

**NOTICE OF NATIONAL INSTRUMENT 21-101
MARKETPLACE OPERATION, COMPANION POLICY 21-101CP AND
FORMS 21-101F1, 21-101F2, 21-101F3, 21-101F4, 21-101F5 AND 21-101F6**

AND

**NOTICE OF NATIONAL INSTRUMENT 23-101
TRADING RULES AND COMPANION POLICY 23-101CP**

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MARKETPLACE OPERATION, COMPANION POLICY 21-101CP AND
FORMS 21-101F1, 21-101F2, 21-101F3, 21-101F4, 21-101F5 AND 21-101F6**

AND

**NOTICE OF NATIONAL INSTRUMENT 23-101
TRADING RULES AND COMPANION POLICY 23-101CP**

1. BACKGROUND

The Commission and the other members of the Canadian Securities Administrators (the “CSA” or “We”), have made

- National Instrument 21-101 *Marketplace Operation* (“National Instrument 21-101”), Companion Policy 21-101CP and Forms 21-101F1, 21-101F2, 21-101F3, 21-101F4, 21-101F5 and 21-101F6 (together the “Marketplace Operation Rule”), and
- National Instrument 23-101 *Trading Rules* (“National Instrument 23-101”) and Companion Policy 23-101CP (together the “Trading Rules”).

The term “ATS Rules” refers to both the Marketplace Operation Rule and the Trading Rules. The full text of the ATS Rules is attached to this notice.

We first published the ATS Rules for comment on July 2, 1999 (“1999 Proposal”) and republished them for comment on July 28, 2000 (“2000 Proposal”). During the second comment period, which expired on October 30, 2000, we received 22 submissions. The names of the commenters, a summary of their comments and our responses are contained in Appendix A to this Notice. We thank all commenters for providing their comments on the two proposals. For additional background and the summary of comments received on the 1999 Proposal, please refer to the notices published with those proposals.

We have made some changes to the 2000 Proposal in response to the comments received and further consultation done. However, we are of the view that republication of the ATS Rules for comment is not required.

2. THE REGULATORY FRAMEWORK FOR ALTERNATIVE TRADING SYSTEMS

The ATS Rules are part of a CSA initiative to create a framework that permits competitive operation of traditional exchanges and other marketplaces, while ensuring that trading is fair and transparent. The ATS Rules set out a scheme for regulating ATSs by giving them a choice about how they will be regulated. The ATS Rules attempt to minimize fragmentation by setting out order and trade reporting requirements, information consolidation requirements and market integration requirements. In addition, the ATS Rules are designed to maintain and improve market integrity through National Instrument 23-101.

The regulatory objectives of the ATS Rules are as follows: to provide investor choice, improve price discovery and decrease execution costs. We have attached as Appendix B a chart that summarizes the transparency requirements and the market regulation obligations under the ATS Rules. The chart is being provided to assist readers; however, in the event of any inconsistency between the chart and the ATS Rules, the ATS Rules govern.

A. Regulatory Choice for Marketplaces

National Instrument 21-101 regulates all marketplaces operating in Canada. Marketplaces include exchanges, quotation and trade reporting systems and ATSs.¹ All marketplaces are subject to certain requirements, including information consolidation², market integration³, reporting and record keeping requirements⁴ and systems capacity requirements.⁵

A marketplace can choose one of three regulatory models under which to operate.

1. A marketplace can choose to be a member of an exchange, and thus be subject to the rules and policies of that exchange. If the marketplace chooses to be a member of an exchange, the marketplace is not subject to National Instrument 21-101.⁶
2. A marketplace can choose to be regulated as an exchange. A marketplace that decides to be regulated as an exchange must apply for recognition under securities legislation, file Form 21-101F1 and is subject to the requirements of securities legislation and the additional provisions of the ATS Rules that apply to exchanges.⁷ The Marketplace Operation Rule provides guidelines for

¹ “Marketplace” is defined in section 1.1 of National Instrument 21-101.

² Parts 7 and 8 of National Instrument 21-101.

³ Part 9 of National Instrument 21-101.

⁴ Part 11 of National Instrument 21-101.

⁵ Part 12 of National Instrument 21-101.

⁶ Section 2.1 of National Instrument 21-101.

⁷ Part 5 of National Instrument 21-101 imposes requirements on recognized exchanges and recognized quotation and trade reporting systems.

determining whether we would consider a marketplace to be an exchange. If a marketplace performs certain functions, we would consider the marketplace to be an exchange under securities legislation and would require it to be recognized as an exchange in order to carry on business, unless it obtains an exemption from securities regulatory authorities.⁸ These functions include providing a listing function, guaranteeing liquidity, setting requirements governing the conduct of marketplace participants, other than those necessary to govern the method of trading or algorithm used by those marketplace participants, and disciplining subscribers.

3. A marketplace can choose to be regulated as an ATS. A marketplace that decides to be regulated as an ATS must register as a dealer under securities legislation, become a member of a self-regulatory entity, file Form 21-101F2 and is subject to the additional provisions of the ATS Rules that apply to ATSs.⁹

Those marketplaces that fit within the statutory definition of a quotation and trade reporting system existing in certain provinces, cannot carry on business as a quotation and trade reporting system unless they are either recognized by the appropriate local jurisdiction or regulated as an ATS under the ATS Rules.

Inter-dealer bond brokers are excluded from the definition of a marketplace. They have a choice about how they will be regulated under the ATS Rules. An inter-dealer bond broker can choose to be subject to By-law No. 36 Inter-Dealer Bond Brokerage Systems (“By-law No. 36”) and Regulation 2100 Inter-Dealer Bond Brokerage Systems (“Regulation 2100”) of the Investment Dealers Association of Canada (the “IDA”). An inter-dealer bond broker that makes this choice is excluded from the definition of a marketplace under National Instrument 21-101 and is subject to the transparency requirements of Part 8 of National Instrument 21-101. We have requested that the IDA amend Regulation 2100 to remove the restriction on clients of inter-dealer bond brokers. The IDA will consider providing an exemption from this restriction until an amendment is finalized. Alternatively, an inter-dealer bond broker can choose to be an ATS and comply with the provisions of the ATS Rules that apply to marketplaces and ATSs.¹⁰

B. Securities to be Traded on an ATS

We have had extensive discussions with commenters on what securities should appropriately be traded on an ATS. Based on these discussions, we have determined at this time to restrict the securities that can be traded on an ATS.

⁸ Subsection 3.3(1) of Companion Policy 21-101CP.

⁹ Parts 6 and 13 of National Instrument 21-101 contain requirements applicable only to ATSs that are not members of an exchange or have not chosen to be recognized as an exchange.

¹⁰ Subsection 2.1(8) of Companion Policy 21-101CP.

Under National Instrument 21-101, an ATS shall not execute trades in securities other than exchange-traded securities, corporate debt securities, government debt securities and foreign exchange-traded securities.¹¹ Exchange-traded securities include equity securities, preferred securities, options and listed debt securities. An inter-listed security is an exchange-traded security. A security that is traded on a facility of an exchange, but is not listed on that exchange, or that is posted on an over-the-counter bulletin board, for example, Nasdaq's OTCBB, is not considered to be a foreign exchange-traded security and cannot be traded on an ATS.

An ATS that wants to trade over-the-counter equity securities may apply to the CSA. The CSA will consider such application and may allow an ATS to trade these securities if it is not contrary to the public interest to do so. To determine whether it is not contrary to the public interest, we will look at a number of factors including whether there are appropriate arrangements for issuer regulation.

C. National Instrument 23-101 Trading Rules

The Trading Rules set forth common trading rules that will apply to all trading, whether on a marketplace or not. They do not prohibit marketplaces from implementing additional rules. The requirements in the Trading Rules include a prohibition against manipulation and fraud¹² and a best execution obligation.¹³ The Trading Rules also impose an obligation on ATSs to enter a contract with a regulation services provider to conduct monitoring of the trading activities of the ATS and its subscribers and enforcement of the requirements of the regulation services provider. A regulation services provider is defined as a person or company that provides regulation services and is a recognized exchange, recognized quotation and trade reporting system or a recognized self-regulatory entity.¹⁴

Under the Trading Rules, a recognized exchange or recognized quotation and trade reporting system is required to set its own requirements and either enforce them directly or enter into an agreement with a regulation services provider that will monitor and enforce compliance with those requirements.¹⁵ In contrast, a regulation services provider for an ATS will adopt requirements that will apply to the ATS and the ATS will agree to comply with those requirements. Subscribers of the ATS will have to enter into an agreement with the ATS that indicates that the subscriber will comply with the requirements set by the

¹¹ Section 6.3 of National Instrument 21-101.

¹² Part 3 of National Instrument 23-101.

¹³ Part 4 of National Instrument 23-101.

¹⁴ Section 1.1 of National Instrument 21-101.

¹⁵ Part 7 of National Instrument 23-101.

regulation services provider of the ATS.¹⁶

Additional background and details about market regulation and the regulation services provider and its role are provided in Part 5 below.

3. TRANSPARENCY REQUIREMENTS UNDER THE ATS RULES

In order to minimize any negative impact of having different marketplaces trade the same security, the ATS Rules impose information transparency requirements on market participants trading exchange-traded securities, foreign exchange-traded securities and unlisted debt securities (corporate debt securities and government debt securities) and impose market integration requirements on all marketplaces. The market integration requirements are discussed in Part 4 below. As a part of the information transparency requirements, marketplaces trading exchange-traded securities or foreign exchange-traded securities must provide information to an information processor. A marketplace, inter-dealer bond broker and dealer trading unlisted debt securities must provide information to an information processor. The information processor will collect and disseminate the information received in the form of a consolidated feed. There may be more than one information processor, one for exchange-traded securities and foreign exchange-traded securities and one for unlisted debt securities.

A. Data Consolidation

(i) Exchange-Traded Securities and Foreign Exchange-Traded Securities

In the 2000 Proposal, the term “data consolidator” was defined as a person or company that has entered into an agreement with a securities regulatory authority to receive and provide information in accordance with Part 7 of National Instrument 21-101.¹⁷ In National Instrument 21-101, the term has been replaced with the term “information processor”. An information processor is defined as a person or company that receives and provides information in accordance with National Instrument 21-101 and files Form 21-101F5.¹⁸

We issued a Request for Proposal (“RFP”) on July 28, 2000 to select a developer and operator of the data consolidator. During the course of the negotiations with the entity selected to develop and operate the data consolidator, we decided to postpone the implementation of data consolidation for exchange-traded securities and foreign exchange-traded securities for a period of about two years. We will instead request

¹⁶ Part 8 of National Instrument 23-101.

¹⁷ Section 1.1 of National Instrument 21-101 of 2000 Proposal.

¹⁸ Section 1.1 of National Instrument 21-101.

that marketplaces and other industry participants develop and implement a solution to consolidate order and trade information for exchange-traded securities and foreign exchange-traded securities by December 31, 2003. In the meantime, National Instrument 21-101 provides an exemption from the requirement for marketplaces to provide order and trade information to an information processor on the condition that the marketplace provides the information to an information vendor. The exemption does not apply after December 31, 2003.¹⁹

(ii) *Unlisted Debt Securities*

An information processor will also collect and disseminate order and trade information for government debt securities and corporate debt securities. The information processor will collect the order and trade information for these securities provided by marketplaces, inter-dealer bond brokers and dealers and will create a consolidated feed and distribute it to information vendors, news services and other customers.²⁰

CanPX has filed Form 21-101F5 to become an information processor for unlisted debt securities in anticipation of the adoption of the ATS Rules. CanPX currently provides information transparency for the wholesale debt market. CanPX links together feeds from participating inter-dealer bond brokers and disseminates the best bid, best offer and last trade information for certain benchmarks and other designated government debt securities.

We will publish a notice indicating that CanPX has filed Form 21-101F5 in order to begin operations as an information processor for fixed income and that the form is publicly available for inspection. The notice will indicate that all interested parties can provide comments to us within 30 days of the publication of the notice. Upon the expiration of the comment period, we will review the comments received and prepare a recommendation indicating whether or not it is contrary to the public interest for CanPX to operate as an information processor under the ATS Rules. We will issue a notice indicating whether or not CanPX will be the information processor for unlisted debt securities.

(iii) *Requirements Applicable to an Information Processor*

The ATS Rules impose a number of requirements on an entity that becomes an information processor. A person or company that intends to carry on business as an information processor is required to file Form 21-101F5 at least 90 days before beginning to carry on business as an information processor.²¹ Upon receipt, we will review the form to determine if it is not contrary to the public interest to have that person

¹⁹ Section 7.5 of National Instrument 21-101.

²⁰ Part 8 of National Instrument 21-101.

²¹ Section 14.1 of National Instrument 21-101.

or company perform the consolidation function for a particular type of security (e.g, exchange-traded securities or unlisted debt securities). An information processor must enter into an agreement with each marketplace, inter-dealer bond broker and dealer providing information to the information processor. An information processor must

- provide timely, accurate, reliable and fair collection, processing, distribution and publication of information,
- keep the books, records and other documents that are necessary for the proper recording of its business transactions and financial affairs, and
- comply with specific systems requirements.²²

The purpose of filing the form and establishing requirements that apply to an information processor is to ensure the availability of prompt and accurate order and trade information and to assess the ongoing viability of the entity performing the consolidation function.

B. Transparency Requirements for Exchange-Traded Securities

(i) Order and Trade Information Transparency

The ATS Rules require that all marketplaces (exchanges, quotation and trade reporting systems, dealers executing exchange-traded securities outside of a marketplace and ATSS) that display orders of exchange-traded securities or foreign exchange-traded securities provide information on these orders to an information processor.²³ For exchange-traded securities or foreign exchange-traded securities, other than options, marketplaces are required to at least provide information on the type, the issuer, the class, the symbol and the series of the security, the five best bid prices and five best ask prices for each exchange-traded security and foreign exchange-traded security displayed and the total disclosed volume at each of those prices. For options, marketplaces must at least provide information on the underlying interest, the expiry month, the strike price, the best bid price and the best ask price for each option displayed and the total disclosed volume at each of those price levels. It is up to the individual marketplace to determine whether to show broker identification numbers and provide them to the information processor.²⁴ Individual marketplaces have to record broker identification numbers for audit trail purposes.

²² Part 14 of National Instrument 21-101.

²³ Subsection 7.1(1) of National Instrument 21-101.

²⁴ Subsection 9.2 of Companion Policy 21-101CP.

In addition, all marketplaces must provide details of all trades of exchange-traded securities and foreign exchange-traded securities to an information processor as required by the information processor.²⁵ For exchange-traded securities or foreign exchange-traded securities other than options, this information includes the type, issuer, class, symbol and series of the security, the volume, the price and time of the trade and any other information required by the information processor. For options, this information includes details of the underlying interest, the expiry month, the strike price, the volume, the price and time of the trade and any other information required by the information processor.²⁶

Marketplaces must provide the order and trade information to an information processor in real-time or as close to real-time as possible.²⁷

As discussed, we have provided an exemption from the transparency requirements for marketplaces trading exchange-traded securities or foreign exchange-traded securities if they provide the information to an information vendor. This exemption does not apply after December 31, 2003.²⁸

C. Transparency Requirements for Unlisted Debt Securities

(i) Order and Trade Transparency

We believe that it is important to improve transparency in the domestic debt markets. To that end, we have engaged in extensive discussions with debt market participants, the Bank of Canada, the provinces and the Department of Finance, Canada in order to determine the appropriate level of transparency for the debt markets. Based on these discussions and with the support of debt market participants, we have refined the transparency requirements applicable to marketplaces, inter-dealer bond brokers and dealers that trade corporate debt securities and government debt securities (together, “unlisted debt securities”). In the 2000 Proposal, marketplaces, inter-dealer bond brokers and market makers were required to provide all order and trade information to the information processor. The requirements for inter-dealer bond brokers have been amended and the market maker requirements have been replaced by dealer transparency requirements.

(1) Marketplaces

All marketplaces that display orders of unlisted debt securities must provide information regarding orders

²⁵ Section 7.2 of National Instrument 21-101.

²⁶ Subsection 9.1(4) of Companion Policy 21-101CP.

²⁷ Subsection 9.1(3) of Companion Policy 21-101CP.

²⁸ Section 7.5 of National Instrument 21-101.

for unlisted debt securities to the information processor as required by the information processor.²⁹ This information includes information on the type, issuer, coupon and maturity of the security, the best bid price, the best ask price and the total disclosed volume at those prices.³⁰ In addition, all marketplaces are required to provide information to the information processor on all trades of unlisted debt securities executed on the marketplace as required by the information processor.³¹ This information includes details as to the type, issuer, class and series of the security, the volume, the price and time of the trade and any additional information required by the information processor.³²

All marketplaces must provide order and trade information about unlisted debt securities to the information processor in real-time or as close to real-time as possible.³³

(2) *Inter-dealer Bond Brokers and Dealers*

An inter-dealer bond broker is required to provide information regarding orders of government debt securities traded through the inter-dealer bond broker to the information processor.³⁴ The information includes information on the type, the issuer, the coupon, and the maturity of the security, the best bid price, the best ask price and the total disclosed volume at those prices for benchmark and designated government debt securities.³⁵ The inter-dealer bond broker must provide this information in real-time or as close to real-time as possible.³⁶

In addition, inter-dealer bond brokers are required to provide information on trades of benchmarks and designated government debt securities and designated corporate debt securities that they trade within one hour of executing the trade.³⁷ Dealers are required to provide trade information on designated corporate debt securities traded by or through the dealer.³⁸ For each of these securities, an inter-dealer bond broker and a dealer must include information on the type, the issuer, the series, the coupon and the maturity of the security, the price and time of the trade and any additional information required by the information processor.³⁹ For government debt securities, inter-dealer bond brokers must also provide the volume traded.

²⁹ Section 8.1 of National Instrument 21-101.

³⁰ Subsection 10.1(2) of Companion Policy 21-101CP.

³¹ Section 8.2 of National Instrument 21-101.

³² Subsection 10.1(3) of Companion Policy 21-101CP.

³³ Subsection 10.1(4) of Companion Policy 21-101CP.

³⁴ Section 8.3 of National Instrument 21-101.

³⁵ Subsection 10.2(2) of Companion Policy 21-101CP.

³⁶ Subsection 10.2(10) of Companion Policy 21-101CP.

³⁷ Section 8.4 of National Instrument 21-101, subsections 10.2(10) of Companion Policy 21-101CP.

³⁸ Section 8.5 of National Instrument 21-101.

³⁹ Subsections 10.2(5) and (6) of Companion Policy 21-101CP.

For corporate debt securities, the volume information will depend on the total par value of the securities traded. For investment-grade corporate debt securities, inter-dealer bond brokers and dealers are required to provide the actual quantity of bonds traded if the total par value of the securities traded is \$2 million or less. For trades above \$2 million, inter-dealer bond brokers and dealers will show the volume information as \$2 million+. For non-investment grade corporate debt securities, inter-dealer bond brokers and dealers are required to provide the actual quantity of bonds traded if the total par value of the securities traded is \$200,000 or less. For trades above \$200,000, inter-dealer bond brokers and dealers will show the volume information as \$200,000+.⁴⁰

(ii) Selection of Unlisted Debt Securities

As stated above, transparency requirements for government debt securities traded through inter-dealer bond brokers apply only to benchmark and other designated government debt securities. The transparency requirements for corporate debt securities traded through an inter-dealer bond broker or traded by or through a dealer will apply initially to at least 20 corporate debt securities. The information processor will establish a list of government debt securities and corporate debt securities that it will display. The process for selecting the benchmark and designated government debt securities and the designated corporate debt securities and the list of designated unlisted debt securities will be posted on the websites of CanPX and the securities regulatory authorities. The information processor will review the benchmarks and designated government debt securities and designated corporate debt securities on a quarterly basis and update the list as necessary. If the list is amended, the information processor and the securities regulatory authorities will post the new list.

We have established the Bond Market Transparency Committee (the “Bond Committee”), which is made up of debt market participants, including issuers, investors, dealers and inter-dealer bond brokers. The Bond Committee will meet with us to discuss issues regarding the development and implementation of the ATS Rules. We will ask the Bond Committee to provide input to the CSA on issues including, but not limited to, fairness, integrity, efficiency, market competitiveness and usefulness of information gathered and disseminated, and technology issues relating to the collection and dissemination of data. It is intended that the Bond Committee will meet regularly to discuss issues relating to the fixed income market.

4. MARKET INTEGRATION

As stated, we are imposing market integration requirements onto marketplaces in order to minimize any negative impact of having different marketplaces trading the same security. The market integration requirements are located in Part 9 of National Instrument 21-101.

⁴⁰ Subsections 10.2(7) and (8) of Companion Policy 21-101CP.

Because market integration is a complex task that raises significant technology challenges, we have developed a two-phased approach. The requirements for the first phase are contained in subsection 9.2(1) and section 9.3 of National Instrument 21-101. The first phase will continue until January 1, 2004 and will require that a marketplace establish an electronic connection to the principal market for each security traded on that marketplace before executing a trade in that security.⁴¹ An information processor will determine the principal market for each security by ascertaining which marketplace had the largest trading volume for that security in the previous calendar year, will provide written notice to the marketplaces trading that security and will make the determination of the principal market publicly available.⁴² If there is no information processor, the securities regulatory authorities will determine the principal market.

The second phase of market integration will begin on January 1, 2004. The second phase requires all marketplaces to establish an electronic connection to a market integrator or, if there is no market integrator, to establish an electronic connection to each other.⁴³ At this time, we will not mandate a specific method of achieving complete market integration. Instead, we plan to monitor the number of marketplaces that operate in Canada and whether they create electronic connections to each other. If the industry achieves complete market integration voluntarily, it may not be necessary to create a market integrator.

5. TRADING RULES AND MARKET REGULATION

A. National Instrument 23-101 Trading Rules

In the past, each of the recognized exchanges implemented trading rules designed to establish fair and equitable trading practices and to prevent abusive and manipulative trade practices. If ATSS are to be allowed to operate independently of recognized exchanges, they and their marketplace participants must also follow similar practices. To ensure that ATSS are not used to avoid rules regarding the integrity of the capital markets, we developed the Trading Rules. The Trading Rules include a prohibition against manipulation and fraud⁴⁴, a best execution obligation⁴⁵, audit trail requirements⁴⁶ and an obligation for ATSS, inter-dealer bond brokers and dealers trading unlisted debt securities to enter a contract with a regulation services provider.

The Trading Rules set out requirements that we consider the minimum requirements applicable to all marketplaces and participants in the market. These rules may not be sufficient to ensure the integrity of a

⁴¹ Subsection 9.2(1) of National Instrument 21-101.

⁴² Section 9.3 of National Instrument 21-101.

⁴³ Subsection 9.2(2) of National Instrument 21-101.

⁴⁴ Part 3 of National Instrument 23-101.

⁴⁵ Part 4 of National Instrument 23-101.

⁴⁶ Part 11 of National Instrument 23-101.

marketplace. Consequently, we will evaluate any rules proposed, or lack of rules proposed, by a marketplace or regulation services provider to determine whether they are sufficient and appropriate.

(i) Application of the Trading Rules

We have provided for an exemption from the application of subsection 3.1(1) and Parts 4 and 5 of National Instrument 23-101. The exemption applies to those persons or companies that comply with the rules, policies and other similar instruments established by

- a recognized exchange or recognized quotation and trade reporting system, if that exchange or quotation and trade reporting system conducts its own market regulation, or
- a regulation services provider for an ATS, inter-dealer bond broker, dealer trading unlisted debt securities outside of a marketplace or a recognized exchange or recognized quotation and trade reporting system that contracts with a regulation services provider.

This exemption ensures that recognized exchanges and their members, recognized quotation and trade reporting systems and their users and marketplaces that have entered into an agreement with a regulation services provider and their marketplace participants are not subject to duplicative requirements. However, if a person or company does not comply with the requirements of the recognized exchange, recognized quotation and trade reporting system or regulation services provider, then the person or company is not exempt from the Trading Rules. Subsection 3.1(1) of National Instrument 23-101 does not apply in Alberta, British Columbia and Saskatchewan because these jurisdictions have provisions in their legislation that deal with manipulation and fraud. Therefore, the exemption from subsection 3.1(1) does not apply in those jurisdictions and the relevant provisions of the legislation apply.

(ii) Short Selling, Frontrunning, Insider Trading of Securities of Foreign Non-Reporting Issuers, Order Exposure Rule and Principal Trading

We have removed these provisions from National Instrument 23-101. We believe that restrictions relating to short selling, frontrunning, insider trading of securities of foreign non-reporting issuers, principal trading and order exposure obligations are important and suitable for all markets. However, we are of the view that identical provisions are not necessarily appropriate for each type of market, marketplace or each type of security. Consequently, when a regulation services provider, exchange or quotation and trade reporting system applies for recognition, we will review its proposed rules to determine if these provisions are included and whether the specific provisions are appropriate in the context of that market, marketplace or security.

(iii) Requirements of the ATS Rules for the Regulation Services Provider, Marketplaces, Inter-Dealer Bond Brokers and Dealers Executing Unlisted Debt Securities Outside of a Marketplace

The ATS Rules contemplate that a regulation services provider will provide monitoring and enforcement services to marketplaces. The concept of a “regulation services provider” replaces the reference to “approved agent” in the 2000 Proposal. A regulation services provider is defined as a person or company that provides regulation services and is a recognized exchange, recognized quotation or trade reporting system or a recognized self-regulatory entity.⁴⁷ At this time, Market Regulation Services Inc. has filed a draft application for recognition as a self-regulatory organization. Please refer to Paragraph 5B(i) of this Notice for a discussion of the filing. In addition, the IDA has filed a proposal for debt market regulation. Please see Part 5B(ii) for a discussion of the IDA’s proposal.

(1) Requirements for a Recognized Exchange and a Recognized Quotation and Trade Reporting System

Part 7 of National Instrument 23-101 provides that a recognized exchange or recognized quotation and trade reporting system must set requirements governing the conduct of its members or users. The requirements set by the recognized exchange or recognized quotation and trade reporting system will be reviewed and approved by the securities regulatory authorities. The recognized exchange or recognized quotation and trade reporting system has the option to monitor and enforce those requirements directly or it may contract with a regulation services provider to do this on its behalf. The requirements of a recognized exchange or recognized quotation and trade reporting system that monitor and enforces its own requirements directly may be different than those set by the regulation services provider for other marketplaces. A recognized exchange or recognized quotation and trade reporting system that does not monitor and enforce its own requirements must contract with a regulation services provider and use the services provided by the regulation services provider. Those services include using the rules of the regulation services provider.

(2) Requirements for an ATS

Part 8 contains the market regulation requirements that apply to an ATS. A regulation services provider must set requirements for an ATS. An ATS cannot execute a subscriber’s order unless the ATS has executed, and is subject to, certain written agreements. The first agreement is an agreement between the ATS and a regulation services provider. The agreement must provide that:

⁴⁷ Section 1.1 of National Instrument 21-101.

- the ATS will conduct its trading activities in compliance with the requirements of its regulation services provider,
- the regulation services provider will monitor the conduct of the ATS and its subscribers,
- the regulation services provider will enforce its requirements against the ATS and its subscribers,
- the ATS will comply with the record keeping requirements in National Instrument 21-101, and
- the ATS will comply with all orders or directions made by the regulation services provider.⁴⁸

Second, the ATS must enter into an agreement with each subscriber that provides that:

- the subscriber will conduct its trading activities in compliance with the requirements of the regulation services provider,
- the subscriber acknowledges that the regulation services provider will monitor the conduct of the subscriber and enforce its requirements against the subscribers, and
- the subscriber will comply with all orders or directions made by the regulation services provider, including orders that exclude the subscriber from trading on any marketplace.⁴⁹

(3) *Requirements for an Inter-Dealer Bond Broker*

Part 9 of National Instrument 23-101 contains the market regulation requirements that apply to an inter-dealer bond broker. The regulation services provider must set requirements for the inter-dealer bond broker. The inter-dealer bond broker must enter into a written agreement with the regulation services provider that provides that:

- the inter-dealer bond broker will conduct its trading activities in compliance with the requirements of the regulation services provider,
- the regulation services provider will monitor the conduct of the inter-dealer bond broker,
- the regulation services provider will enforce its requirements against the inter-dealer bond broker, and
- the inter-dealer bond broker will comply with all orders or directions made by the regulation services provider.⁵⁰

(4) *Requirements for a Dealer Executing Trades of Unlisted Debt Securities Outside of a Marketplace*

⁴⁸ Section 8.3 of National Instrument 23-101.

⁴⁹ Section 8.4 of National Instrument 23-101.

⁵⁰ Section 9.2 of National Instrument 23-101.

Part 10 of National Instrument 23-101 contains the market regulation requirements for a dealer trading unlisted debt securities outside of a marketplace. These requirements mirror the requirements that apply to an inter-dealer bond brokers in Part 9.

(iv) Regulation of the Debt Market - Exemption

National Instrument 23-101 provides ATSS trading unlisted debt securities, inter-dealer bond brokers and dealers trading unlisted debt securities outside of a marketplace an exemption from the requirement to enter into an agreement with a regulation services provider if the ATS, inter-dealer bond broker or dealer complies with IDA Policy No. 5. This exemption does not apply after December 31, 2003. We have provided this transitional exemption to ensure that dealers are subject to market regulation during the period between the effective date of the ATS Rules and the recognition of a regulation services provider for unlisted debt securities market. For more details, please see section B(ii) below.

B. Market Regulation by a Regulation Services Provider

In July 2000, the CSA published the ATS proposal without taking a position on how market regulation should be performed for the equity market. The request for comment invited industry participants to consider possible solutions. The CSA made it clear that it was willing to participate in discussions but was looking to the industry to propose alternatives for market regulation in the equity market. Eight commenters argued in favour of either direct regulation by the CSA or regulation by an independent self-regulatory organization (“SRO”).

In choosing a market regulator model, we will look at the following factors:

- Regulation should clearly and effectively address legitimate concerns without unnecessarily restricting competition.
- The primary objective of the regulatory framework should be to promote open and effectively competitive markets.
- The regulatory environment should neither favour nor constrain the ability of particular market participants to compete in the market.
- The regulatory process should be impartial and not self-serving i.e. the governing body should broadly represent all aspects of the industry being regulated.
- Governance of an SRO should ensure the transparency of self-regulatory activities i.e. independent public membership should balance industry representation on the SRO’s board of directors.
- An SRO should institute a formal complaint handling process.
- A regulatory scheme should allow for periodic assessment of its effectiveness and be subject to

regular reviews, such as audits and the filing of annual reports.

(i) *Exchange-Traded Securities and Foreign Exchange-Traded Securities*

In response to the request for comment on the market regulation issue, the Toronto Stock Exchange (the “TSE”) and the IDA outlined a proposal to regulate marketplaces trading exchange-traded securities and foreign exchange-traded securities. At the same time, TSE Regulation Services and the Canadian Venture Exchange Inc. developed the Universal Market Integrity Rules (the “UMI rules”). Those rules were published for comment on April 20, 2001. We expect that the proposed regulation services provider will adopt and administer the UMI rules.

Market Regulation Services Inc. (“RS Inc.”), a corporation to be jointly owned by the TSE and the IDA, has filed a draft application for recognition as a self-regulatory organization and as a regulation services provider. Once finalized, we will publish it for comment.

Initially, we expect that RS Inc. will provide regulation services to the TSE, CDNX and other marketplaces that retain its services. We are examining the application to determine if it is not contrary to the public interest to recognize RS Inc. as a self-regulatory organization. In reviewing the application, we are considering a number of factors, including:

- the factors identified above,
- the proposed ownership structure of RS Inc.,
- the proposed governance structure of RS Inc.,
- the applicability of the proposed UMI rules to a variety of marketplace models (auction markets, call markets, etc.), and
- the ability of both initial owners of RS Inc. to avoid or manage situations of conflicts of interest or the appearance of conflicts of interest relating to the self-regulatory obligations of RS Inc.

We expect that ATSS will contract with RS Inc. to monitor and enforce the UMI rules.

We note that we will review the requirements adopted by any regulation services provider, including RS Inc., to ensure that the requirements are appropriate.

(ii) *Unlisted Debt Securities*

Currently, all IDA member dealers trading domestic debt are subject to IDA Policy No. 5. We have received a proposal from the IDA to provide regulation services to ATSS, inter-dealer bond brokers and

dealers trading unlisted debt securities. This proposal is based on the requirements in IDA Policy No. 5. Until the proposal is finalized, we have provided an exemption to ATSS trading unlisted debt securities, inter-dealer bond brokers and dealers trading unlisted debt securities outside of a marketplace from the requirement to enter into an agreement with a regulation services provider if the ATS, inter-dealer bond broker or dealer complies with IDA Policy No. 5. IDA Policy No. 5 provides a regulatory regime that is tailored to the domestic debt market. It requires that dealers have standards and procedures relating to the trading of unlisted debt securities, that dealers ensure that their personnel are properly trained and qualified and that internal controls are in place to ensure that customer dealings are carried out on a confidential basis. As well, the policy sets out specific requirements for dealing with customers and counterparties, standards relating to market conduct, enforcement provisions and specific reporting requirements.

We have provided an exemption for ATSS trading unlisted debt securities, inter-dealer bond brokers and dealers executing trades of unlisted debt securities outside of a marketplace from having to enter into an agreement with a regulation services provider pursuant to NI23-101. This exemption does not affect the requirement for an ATS to become a member of the IDA or the requirement for ATSS and dealers that are members of the IDA to comply with the IDA's requirements. The exemption does not apply after December 31, 2003. Until that date, we will work with the IDA and debt market participants to develop and implement an appropriate structure for the regulation of the unlisted debt market. To that end, the CSA and the IDA will engage in a fact-finding exercise to identify and address any market integrity issues that may exist. Once the exercise is complete, we will determine if additional steps need to be taken to regulate the unlisted debt market.

C. Audit Trail Requirements

Part 11 of National Instrument 21-101 imposes recordkeeping requirements on marketplaces. These requirements require a marketplace to keep electronic records of certain information about orders and trades, among other things. An ATS is required to transmit information in electronic form to a regulation services provider when required by the regulation services provider.

Part 12 of National Instrument 23-101 sets record keeping requirements about orders and trades that are applicable to dealers. Dealers must transmit information to a regulation services provider when requested by the regulation services provider. We recognize that many dealers do not currently keep their records in electronic form. Consequently, we have given dealers two years to develop electronic recordkeeping capabilities. Between the implementation of the ATS Rules and December 31, 2003, we will facilitate discussions with the industry to determine the steps and the technology necessary to have all dealers move to electronic recordkeeping.

6. TRANSITIONAL PROVISIONS

We have included a number of transitional provisions into the ATS Rules. This section summarizes those provisions and cross-references the sections of this Notice where detailed discussions of the provisions can be found.

A. Transition for Transparency Requirements for Exchange-Traded Securities

Section 7.5 of National Instrument 21-101 provides an exemption for ATSS that trade exchange-traded securities from providing order and trade information to an information processor, if the information is provided to an information vendor at a reasonable cost. This exemption does not apply after December 31, 2003. Please see Part 3A of this Notice for a discussion of data consolidation requirements and the exemption.

B. Disclosure of Transaction Fees

Section 10.2 of National Instrument 21-101 provides an exemption for a marketplace that executes trades of exchange-traded securities and foreign exchange-traded securities from disclosing a schedule of transaction fees to the information processor provided that the marketplace makes the schedule of transaction fees publicly available. This exemption is not available after December 31, 2003.

C. Phase 1 and Phase 2 Integration

We have provided for two phases of market integration. The first phase will require marketplaces to connect to the principal market for the securities traded on the marketplace. This phase continues until January 1, 2004. On and after January 1, 2004, the second phase will require either all marketplaces to enter into an agreement with a market integrator, or if there is no market integrator, to establish an electronic connection to all other marketplaces. Please see Part 4 of this Notice for a detailed discussion of market integration.

D. Market Regulation

National Instrument 23-101 provides that an ATS trading unlisted debt securities, an inter-dealer bond broker and a dealer trading unlisted debt securities outside of a marketplace do not have to enter into an agreement with a regulation services provider if the ATS, inter-dealer bond broker or dealer complies with IDA Policy No. 5. This exemption does not apply after December 31, 2003. Please see Part 5A(v) and Part 5B(ii) of this Notice.

E. Audit Trail in Electronic Form

We are only requiring dealers to record and transmit information to a regulation services provider in electronic form after December 31, 2003. Please see Part 5C of this Notice for a detailed discussion of this deferred requirement.

7. IMPLEMENTATION OF THE ATS RULES

The effective date of the ATS Rules is December 1, 2001.

On that date, all ATSs currently operating in Canada must comply with the provisions of the ATS rules, including the requirement to be registered as a dealer in the appropriate jurisdictions.

If an ATS registered as a dealer in one jurisdiction in Canada provides access in another jurisdiction in Canada to subscribers who are not registered dealers under securities legislation, the ATS must be registered in that other jurisdiction. However, if all of the ATS's subscribers in the other jurisdiction are registered as dealers in that other jurisdiction, the securities regulatory authority in the other jurisdiction may consider granting the ATS an exemption from the requirement to register as a dealer under subsection 6.1(a) of National Instrument 21-101 and from the registration requirements of securities legislation.

8. QUESTIONS

Questions may be referred to any of:

Louyse Gauvin
Special Advisor to the Chair
British Columbia Securities Commission
(604) 899-6538 or (800) 373-6393 (in B.C.)

Robert Hudson
Manager, Capital Markets Regulation
British Columbia Securities Commission
(604) 899-6691 or (800) 373-6393 (in B.C.)

Glenda Campbell
Vice-Chair
Alberta Securities Commission

(403) 297-4230

Randee Pavalow
Director, Capital Markets
Ontario Securities Commission
(416) 593-8257

Tracey Stern
Legal Counsel, Market Regulation
Ontario Securities Commission
(416) 593-8167

Dave McCurdy
Technical Advisor
Ontario Securities Commission
(416) 593-3669

Diane Joly
Director, Research and Market Development
Commission des valeurs mobilières du Québec
(514) 940-2199, ext. 4551

Pierre Godin
Special Advisor to the Chair
Commission des valeurs mobilières du Québec
(514) 940-2199, ext. 4541

APPENDIX A

List of Commenters

The following submitted comment letters in response to the Request for Comments published on July 28, 2000:

1. Toronto Dominion Securities Inc. (“TD Securities”)
2. Commissioner of Competition, Competition Bureau (“Competition Bureau”)
3. RBC Dominion Securities (“RBCDS”)
4. Ontario Municipal Employees Retirement Service (“OMERS”)
5. Ontario Teachers’ Pension Plan Board (“OTPPB”)
6. Bank of Canada
7. Barclays Global Investors Canada (“Barclays”)
8. Investment Dealers Association of Canada Capital Markets Committee and IDA Primary Dealer Money Market Committee (“IDA Committees”)
9. Swift Trade Securities Inc. (“Swift Trade”)
10. Canadian Securities Traders Association (“CSTA”)
11. ITG Canada Corp. (“ITG Canada”)
12. Canadian Pacific Investment Management Limited (“CPIM”)
13. Shorcan Brokers Limited (“Shorcan”)
14. Instinet Canada Limited (“Instinet Canada”)
15. Investors Group
16. The Canadian Depository for Securities Limited (“CDS”)
17. Bloomberg L.P. (“Bloomberg”)
18. Canadian Venture Exchange (“CDNX”)
19. Investment Dealers Association of Canada Equity Trading Committee (“ETC of IDA”)
20. Toronto Stock Exchange Inc. (“TSE”)
21. Instinet Fixed Income Inc. (“IFI”)
22. Ministry of Finance and Corporate Relations, British Columbia

SUMMARY OF COMMENTS RECEIVED AND CSA RESPONSE

DATA CONSOLIDATION

Definition of “data consolidator” and “information processor”

CDS - CDS requests that the definitions of “data consolidator” and “information processor” be clarified so as to reflect the distinction between the equities market and the fixed income market. They ask that the definitions be revised so that it is clear that the “information processor” role only pertains to fixed income securities.

CSA Response: The CSA have decided to use one term “information processor” to describe the person or company that receives and distributes information. An information processor will collect and disseminate information for both exchange-traded securities and unlisted debt securities.

Five levels of information

ETC of IDA - The ETC is concerned that the requirement to display five levels of independent bid and offered prices in a decimal pricing systems may not be what the marketplace requires and may require a technology infrastructure more sophisticated and more costly than systems currently operational in equity markets. It may suffice to state the ultimate objective but simply require the publication of a national best bid/offer by the consolidator in Phase 1 and provide data vendors with the ability to create more complex market data displays.

CSA Response: The specific requirements in NI 21-101 have been modified to state that the information to be displayed by the information processor will be in accordance with requirements set by the information processor. Through the use of an advisory committee, the CSA and information processor will determine the appropriate level of information that will be displayed. However, the CSA are of the view that at least five levels of information must be shown, if it is available.

Leave data consolidation to the industry

TSE - The TSE believe that the basic objectives of data consolidation can be achieved by using a phased approach employing existing infrastructure at a lower costs, provided that the CSA is flexible on the manner in which the data consolidator is organized and distributes the consolidated feed. The TSE recommends that the CSA mandate objectives of data consolidation but leave it to the markets and industry to best determine how to implement them.

CSA Response: In order to see how the market develops, the CSA are requesting that the industry propose the appropriate model for data consolidation. The CSA have provided an exemption from the requirement to provide information to the information processor to those marketplaces that execute trades of exchange-traded securities. The exemption is not available after December 31, 2003. The industry has until that date to develop and implement a system that consolidates data.

Question 1:

TD Securities - TD Securities believes that any omission of broker designations on trades could

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

lead to misinformation, decreased information transparency and reduced competition among market participants. TD Securities believes that broker numbers promote competition in the marketplace and play an important marketing and business enhancing role in the Canadian brokerage community.

OTPPB - For *equity securities*, broker numbers should be collected by the data consolidator. The broker numbers should be disseminated by the data consolidator. When an institution wants to transact a large block of stock, it will determine which broker has been active in that stock. Without this information, institutions are forced to search for that broker, thus providing information to a number of market participants. This may lead to the movement of the price of the stock and may lead to guess-estimates of the size of the order which may lead to more volatility. The customer should not be able to decide whether the broker ID is disseminated.

For *fixed income securities*, the question assumes brokers will facilitate all trades. This is not necessarily the case. A marketplace may be established that allows direct client to client transactions. These client to client transactions may or may not be on a name give-up basis. Commitment to traditional industry structures is not required. Activity levels of identified participants should not be disseminated, other than perhaps activities in Government of Canada bonds by primary dealers.

Barclays - Broker ID numbers should be collected and disseminated by the data consolidator. Without this information, investors have to approach many dealers, leading to less favourable market conditions for large trades. In addition, settlement quality and credit quality of the broker can be important factors in deciding when to execute trades. It is also important to collect broker ID numbers to aid in compliance and investigations. Customers should not be able to decide whether broker ID numbers are disseminated.

CSTA - Yes. It is imperative that the data consolidator provide as much relevant information as possible including broker ID numbers. Broker ID numbers are an important source of information, without which there will be decreased information transparency and competition for all market participants. Broker ID numbers play an important marketing and business enhancing role for the brokerage community, provide early and effective indications of unfair trading activity and are used extensively to monitor trades and traders by both the buy side and the sell side compliance officers. Customers should not have the ability to decide whether the broker ID number is disseminated.

ITG Canada - As a general rule, broker ID numbers should be collected and disseminated, as it will improve information transparency and lead to increased competition among market participants. ITG Canada has some concern that the broker ID number could be used to piece together the identity of a client and as a result, believes that the client should be able to suppress the broker ID number.

CPIM - The collection and dissemination of broker ID numbers should be continued by a data consolidator. The transparency and integrity of the Canadian equity auction market is reinforced by the exposure of broker numbers on all trades. Clients should not have the ability to remove broker numbers.

Instinet Canada - Yes, as the collection and dissemination of broker ID numbers contributes to marketplace competition.

Investors Group - Broker identification should be collected and disseminated by the data consolidator. The customer should not be the one that decides whether it is disseminated.

CDNX - Broker ID numbers should be collected and disseminated by the data consolidator. In the junior market, this increases the possibility of the investor being able to identify and track the particular order in the marketplace. The information is also useful in helping to find liquidity quickly and efficiently.

CSA Response: *The CSA have determined that it is up to the marketplace to decide whether broker identification numbers will be provided to the information processor.*

MARKET REGULATION

Market Regulation - Equity

Question 2:

Who should provide market regulation for ATSS? Please provide reasons for your answer.

TD Securities - Stock exchanges have conflicts of interest precluding them from carrying out market regulation of competing trading systems. Attempting to address conflicts through “process-driven” solutions such as a separate board of directors is not a substitute for true independence. TD Securities believes that the solution is to transfer the regulatory functions to an independent SRO, like the IDA. Pending such a solution, TD Securities is prepared to support the TSE’s independent regulation services unit provided measures are put in place to address conflicts of interest and prevent the TSE from influencing the market regulator. The CSA has an important role in dealing with disagreements if the ATSS perceive that market regulation is not sufficiently neutral.

OTPPB - There are two avenues of market regulation. First, a separate market regulator should be established, independent of the exchanges and ATSS. The cost of funding the regulator could be covered by an imposition of a small tariff on trading. Second, the exchanges are in a conflict of interest with ATSS. Therefore, if they continue to have a regulatory role, it should be moved to a separate division or subsidiary.

Barclays - There are two preferences for the regulation of the equity markets. First, is for the CSA to provide direct regulation for exchanges and ATSS, with industry participation. The second preference is for a self-regulatory organization which will provide a level-playing field and will be overseen by the CSA. In either case, the cost can be financed by modest trading fees.

CSTA - Market regulation should be by the jurisdiction in which the ATS operates and resides. However, the regulation of ATSS by existing exchanges would raise a serious conflict of interest. One solution is for the ATS to be regulated by an SRO, like the IDA. Another solution is to see the exchanges move market regulation into separate divisions or subsidiaries.

ITG Canada - It is not clear that ATS could, at least initially, support the cost of establishing and operating a separate market regulator. Although ITG Canada shares the concerns that the regulation of competing trading systems by the exchanges may give rise to conflicts of interest, ITG Canada believes that these conflicts can be sufficiently mitigated where market regulation is performed by and by independent divisions or subsidiaries of the existing Canadian stock exchanges, provided that the surveillance functions are kept separate and apart from the “for-

profit” activities of the exchange. As well, appropriate measures, such as corporate governance protections, should be established and agreed to by industry participants.

CPIM - An independent market regulator should oversee all markets and should report to the CSA.

Instinet Canada - Stock exchanges have widely recognized conflicts of interest which they must confront before they can be considered. The equities market regulator must be publically committed to a position of neutrality, must have a corporate governance structure that is consistent with that public commitment and must agree to a form of oversight by CSA members that affords prompt resolution of any perceived conflict.

Investors Group - The regulation of ATSs should not be placed in the hands of an organization that is in competition with them. Therefore, exchanges should not regulate ATSs. It is far from clear that conflicts of interest concerns can be addressed by having the exchange set up a separate division to handle market regulation. The authority should be vested in an SRO that has expertise and independence to provide the regulation.

CDNX - The minimal trading rules set out in the ATS Proposal will become the Canadian standard. There is no reason to believe that any exchange or ATS will pay the cost of exceeding minimum standards unless there is a commercial reason to do so. CDNX believes that the most appropriate solution would be the establishment of a single market regulation SRO representing trading systems and the users of the systems. Alternatively, there could be more than one SRO that would develop common trading rules and practices on core issues. Ideally, a new national regulator or a few regulators formed by Canadian SROs with appropriate organizational structures to avoid the perception of and risk of conflicts of interest would provide market regulation for ATSs.

Bloomberg - Bloomberg thinks that there is no self-evident answer to the question of market regulation in the Canadian securities market.

ETC of IDA - Representatives of the ETC and TSE have proposed a possible solution to the market regulation issue. They propose to create an affiliated corporate structure with management reporting to an independent Board of Directors. In the opinion of the ETC and TSE, the proposed structure addresses conflict of interest concerns via the governance model, provides a formal linkage to the member regulation SRO (the IDA), maintains a significant linkage to the principal marketplace (the TSE) and provides an avenue for bringing in other exchanges into the structure. The ETC suggests that it will be important that the CSA assign one principal securities commission with lead responsibility for senior equities, one for derivatives and one for the growth market.

TSE - The TSE believes that it is imperative that all market centres be covered by the SRO system to ensure high standards of conduct and market integrity across all markets in Canada and to provide a fair basis for competition without providing incentives to compete based on lower standards of market regulation. The TSE believes that the model proposed by the TSE and IDA will ensure investor protection and vigorous competition for trading services and promote an efficient, responsive equities market in Canada. The TSE argues that U.S. ECNs are regulated by

NASD-R, which is considered to be a competitor. The TSE states that it does not carry out a member regulation function, but rather focusses on the regulation of equity markets. Notwithstanding this, the TSE has proposed to house Regulatory Services in a separate company. The TSE's proposed solution is akin to Nasdaq's except that, in the view of the TSE, the scope of potential conflicts is narrower in the TSE's case. The TSE submits that ATSs must be required to join an SRO that will have full powers to regulate all marketplaces and market participants or register as an exchange.

TSE Regulation Services Inc. is not intended to regulate the business operations of marketplaces, but to set standards of market integrity. The rules proposed will apply to all marketplaces. If created, Regulatory Services should adopt rules that address the substance of the framework rules at a self-regulatory level. The CSA would not need to establish the trading rules. These rules will be harmonized with other SROs, like CDNX. The current model is designed to accommodate participation of other exchanges but it is initially designed to oversee trading in TSE securities. The CSA framework rules should be limited to those needed to cover activities of those outside SRO jurisdictions. Since ATSs would be members of the SRO, they would not have to contract with an approved agent., although that option should be available to an ATS that registers as an exchange.

Competition Bureau - Competition between stock exchanges and ATSs is in the best interest of consumers, the securities industry and the Canadian economy. A regulatory environment will stimulate innovation and encourage markets to be more responsive to the needs of participants. Industry self-regulation can also provide benefits in the public interest. Therefore, the Bureau does not oppose, in principle, industry regulation which can complement the *Competition Act* in establishing appropriate rules of conduct. However, self-regulation involves risks for the competitive process and therefore, the Bureau asks that a number of factors be considered. Regulation should clearly and effectively address legitimate concerns without unnecessarily restricting competition. The primary objective of the regulatory framework should be to promote open and effectively competitive markets. The regulatory environment should neither favour nor constrain the ability of particular market participants to compete in the market. The regulatory process must be impartial and not self-serving i.e. the governing body must broadly represent all aspects of the industry being regulated. Governance of the SRO should ensure transparency of self-regulatory activities i.e. independent public membership should balance industry representation on the SRO's board of directors. The SRO should institute a formal complaint handling process. A regulatory scheme should allow for periodic assessment of its effectiveness and be subject to regular reviews, such as audits, the filing of annual reports. Care must be taken when delegating enforcement powers to SROs.

CSA Response: The CSA are considering the TSE/IDA proposal. Factors to be considered in determining if the proposed entity should conduct market regulation will include the corporate governance structure and the scope of its activities. The CSA will closely monitor any entity performing a market regulation function to ensure conflicts of interest are appropriately addressed.

**Market Regulation -
Fixed Income**

TD Securities - TD Securities submits that it is premature to give excess consideration to the selection of a market regulator for all participants in the debt market until the full implications of the ATS Proposal have been determined.

Question 3:

Is it appropriate for the IDA to assume the role of market regulator for all participants in the debt market?

OTPPB - Market regulation for ATSS should not be provided by the IDA. Members of this group act as principals and would not be expected to act in an objective manner. Concerns for fair treatment for all sides would be better answered by an independent body, such as the OSC. Further, the fixed income market is a market of sophisticated investors, many of which do not feel well represented by the IDA. In general, institutional money managers should not be regulated or represented by investment dealers, their agents or organizations associated with them who are direct market competitors.

Barclays - No. There are many participants in the debt market and an SRO based on broker interests is not appropriate as the regulator of the entire marketplace.

Bank of Canada - The Bank of Canada is not aware of the compelling reasons for market regulation to be introduced in the fixed income markets. They suggest a thorough examination of the costs and benefits. While the IDA may be a possible entity to be the market regulator, the Bank of Canada has some concerns. The IDA has regulatory jurisdiction over its members, which are only a sub-set of fixed income market participants. It would be necessary for the IDA to gain jurisdiction over all participants in the market. It is not clear how this would be accomplished. As well, the ATS Proposal implies a type of market surveillance that the IDA does not currently provide and may not be able to provide given its current structure and the level of resources that it applies to the task of surveillance.

CPIM - The IDA should not be the market regulator for fixed income. There are many participants in the debt market whose interests conflict with the interests of the members of the IDA.

Shorcan - Shorcan believes that the IDA has a natural and long-standing interest in the Canadian debt markets. If the IDA is to assume the role of market regulator, the IDA must publically confront and address the potential for conflicts of interest presented by the fact that the IDA members are intimately involved in the debt market, are likely to be sponsors of ATSS in the fixed market, competing with IDBs and may take part in IDA committees that directly regulate or propose rules for the regulation of the fixed income market. The use of independent directors, independent staff or some other means must be introduced to ensure fairness to all stakeholders. Members of the IDA must suggest solutions to reconcile conflicts that may arise from simultaneously participating in the formulation of regulation, the establishment of transparency vehicles such as CanPX and acting as customers and owners of IDBs.

Investors Group - The IDA has a role to play in the regulation of participants in the debt market, although, perhaps others like the Federal Office of the Superintendent of Financial Institutions should also be involved. Given that the IDA is controlled by its members, many of whom are active in the debt market, conflict of interest concerns could be addressed by having the IDA spin off its regulatory aspects, like NASD-R.

CSA Response: *The CSA recognize the potential existence of conflicts of interest that exist in any self-regulatory organization. The role of the regulator, through its oversight, is to ensure that these conflicts do not result in decision-making that is contrary to the public interest and that the corporate governance structure is appropriate.*

SECURITIES TRADED ON AN ATS

Restrict trading on ATSS

CDNX - It is CDNX's position that by not requiring issuers to be listed on an exchange or registered with a securities regulator, the potential for reputational damage to the Canadian capital markets is significant. CDNX is concerned that there may be an assumption that all Canadian companies will be listed on a Canadian exchange or foreign stocks will be listed in a jurisdiction with comparable standards. The ATS Proposal allows those companies that want to avoid scrutiny to go public outside of the closed system and make a Canadian ATS their principal or sole marketplace, while avoiding the reporting issuer obligations in securities legislation. CDNX proposes that the solution to this problem is to amend the ATS Proposal to restrict trading to issuers listed in an enumerated list of recognized jurisdictions. To do so will mean that in order to be competitive, an exchange will have to adjust its standards to world norms. In the opinion of CDNX, this would mean a significant change for CDNX, which has the most significant regulation of any exchange.

ETC of IDA - While the ETC is generally supportive of the deletion of the definition of "ATS security", it suggests that ATS trading be limited to listed and unlisted securities of Canadian reporting issuers and foreign securities listed on a bona fide foreign stock exchange.

TSE - The TSE recommends that ATSS should not be permitted to trade securities of issuers which are not listed on an exchange (Canadian or foreign) recognized as having acceptable listing requirements and sound regulatory oversight of its listed issuers. This would prevent ATSS from becoming a new home for trading in unlisted penny stocks.

CSA Response: *The CSA have amended the rule so that ATSS are only permitted to trade exchange-traded securities (as defined in the Instrument), government and corporate debt securities and foreign exchange-traded securities.*

INFORMATION TRANSPARENCY REQUIREMENTS

Equity vs. Fixed Income

TD Securities - The fixed income markets in Canada are multiple-dealer, debt markets with sophisticated participants. These markets are inherently decentralized and there does not exist a primary or central marketplace for fixed income trading. The model proposed in the ATS Proposal is designed based on equity markets and not fixed income markets.

RBCDS - RBCDS states that much of the terminology used in the ATS Proposal is not applicable to the bond market and the model of a centralized market with customer limit orders improving the bid-ask is equity specific.

OTPPB - Fixed income markets are different from equity markets. Major differences come from the characteristics of each market and position risks.

IDA Committees - The structure of the debt and equity markets in Canada are fundamentally different and demand different trading rules and organizational framework. These differences also have different implications. By moving beyond the wholesale marketplace to include requirements applying to market makers and other marketplaces, CSA staff have failed to take fully into account certain characteristics of debt markets, notably that dealing prices on many debt securities are made on demand and not part of a continuous and regular market-making process, prices vary

significantly by individual transaction size, that prices are often discontinuous and that debt prices signal underlying inventory positions in dealing books.

Shorcan - The underlying nature of the equity and fixed income markets are different. The equity market is better suited to the concept of an integrated limit order book than the fixed income market.

IFI - It is IFI's belief that the ATS Proposal is heavily influenced by the needs of the equity market. Some aspects of the proposal would be detrimental to the fixed income markets and the ATSS participating in them.

CSA Response: *The CSA acknowledge in the ATS Rules that the fixed income market is different than the equity market. The debt market is mostly an over-the-counter dealer market and the CSA recognize that different treatment is necessary. Therefore, different information transparency and market regulation requirements have been imposed on the fixed income market.*

**Information
Transparency
Requirements for
Debt Securities and
Liquidity**

TD Securities - While the ATS Proposal will increase transparency, the resulting environment may significantly reduce the willingness of dealers to play the market-making role by lowering bid-ask spreads to the point where the risk for a market maker associated with supplying continuity to a market is simply not adequately rewarded.

RBCDS - RBCDS believes that increasing transparency to the level of real-time full disclosure of all trades will seriously reduce the liquidity of the market. Market liquidity is reduced if the identity of the seller and buyer are revealed to the market and price discovery does not depend on this knowledge.

OMERS - OMERS is concerned that broker/dealers may be reluctant to commit capital currently employed in an entirely transparent system. OMERS is generally in favour of better disclosure and reporting practices for the Canadian securities markets. However, they have concerns that the ATS Proposal mandates a higher level of transparency of the debt markets than anywhere else in the world and will have a negative impact on liquidity.

OTPPB - Publishing names and transactions could seriously damage liquidity in the fixed income markets because the potential counterparty to a hedging strategy will be reticent to take on a position if the position is to be revealed to the market. The premise that transparency is of primary importance is wrong. Liquidity and the ability to derive a relative value analysis is of primary importance. Transparency is only important in auction processes and dealing practices.

IDA Committees - Since quoted bid and offered prices relate to underlying inventory positions of dealers, display of this information would expose dealing positions and make market makers reluctant to quote prices on a continuous basis, thus damaging liquidity and the price discovery process. Exposure risks would be more pronounced in less liquid markets suggesting that mandated display of market data on corporate securities would have serious repercussions for liquidity. Further, the display of this dealing information could signal trading intentions of institutional investors that could discourage their participation in secondary markets. Reduced trading activity by dealers and investors will widen bid-offered spreads and raise borrowing costs.

Bank of Canada - The CSA's transparency requirements for fixed income markets are extremely far-reaching compared to the requirements in other countries. It is predominantly the proposed increase in *post-trade* levels of transparency that poses a potentially detrimental impact on the liquidity of the fixed income market. The real-time display of customer-dealer trades has two interrelated detrimental effects on the dealer's willingness to provide liquidity. First, it reduces the dealer's desire to compete for customer order flow since they can no longer profit from their proprietary order flow information. Second, is that the market becomes instantaneously informed about the potentially large customer orders hitting the market. This causes the dealers, who conduct principal trading and not agency trading, to incur greater inventory management risks as other dealers who observe this order flow will pre-emptively move their quotes in the inter-dealer market, which raises the dealer's inventory risk management costs. These costs will be passed onto institutional investors in the form of wider bid-ask spreads and smaller depth, thus reducing market liquidity. The reduction in market liquidity can be mitigated by allowing some degree of delayed trade reporting, which allows dealers time to lay off their inventory risk at lower cost and by reducing the precision of the information on the size of the order transacted, which helps keep the incentive for dealers to compete for customer order flow intact.

Pre-trade transparency - The ATS Proposal requires IDBs to provide information on all securities traded to the information processor. This amounts to an institutionalization of CanPX and is unlikely to be contentious. The requirement for market makers to provide information is difficult to interpret. While customers do place limit orders with dealers, one does not usually think of market makers placing orders in that sense (except with IDBs). The Bank of Canada is of the view that the CSA must clarify some ambiguities in the ATS Proposal. In the customer sphere, "market maker order" would most likely be the quotes on securities that dealers offer in response to customer requests or firm quotes on smaller trade sizes posted by dealers on some securities. The problem is that dealers in the fixed income market do not continuously offer quotes. If market makers are required to submit quotes that they make, the entire market will know that someone is looking to buy or sell a certain amount of a certain security. Under this scenario, post-trade information is redundant. The Bank of Canada has long advocated increased transparency in fixed income markets from a base of near-zero transparency. However, there is evidence that some positive amount of quote and trade disclosure improves market efficiency and liquidity but that too much will negatively impact markets.

BC Ministry of Finance and Corporate Relations - As an issuer of debt securities, the Province of British Columbia is concerned that some of the proposed changes may result in a fundamental change in the operation of the Canadian fixed-income market, which we believe will have a negative impact. The proposed changes of most concern are those that are aimed at enhancing transparency and liquidity in the Canadian fixed-income market. It is our belief that some of the transparency requirements being put forth will actually reduce liquidity in the Canadian fixed-income market. In particular, we believe that the requirement of complete and immediate pre- and post-trade transparency will make dealers less likely to make markets in fixed-income securities. This will obviously affect liquidity in the fixed income market and that ultimately will negatively impact costs for market participants in this market. We are concerned that the effect on market liquidity will be felt to a greater degree in less liquid markets, such as the provincial markets.

As the issuance of government debt has grown less frequent in the last few years, liquidity in

these securities has continually become more of an important factor in the determinant of a security's value and also our cost to issue these securities. In recent years, the Province of British Columbia has been working towards creating liquid benchmark bonds in the market, and for which dealers are willing to actively make markets. The changes outlined in the ATS proposal would undermine this effort and inevitably increase issuance costs for the province.

CSA Response: *It is the intent of the CSA to move forward on the ATS and IDB requirements for transparency. CanPX has filed an application to become the information processor for unlisted debt securities. The CSA have refined the transparency requirements for the fixed income market to reflect discussions with market participants, issuers, the Bank of Canada, the IDA and the Department of Finance. These adjustments reflect the unique nature of the debt market and the fact that it is an over-the-counter dealer market.*

Lack of initial data consolidation and market integration

CDNX - CDNX is concerned that the ATS Proposal does not require that data consolidation and market integration be operational when the National Instruments are implemented.

CSA Response: *Without any certainty as to which and how many marketplaces will be operating in Canada, the CSA are of the view that a transitional period for both data consolidation and market integration is appropriate.*

Display Requirements for Marketplaces

(National Instrument 21-101, Parts 7 and 8)

Bank of Canada - The trading of certain innovative trading systems are predicated on the assumption of zero pre-trade transparency, for example, periodic call auction systems. This type of system would presumably be prevented from operating in Canada under the ATS Proposal's pre-trade transparency requirements.

CSA Response: *The requirements for pre-trade transparency only require that marketplaces provide information to the information processor if the marketplace displays the pre-trade information to other participants in the marketplace. Those systems that run an anonymous call auction do not display orders and therefore are not subject to the transparency requirements.*

Exemption from Display Requirements for Debt Securities

Question 4:
Should there be an exemption from the display requirement for debt securities based on the value of the order or some other criteria? If so what should the criteria be?

(National Instrument 23-101, Part 6)

TD Securities - TD Securities is of the opinion that the CanPX approach should be used. Accordingly, TD Securities does not recommend an exemption from the display requirement based on the value of the order. Rather, in keeping with the CanPX model, the display requirement should be left to the discretion of the dealer because the dealer is the "customer" and the dealer's display preferences should be respected. The CanPX model makes transparent on a real-time basis all orders in relation to "designated issues" that are either displayed or completed through inter-dealer bond broker screens. Historically, however, bilateral trading activity between dealers away from the IDB obligation has not been the subject of display requirements and should remain that way because it achieves the right balance between the customer's need to access the inside market's bid/ask spread and the dealer's need to manage its own position.

OTPPB - Presentation of transactional information from an electronic marketplace in standardized and relatively liquid securities such as benchmark GOC bonds is sufficient. A requirement of full disclosure on all activities is not necessary and could substantially reduce the efficiency of the market. Where information is available on blocks of illiquid securities, its presentation should be limited to transactions of a minimum size, i.e blocks of \$5 million+ traded. The display of large block orders is not advisable in the debt market.

Barclays - Yes. The criteria should be based on the dollar value of the order. This threshold may need to differ between government and corporate bonds.

CPIM - CPIM does not believe that there should be a display requirement for debt securities. Transparency is useful to an investor only to the extent that it improves liquidity and/or efficiency. It is their opinion that their ability to execute in the debt market is high and so transparency in the debt market is likely close to optimal.

Investors Group - Clients should not be able to determine how much of their order is displayed. They should not have to display “intention”. All actual orders should be displayed and there should be no exemption based on value or other criteria.

CSA Response: The CSA have amended the transparency requirements for unlisted debt securities for IDBs. Although there will be no exemption from the display requirements for unlisted debt securities based on the value of the order, the trade volume to be displayed for corporate debt securities will depend on the value of the transaction.

Definition of Market Maker

OTPPB - The definition is appropriate. However, few players today will commit to providing a bid and offer at all times. There are a wide variety of practices followed by dealers and different spectrums of risk are assumed.

Question 5:

Is the definition of market maker appropriate?

Barclays - Yes.

IDA Committees - For many government securities, particularly securities issued by smaller provinces, municipalities and crown corporations, and virtually all corporate securities, including investment grade bonds, dealers quote selectively on demand from clients. For these securities, dealing activity would fall outside the definition of “market maker” and pre-trade and post-trade information would not be provided.

(National Instrument 23-101, section 1.1)

CPIM - CPIM agrees with the definition.

Investors Group - The definition would appear to be appropriate.

CSA Response: The CSA have removed the requirements applicable to market makers and have therefore deleted the definition of “market maker”. These requirements have been replaced with requirements applicable to dealers.

Timing of Providing Pre-Trade Information for Debt Securities

TD Securities - TD Securities believes that the CanPX model should be followed with the result that real-time rather than delayed data should be used. The only circumstance in which departures from real-time dissemination should be allowed is where there are compelling technological reasons.

Question 6:

Should requirements imposed on market makers to provide pre-trade information for the debt market be

OTPPB - The proposed obligation will work for orders that IDBs and ATs have but not for others. The obligation to present all trade interest is difficult to fulfil and not always applicable. The dealers already have a vehicle for the presentation of market interests in IDB screens. These, along with information available on ATs, is enough.

RBCDS -The definition of an order implies that a market maker who, upon request, verbally

implemented on a gradual basis? What information should be provided? When should this information be provided initially? If information is provided on an end of day basis, what time is appropriate? Is it appropriate to require this information be provided in real time in one year?

shows a customer a bid within the quoted market for securities must disclose the bid to the marketplace whether the transaction occurs or not. In fact, any time a market maker quotes a bid or offer which is inside the quoted market (posted on IDB screen), it must be reported. This will discourage all dealers from bidding or offering competitively and from accepting customer orders that are within the quoted market due to increased reporting requirements.

Barclays - The requirements imposed on market makers should not be imposed on a gradual basis. If the rationale for providing the information is to create more transparency and to draw out hidden liquidity, then providing it once per day does not serve that purpose. The information should include bid/offer, size, price and yield to maturity. Information should be provided in real-time or as close to real-time as possible. End-of-day timing precludes it from being pre-trade information. The information should be provided as soon as technically possible (sooner than one year).

CPIM - CPIM believes that market makers should not be required to provide pre-trade information. As customers, their ability to efficiently execute the most elementary transactions would be compromised if market makers had to provide pre-trade information.

Investors Group - Market makers should be required to provide pre-trade information on a real-time basis as soon as possible.

IDA Committees - If pre-trade and post-trade information is mandated, it would not be helpful to investors because most pre-trade prices would not be immediately executed and that intermittent dealing activity in these securities would result in a discontinuous pattern of pricing as market conditions change. As well, pre-trade and post-trade prices on debt securities depend on the transaction size, reflecting the inclusion of dealer mark-ups and settlement costs. Consequently, prices on similar debt securities can vary significantly. The information would be confusing to investors.

CSA Response: *IDBs and marketplaces will have to provide pre-trade information on government debt securities in real-time. At this time, there will be no dealer obligation to display pre-trade information regarding government debt securities or corporate debt securities.*

Pre-trade Information on only Most Liquid Debt Securities?

Question 7:

Should information only be required on a pre-trade basis for the most liquid debt securities or based on some other criteria? How should "most liquid" debt securities be defined? What

TD Securities - The information should be supplied in relation to all debt securities thought to be of importance. This result is achieved in the CanPX model by using the concept of "designated issues" i.e. preselected securities including benchmark issues for information display and dissemination.

OTPPB - It will be impossible to enforce capturing even a small portion of pre-trade information in the fixed income markets. Pre-trade information from clients to dealers should be presented only at the request of those who would wish to post their interests.

Barclays - Information should be required only for the most liquid debt securities. However, this does not preclude participants from providing information for other less liquid securities. The most liquid securities could be defined as GOC bonds, federal agencies and large provincial and corporate issues. Large issues would be those over \$250 million in size outstanding. This information should include bid/offer, size, price and yield to maturity.

information should be provided?

Investors Group - As much pre-trade information should be provided as possible. Restricting this to “the most liquid” debt security goes against this principle. Any definition of “most liquid” is problematic.

CSA Response: IDBs and marketplaces will have to provide pre-trade information on government debt securities in real-time. At this time, there will be no dealer obligation to display pre-trade information regarding government debt securities or corporate debt securities.

Timing of Providing Post-Trade Information for Debt Securities

TD Securities - TD Securities believes that the CanPX model should be followed with the result that real-time rather than delayed data should be used. The only circumstance in which departures from real-time dissemination should be allowed is where there are compelling technological reasons.

Question 8:
Should requirements imposed on market makers to provide post-trade information for the debt market be implemented on a gradual basis? If so, when should this information be provided in initially? If information is provided on an end of day basis, what time is appropriate? Is it appropriate to require this information be provided in real time in one year?

OTPPB - Post-trade information should consist of only summaries of transactions on IDBs or ATSS. Disclosure of all transactions is unfair since such information could easily be used to the investor or dealer’s disadvantage in illiquid securities without material benefit to the market.

Barclays - Information about post-trade information should be imposed on a gradual basis. It is less critical to draw out hidden liquidity than for pre-trade information. The information should be provided each trading day by 4:00 PM. It is appropriate to require this information within one year.

CPIM - A requirement to provide post-trade information, while useful for customers will almost certainly inhibit the willingness of market makers to enter into transactions in debt securities. It should be noted that there is no effective “end of day” in trading debt securities since they are traded globally. There is a gap of 2-3 hours after 5 pm New York time. Currently, a market maker who takes on a large position late in the day in Toronto, passes the book to Tokyo who then passes it to London. If required to display the trade information at the end of the day in Toronto, they would be forced to disclose their position before they had time to work it off.

Investor Group - As with pre-trade information, market makers should be required to provide post-trade information on a real-time basis as soon as possible.

CSA Response: IDBs and marketplaces will have to provide post-trade information on government debt securities in real-time. At this time, there will be no dealer obligation to display post-information regarding government debt securities. With respect to corporate debt securities, IDBs and dealers will initially have to provide trade reports for a list of at least 20 corporate securities. The trade reports must be reported within one hour of the trade. The list of corporate bonds may be expanded, depending on the effect of transparency on the market and the recommendations of the information processor. All information must be provided as required by the information processor.

Post-trade Information on only Most Liquid Debt Securities?

TD Securities - The information should be supplied in relation to all debt securities thought to be of importance. This result is achieved in the CanPX model by using the concept of “designated issues” i.e. preselected securities including benchmark issues for information display and dissemination.

Question 9':

OTPPB - With respect to post-trade information, information should be available on only the

Should information only be required on a post-trade basis for the most liquid debt securities? How would “most liquid” debt securities be defined?

most liquid debt securities - i.e. on GOC bonds.

Barclays - The more information the market has the better it will be served. The preference is to see this information provided for all securities, not just the most liquid ones.

Investors Group - Restricting any information to the most liquid securities is inconsistent with the principles of transparency. Again, defining “most liquid” would not be simple.

CSA Response: For government securities, trade reports will be required for benchmark and designated government securities and an initial list of at least 20 corporate securities traded by IDBs and dealers. These securities will be determined by the information processor and all information must be provided as required by the information processor.

Specific Display Requirements for Debt Securities

Question 10:

Should the CSA follow a similar approach [as the U.S.]?

TD Securities - The market for corporate bonds has traditionally represented a relatively insignificant portion of fixed income trading in Canada and the economic argument for providing a special reporting and transaction dissemination facility would have to be made to justify such a facility. TD Securities has no objection in principle to this innovation, provided that it is economically viable.

OTPPB - A similar approach is advisable.

Barclays - No. It is appropriate to see full information for all trades.

Investors Group - Trade report information should contain as much information as possible.

CSA Response: The CSA will implement a volume dissemination cap with respect to corporate debt securities traded by IDBs and dealers. Post-trade volume amounts of up to \$2million and \$2million+ for investment grade debt securities and up to \$200,000 and \$200,000+ for non-investment grade debt securities will be displayed. This approach is similar to the U.S. approach which requires display of trading volumes for investment-grade corporate debt securities up to \$5 million and above that amount, 5MM+ and for non-investment grade corporate debt securities up to \$2 million and above that amount, 2MM+.

Costs

RBCDS - RBCDS is of the view that real-time full disclosure will increase the costs for all participants. The ATS Proposal may improve price discovery for the small investor, but will do little for his execution costs while dramatically increasing the execution costs of institutional investors.

IDA Committees - Transparency efforts will lead to increased borrowing costs and significant costs that will be borne by the industry and investors. The CanPX project has cost IDA member firms \$500,000 since the early 1990's. Requirements to expand the systems to incorporate market information from dealing desks and ATSs will require expanded infrastructure and related expenditure. The significant costs of a modified CanPX system will not be recouped from the sale of information, causing costs to be absorbed by dealers or passed through to investors.

Bank of Canada - The transparency requirements will increase the market impact costs faced by both customers and dealers in the course of their trades. As liquidity in secondary markets falls, borrowing costs for issuers rise.

CSA Response: Commenters have provided no evidence supporting the contention that transparency will actually increase costs to investors, especially if bid-ask spreads narrow. It is not the intention of the CSA to impose a level of transparency that would significantly affect market impact costs. The CSA recognize that dealers may have costs to comply with the ATS Rules, but this is true whenever new requirements are imposed.

Current Market Information Available

RBCDS - RBCDS and many other dealers provide data intraday to Reuters, Telerate, Bloomberg or other information vendors, as well as end of day pricing to the Globe and Mail. The data includes data on all Government of Canada benchmark bonds and selected Provincial Government and corporate bonds. While not all-inclusive, the list of bonds quoted represents the majority of bonds traded by volume on most days. RBCDS believes that general market pricing is reasonably available to most market participants and that efforts should be focussed on consolidating this information before increasing the burden and cost of providing more detailed trade data.

IDA Committees - Market information for actively traded benchmark and “off-the-run” government securities from the liquid wholesale market, as provided by CanPX, provide an unambiguous reference or benchmark for institutional and retail investors to assess security value in the marketplace. The information is supplemented by indicative price information on actively traded bond and money market securities available through an array of internet websites and information service providers.

Bank of Canada - One source of price information available to customers in the inter-dealer sphere is CanPX. CanPX was designed to display the best bid and ask orders and transactions on Canada’s inter-dealer bond brokers (dealers have access to the information on any of the IDBs for which they have screens). While availability has been unpredictable, and the range of bonds on the system is limited, CanPX represents a significant step forward.

CSA Response: The CSA recognizes that CanPX information provides valuable information for government debt securities from inter-dealer bond brokers. It is the intention of the CSA to work with the information processor for unlisted debt securities to expand the securities shown on its screens to include corporate debt securities traded by dealers and IDBs and the unlisted debt securities traded by ATSS.

INTER-DEALER BOND BROKERS

Effect of Debt Market Transparency on IDBs

Shorcan - Shorcan and other IDBs are affected by the transparency introduced by CanPX to the brokered segment of the market. Over the years, 40% of the trades in Canadian government debt securities occur through IDB systems. The balance occur in the non-broker market, that is dealer/account trades plus dealer/dealer direct trading. If the impact of the CanPX system is to drain away trading volume from the brokered/visible segments of the market to the non-brokered segment, there will be implications. The disparity in transparency requirements between brokered and non-brokered segments of the market will have to be addressed and the regulatory approach should be revisited on the basis of fairness and the fact that the objective of transparency will be undermined by the drain off in liquidity in favour of the less transparent market. If electronic trading vehicles emerge which choose not to regulate themselves as IDBs, and therefore escape from having to contribute to CanPX, the burden of providing transparency would have been shared inequitably among market participants, with IDBs shouldering a large burden.

CSA Response: The CSA agree that to the extent it is appropriate, similar levels of transparency should be imposed on all marketplace participants. The ATS Rules provide that all marketplaces and IDBs provide information relating to government debt securities. In addition, IDBs and dealers will provide the same amount of transparency for corporate debt securities.

Question 12:
Is Regulation 2100 of the IDA still appropriate?

TD Securities - Though current IDBs will not be regulated as marketplaces under the ATS Proposal, it will still be possible for new ATSs to operate in the fixed income market. If the ATSs are configured so that the current customers of dealers can interact with other customers of dealers, the structure of the current market will be so radically changed that Regulation 2100 may be too narrow and IDB specific to be of continuing utility. It seems possible that parties not currently eligible to participate in IDB systems would have an incentive to form ATSs which would put IDA members subject to Regulation 2100 at a disadvantage.

OTPPB - This prohibition is no longer appropriate. Activity on IDB screens is largely public in today's debt markets anyway.

Barclays - The portion of Regulation 2100 that prohibits inter-dealer bond brokers from dealing with anyone other than IDA members and Canadian chartered banks is no longer appropriate. It would prevent such brokers from becoming ATSs.

Investors Group - The rules should not prevent inter-dealer bond brokers from becoming ATSs, as long as concerns about credit worthiness are effectively addressed.

Shorcan - Regulation 2100 is specific to the market as it exists today. If ATSs emerge which give institutional purchasers of fixed income instruments greater participation in the wholesale market than they currently enjoy, it is likely that Regulation 2100 will have to be significantly overhauled or abandoned in favour of the ATS Proposal.

CSA Response: The CSA have requested that the IDA amend Regulation 2100.4(a). An IDB is now provided with the choice of maintaining its status as an IDB under the rules of the IDA or becoming an ATS and being governed by all of the requirements imposed onto marketplaces under the ATS Rules. If the IDB chooses to become a marketplace, the IDB will be exempt from Regulation 2100 and IDA by-law 36.

INFORMATION PROCESSOR

(National Instrument 21-101, Part 15)

Requirements for the Information Processor

Question 11:
Are there any other requirements that should apply to the information processor?

TD Securities - TD Securities notes that the decision was made to proceed with the appointment of an information processor without resorting to a request for proposals. They suggests that the CSA review (i) a business plan with pro forma financial statements and estimates of revenue, (ii) a statement of whether the information processor will employ its own people or rely on third parties for outsourcing and (iii) provisions for the communication to the CSA of material changes to operations including commencement of new businesses, the completion of, or proposal to effect, a change of control transaction and the like. Exhibit K in Form 21-101F5 should deal explicitly with procedures for safeguarding the confidentiality of information received.

Shorcan - Shorcan submits that the role of the information processor should be strictly enough circumscribed that it does not emerge as a competitor of the very participants who are supplying

the data that makes it transparent. The information processor should not have a means or an incentive to use its role to enjoy an advantage over other market contributors with whom the processor may directly or indirectly be in competition.

Investors Group - It is unclear whether any additional requirements other than those proposed in the notice should apply to the information processor.

CSA Response: The CSA adopt the recommendation to review a business plan, statement of whether the information processor will employ its own people and provisions for the communication of material changes to the CSA. The role of the information processor is not intended to be a competitor of the participants who are supplying data. The CSA will conduct oversight on the information processor to ensure that all potential conflicts of interest are appropriately addressed.

MARKET INTEGRATION

Systems Solution

IFI - The ATS Proposal, as it relates to market integration, does not directly address certain technological implications. The connection between marketplaces must be acceptable to marketplaces and must not degrade the participating ATSs' systems by lowering their speed or making them less reliable. As well, interconnecting would be difficult, time consuming and expensive. ATSs each have their own technology platforms. The market integrator needs to work out a plan to ensure that the cost and time necessary to achieve connectivity is minimized. In addition, developing a suitable interface to other ATSs or to a market integrator should be a cooperative effort undertaken by the market integrator in consultation with ATSs so that there is minimal time lost in arriving at the correct interface solution.

CSA Response: The CSA imposed a staged approach in order to meet the needs of the market and its participants. The CSA are flexible as to the appropriate technological solution.

“Double Jeopardy” in Order Execution

IFI - One of the obstacles of posting bids and offers from other ATSs on an ATS is the “double jeopardy problem” which occurs if the bids and offers of competitors appears on its screens and on IFI's at the same time. It is possible that clients may respond to the same bid or offer at the same time, resulting in a purchase or sale of twice the amount actually available. Technical solutions are available to avoid such an outcome but such solutions can contribute to latency problems (time between posting of an order and its display to all participants) and create client frustration when they cannot immediately execute what they see on the screen while the system checks for double jeopardy events.

CSA Response: Each marketplace system must establish systems to avoid double jeopardy and to inform participants how to enter orders. When any marketplace sends an order to another system for execution, it should have a reasonable expectation that orders will be filled immediately.

Costs and Pricing

IFI - How will ATSs make a profit from transactions which cross their systems? Currently, ATSs use transaction pricing as a competitive tool. The market integration plan omits information necessary for ATSs to assess the financial viability of participating in the new system. Any protocol selected for achieving market integration must be articulated for and accepted by the ATS community to ensure that there is a reasonable assurance of acceptable revenue when orders are executed across marketplaces.

CSA Response: Market integration should not have a negative impact on an ATS's ability to charge prices and collect revenue in that the ATS will be able to charge a transaction fee for all trades executed in its system. The ATS should develop a business model that is not based on receiving orders from other markets but rather from receiving and executing orders on its own system.

Trade Integration

TSE - The TSE submits that there are three potential solutions for integrating trading in order to transmit marketable orders to the market centre with the best available price: (a) a central integrator which routes all orders across all marketplaces; (b) a distributed model which allows for multiple providers of best market order routing capabilities; and (c) a market centre approach, with each marketplace being capable of routing orders to another marketplace. All have advantages and disadvantages. A central solution, suggests the TSE, would provide all participants with the same routing facilities and will involve network transmission delays that impact the handling of orders.

CSA Response: The CSA have provided a model for Phase I Market Integration and will consider what model is the appropriate model for Phase II.

COMMENTS ON SPECIFIC SECTIONS OF NATIONAL INSTRUMENT 21-101

Definition of Marketplace

(National Instrument 21-101, Part 1)

Bloomberg - Bloomberg suggests that the definition of "marketplace" specifically include exclusions for single-dealer quotation systems, order-routing systems, systems that automate the activities of registered market makers and electronic bulletin boards, as done in Rule ATS in the United States. In addition, the CSA should provide guidance as to when order-routing systems would need to be registered as a dealer. Bloomberg is of the view that communication between dealers and their customers should not be regulated.

CSA Response: In Companion Policy 21-101CP, the CSA have specifically excluded single-dealer quotation systems, order routing systems and bulletin boards from the definition of marketplace.

Risk Disclosure

(National Instrument 21-101, section 6.8)

Swift Trade - The requirement for risk disclosure on foreign securities seems peculiar in the case of U.S. given the quality of the U.S. markets. It would slow down transactions because of the necessity to get an acknowledgment, unless they apply solely to the dealer.

Bloomberg - While the risk disclosure statement may be appropriate if the ATS were open to retail investors, subscribers to Tradebook are broker-dealers or institutional investors that do not require repeated reminders regarding the risks associated with trading on an ATS. If necessary with respect to non-retail investors, Bloomberg believes that this disclosure should be provided at the time that the customer becomes a subscriber of an ATS. In addition, requiring the disclosure before every order would impose a heavy burden on the ATS.

CSA Response: The risk disclosure does not reflect risk in any specific company, but is an attempt to identify the risk associated with trading in securities of issuers that are listed on exchanges outside of Canada. The CSA will clarify that the disclosure is to be provided at the time the customer becomes a subscriber of the ATS and before the customer places the first order for foreign securities.

Cross Trades

(National Instrument 21-101, section 7.1 and section 7.3 and Companion Policy 21-101CP)

Barclays - Barclays is of the opinion that in certain instances, the wording of the ATS Proposal is unclear as to how some trades would be treated. It is expected that some ATS trades will be in the nature of anonymous cross trades, whereby investors indicate volumes at which they would be prepared to buy and sell at a price which is referenced elsewhere and yet to be determined. Barclays asks that National Instrument 21-101 section 7.1 be clarified to indicate that an ATS that is a pure crossing network has no orders to display.

CSA Response: *It is not possible to provide clarification for new technology that may be developed. Any questions regarding the application of the ATS Rules should be addressed to staff directly. However, the CSA are of the opinion that for anonymous crossing networks, pre-trade information does not have to be provided.*

Disclosure of Transaction Fees for Marketplaces

(National Instrument 21-101, Part 10)

Barclays - Transaction or access fees of an ATS are frequently the only transaction fee involved in trading on that ATS with no further commissions. Comparison of an ATS price with the ATS transaction fee included to an exchange price without commission may lead to misleading interpretations of best bid and offer, with consequent impact on trading rules. The current ATS Proposal does not call for anything more than the publishing of transaction fee schedule with the data consolidator, and does not call for a combined price calculation. This is appropriate and the companion policy should be amended to clarify that this combined price is not intended to be calculated.

CSA Response: *The CSA agree with the comments and will change the Policy to clarify what is intended.*

ATS Trade Report Transmittal

(National Instrument 21-101, section 11.5)

TSE - The TSE does not agree with section 11.5 that allows an ATS to submit order and trade information to its approved agent with a delay of 90 seconds. The rule should be amended to state that the ATS must provide its information in real-time.

CDNX - The CSA should require that ATSs provide order and trade data feeds in real-time, and not in 90 seconds following execution.

CSA Response: *The Instrument has been amended to require that information be provided when required by the regulation services provider as required by the regulation services provider.*

Foreign Jurisdiction

(National Instrument 21-101, Part 14)

Swift Trade - The requirement that foreign ATSs register in at least one jurisdiction is an unreasonable trade barrier, does not benefit the capital markets or investor choice and would harm Swift Trade's business. In their opinion, it would create an unlevel playing field because there is no suggestion that foreign exchanges that deal directly or indirectly with dealers require registration. In their view, it would be impossible to satisfy the OSC and IDA requirements that require a Canadian incorporated entity and a local presence. If registration was required, it would force Canadian dealers to access U.S. ATSs through U.S. dealers, imposing unnecessary delays and administrative burdens.

Foreign ATS, if registered, would be subject to information consolidation, market regulation, market integration, clearing and settlement, audit trail requirements and other requirements that make no sense. Securities traded in foreign markets should not be subject to those requirements, including inter-listed securities. In Swift Trade's opinion, foreign ATSs or securities being traded in foreign markets should be carved out of the ATS proposal or current arrangements with foreign

ATSS should be grandfathered.

Bloomberg - Bloomberg believes that an ATS should not have to register as a dealer in a local jurisdiction if it were providing access to dealers and prescribed institutions.

CSA Response: *If these entities are carrying on business in a jurisdiction, they must be registered and regulated by the securities regulatory authority in that jurisdiction. However, if the ATS registered in a jurisdiction is dealing only with subscribers who are registered as dealers in another jurisdiction, the other jurisdiction will consider granting an exemption from registration to the ATS.*

Clearing and Settlement

(Companion Policy 21-101, Part 16)

CDS - Subsection 16.1(2) states that an ATS or its subscriber may report an executed trade to a clearing agency. This raises two issues. First, there is a risk of both the subscriber and the ATS reporting the trade. This will lead to duplicate trade reporting and confusion. CDS suggests that the ATS and the subscriber agree amongst themselves on who will report the trade. Second, the subscriber may or may not be a clearing agency participant. The ATS Proposal assumes that if the subscriber is not a participant, the ATS will report the trade. However, the subscriber may use a settling broker. CDS suggests that 16.1(2) be revised to enable the subscriber or its agent to report the trade.

CSA Response: *Part 13 of the Instrument has been amended to state that for subscribers registered under securities legislation, the ATS, the subscriber or an agent of the subscriber that is a clearing member of the clearing agency must report the trade. If the subscriber is not registered, the ATS or an agent of the subscriber must report the trade. The CSA have stated in the policy that the ATS will determine whether it or its subscribers will report the trade, will make the appropriate arrangements with the clearing agency and will inform the CSA how the trades will be reported and settled.*

Clearing and Settlement

(National Instrument 21-101, Part 13)

CDS - CDS requests that the word “confirmed” be deleted from section 13.1, as it is a term generally used to indicate an agreement of a trade done outside of an exchange. Trades done on an exchange do not need to be confirmed because they have been pre-matched as part of the operation of the exchange. Thus, CDS expects that the output of an ATS will be pre-matched trades to be reported to the clearing agency and those trades do not need confirmation.

IFI - It is unclear how the ATS Proposal will address legal obligations as between ATSS or between ATSS and the market consolidator, if a centralized approach is adopted. If the obligation is supposed to flow through an ATS or market consolidator, such that IFI would have to recognize the ultimate client of the other ATS as its counterparty, the issue that arises is how IFI can know in advance that it is dealing with an acceptable counterparty for whom sufficient credit limits have been established. On the other hand, if the obligation runs only to the other ATS or market consolidator, there is potential for risk concentration against one counterparty.

CSA Response: *The responsibility for ensuring appropriate clearing is on the ATS. The ATS shall ensure that the appropriate clearing arrangements have been made. The only possible counterparties are those that have access to the clearing agency (the ATS or the subscriber) or have retained an agent to act on their behalf. In the case of an agent, the agent would be a member of the clearing agency and meet all of the credit requirements of the clearing agency.*

FORMS

Form 21-101F3

Bloomberg - Bloomberg believes that quarterly trading information with respect to all Canadian and foreign securities traded on its system is over-inclusive and that more focussed reporting requirements are necessary. Bloomberg urges the CSA to limit the reporting requirements to securities where either the issuer is organized in Canada and has a trading market for its securities in Canada or the particular trade occurs on a Canadian exchange and the Canadian exchange is the principal market for the security.

CSA Response: The purpose of quarterly reporting is to keep track of all trading that occurs on marketplaces operating in Canada, no matter where the issuer is located.

CROSS-INTERFERENCE RULE - DISPLAY REQUIREMENTS

Exceptions Based on Number of Equity Securities or Preferred Securities

TD Securities - The decision to abandon the cross-interference rule and substitute display requirements need not carry with it an exception from the display requirements based on the number of shares traded. Order display requirements linked to order size tend to be specific to each particular market and it is hard to develop rules of general application that are fair and appropriate.

Question 13:

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

OTPPB - In the *equity market*, the sole exception to the cross interference rule should be based on the block of stock being handled - \$100,000 for equities and 100 contracts for options.

Barclays - There is a need for further exceptions based on number of shares traded. Sometimes, participants may need to trade a block of low-priced shares where the total value of the shares may not sum up to \$100,000, but where the trade involves a large portion of the available float of the company. This exception is likely to have no impact on large-capitalization equities.

CSTA - Any order that is given to the marketplace should be displayed to all, regardless of size and/or dollar value.

ITG Canada - ITG Canada believes that in addition to an exception based on value of shares traded, separate exceptions are needed based on (i) number of shares traded (for low-priced securities for which the threshold is too high) and (ii) the liquidity of shares traded (for highly liquid shares for which the threshold is too low). ITG Canada proposes that orders for equity and preferred shares in excess of 100,000 shares but which do not meet the \$100,000 threshold, should be exempted from display. Conversely, ITG Canada proposes that orders for equity and preferred securities that are highly liquid, should be subject to a higher threshold of \$200,000.

Instinet Canada - The decision to abandon the cross-interference rules and substitute broader display requirements is useful. Instinet believes that an exemption based on a number of shares traded is needed. The exemption should be provided on a sliding scale based on the price of the shares.

Investors Group - Clients should be entitled to determine how much of their order is displayed since they own it. Requiring that all orders having a value of less than \$100,000 be fully displayed is inconsistent and may hinder getting the best price.

CDNX - There should be no exemption to the display requirement. Full display requirements are important for all investors. Retail investors do not have the same opportunities as large investors and the playing field should be balanced to rectify that. It is artificial to set exemptions based on dollar value as \$100,000 in a security trading at \$100 is different than \$100,000 in a security trading at \$1.00. The ATS Proposal has no cross-interference or put-through rule. Junior equity investors need the protection of a cross-interference rule which allows dealers to match orders within the existing bid-ask, but only if they are willing to give up 50% to the existing book if the aggregate value is \$75,000 or less. Retail investors will have confidence in the integrity and fairness of the marketplace if they know that their orders will have a fair opportunity of being filled on a price/time priority.

ETC of IDA - The ETC has concerns that the \$100,000 threshold could pose problems with respect to orders in low priced securities. The ETC recommends a rule that uses the lesser of \$100,000 value or 10,000 threshold. It may also be appropriate to enable the client to request that an order be withheld.

CSA Response: The CSA have deleted this requirement.

**Customer Limit
Orders for Fixed
Income Securities**

Question 14:

Should the requirement regarding customer limit orders apply to the fixed income market?

(National Instrument 23-101, section 6.1)

TD Securities - The fixed income market is a dealer market in which customer limit orders are not displayed with the results that the display requirement should not apply.

OTPPB - It is worthwhile displaying inside bids or offers. This requirement should only apply to participants who wish to show the market their interest. If the client does not wish a limit order to be displayed, then the market in the security in which they have interest can trade through their level.

Barclays - Yes, the requirement regarding customer limit orders should apply to the fixed income market.

CPIM - CPIM does not support the display of customer limit orders. As a customer, CPIM does not want its limit orders posted if they are an improvement on the market maker's price. Doing so will ensure that they are filled at their limit, whereas they wish to retain the option to do better. In practice, they have a limit in mind when contemplating a transaction, but do not disclose it to the market maker.

Investors Group - The requirement regarding customer limit orders should apply to the fixed income market as well.

CSA Response: The CSA have amended the transparency requirements for the fixed income market. All dealers are required to provide post-trade information on corporate debt securities as required by the information processor.

**Exemption for Fixed
Income Securities**

Question 15:

Should there be an exemption based on the

TD Securities - With respect to order display in general, TD Securities recommends adherence to the "CanPX-style" methodology.

OTPPB - The display of large block orders is not advisable in the debt market.

Barclays - Yes, The exemption should be based solely on the value of the order. That threshold

value of the order or some other criteria for fixed income securities?

may need to be different for government securities than corporate securities and should be established in consultation with industry participants.

Investors Group - Incorporating an exemption based on the value of the order or some other criteria is inconsistent with the goal of transparency in the market.

Bloomberg - Bloomberg urges the CSA to permit market participants to comply with their customer limit order obligation through a "Display Alternative" mechanism, as does the SEC. SEC Rule 11Ac1-4 requires market makers to make publicly available any superior prices that the dealer quotes through a private system. The market maker may comply with the rule by changing its quotation on the Nasdaq montage to reflect the superior price or may deliver its better priced orders to an ECN, as long as the ECN complies with the "Display Alternative". Under the "Display Alternative", a market maker that is displaying a better price need not update its quotation if the ECN disseminates the best bid and offer in the ECN, for display under the ECN's name in the montage and provides for equal execution access to that quotation for any NASD broker-dealer. Under this mechanism, customer limit orders providing superior prices are integrated into the public quotation stream. At the same time, anonymity is preserved for the subscriber.

CSA Response: No exemptions from the display requirement will be provided for fixed income securities. However, the trade volume to be displayed for corporate debt securities will depend on the value of the transaction.

AUDIT TRAIL REQUIREMENTS

(National Instrument 23-101, Part 11)

Audit Trail Requirements

Question 16:

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

TD Securities - TD Securities is in agreement with the approached proposed in Part 11 of the ATS Proposal. They believe that dealers participating in the marketplace should be required to record details of every order received, the time of receipt and the time the order was conveyed to the market. On the other hand, audit trails of marketplaces should be sufficiently detailed to allow the reconstruction of the trading environment which a particular order faced when it was sent by the market participant.

OTPPB - Audit trail requirements should be established. The audit trail should collect information on all trades reported to the data consolidator including the time, nature of a trade (buy/sell), the size of a trade, the broker executing the trade and the bid/ask at the time.

Barclays - Audit trail requirements should be established. The audit should collect information on all trades reported to the consolidator including the time, nature of the trade (buy/sell), the size of a trade, the broker executing the trade and the bid/ask at the time.

CSTA - All participants should be subject to whatever minimum audit trail requirements are necessary.

Instinet Canada - Dealers already record details of every order received, the time of receipt and the time the order was conveyed to the market for execution. Instinet Canada anticipates that the audit trails of marketplaces will be sufficiently detailed to allow for reconstruction of the trading

environment. The approved agent could set up the audit trail working to a specification satisfactory to the CSA.

Investors Group - All ATs should be required to meet minimum audit trail requirements.

CDNX - Audit trail requirements should be adopted and should apply to all marketplaces. CDNX and the TSE have agreed to work together to develop consistent audit trail requirements for all member firms.

TSE - The TSE submits that the Canadian markets are different from the Nasdaq's market, to which the NASD's OATS requirements apply. The TSE is of the view that a more efficient and less costly solution than OATS should be created for the Canadian market. The TSE recommends that the CSA not adopt the proposed framework rule but rather wait for the outcome of the SRO's initiative to develop requirements for an electronic audit trail system (TSE and CDNX). Any concerns of the CSA has about the comprehensiveness of the SROs' proposal may be addressed through consultation and the rule approval process. It is intended that the proposed requirements and implementation plan be released in early 2001.

CSA Response: *The CSA agree with the comments received that we should set the audit trail requirements.*

Determination of Audit Trail Requirements

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

TD Securities - The approved agent could set up the audit trail working to a specification satisfactory to the CSA.

OTPPB - The minimum audit trail requirements should be established by the CSA. A minimum standard is required. With respect to the debt market, the requirement should be the responsibility of an independent agency, not the IDA.

Barclays - The minimum audit trail requirements should be established by the CSA and not delegated. Investors must have confidence regardless of where they trade in Canada that there is a quality standard that is there to protect them.

CSTA - The CSA should only establish new audit trail requirements if the requirements in place do not meet the goals of a well-regulated Canadian marketplace.

Investors Group - The audit trail requirements should be established by an SRO with the ability and independence to fulfill this role. This should not be the exchange.

CDNX - The new national regulator(s) should be responsible for providing market regulation and should establish the audit trail requirements.

CSA Response: *While the CSA will determine the appropriate requirements, the process for collecting the information will be determined by the entity performing market regulation.*

THE REPORTED MARKET

Expansion of Display to Over-the-Counter

TD Securities - The display requirements for over-the-counter orders for equity securities (other than options) should be the same as those for orders executed in organized marketplaces. The

Transactions

information should be sent to the data consolidator.

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

OTPPB - Display requirements for over-the-counter orders for equity securities should be expanded to all dealers. Information should be sent to the data consolidator.

Barclays - Yes, display requirements for over-the-counter orders or trades should be expanded from market makers to all dealers. The information should be sent to the data consolidator.

CSTA - The CSTA believes that the display requirements for over-the-counter orders should be expanded to provide as much information as possible and should be sent to the data consolidator.

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

ITG Canada - ITG Canada believes that the display requirements for over-the-counter orders should be expanded from market makers to all dealers. The information should be sent to the data consolidator.

Instinet Canada - The display requirements for over-the-counter orders should not differ from those applicable to orders executed in organized marketplaces. The information should be sent to the data consolidator.

Investors Group - Display requirements for over-the-counter orders and trades should be expanded from market makers to all dealers. The information should be sent to the data consolidator.

CDNX - The display requirements should be expanded to all dealers. More transparency leads to a level playing field and more liquidity. The information should be sent to the data consolidator.

CSA Response: Transparency requirements will initially apply for all listed securities. Over time, the CSA will look at expanding the application of the requirements to dealers and over-the-counter equity securities.

TRADING RULES

Setting minimum standards

CDNX - The imposition of minimal trading rules on ATs is expected to result in a race for the bottom that will directly and negatively impact junior equity investors. The CSA should rework the ATS Proposal to set only broad goals and minimum standards, without detailing the means by which every marketplace achieves those goals. In the event that more than one SRO regulates ATs, there should be the highest level of harmonization of market integrity rules among different marketplaces. The TSE and CDNX have committed to developing harmonized trading rules. The ME has been invited to participate

ETC of IDA - The ETC of IDA strongly supports the CSA proposals to establish core trading rules that provide a minimum common standard for market integrity across marketplaces. Under the ATS Proposal, competing marketplaces are free to develop additional rules should they deem it beneficial to their market's competitive position.

TSE - The framework trading rules are incomplete and inadequate in comparison to the exchanges' existing rules. It will be difficult for an exchange to compete on the basis that it offers higher regulatory standards. Without a regulatory SRO, the regulatory gap will create a race to the

bottom, forcing the exchanges to lower their standards to preserve order flow that will migrate to ATSS. If an SRO has authority to regulate trading in all marketplaces, many of the trading rules do not need to be adopted by the CSA. The TSE strongly urges the CSA to fully delegate the monitoring of, administration (including the ability to grant exemptions) and enforcement of framework rules to Regulation Services and other SROs as required. The TSE supports the adoption of anti-manipulation rules and rules in areas such as best execution.

CSA Response: National Instrument 21-101 and Companion Policy 23-101CP set forth common trading rules which will apply to trading on all marketplaces and do not prohibit marketplaces from implementing additional rules. The CSA have provided for an exemption from the application of subsection 3.1(1) and Parts 4 and 5 of National Instrument 23-101 to those persons or companies that comply with the rules, policies and other similar instruments established by a regulation services provider.

Application of Trading Rules to the Fixed Income market

Bank of Canada - The trading rules in the ATS Proposal do not appear to be aimed specifically at fixed income markets, but rather at equity and exchange-traded markets. The markets are sufficiently different as to justify separate treatment. The Bank of Canada urges the CSA to look closely at Policy No. 5 for guidance.

OTPPB - Fixed income market is made up of institutional players. Extensive regulation and trading rules to protect small investors are all ready in place.

CSA Response: The CSA are of the view that an ATS trading unlisted debt securities, an inter-dealer bond broker and a dealer trading unlisted debt securities outside of a marketplace should be exempt from the Trading Rules if they are in compliance with the requirements of a regulation services provider. These entities are exempt from having to enter into an agreement with a regulation services provider if they comply with IDA Policy No. 5. The exemption is not available after December 31, 2003. During the time between the implementation of the ATS Rules and December 31, 2003, the CSA will be working with debt market participants, the Bank of Canada and the Department of Finance to determine the appropriate model of market regulation for the debt market and evaluate whether any additional requirements are necessary.

Additional rules that should be considered

CDNX - The ATS Proposal is silent with regard to Pro Group Reporting. This requirement should also apply to ATSS. In addition, the following rules are not found in the ATS Proposal: (a) a market corner rule prohibiting members, approved persons and their employees from “cornering the market” by agreeing to trade back and forth with each other in a security, so that the price is influenced; (b) requiring all remuneration received by members and their employees for trades to be declared and reported; (c) prohibiting members and approved persons acting as agents for clients from buying and selling for their own account, or engaging in activity that creates the appearance of conflict between their interests and those of investors; (d) prohibiting members from making a practice of taking the opposite of the market to the side taken by clients, whether directly or indirectly.

CSA Response: In the opinion of the CSA, market cornering is covered by the manipulation and fraud provisions of the Trading Rules. Disclosure of commissions must be provided to clients on trade confirmations provided to the client by the dealer. If this requirement is insufficient, the CSA are of the view that additional remuneration disclosure is more appropriately dealt with in the IDA rules. With respect to activities discussed in (c), the CSA are

of the view that there are a variety of requirements relating to conflicts of interest between registrants and clients. With respect to taking the opposite side of the market, there is no consensus that principal trading should be prohibited under any circumstances.

Short Selling

(National Instrument
23-101, Part 3)

Bloomberg - The SEC has questioned the utility of its own short sale rule in the context of the move toward decimal pricing. As Canadian markets are also likely to introduce decimal pricing, Bloomberg suggest that the CSA defer in imposing a short sale rule at this time.

Barclays - The relaxation of the short selling rules to permit a zero-tick rule is appropriate. However, there still remains inconsistency with one type of instrument. Futures contracts on stock indexes face no such rule and can be sold on a down-tick. It seems appropriate to allow down-tick short sales on those exchange traded funds that are direct equivalents of exchange-traded futures contracts on stock indexes. An institutional investor that wishes to sell the Canadian equity market as part of an overall investment strategy would now be forced to use futures contracts, depending on the most recent tick. This requirement may not be cost effective at times, introducing a distortion into the marketplace and increasing the reliance on derivatives instruments unnecessarily.

CDNX - The CSA adopted a less stringent “zero-tick” rule as a result of comment received that the market share would be lost. The result is an inflexible approach that the TSE believes will hurt the liquidity and efficiency of its market and that CDNX believes will put investors in the venture market at risk. An SRO is best able to evaluate these concerns and develop, monitor and adjust rules that would address the concerns.

ETC of IDA - The ETC commends staff for changing the “zero plus tick” to a “zero tick” (last trade prices).

TSE - The TSE is of the view that this rule should be delegated to SROs or at a minimum a blanket exemption should be provided for trades done on a recognized exchange, in accordance with its rules.

CSA Response: *The CSA have deleted the short sale provision from the Trading Rules and expect marketplaces and marketplace participants to comply with the rules of the regulation services provider. The CSA will examine the appropriateness of adopting a short sale rule at a later date.*

Short Selling

Question 20:

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

TD Securities - There does not appear to be a basis for distinguishing between short selling in over-the-counter equity securities and marketplace-traded securities.

OTPPB - Short selling does not apply in the debt market.

Barclays - The provisions should apply to a dealer trading outside of a marketplace.

CSTA - In order to be effective, the short selling rule must be applied equally to all market participants. The rule should be based on the last sale of a board lot displayed by the data consolidator.

ITG Canada - The short selling provision should apply uniformly. There does not appear to be

any justification for distinguishing between short selling in over-the-counter equity securities and marketplace-traded securities.

Instinet Canada - A distinction between short selling in over-the-counter equity securities and marketplace-traded securities does not seem to be justifiable.

Investors Group - The short selling rules, to ensure consistency and fairness, should apply to all participants inside and outside the marketplace.

CDNX - Short selling provisions should be applied to dealers trading outside a marketplace. Short selling has the potential to drive the price of a security down, creating volatility and harming investors. Junior equity investors are particularly vulnerable to this volatility.

CSA Response: *The CSA have deleted the short sale provision from the Trading Rules and expect marketplaces and marketplace participants to comply with the rules of the regulation services provider. The CSA will examine the appropriateness of adopting a short sale rule at a later date.*

Frontrunning

(National Instrument
23-101, Part 4)

Bank of Canada - It is our understanding that it was not the CSA's intention that subsection 4.1(1) not apply to trading in fixed income markets (i.e. it refers to only trading on a marketplace and no entities in Canadian debt markets currently fall under that definition). Applied to fixed income markets, this provision would prevent some of the legitimate activity that currently takes place. Dealers in the fixed income market service their customers by buying and selling for and from their own inventories and not on an agency basis. Customers often give advance warning of an impending order to the dealer to give the dealer time to adjust the risk profile of its book (by hedging with futures). Without time to adjust the profile, the prices quoted by market makers would adjust to compensate for the magnitude of risk, therefore increasing the costs for their clients. Other common situations involve the lead underwriter of a debt issuance making trades in anticipation of their client's needs on the issuance date. Since this improves the ability of market makers to provide liquidity, the interests of investors would not be served by the elimination of these practices. This is not to say that front running is acceptable in the fixed income market. The Bank of Canada applauds the CSA's goal in seeking to eliminate this and other forms of market manipulation. At the same time, it seems clear that more work needs to be done in formulating rules that will be effective in achieving this goal with respect to fixed income markets.

CSA Response: *The CSA have deleted the frontrunning provision from the Trading Rules.*

**Market Maker
Orders**

Bank of Canada - Does market maker order include bids at auction? Primary market activities are not specifically excluded from the requirement.

CSA Response: *The ATS Rules do not include primary market activities.*

Best Execution

(National Instrument
23-101, Part 5)

Bloomberg - ATSs are passive vehicles that do not undertake a duty to "find" the best market by routing orders to other liquidity pools. ATSs do not assume traditional agency roles in secondary markets. The responsibility for best execution should rest with the user of the ATS who effects or performs a customer order, not the ATS itself. Consequently, Bloomberg suggests that the ATS Rules should acknowledge the fact that a duty of best execution should not attach to ATSs and similar electronic trading systems or their operators.

CSA Response: The CSA agree that ATSS should not have the duty of best execution. The requirement has been amended to exclude those dealers who are carrying on business as an ATS.

Principal Trading

(National Instrument 23-101, section 7.1)

ITG Canada - Under this section, a marketplace participant can no longer effect a principal trade at a price equal to the best price then available on an exchange. ITG Canada has some concern that the section can be circumvented by the introduction of a separate legal entity affiliated with the broker, acting in the capacity of a customer, on the other side of all trades. The section does not preclude a broker-dealer from effectively sub-dividing the functions of their trading desk and offsetting customer orders through an unregulated corporate affiliate. As a possible solution, ITG Canada recommends that the definition of “marketplace participant” be expanded to include the beneficial owner of any account where (i) capital is provided by an affiliate of the registered broker-dealer and (ii) the personnel operating the account in question are located in the same premises and under common senior management as the broker-dealer.

CSA Response: The CSA have deleted the principal trading provision.

Regulatory Halts

(National Instrument 23-101, Part 8)

Bloomberg - Bloomberg suggests that with respect to inter-listed securities, a market centre that is not the principal market for a security should not impose a worldwide halt on an ATS’s trading such security. It would be reasonable for Canadian regulators to prohibit Canadian customers from trading a certain stock, if a trading halt were imposed. It may be, however, that a more coordinated approach among regulators of different market centres would provide a long-term solution.

CSA Response: All entities performing market regulation for marketplaces in Canada will co-ordinate halts for securities traded on multiple marketplaces in Canada.

EXTRA-TERRITORIALITY OF THE ATS Rules

Extra-territoriality

Bloomberg - Bloomberg recommends that the ATS Rules clearly articulate the extent, if any, to which the rules and principles are meant to apply outside Canada or to securities of non-Canadian issuers. For example, are Parts 10 and 11 of National Instrument 21-101 meant to apply to quotations in non-Canadian securities, orders received outside of Canada, transactions in Canadian securities effected outside of Canada or transactions in non-Canadian securities effected on a Canadian market?

CSA Response: The Policy clarifies that the ATS Rules apply to all marketplaces operating in Canada and all securities traded on those marketplaces. CP 21-101 discusses the circumstances in which the CSA may consider granting an exemption from the requirements of the rules.

MISCELLANEOUS

Central Limit Order Book

CSTA - The CSTA believes that a strong central limit order book must be established in order to prevent further market fragmentation in the Canadian market. This system should be put in place before competition from ATSS is introduced.

CPIM - CPIM believes that the most significant oversight of the CSA’s proposal is the lack of a central limit order book.

CSA Response: The CSA are of the view that it is best not to introduce a central limit order book at this time. The information processor and market integrator when introduced, will minimize

fragmentation.

Payment for order flow

ETC of IDA - The ETC strongly opposes a ban on payment for order flow or preferencing. Doing so would be anti-competitive. Although the ETC acknowledges that payment for order flow on its own could create a conflict of interest potential, the establishment of a best execution rule combined with monitoring and enforcement by the SRO responsible for market regulation should eliminate the problem.

TSE - The TSE is concerned that ATSs may pay for order flow, which will force the exchanges to do the same. The TSE is of the view that payment for order flow creates a clear conflict of interest for firms routing client orders because the order could be routed based on financial benefits to the brokerage firm rather than obtaining best execution of client orders. Therefore, the TSE recommends that the CSA prohibit payment for order flow. Arguably, an ATS that pays for order flow would be considered to be offering a liquidity guarantee, requiring it to register as an exchange. However, this is not the TSE's recommended approach because it does not address the fundamental conflicts of interest. If the CSA does not ban the practice, the TSE submit, at a minimum, that the requirement to register as an exchange should be explicit in the regulations, along with rules that address conflict of interest.

CSA Response: *In the view of the CSA, once one party guarantees execution for a price, they have provided a guarantee of liquidity. Consequently, that party must be recognized as an exchange.*

APPENDIX B

SUMMARY OF THE ATS RULES

Type of Security	Who will trade?	Transparency Requirements	Market Regulation
Exchange-traded securities <ul style="list-style-type: none"> • equity • options • debt 	Marketplaces <ul style="list-style-type: none"> • Exchange • ATS • Quotation and trade reporting system (QTRS) • Dealer that executes trades of exchange-traded securities outside of a marketplace 	Marketplaces provide <ul style="list-style-type: none"> • order information • trade information to an information processor in real-time Exemption if the marketplace provides information to an information vendor <ul style="list-style-type: none"> • exemption does not apply after December 31, 2003 	Exchange and QTRS <ul style="list-style-type: none"> • directly • indirectly by a regulation services provider ATS <ul style="list-style-type: none"> • by a regulation services provider Audit trail requirements
Over-the-counter equity securities	Dealers	None	In Ontario, trade reporting to CUB (section 154 of Ontario Regulations) In Ontario, surveillance of CUB done by CDNX Audit trail requirements
Foreign exchange-traded securities <ul style="list-style-type: none"> • equity • options • debt 	Marketplace (ATS)	Marketplaces (ATS) provide <ul style="list-style-type: none"> • order information • trade information to an information processor in real-time Exemption if the marketplace provides	ATS <ul style="list-style-type: none"> • by a regulation services provider Audit trail requirements

Type of Security	Who will trade?	Transparency Requirements	Market Regulation
		information to an information vendor <ul style="list-style-type: none"> • exemption does not apply after December 31, 2003 Dealers – no requirements	
Government debt securities	Marketplace (ATS) Inter-dealer bond broker Dealer executing trades outside of a marketplace	Marketplace (ATS) provide <ul style="list-style-type: none"> • order information • trade information to an information processor in real-time Inter-dealer bond brokers provide <ul style="list-style-type: none"> • order information • trade information on certain benchmarks and designated government debt securities to an information processor in real-time Dealers - no requirements	ATS Inter-dealer bond broker Dealer executing trades of unlisted debt securities outside of a marketplace <ul style="list-style-type: none"> • by a regulation services provider Exemption if the ATS, IDB or dealer complies with IDA Policy No. 5 <ul style="list-style-type: none"> • exemption does not apply after December 31, 2003 Audit trail requirements
Corporate debt securities	Marketplace (ATS) Inter-dealer bond broker Dealer executing trades outside of a marketplace	ATSS provide <ul style="list-style-type: none"> • order information • trade information to an information processor in real-time Inter-dealer bond brokers and Dealers provide <ul style="list-style-type: none"> • trade information on certain designated corporate debt	ATS Inter-dealer bond broker Dealer executing trades of unlisted debt securities outside of a marketplace <ul style="list-style-type: none"> • by a regulation services provider Exemption provided that the ATS, IDB or dealer complies with IDA Policy No. 5 <ul style="list-style-type: none"> • exemption does not apply after December

Type of Security	Who will trade?	Transparency Requirements	Market Regulation
		securities to the information processor within one hour of the trade Volume disseminated <ul style="list-style-type: none"> • Investment grade - \$2 million /\$2million+ • Non-investment grade - \$200,000/\$200,000+ 	31, 2003 Audit trail requirements