so that compliance with Part 6 of Regulation 23-101 can be adequately evaluated by regulatory authorities.</i></p>

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?	
<i>Comments</i>	<i>CSA Responses</i>
<p>A number of commenters responding to this question believe that a specified time period may not be practical. One commenter suggested that instead of a specific period of time after the trade that would provide a safe harbour from trade-throughs, dealers should be required to demonstrate through either system documentation or through their audit trail that, at the time of order entry their orders were routed to the best priced marketplace given their current view of market data.</p> <p>Other commenters suggested that the appropriate duration should vary given the nature of the order, time of day and transaction load and one commenter suggested that it may be appropriate to have several time periods based on the nature of the order entered. One commenter suggested a quote which lasts for less than 5 seconds should not be subject to trade-through protection.</p>	<p><i>We have allowed for the provision of “flickering orders” where a marketplace displaying the best price was traded through but had displayed, immediately prior to execution of the trade-through, an order with a price that was equal or inferior to the price of the trade-through transaction. We have asked a specific question as to what length of time should be considered an “immediate” response by a marketplace to a received order in the attached Notice. In our view, because of the high speed of trading, one second may be too long.</i></p>
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?	
<i>Comments</i>	<i>CSA Responses</i>
<p>Three commenters specifically stated that they support the exemption from trade-through obligations of Market-On-Close (MOC) orders.</p> <p>One commenter requested further clarification on what factors will be used to determine what the opening and closing price is for a security.</p>	<p><i>As mentioned above, if a marketplace is operating a special trading facility with a set closing price, under paragraph 6.2(e of Regulation 23-101), a marketplace could execute closing price orders and would not be required to take steps to reasonably prevent trade-throughs of orders on another marketplace. Otherwise, if two marketplaces with displayed protected orders are open for trading in their regular trading session, the trade-through protection rule would apply.</i></p>

One commenter referred to its position that trade-through protection should apply to all marketplaces that are open for continuous trading at any given time.	
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?	
<i>Comments</i>	<i>CSA Responses</i>
<p>While five commenters were in support of a last sale price order facility exception they varied in their stances as to how this exception should be applied. One commenter stated that the last sale price exemption should be limited to the residual volume while others argued for the exception to be limited to the volume traded during the session the trade in question took place. Another commenter cited that trades should be encouraged to take place in the current context of the market and would not be supportive of a last sale price order facility exception being granted for residual volume of a trade.</p> <p><i>Appropriate Time Limit</i></p> <p>Suggestions for the duration of the exception ranged from 60 seconds to two minutes. Another commenter deferred to the expertise of the marketplace to determine volumes and time limits.</p> <p><i>Opposition to Last Sale Price Order Facility Exception</i></p> <p>Five commenters were of the view that there should not be a special exception for a last sale price order facility. One of these commenters, while not in favour of an exception for a last sale price order facility that operates during a market's normal trading hours, was supportive of the idea of allowing trades to continue at the closing price of a marketplace.</p>	<p><i>We have not allowed for trade-throughs by transactions resulting from the execution of residual volumes of a trade within a last sale price order facility. We believe that better displayed prices should be honoured by all marketplace participants.</i></p>

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?	
Comments	CSA Responses
<p>The following exemptions from trade-through protection were suggested by commenters:</p> <ul style="list-style-type: none"> • specialty price crosses (including basis, VWAP, contingent and special trading session crosses); • special settlement terms; • Market-On-Close orders; • Derivative-related trades; • All-or-none orders (re: orders that are already in the special terms book where the trade is triggered by the marketplace algorithm); • Minimum size orders; and • Stop orders and short orders where pricing is managed by an exchange. <p>Another commenter is of the view that trade-throughs should not be allowed in any circumstance other than those listed in the joint notice.</p> <p>One commenter supported trade-through exemptions for situations where the trade price is not known at the time of order entry.</p> <p>Two commenters called for the CSA to maintain flexibility with respect to trade-through exemptions.</p>	<p><i>As mentioned above, the current proposal permits trade-throughs for orders containing special settlement terms, closing price orders and orders where the trade price is not known at the time of order entry and is to be calculated based on, but will not necessarily be equal to, the price of the security at the time of execution.</i></p> <p><i>All-or-none, minimum fill and other special terms orders that are not immediately executable or that trade in special terms books are not required to be provided to an information processor or information vendor under subsection 5.1(3) of Policy Statement 21-101. Therefore these types of orders would not fall under the definition of “protected orders” under the proposed rule and would not receive trade-through protection.</i></p>

Comments to Questions 15 to 18 and the corresponding CSA responses were published on June 20, 2008 in the Bulletin de l'Autorité des marchés financiers, Vol. 5, n° 24, 2008-06-20.

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?

<i>Comments</i>	<i>CSA Responses</i>
<p>Four commenters suggested that multiple marketplaces should be in operation for some time before determining the usefulness of reporting information.</p> <p>The majority of commenters responding to this question supported the proposed information requirements placed on marketplaces. One commenter suggested that the marketplace reporting requirements should be modeled after “Dash 5” reports produced in the U.S. given the significance of interlisted trading in Canada. This commenter stated that while the basic metrics proposed by the CSA are appropriate, they are insufficient since the structures of different marketplaces also need to be considered and the metrics provided in the Dash 5 type reports provide information that allows the end recipient to compare the costs and benefits of executing on various marketplaces.</p> <p>Some commenters did not believe that the information to be provided by the dealers would be useful to the public or for firms.</p> <p><i>Suggestions for Other Useful Information</i></p> <p>One commenter suggested that disclosure of routing and execution practices by marketplaces and dealers would provide valuable tools for monitoring and assessing best execution and help to improve the efficiency of capital markets. This commenter</p>	<p><i>The CSA delayed the implementation of the reporting requirements to enable multiple marketplaces to begin operations and for marketplace participants to adjust to the changing market structure. We continue to think that this reporting is important.</i></p> <p><i>We have further streamlined the proposed reporting requirements to focus on areas that we think would provide useful information to assess quality of execution.</i></p>

<p>also stated that dealers should still provide the identity of market centres where they route a significant portion of their orders, disclosure of their relationship with such market centres or any conflict of interest that may exist.</p> <p>One commenter was of the view that ATSs should provide standardized and periodic data in order for market participants to be able to reasonably consider any dark pool options for best execution.</p>	
Question 20: Should trades executed on a foreign market or over-the-counter (OTC) be included in the data reported by dealers?	
<p><i>Comments</i></p>	<p><i>CSA Responses</i></p>
<p><i>Foreign Trades</i></p> <p>The majority of commenters who responded to this question do not believe there should be a requirement to report foreign trades in Canada. Two commenters elaborated that there is a great potential cost in providing this information with little tangible benefit.</p> <p>Three commenters favoured the disclosure of foreign trades. One of these commenters supported this type of disclosure when there is a relationship between the parties which dictates how orders are routed. Another commenter suggested that this information would provide additional data points for internal analysis.</p> <p><i>OTC Trades</i></p> <p>With respect to OTC trade information, one commenter noted that although a lack of transparency combined with limited comparative information can make it difficult to measure best execution on the OTC market, such information may be useful in certain cases such as government issues.</p>	<p><i>We are not proposing that trades executed on a foreign market or over-the-counter be included in the data. We are focussing on where securities are traded on multiple marketplaces in Canada.</i></p>

Question 21: Should dealers report information about orders that are routed due to trade-through obligations?	
<i>Comments</i>	<i>CSA Responses</i>
<p>The majority of commenters responding to this question did not believe that dealers should report information about orders that are routed due to trade-through obligations. Reasons for this position included:</p> <ul style="list-style-type: none"> • Detailed information about routing of orders and decisions made in the trade process is more appropriately collected as part of the TREATS initiative; • This requirement would induce more delays and offloads undue operational and regulatory costs onto participants; and • Additional reporting requirements should be deferred until the market has been operating in the context of the proposed regulations for a reasonable amount of time and careful study reveals a compelling regulatory need for such a requirement. <p>Two commenters supported the reporting of information relating to orders routed for trade-through compliance purposes. One of these commenters however stated that it wants the CSA to be confident that the benefits of receiving such reports outweigh the costs associated with building a reporting structure before mandating this information.</p>	<p><i>We are not proposing at this time to include information about orders that are routed due to trade-through obligations. This may be re-assessed once the trade-through requirements have been in place for a period of time.</i></p>

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

<i>Comments</i>	<i>CSA Responses</i>
<p>Six commenters did not support the requirement of marketplaces reporting spread-based statistics. Some reasons listed for this position include:</p> <ul style="list-style-type: none"> • There are difficulties in setting objective standards so that everyone reports in similar ways and the statistics could be manipulated by selectively including/omitting execution data; • Depending on the nature of the marketplace, it may be completely irrelevant information; and • Spread based statistics will not assist in determining speed of execution, certainty of execution and over-all cost of the transaction. <p>Five commenters indicated that spread based statistics should be reported for the following reasons:</p> <ul style="list-style-type: none"> • Spread statistics are required when considering best execution for passive order flow; • This information is important for conducting transaction cost analysis in the form of implementation shortfall analysis; and • This information is the best metric for liquidity. 	<p><i>There were mixed views on whether to include spread-based statistics. As a result, we have proposed that marketplace reporting include spread-based statistics and have specifically requested comment on this point.</i></p>
<p>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?</p>	

<i>Comments</i>	<i>CSA Responses</i>
<p>Most commenters responding to this question did not believe the information included in the proposed reporting requirements would be useful if securities are traded on only one marketplace. Some commenters reasoned that the value of the information would not be justified by the cost of collection of the information.</p> <p>Three commenters did think that the information included in the proposed reporting requirements would be useful even if the securities were traded only on one marketplace. One commenter contended that this historical set of data can be used if or when the issuer graduates to a larger market where its securities will be listed on multiple marketplaces. Another commenter believes that transaction cost analysis can be conducted even if securities are traded on a single marketplace. As well, another commenter noted that the reporting requirements offer metrics to measure the expected execution quality of a marketplace and that since it is difficult to track interlisted securities on a real-time basis, this commenter is of the view that the best alternative is to standardize marketplace reporting requirements regardless of whether the securities traded are interlisted.</p>	<p><i>We have not limited the marketplace reporting requirements where securities are traded only on one marketplace. We think that the proposed reporting requirements contain useful information to assess execution quality.</i></p>

II. List of Respondents

1. Bloomberg Tradebook Canada Company
2. BMO Financial Group
3. Canadian Security Traders Association Inc.
4. CNQ
5. CPP Investment Board
6. egX Canada
7. Highstreet Asset Management Inc.
8. Investment Industry Association of Canada
9. ITG Investment Technology Group
10. Liquidnet Canada Inc.
11. Merrill Lynch Canada Inc.
12. Perimeter Markets Inc.
13. Raymond James Ltd.
14. RBC Asset Management Inc.
15. RBC Dominion Securities Inc.
16. Scotia Capital Inc.
17. TD Asset Management Inc.
18. TD Newcrest
19. TSX Group Inc.