Notice of Proposed Amendments to
National Instrument 21-101 Marketplace Operation and National Instrument 23-101 Trading Rules

I.   INTRODUCTION

The Canadian Securities Administrators (CSA or we) are publishing for comment proposed amendments (the Proposed Amendments) to National Instrument 21-101 *Marketplace Operation* (NI 21-101), National Instrument 23-101 *Trading Rules* (NI 23-101) (together, the ATS Rules) and the related companion policies.

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

II.   BACKGROUND

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

The 2005 Discussion Paper asked a number of questions to get feedback on what values and rules were important to Canadian market participants. Because of the importance of the issues relating to the trade-through obligation and their impact on the Canadian capital market, the CSA held a public forum on October 14, 2005 to permit all interested parties to participate in discussions relating to trade-through protection.[1]

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

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

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[1] The transcript of the trade-through forum is published on the OSC website at: http://www.osc.gov.on.ca/Regulation/Rulemaking /Current/Part2/rule_20051014_23-403_trade-through-forum.pdf.

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

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

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

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

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

III.   TRADE-THROUGH PROTECTION

1.   What is Trade-through Protection?

Trade-through protection ensures that all immediately accessible, visible, better-priced limit orders are executed prior to inferior-priced limit orders. Commenters generally agreed that the obligation not to "trade-through" (i.e. bypass better-priced limit orders in favour of inferior-priced limit orders) is an obligation owed by all marketplace participants to the market as a whole. Unlike the obligation for best execution, the obligation not to trade-through is not a fiduciary duty and cannot be waived.[2] It is proposed that trade-through protection would apply whenever two or more marketplaces with displayed protected orders are open for trading.

2.   Why is Trade-through Protection Important?

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

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

they transact. This confidence encourages more liquidity in the market and a more efficient price discovery process.

3.   The Current Regulatory Regime

Currently in Canada, trade-through protection is addressed as part of the best price obligation imposed by IIROC in its Universal Market Integrity Rules (UMIR), Rule 5.2 *Best Price Obligation* (UMIR Best Price Rule). The rule imposes a requirement on dealers that trade on marketplaces that have retained IIROC to use reasonable efforts to obtain the best price available. There are a number of exemptions available and the factors to be considered in determining if reasonable efforts have been used are broadly outlined.[3]

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

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

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

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

When multiple marketplaces began trading TSX-listed securities, the dealers in Canada had difficulty complying with the UMIR Best Price Rule. Technology was not yet at a point where dealers could monitor multiple marketplaces and effectively route orders to where the best price was displayed. In addition, order data was not consolidated. In response, RS at the time, proposed an approach whereby the factors to be considered in determining if a dealer used "reasonable efforts" to obtain the best price were broadened. RS introduced an immediate implementation rule, effective on May 16, 2008[4], that broadened these factors to include:

- whether the dealer has used an order router offered by it or a marketplace,
- whether the dealer relies on another dealer to route its orders,
- the timing of the launch of the marketplace,
- whether the marketplace has had a material malfunction or interruption of services,
- whether the data being transmitted by the marketplace is easily and readily used by dealers, and

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[3] See UMIR Rule 5.2 *Best Price Obligation* and the related policy.
[4] The UMIR Best Price Rule was published for comment on May 16, 2008, MIN 2008-009.

- whether the marketplace executes an inordinate proportion of orders at an inferior price or there is no fill at all.

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

4. The Proposed Trade-through Protection Rule

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

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

(i) Marketplace Obligation

The Proposed Trade-through Protection Rule would require each marketplace to establish, maintain and enforce written policies and procedures that are reasonably designed to prevent trade-throughs on that marketplace. Marketplaces would be required to regularly review and monitor the effectiveness of these policies and procedures and act promptly to remedy any identified deficiencies. The purpose of this approach is to require marketplaces to eliminate trade-throughs that can reasonably be prevented, but also provide them with flexibility about how to do so. Marketplaces may choose how to implement the obligation in various ways including, for example, voluntarily establishing direct linkages to other marketplaces, or designing specific trade execution algorithms. However, marketplaces would not be able to avoid their obligations by establishing policies and procedures that instead require marketplace participants to take steps to reasonably prevent trade-throughs.

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

Marketplaces would be required to provide their policies and procedures, and any amendments thereto, to the securities regulatory authority and their regulation services provider 45 days prior to implementation. It is expected that marketplaces would also maintain relevant information so that the effectiveness of its policies and procedures could be adequately evaluated by regulatory authorities.[5]

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[5] Proposed section 6.1 of NI 23-101.

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

(ii)   Protected Orders

Trade-through protection would only be applicable to certain orders ("protected orders"). A protected order would be defined as a "protected bid or protected offer." A "protected bid" or "protected offer" would be an order to buy or sell an exchange-traded security, other than a derivative, that is displayed on a marketplace with automated functionality and about which information is provided to an information processor or information vendor.[6] The CSA do not consider special terms orders that are not immediately executable or that trade in a special terms book, such as all-or-none, minimum fill, or cash or delayed delivery, to be orders that are protected.[7] However, those executing against these types of orders are required to execute against all better-priced orders first. A marketplace that is considered to have "automated functionality" would have the ability to immediately and automatically:

- permit an incoming order entered on the marketplace electronically to be marked as fill-or-kill,
- execute a fill-or-kill order,
- cancel unexecuted portions of that order,
- transmit a response to the sender indicating the action taken, and
- display information that updates the displayed order.[8]

A marketplace would also be required to have policies and procedures relating to the handling and display of these orders (to be included in their policies and procedures required under section 6.1 of the Instrument) and would be required to immediately inform all regulation services providers and other marketplaces when it experiences a failure, malfunction or material delay of its systems or equipment.[9]

(iii)   Full Depth-of-book

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

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[6] Proposed definition in section 1.1 of NI 23-101.
[7] See subsection 5.1(3) of 21-101CP.
[8] Proposed amendment to section 1.1 of NI 23-101.
[9] Proposed section 6.4 of NI 23-101.

(iv)   Visible Orders

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

In addition, hidden orders or those parts of iceberg orders that are not visible would not be protected. Currently, the manner by which "dark" portions of orders in an otherwise transparent order book would be avoided is by using the "bypass" marker introduced by IIROC.[10] The bypass marker signals to the marketplace that the order routed to the marketplace should not execute against any hidden liquidity. It is intended that this marker will evolve into the marker used for an inter-market sweep order discussed below.

(b)   "Permitted" Trade-throughs

The overall purpose of trade-through protection is to promote confidence and fairness in the marketplace where the visible portions of better-priced limit orders trade ahead of inferior-priced orders. It is important to acknowledge, however, that the issues relating to preventing all trade-throughs in a multiple marketplace environment have become highly complex, particularly with the advent of new types of orders and other developments in market structure in Canada.

As a result, we have proposed a number of circumstances where trade-throughs would be permitted.[11] These "permitted" trade-throughs or "exceptions" are primarily designed to achieve workable inter-market trade-through protection while facilitating the use of trading strategies and order types that are useful to investors. They are intended to promote fairness, innovation and competition.

Although trade-though protection is an obligation owed by all marketplace participants to the market as a whole, in certain circumstances, the marketplace can trade through better-priced orders on other marketplaces where a marketplace participant has taken certain action (for example, routing an inter-market sweep order). In these circumstances, it is important that marketplace participants create policies and procedures that will reasonably prevent trade-throughs and maintain relevant information so that the effectiveness of section 6.1 of NI 23-101 can be adequately evaluated by regulatory authorities.[12]

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

We are proposing an exception for any failure or malfunction of a marketplace's systems as well as any material delay (systems issues).[13] If a marketplace repeatedly fails to respond immediately after receipt of an order, under the Proposed Trade-through Protection Rule, this would

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[10] Market Integrity Notice 2008-008 approving amendment to UMIR regarding "Provisions Respecting Off Marketplace Transactions" was published on May 16, 2008.
[11] The list of "permitted" trade-throughs is set out in proposed section 6.2 of NI 23-101.
[12] Proposed subsection 6.1(3) of 23-101CP.
[13] Proposed paragraph 6.2(a) of NI 23-101.

constitute a material delay. This is intended to provide marketplaces with flexibility when dealing with another marketplace that is experiencing a systems problem (either of a temporary nature or a longer term issue). The marketplace that is experiencing the failure, malfunction, or delay is responsible for informing all other marketplaces, its marketplace participants, and any regulation services providers when the failure, malfunction or delay occurs. However, if a marketplace fails repeatedly to provide an immediate response to orders received and no notification has been issued by the marketplace that may be experiencing systems issues, a routing marketplace or a marketplace participant may rely on paragraph 6.2(a) of NI 23-101, in accordance with its policies and procedures that outline processes for dealing with these systems issues. The marketplace or marketplace participant must immediately notify the marketplace that may be having systems issues, its own marketplace participants (where applicable) and all regulation services providers. This notification will enable the marketplace that may be experiencing systems issues to assess whether it is in fact experiencing systems issues.

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

(ii)   Inter-market Sweep Order

We are proposing an exception to allow the execution of inter-market sweep orders. An inter-market sweep order (ISO) is an order that is marked to inform the receiving marketplace that it can be immediately executed without delay or regard to any other better-priced orders displayed by another marketplace.[14] It may be marked "ISO" by a marketplace or a marketplace participant. The definition allows for simultaneous routing of more than one ISO in order to execute against protected orders. In addition, marketplace participants may send a single ISO to execute against the best protected bid or best protected offer. An ISO may enable participants to execute large block orders, provided that they simultaneously route one or more ISO's to execute against better-priced orders. This would facilitate compliance with the trade-through obligation.

(iii)   Flickering Orders

With the growth of algorithmic and computer-generated trading, there has been a substantial increase in the number of short term orders generated (often generated and cancelled within seconds) for every trade executed. This has subsequently increased the number of times a better-priced order may be displayed. Given the speed with which orders change, there may be technical occurrences of trade-throughs, even though all reasonable precautions were taken and there was a legitimate attempt to execute a trade at the best available price. As a result, we are allowing for a transaction that occurs when the marketplace displaying the best price that was traded through had displayed, immediately prior to execution of a trade that resulted in a trade-through, an order with a price that was equal or inferior to the price of the trade-through transaction.[15]

(iv)   Non-Standard Orders

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[14] Proposed paragraphs 6.2(b) and (c) of NI 23-101.
[15] Proposed paragraph 6.2(d) of NI 23-101.

Non-standard orders have been included on the list of "permitted" trade-throughs. A non-standard order refers to an order for the purchase or sale of a security that is subject to non-standard terms or conditions relating to settlement that have not been set by the marketplace on which the security is listed or quoted.[16] A marketplace participant, however, may not add a special settlement term or condition to an order solely for the purpose that the order becomes a non-standard order so that it qualifies for an exception from the Proposed Trade-through Protection Rule.

(v)   Calculated Price Order

We are proposing to include an exception for orders where the price is not known at the time of order entry and is to be calculated based on, but will not necessarily be equal to, the price of the security at the time of execution.[17] Orders that would be included under this definition are:

- call market orders – where the price of a trade is calculated by the trading system of a marketplace at a time designated by the marketplace,
- volume-weighted average price orders – where the price of a trade is determined by a formula that measures a weighted average price on one or more marketplaces,
- opening orders – where each marketplace may establish its own formula for the determination of opening prices,
- closing orders – where execution occurs at the closing price on a particular marketplace, but at the time of order entry, the price is not known, and
- basis orders – an order that must be approved by a regulation services provider to ensure that the price of the order is based on one or more derivative transactions executed in conjunction with securities where the securities transaction comprises at least 80% of the underlying interest of the derivative instruments.[18]

(vi)   Closing Price Order

We are proposing to also include an exception for an order entered on a marketplace for the purchase or sale of an exchange-traded security that would execute at the established closing price on that marketplace for that trading day for that security.[19] Some marketplaces provide an after-hours trading session at a price established by that marketplace during its regular hours for marketplace participants who are required to benchmark to a certain closing price. Therefore, we propose to allow for trade-throughs resulting from the execution of transactions in these circumstances so that a better-priced order on another marketplace would not need to be accessed.

(vii)   Crossed Market

We are proposing an exception for a transaction that occurred where the transaction that constituted the trade-through was executed at a time when the best protected bid was higher than

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[16] Proposed subparagraph 6.2(e)(i) of NI 23-101.
[17] Proposed subparagraph 6.2 (e)(ii) of NI 23-101.
[18] Proposed section 2.3 of NI 23-101CP.
[19] Proposed subparagraph 6.2(e)(iii) of NI 23-101.

the best protected offer (crossed market).[20] Without this exception, no marketplace could execute transactions in a crossed market because it would constitute a trade-through. The CSA recognize that crossed markets may occur as a result of trade-through protection only applying to displayed orders or parts of orders, and not to hidden or reserve orders. Intentionally crossing the market to take advantage of this exception would be a violation of proposed section 6.5 of NI 23-101.

Question 3: Are any additional exceptions necessary?

(c) *Access to Marketplaces*

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

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

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

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

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

(d) *Trading Fee Limitation*

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

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[20] Proposed paragraph 6.2(f) of NI 23-101.
[21] Proposed amendments to sections 7.1 and 8.2 of 21-101CP.

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

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

(e)   Locked and Crossed Markets

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

- typically, more buyers and sellers appear resulting in subsequent trades and immediate correction; or

- one of the participants involved in the lock removes their order and places the order on another marketplace to immediately execute the trade.

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

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

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

(f)   Trade-through and Best Execution

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

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

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

The Proposed Trade-through Protection Rule does not propose to address trading on foreign markets. However, we reiterate that marketplace participants should consider foreign markets when addressing best execution. We have also included an anti-avoidance provision that prohibits a person or company from routing orders to foreign marketplaces only for the purpose of avoiding the trade-thorough protection regime in Canada.[22]

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

(g)   Other Jurisdictions

(i)   U.S. Approach

On April 6, 2005, the SEC implemented the Order Protection Rule in Regulation NMS.[23] It requires trading centers to establish, maintain, and enforce written policies and procedures that are reasonably designed to prevent trade-throughs, and, if relying on one of the exceptions, these policies and procedures must be reasonably designed to assure compliance with the exception. To be protected, a quotation must be immediately and automatically accessible. Trade-through protection will apply to the best bid and offer from every type of participant on all marketplaces. One of the impacts of this

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[22] Proposed section 6.7 of NI 23-101.
[23] "SEC Adopts Regulation NMS and Provisions Regarding Investment Advisers Act of 1940", online: U.S. Securities and Exchange Commission, http://www.sec.gov/news/press/2005-48.htm on July 15, 2008.

order protection is increased linkages between trading centers. Regulation NMS includes a number of exceptions from "order protection" obligations, such as exemptions for opening or closing orders, crossed markets, benchmark orders where the material terms are not known, inter-market sweep orders, delays in responses caused by systems problems, and flickering quotes.

(ii)   European developments

The European Union (EU) implemented MiFID on November 1, 2007 to replace the existing Investment Services Directive as part of its Financial Services Action Plan designed to create a single market in financial services for EU member states. [24] MiFID does not impose a trade-through obligation that prohibits the by-passing of better priced quotes when executing transactions. Instead, MiFID introduces a best execution standard that requires firms to take "all reasonable steps to obtain the best possible result" for their clients, taking into consideration not only execution price, but also the cost, speed, size and nature of the order, the likelihood of execution and settlement when trading and any other factors deemed relevant to the execution of the order.

(h)   Next Steps

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

If you are interested in participating on the committee, please send an e-mail to: **marketregulation@osc.gov.on.ca.** Responses before November 7, 2008 would be appreciated as the first committee meeting is expected to be scheduled in mid-November.

IV.   ADDITIONAL AMENDMENTS

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

1.   Reporting Requirements for Marketplaces and Dealers

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

- a marketplace to report certain information on a monthly basis, including: number of orders, number of trades, and speed of execution, and

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[24] "Markets in Financial Instruments Directive – Background Information", online: Financial Services Authority, http://www.fsa.gov.uk/pages/about/what/international/pdf/MiFID.pdf on July 8, 2008.

- a dealer to report certain information on a quarterly basis: percentage of orders executed at a location determined by the dealer, identity of marketplaces and percentage of orders routed to each marketplace, and disclosure of any material arrangements with a marketplace.

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

When finalizing the best execution amendments in June 2008, the CSA decided to postpone the implementation of the proposed best execution reporting requirements for marketplaces and dealers due to intervening market developments. However, we are of the view that it is appropriate to republish them for comment with this package of amendments. A cost-benefit analysis of the implementation of reporting requirements for marketplaces and dealers was published with the Joint Notice.

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

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

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

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

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

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

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

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

Question 11:   **Would it be useful to include reporting similar to the near-the-quote orders required by the SEC in the United States?[25] What price increment away from the quote would be appropriate to use for the Canadian market?**

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

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

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

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

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

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

2.   Marketplace Systems

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

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

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

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

3.   Transparency

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

4.   Information Processor Requirements and Systems

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

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

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

We are proposing some amendments to Part 16 of 21-101CP to clarify the requirements under subsections 14.4(2) and (5) of NI 21-101 regarding certain obligations that an information processor has towards its users and providers of order and trade information, in relation to the collection, processing, distribution and publication of that information. In addition, we have proposed changes to the systems requirements applicable to an information processor that are outlined in Part 14 of NI 21-101. The changes mirror those described above for a marketplace. However, an information processor will be required to conduct an annual independent systems review, unless an exemption is sought and granted.

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

We have amended subsections 7.2(c), 7.4(c), and 8.3(d) to require that the agreement between a regulation services provider and a marketplace mandates that the marketplace provide the

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

V. AUTHORITY FOR THE PROPOSED AMENDMENTS

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

In Ontario, the Proposed Amendments are being made under the following provisions of the *Securities Act* (Ontario) (Act):

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

- Paragraph 143(1)11 authorizes the Commission to make rules regulating the listing or trading of publicly traded securities including requiring reporting of trades and quotations.

- Paragraph 143(1)12 authorizes the Commission to make rules regulating recognized stock exchanges, recognized self-regulatory organizations, and recognized quotation and trade reporting systems including prescribing requirements in respect of the review or approval by the Commission of any by-law, rule, regulation, policy, procedure, interpretation or practice.

- Paragraph 143(1)13 authorizes the Commission to make rules regulating trading or advising in securities to prevent trading or advising that it is fraudulent, manipulative, deceptive or unfairly detrimental to investors.

- Paragraph 143(1)39 authorizes the Commission to make rules requiring or respecting the media, format, preparation, form, content, execution, certification, dissemination and other use, filing and review of all documents required under or governed by the Act, the regulation or the rules and all documents determined by the regulations or the rules to be ancillary to the documents.

VI.   COMMENTS AND QUESTIONS

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

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

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

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

and

Me Anne-Marie Beaudoin
Corporate Secretary
Autorité des marchés financiers
800, square Victoria, 22e étage
C.P. 246, tour de la Bourse
Montréal, Québec H4Z 1G3
e-mail: consultation-en-cours@lautorite.qc.ca

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

Questions may be referred to any of:

Tracey Stern   Susan Greenglass

Ontario Securities Commission
(416) 593-8167

Ontario Securities Commission
(416) 593-8140

Sonali GuptaBhaya
Ontario Securities Commission
(416) 593-2331

Matthew Thompson
Ontario Securities Commission
(416) 593-8223

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

Doug Brown
Manitoba Securities Commission
(204) 945-0605

Lorenz Berner
Alberta Securities Commission
(403) 355-3889

Mark Wang
British Columbia Securities Commission
(604) 899-6658

Meg Tassie
British Columbia Securities Commission
(604) 899-6819

Cassie Scanlan
British Columbia Securities Commission
(604) 899-6766

Appendix A

SUMMARY OF PUBLIC COMMENTS ON PROPOSED AMENDMENTS TO NATIONAL INSTRUMENT 21-101 *MARKETPLACE OPERATION* AND NATIONAL INSTRUMENT 23-101 *TRADING RULES* REGARDING THE TRADE-THROUGH PROPOSAL AND CANADIAN SECURITIES ADMINISTRATORS RESPONSES

General Comments *Framework for Trade-Through Proposal* General support was expressed by a number of commenters for the proposal that responsibility for trade-through protection should lie with marketplaces. Two commenters did not favour a trade-through rule. One of these commenters stated that it did not believe a trade-through rule was necessary, particularly for institutional orders.	*The Canadian Securities Administrators (CSA or we) believe that a trade-through protection rule will help in maintaining investor confidence and fairness in our markets. In addition, imposing the obligation on marketplaces would allow flexibility in determining how to best implement the trade-through protection rule.*
A couple of commenters urged Canadian regulators to implement a consistent system with that of the U.S.	*Where appropriate, the CSA have endeavoured to make the proposed trade-through protection regime consistent with the system used in the U.S.*
Finally, another commenter remarked that marketplaces must be responsible for ensuring accessibility on a consistent and reliable basis prior to launch involving the dealers, the marketplaces and the vendors. This commenter further stated that since the Canadian marketplace relies on third party vendor technology for access to marketplaces and post-trade processing, coordinated and successful industry-wide testing is a critical success factor to the introduction of new marketplaces in Canada. *Need for Data Consolidation and Smart Order Routers*	*We have updated existing provisions to require a marketplace to publicly make available its technology requirements in their final form for at least three months immediately prior to operations and to provide public testing facilities for interfacing with or accessing the marketplace for at least two months immediately prior to operations. However, industry-wide testing is not being proposed at this time.*
Some commenters expressed the view that a	*While we are of the view that a centralized*

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

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

Comments	*CSA Responses*
An overwhelming majority of commenters were not supportive of imposing an obligation on marketplace participants to address trade execution on a foreign market.	*The CSA agree that the trade-through obligation should not apply to protect better-priced orders displayed on a foreign market. However, we note that currently, best execution would require marketplace participants to consider foreign markets when executing a trade. We have also proposed an anti-avoidance provision (section 6.7 of NI 23-101) to prevent the routing of orders to foreign marketplaces only for the purpose of avoiding the trade-through regime in Canada.*

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

Comments	CSA Responses
Commenters recommended the following factors should be considered when developing a cost-benefit analysis for the trade-through proposal: • Total cost to the marketplace of imposing trade-through obligations on various marketplace participants; • Total industry costs; • Access fees, settlement and clearing fees, cost of surveillance and monitoring of trading on each marketplace; • Costs of a system that is inconsistent with the U.S.; • Benefits of maintaining strict trade-through protection; • Net measurement of the benefit to the client; • Aggregate cost to the industry rather than on a dealer by dealer basis; • Cost of surveillance and monitoring within the dealers' compliance units; • Regulatory costs of the market regulator(s); • Impact of latency – missed opportunities, information leakage and high transaction and clearing costs if orders must travel to many destinations before they are filled; and • Look at the cost-benefits for trade-through on a portfolio or multiple order basis in addition to a single stock basis. One commenter stated that it is important to view all of the limit orders at the bid or ask in the aggregate in order and to consider the contribution made by retail orders.	*The CSA thank all commenters for their input. We are publishing a cost-benefit analysis which examines the anticipated incremental impact of the proposed amendments. The comments received have, where appropriate, informed that analysis. For example the current participant level obligation, removing current requirements and applying the trade-through obligation at the marketplace level were considered in the CBA.*

Question 3: Would you like to participate in the cost-benefit analysis by providing your input?	
Comments	*CSA Responses*
Seven commenters expressed an interest in providing input into the cost-benefit analysis.	*The CSA thank these commenters for their interest in participating in the cost-benefit analysis. We are publishing a cost-benefit analysis along with the proposed amendments and invite all interested parties to provide comments and estimates of the anticipated costs and benefits of the proposal. We will be considering conducting targeted consultation in the future.*

Question 4: Should trade-through protection apply only during "regular trading hours"? If so, what is the appropriate definition of "regular trading hours"?	
Comments	*CSA Responses*
Ten commenters believe that trade-through protection should only apply during "regular trading hours". Many of these commenters suggested that 9:30 a.m. to 4 p.m. ET should be the appropriate definition of "regular trading hours".	*The CSA are of the view that trade-through protection should apply across markets whenever two or more marketplaces with displayed protected orders are open for trading. Consequently, we have not defined "regular trading hours" but have provided some guidance in 23-101CP.*
Some commenters did not believe that trade-through protection should be limited to a portion of a trading day.	
A few of these commenters cited that trade-through protection should apply when two or more marketplaces are open simultaneously however trade-throughs of marketplaces that are closed should be allowed.	
Some reasons cited for this stance included: • Applying trade-through protection at all times would prevent liquidity to migrate to hours when trade-through obligations do not apply; and • Will avoid the confusion that may arise from different interpretations of	

"regular trading hours".	

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

Comments	*CSA Responses*
Most commenters believe that that all visible, better-priced orders should be protected and that the trade-through obligation should extend through the whole depth-of-book.	*The CSA agree that the trade-through obligation should apply to the full depth-of-book. Under the proposed trade-through protection rule, all visible, better-priced orders displayed on marketplaces with automated functionality would be protected, subject to certain "permitted" trade-throughs as described in our response to comments in Question 9 below.*
One commenter remarked that trade-through protection for the top five levels would be an onerous requirement and concurs with the U.S. approach that trade-through protection should extend to top-of-book quotations only.	
Another commenter was of the view that a trade-through rule is only appropriate where a consolidated quote is available.	*The CSA agree that a consolidated quote would assist in meeting the trade-through obligation but this is not a necessity to effectively meet this requirement. As stated above, we are currently working towards the introduction of an information processor.*

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

Comments	*CSA Responses*
The majority of commenters responding to this question indicated that they are not supportive of imposing a limit on the fees charged on a trade-by-trade basis to access an order on a marketplace for trade-through purposes. Many of these commenters cited that fees should be determined by competition.	*In response to the comments received, we are proposing not to impose a specific limit on the fees charged but to refer to the minimum price increment outlined in IIROC Universal Market Integrity Rule 6.1. We have also prohibited a marketplace from imposing terms that have the effect of discriminating between orders routed to the marketplace to prevent trade-throughs and orders that originate on that marketplace. We have requested further comment as to whether it is appropriate to set a cap with a specified dollar amount.*
Six commenters did favour fee caps. Some reasons for this position included: • The playing field for all participants would be level and memberships to an	

ATS may increase; • Prices would be easily comparable across marketplaces; • Dealers would be protected from becoming captive to unreasonable marketplace fees; and • Investors would not have to indirectly bear a disproportionate amount of the costs for accessing quotes under the trade-through obligations.	

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

Comments	*CSA Responses*
Most commenters responding to this question were in favour of establishing a threshold that would require an ATS to permit all groups of marketplace participants. Suggested appropriate thresholds included: 20%, 10%, and 5% of market share. One commenter stated that ATSs should provide access to all groups of market participants when they have been deemed to be a relevant marketplace. Another commenter was of the belief that marketplaces should not unduly restrict access and that all categories of marketplace participants should be allowed to trade. Another commenter was unsure of an appropriate threshold in the absence of a fully competitive environment. This commenter suggested that this concept be revisited after a year of the operation of multiple marketplaces to assess the feasibility of establishing a suitable threshold for Canadian marketplaces. Five commenters did not support a legislated threshold that would require ATSs to allow access to all groups of marketplace participants. Some of these commenters believed that: • The CSA practice of looking at this issue on a case by case basis from the	*Rather than requiring that a marketplace provide direct access to all groups of participants when it meets a certain threshold, we have instead provided additional guidance regarding fair access in 21-101CP. We will continue to monitor this issue.*

broad public interest point of view is appropriate; and
- It is unclear whether exchanges are complying with the U.S. fair access rule since only dealers can be members.

Question 8: Should it be a requirement that specialized marketplaces not prohibit access to non-members so they can access, through a member (or subscriber), immediately accessible, visible limit orders to satisfy the trade-through obligation?
- **Should an ATS be required to provide direct order execution access if no subscriber will provide this service?**
- **Is this solution practical?**
- **Should there be a certain percentage threshold for specialized marketplaces below which a trade-through obligation would not apply to orders and/or trades on that marketplace?**

Comments	*CSA Responses*
Access of Non-members to Specialized Marketplaces Many commenters responding to this question supported the requirement of specialized marketplaces allowing access to non-members so that they can access immediately accessible, visible limit orders to satisfy the trade-through obligation. Some reasons cited for this position included: • the trade-through obligation is a duty owed by all marketplace participants to the capital markets in general and therefore all marketplace participants with such an obligation should have fair access to all better-priced orders; and • such a prohibition creates a powerful disincentive to join new marketplaces as compliance burdens will increase. Other commenters not in favour of this requirement submitted that: • marketplaces that limit membership contain, by definition, orders that are	*With respect to issues relating to access to marketplaces by non-members/subscribers to a marketplace, we are not proposing that a marketplace provide direct access to non-members/subscribers. Under the proposed amendments, marketplaces would be given the discretion to determine how best to meet their trade-through obligations. This issue will be discussed with the industry implementation committee.*

not immediately accessible, visible limit orders (by virtue of the fact that excluded members cannot see or execute against orders in this type of marketplace) and therefore these orders should be deemed "excluded orders"; and

- it is not appropriate or necessary to force a specialized marketplace to change its technology or by-laws merely to allow the occasional and otherwise non-qualifying market participant to displace a quote for trade-through purposes.

Direct Order Execution Access

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

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

Practicality of Direct Order Execution Access

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

Two commenters did not believe this is a practical solution.

Threshold Limits for Trade-Through Obligation

Suggested thresholds for which a trade-through obligation would not apply to orders and/or trades on a marketplace ranged from

The CSA have not set a threshold at which the trade-through obligation would apply and believe that the obligation should apply to all

5% (after one year of continuous trading) to 10% of trading volume of a Canadian issuer.	*visible limit orders on a marketplace.*

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

Comments	*CSA Responses*
Many commenters remarked that the exemption of special terms orders listed in the joint notice is appropriate. One commenter cited that special terms orders that are used to establish the last sale price should not be exempt from the trade-through obligation. Another commenter contended that all special terms orders should be exempted. Another commenter specified that the ability for a "fill" term order (all-or-none, minimum fill) to trade-through a better-priced order on another marketplace should be consistent with how it is treated in a market and any exemptions for marketplaces with larger minimum order sizes. This commenter also added that "settlement" terms such as cash, delayed delivery etc. and odd lots should also be exempt from the trade-through rule. One commenter stated that the exclusion of special terms orders should be consistent with UMIR.	*We have not proposed a general exemption for all special terms orders. However, subsection 5.1(3) of Companion Policy 21-101 CP outlines that special terms orders that are not immediately executable or that trade in special terms books, such as all-or-none or minimum fill orders, are not required to be provided to an information processor or an information vendor. Therefore, these types of orders would not fall under the definition of "protected orders" under the proposed rule and hence would not receive trade-through protection. However, those executing against these types of orders are required to execute against all better-priced orders first.* *In addition, orders with special settlement terms and "calculated price orders" have been included in the list of "permitted" trade-throughs in paragraph 6.2(e) of NI 23-101.* *As well, certain marketplaces provide an after-hours trading session at a price established by that marketplace during its regular trading hours for marketplace participants who are required to benchmark to a certain closing price. In these circumstances, a marketplace would not be required to take steps to reasonably prevent trade-throughs of orders on another marketplace.*

Question 10: Are there current technology tools that would allow monitoring and enforcement of a flickering quote exception?	
Comments	*CSA Responses*
While commenters responding to this question were not aware of any technology tools available to allow for the monitoring and enforcement of a flickering quote exception, some suggested an "inter-market sweep order" to address this issue. Another commenter stated that it would be possible to develop a non-real time monitor at RS that would compare time stamps of orders and trades. Some commenters stated that it would be impractical to monitor for flickering order exceptions. Commenters offered the following alternative suggestions to a flickering order exception: • dealers should demonstrate that their trading policies and procedures are designed to minimize instances of trade-through caused by "flickering orders"; • initially monitor the reality of a multi-market operating environment in order to ascertain if this will actually be a material issue that warrants development work; • dealers to keep a log book that documents the instances and rationale as to why an order was non-executable, and if appropriate, the Participant could send an exception report to RS when this occurs; and • use "pattern" based regulation so that if a participant demonstrates a consistent pattern of abusing the exception it would be dealt with by regulators at that time.	*It is expected that a marketplace will conduct periodic reviews to test the effectiveness of its policies and procedures for reasonably preventing trade-throughs and ensuring compliance with Part 6 of NI 23-101. We are of the view that a marketplace must retain relevant information so that the effectiveness of its policies and procedures can be adequately evaluated by regulatory authorities. In certain circumstances, such as sending an inter-market sweep order, it may be appropriate for marketplace participants to maintain relevant information so that compliance with Part 6 of NI 23-101 can be adequately evaluated by regulatory authorities.*

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

Comments	*CSA Responses*
A number of commenters responding to this question believe that a specified time period may not be practical. One commenter suggested that instead of a specific period of time after the trade that would provide a safe harbour from trade-throughs, dealers should be required to demonstrate through either system documentation or through their audit trail that, at the time of order entry their orders were routed to the best priced marketplace given their current view of market data. Other commenters suggested that the appropriate duration should vary given the nature of the order, time of day and transaction load and one commenter suggested that it may be appropriate to have several time periods based on the nature of the order entered. One commenter suggested a quote which lasts for less than 5 seconds should not be subject to trade-through protection.	*We have allowed for the provision of "flickering orders' where a marketplace displaying the best price was traded through but had displayed, immediately prior to execution of the trade-through, an order with a price that was equal or inferior to the price of the trade-through transaction. We have asked a specific question as to what length of time should be considered an "immediate" response by a marketplace to a received order in the attached Notice. In our view, because of the high speed of trading, one second may be too long.*

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

Comments	*CSA Responses*
Three commenters specifically stated that they support the exemption from trade-through obligations of Market-On-Close (MOC) orders. One commenter requested further clarification on what factors will be used to determine what the opening and closing price is for a security. One commenter referred to its position that	*As mentioned above, if a marketplace is operating a special trading facility with a set closing price, under paragraph 6.2(e of NI 23-101) a marketplace could execute closing price orders and would not be required to take steps to reasonably prevent trade-throughs of orders on another marketplace. Otherwise, if two marketplaces with displayed protected orders are open for trading in their regular trading session, the trade-through protection*

trade-through protection should apply to all marketplaces that are open for continuous trading at any given time.	*rule would apply.*

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

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

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

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

Comments to Questions 15 to 18 and the corresponding CSA responses were published on June 20, 2008 in the Ontario Securities Commission Bulletin at (2008) 31 OSCB 6306.

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

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

14

or any conflict of interest that may exist.	
One commenter was of the view that ATSs should provide standardized and periodic data in order for market participants to be able to reasonably consider any dark pool options for best execution.	

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

Comments	*CSA Responses*
Foreign Trades The majority of commenters who responded to this question do not believe there should be a requirement to report foreign trades in Canada. Two commenters elaborated that there is a great potential cost in providing this information with little tangible benefit. Three commenters favoured the disclosure of foreign trades. One of these commenters supported this type of disclosure when there is a relationship between the parties which dictates how orders are routed. Another commenter suggested that this information would provide additional data points for internal analysis. *OTC Trades* With respect to OTC trade information, one commenter noted that although a lack of transparency combined with limited comparative information can make it difficult to measure best execution on the OTC market, such information may be useful in certain cases such as government issues.	*We are not proposing that trades executed on a foreign market or over-the-counter be included in the data. We are focussing on where securities are traded on multiple marketplaces in Canada.*

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

Comments	*CSA Responses*
The majority of commenters responding to this question did not believe that dealers should report information about orders that are routed due to trade-through obligations. Reasons for this position included: • Detailed information about routing of orders and decisions made in the trade process is more appropriately collected as part of the TREATS initiative; • This requirement would induce more delays and offloads undue operational and regulatory costs onto participants; and • Additional reporting requirements should be deferred until the market has been operating in the context of the proposed regulations for a reasonable amount of time and careful study reveals a compelling regulatory need for such a requirement. Two commenters supported the reporting of information relating to orders routed for trade-through compliance purposes. One of these commenters however stated that it wants the CSA to be confident that the benefits of receiving such reports outweigh the costs associated with building a reporting structure before mandating this information.	*We are not proposing at this time to include information about orders that are routed due to trade-through obligations. This may be re-assessed once the trade-through requirements have been in place for a period of time.*

Question 22: Should information reported by a marketplace include spread-based statistics?	
Comments	*CSA Responses*
Six commenters did not support the requirement of marketplaces reporting spread-based statistics. Some reasons listed for this position include: • There are difficulties in setting objective standards so that everyone reports in similar ways and the statistics could be manipulated by selectively including/omitting execution data; • Depending on the nature of the marketplace, it may be completely irrelevant information; and • Spread based statistics will not assist in determining speed of execution, certainty of execution and over-all cost of the transaction. Five commenters indicated that spread based statistics should be reported for the following reasons: • Spread statistics are required when considering best execution for passive order flow; • This information is important for conducting transaction cost analysis in the form of implementation shortfall analysis; and • This information is the best metric for liquidity.	*There were mixed views on whether to include spread-based statistics. As a result, we have proposed that marketplace reporting include spread-based statistics and have specifically requested comment on this point.*

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

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

II. *List of Respondents*

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

Appendix B

Cost-benefit Analysis

Proposed Trade-through Protection Rule

On April 20, 2007, the CSA and Market Regulation Services Inc. (now the Investment Industry Regulatory Organization of Canada or IIROC) published the *Joint Notice on Trade-Through, Best Execution and Access to Marketplaces* (Joint Notice).[1] In the Joint Notice, we said that we would prepare a cost-benefit analysis for the proposal and we asked for comments on what factors we should consider. We also invited interested parties to let us know if they would like to participate further in our analysis process.

We thank everyone who submitted comments. This paper outlines the qualitative cost-benefit analysis we conducted to aid in the policy making process. The analysis incorporates the comments we received.

Our economic rationale for proposing a trade-through protection rule, where the obligation falls on marketplaces, reflects the following economic realities:

- marketplaces are well positioned to take advantage of economies of scale and can implement the necessary technical infrastructure at a lower cost than if all participants were required to do so
- the incremental compliance costs for dealers will be modest because there is already a trade-through rule (UMIR Best Price Rule, defined below), and
- marketplaces are already adding order routing capabilities that can be used to comply with the proposed rule, both as a service to their participants and in anticipation of CSA rulemaking

We welcome your feedback on this cost-benefit analysis and are interested in any empirical data you can provide in support of your comments. As part of the next phase, we will be contacting those who expressed interest in participating further in the analysis.

Overview

The CSA does not address trade-throughs[2] or a best-price obligation[3] in any of its rules. These obligations are currently set out in UMIR Rule 5.2 *Best Price Obligations* (UMIR Best Price Rule). However, this rule only applies to investment dealers that are members of IIROC.

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[1] (2007) 30 OSCB (Supp-3).

[2] A trade-through occurs when better-priced limit order is bypassed in favour of an inferior-priced limit order.

[3] A best-price obligation is an obligation to ensure that trades are not executed at inferior prices.

In the past, the UMIR Best Price Rule was sufficient to protect better-priced limit orders from being traded-through because only dealers had direct access to marketplaces. In addition, after the specialization of exchanges in 1999, individual securities were traded only on a single marketplace. The marketplace could then enforce price priority and avoid trade-throughs on an intra-market basis.

The introduction of multiple marketplaces trading the same security, including some marketplaces that allow direct access by non-dealers, has limited the effectiveness of the UMIR Best Price Rule. Multiple marketplaces increase the potential for trade-throughs because no one marketplace can enforce price priority on an inter-market basis.

In addition, the limited jurisdiction of UMIR means dealers and non-dealers that engage in similar trading activities[4] are operating under different regulatory requirements. As a result, non-dealers can trade-through better-priced orders without breaching any regulations.

When participants that conduct the same activity are subject to different regulatory standards, regulatory asymmetry occurs. This is a concern to the CSA because it can:

(a)   impact competition
(b)   adversely affect the broader market and its participants, and
(c)   create "free-riders" in the market

(a)   Impact on competition

The asymmetry in the regulatory treatment of dealers and non-dealers can affect how marketplaces compete for large transactions.

Institutional investors often want to limit the risks and costs associated with trading a block of shares by minimizing the potential for information leakage to the wider market. Institutional traders will not post a limit order for the full size of an order because the market could move against the trader, affecting the price paid and therefore the total cost of the transaction.

Instead, institutional traders will break a large order into smaller orders or trade on a less transparent marketplace where the risk of information leakage is reduced. For example, they may execute the trade:

- through a dealer in the "upstairs" market
- using hidden orders within a transparent limit order book (e.g. an iceberg order), or
- on an ATS that does not have pre-trade transparency (i.e. a dark pool[5])

If a dealer is trading via an exchange or an ATS, it is required to honour all better-priced limit orders. However, an institution can trade-though better-priced orders by trading

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[4] Although non-dealers are only able to participate on a principal basis
[5] A dark pool is a marketplace that allows buyers and sellers to anonymously match stock orders without pre-trade transparency.

directly on an ATS. This can give non-dealer participants a competitive advantage over dealers. It can also give ATSs with non-dealer access an advantage over other marketplaces.

(b)   Impact on broader market

Trade-throughs can negatively affect other market participants. Limit order traders are impacted when a trade-through causes the delayed or missed execution of a limit order. This represents a cost to the trader that posted the limit order. Imposing a cost on others without compensation is a form of market failure and is of particular concern of regulators.

Repeated trade-throughs could also affect the market as a whole by decreasing the value of posting a limit order. As trade-throughs become more common, more participants may feel that they are not being compensated for exposing their limit orders and that the market is becoming less fair. Traders might then post fewer limit orders, which could negatively affect price discovery and market quality.

(c)   Free-rider issues

Regulatory asymmetry creates free-riders that benefit from market integrity without necessarily paying for it. Dealers have the obligation to prevent trade-throughs and bear the costs of meeting that obligation. An example is the cost of monitoring multiple marketplaces on a real-time basis. The market benefits from the resulting market integrity and perception of fairness. This in turn, encourages traders to post limit orders and fosters an efficient price discovery process.

However, because non-dealer participants do not have this same obligation they can benefit from participating in a robust market without incurring the associated costs or taking into account other market participants. In essence, non-dealers are free-riders.

Scale and scope

Over the past few years, the number of marketplaces for trading equity securities in Canada has increased. Today, there are seven marketplaces that trade TSX-listed securities. Four of the current marketplaces use a continuous auction trading model, while the others use call auctions or negotiated trading.

Two of these marketplaces (Blockbook and Liquidnet) are ATSs which operate as dark pools and allow non-dealers to trade directly. While the ATS market in Canada is still developing, we expect that Canadian institutional investors will increase their use of these marketplaces over time. However, we do not anticipate that these marketplaces will completely replace dealer intermediated trading by institutional investors.

For some insight on the likely extent of dark pool trading we can look to the U.S. market. The U.S. has seen considerable growth in the number of dark pools and their use by

institutional investors, but dark pool trading still accounts for less than 7% of total market volume.[6]

Trading on Blockbook and Liquidnet has resulted in a number of trade-throughs by non-dealers. While these trade-throughs do not represent a significant proportion of total traded volume on Canadian markets, they have, to varying degrees, affected the traders whose posted limit orders were traded-through.

Objective and policy rationale

The CSA's objective is to promote competition, fairness, and price discovery in Canada's equity markets by updating market policy to reflect changes in market structure. This includes applying regulatory requirements consistently to participants engaging in similar activities.

Since IIROC has limited jurisdiction over non-dealer marketplace participants, it cannot enforce the UMIR Best Price Rule on these participants. Non-dealers have an economic incentive to trade-through better-priced orders if they can execute larger trades without the information leakage and costs associated with exposing their intent.

As a result, there is little incentive for non-dealers to voluntarily honour those better-price orders. We think that regulatory intervention is necessary to create a level playing field for market participants and to address the potential negative market impacts and free-rider issues associated with the current regime.

Policy alternatives

The status quo is not desirable because of the identified competitive issues and the potential negative effect on the market. We have considered the following three policy alternatives and evaluated each in terms of their anticipated impact on the market and its participants and the ability of each option to achieve our regulatory objective:

(a)   create a participant-level best-price obligation for non-dealers
(b)   remove the UMIR Best Price Rule, and
(c)   create a trade-through obligation that applies to marketplaces (the Proposed Trade-through Protection Rule or the proposed rule)

Costs and benefits

(a)   Participant-level obligation

As noted above, dealers already have obligations under the UMIR Best Price Rule but non-dealers do not. One way to address the current regulatory asymmetry is to create a best price rule that applies to non-dealer participants as well as dealers. Requiring both dealers and non-dealers to take reasonable steps to prevent trade-throughs would address the competitive imbalance of the current environment. Non-dealers would no longer be able to free-ride on the activities of dealers.

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[6] Rosenblatt Securities, "Let there be light, Rosenblatt's Monthly Dark Liquidity Tracker", May 22, 2008.

This alternative would not impose any new requirements on dealers. Those that are complying with the existing UMIR Best Price Rule would not incur any additional compliance costs. However, non-dealers would have to implement policies and procedures to prevent trade-throughs. This would include building systems to monitor multiple marketplaces and route orders to the best available price. These costs could be significant.

To a large degree, these costs would be fixed costs and would not be proportional to the size of the firm. Large firms might be able to absorb these costs given their high volume of trading. However, smaller firms would face proportionally higher compliance costs because of the limited economies of scale.

The costs could discourage some non-dealers, especially smaller firms, from directly participating in the market. This could affect the ability of marketplaces whose niche is serving institutional investors to offer a competitive alternative to existing marketplaces. Fewer execution options for institutional investors could result, which is inconsistent with our objective of promoting competition.

(b)   Remove the UMIR Best Price Rule

Removing the current UMIR Best Price Rule is, perhaps, the most controversial of the options. Some argue that a trade-through or best-price rule is not required.[7] However, industry commenters to the April 2007 Joint Notice generally supported the need for trade-through protection in the Canadian market.

Removing the UMIR Best Price Rule would eliminate the regulatory asymmetry present in the current regime and addresses the free-rider concern. There would be no additional compliance costs for dealers or non-dealers.

However, limit order traders and the broader market are affected if traders are allowed to trade-through better-priced orders. Without a best price rule, traders could choose which orders to trade against, subject to their best execution obligations. They would not take into account the impact on better-priced orders. Trading-through a better-priced order could result in a delayed or missed execution for posted orders. A decrease in the likelihood of execution represents an increase in trading costs for limit order traders. A decrease in the value of exposing limit orders to the market could result in fewer limit orders being placed.

Having the UMIR Best Price Rule has meant that Canadian market participants are used to, and expect, a market with price priority. Removing that rule, and therefore price priority across marketplaces, could make Canada a less attractive market in which to post limit orders. Canadian marketplaces might find it harder to attract liquidity which could affect the efficiency of the Canadian market and its ability to compete. It is important to

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[7] For an overview of academic research in this area see Comerton-Forde, Carole and Bruce Robert Arnold, 2005, Literature Review: Best Execution and Trade-Though, Market Regulation Services Inc.

keep in mind that that the SEC's Regulation NMS does create a marketplace level best-price obligation in the U.S. market.

Removing the UMIR Best Price Rule could also reduce competition in the Canadian market. Attracting liquidity and traders away from the established marketplaces can be a significant barrier to entry for new marketplaces. A best price obligation results in orders being directed to the marketplace with the best price.[8] This lowers the barriers to entry for those new marketplaces that are able to offer competitive quotes. Without a best price obligation it could be more challenging for a new marketplace to compete.

Finally, to the best of our knowledge there has been no research on a market that has removed an entrenched best-price rule. As a result, there is little to indicate what the actual impact would be of removing the UMIR Best Price Rule.

(c)   Create a marketplace level rule

These first two alternatives would address the regulatory asymmetry between dealers and non-dealers, however there could be significant negative impacts associated with each of them. Therefore, our analysis focuses on the Proposed Trade-through Protection Rule, which would apply to marketplaces rather than participants.

(i)   *Compliance costs for marketplaces*

Imposing a trade-through rule at the marketplace level would result in costs for Canadian marketplaces trading equities. Marketplaces could have to:

- determine how to comply with the rule
- implement and maintain written policies and procedures to prevent trade-throughs
- train staff on the rule and their policies and procedures
- maintain and update the policies and procedures to ensure continued compliance with the rule
- acquire information and systems to monitor activity on all other protected marketplaces
- update trading systems to be able to process the Inter-market Sweep Order (ISO) marker and identify other permitted trade-throughs, and
- implement polices and procedures relating to the identification of system malfunctions and the required communication to other marketplaces, regulation service providers and marketplace participants

The following is a summary of the most significant costs for marketplaces under the proposed rule.

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[8] The current UMIR Best Price Rule contains a number of qualifications that are designed to restrict the benefits of the requirement to marketplaces that meet certain standards.

Policies and procedure to prevent trade-throughs
The Proposed Trade-through Protection Rule intentionally includes flexibility for
marketplaces and does not prescribe any one way in which a marketplace can meet its
regulatory obligations.

Marketplaces would need access to real-time consolidated bid and offer information to
identify possible better-priced orders. They could develop this information themselves, as
many with order routers have done, or they may be able to buy the information from an
information vendor or service provider.

However, trade-throughs could be prevented by choosing to reject orders that would
result in a trade-through of a better-priced protected order. This logic would have to be
programmed into the marketplace's trading system.

Or, a marketplace could redirect incoming orders to the better available price(s) by
establishing linkages with other marketplaces. This could be done using in-house smart
order routing technology or a service provider.

We recognize that implementing a smart order router could be costly. However, most
existing Canadian marketplaces have added or plan to add order routing capabilities[9]
through a smart order router or a third-party service provider. They are doing this as a
value-added service and, possibly, in anticipation of the proposed rule creating a
marketplace obligation. As a result, we anticipate that these marketplaces have already
provided for these costs.

Compliance monitoring
Access to historical consolidated bid and offer information would be necessary to
perform ongoing monitoring of a marketplace's policies and procedures. Marketplaces
could compile this information from what is currently available or it may become
available from a service provider. If marketplaces compile the information in-house and
build their own historical database there would be associated, and possibly significant,
costs.

We do not anticipate that access to consolidated bid and offer information would be a
significant incremental cost for marketplaces with a smart order router as such data
would be needed for more than compliance with the proposed rule.

The other component to monitoring compliance is information about the trading activity
on each marketplace. Marketplaces may already be storing such information for business
purposes and so we do not anticipate material incremental costs as a result of the
proposed rule.

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[9] Either through the use of a smart order router or via a third-party service provider.

Updated systems, policies, and procedures
Marketplaces would need to update their trading systems to incorporate the proposed ISO marker. Incorporating the ISO marker should involve minimal incremental costs because it is expected to evolve from the current bypass marker

(ii) *Compliance costs for dealers*

We anticipate that there would be compliance cost savings for dealers if the trade-through obligation is moved to the marketplace level.

Marketplace monitoring
Under the current regime, dealers need to monitor other marketplaces so as to identify better-priced orders and route their orders as necessary.

Some dealers have implemented monitoring and routing systems to address a business need as well as meet regulatory requirements. Firms that have high trading volumes and want to take advantage of low latency trading would arguably invest in this technology whether or not there is a trade-through rule. Because these firms are able to exploit the available economies of scale, the cost per-client or per-trade is expected to be reasonable.

Dealers that operate on a smaller scale or who trade lower volumes are faced with significant costs in order to comply with the current dealer level obligation contained in the UMIR Best Price Rule. These firms cannot take advantage of economies of scale and would find it difficult to realize a return on the necessary investment in infrastructure. We anticipate that the proposed rule would reduce the burden on these firms because they would no longer be subject to market monitoring and access requirements.

Updated systems, policies, and procedures
Dealers would need to update their trading systems to incorporate the proposed ISO marker. These costs could be higher for dealers with proprietary software than for dealers that use third-party systems. System vendors would presumably make changes for the benefit of all their clients, which would reduce the cost per client.

Incorporating the ISO marker should involve minimal incremental costs because it is expected to evolve from the current bypass marker. However, dealers would also have to develop and implement policies and procedures to ensure that the ISO order marker is used appropriately. This would include training staff on using the marker.

The ISO marker would also allow firms to benefit from any market monitoring and order routing technology that they have already invested in. There could be some degree of latency associated with a marketplace checking an incoming order against the quoted prices on other marketplaces. The ISO marker would allow dealers to avoid that latency if it duplicates the checks they already perform.

Dealers would also have to develop policies and procedures on using the ISO marker when dealing with systems failures or malfunctions experienced by a marketplace. They

would have to document and keep records of the steps taken and notify the marketplace with the apparent system malfunction and the regulation service provider.

Dealers would have to be able to demonstrate compliance with the requirements relating to ISO markers and would have to access information about market conditions at the time an ISO order was routed.

Dealers may be able to access consolidated market data via a vendor[10] or choose to construct that consolidation themselves. Firms would have to access historical consolidated market data to demonstrate compliance on a post-trade basis. The cost of data storage could be significant because the proposed rule applies on a depth-of-book basis.

A data consolidator or other data vendor may make consolidated historical information available at a reasonable cost. In the United States, service providers and exchanges sell access to these databases. For example, Nasdaq's Market Replay, which allows users to display market conditions at a point in time, is available for a relatively modest cost.

(iii) *Compliance costs for non-dealer market participants*

Updated systems, policies, and procedures
Costs related to implementing the ISO marker would only be incurred by non-dealers that want to use the marker. Firms that choose to use the ISO order marker might have to update their trading systems. We anticipate that this cost would be higher for firms using proprietary trading systems. They would also have to develop and implement policies and procedures to ensure that the ISO order marker is used appropriately. This would include training staff using the marker.

Firms would also have to store certain information about market conditions at the time an ISO order was routed. As noted above, the cost of storing data in-house could be significant. However, we anticipate that a data vendor will be able to take advantage of economies of scale and make a database available at a reasonable cost.

Impact on trading
Transaction costs for certain types of trades (i.e. block trades) might increase for non-dealers because they would no longer be able to trade-through better-priced orders.

(iv) *Costs for other stakeholders*

Market data vendors and other service providers would have to modify their systems to:

- process markers for ISOs, and
- identify marketplaces that are experiencing a system failure or malfunction

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[10] TSX, "TSX Datalinx to launch consolidated Canadian data feed including data from ATSs", press release, October 31, 2007

(v) *Impact on competition*

We expect the proposed rule to restore an appropriate competitive balance. Marketplaces would be required to have policies and procedures to prevent trade-throughs and, as a result, dealers and non-dealers would be subject to same trading constraints. These requirements would apply to all marketplaces. Those that permit non-dealer access would not have a regulation based advantage over other marketplaces in attracting order flow from institutional investors.

While there is some degree of flexibility in how marketplaces would meet their obligation to prevent trade-throughs, many would likely implement order routing capabilities. The costs associated with this could be a barrier to entry for new marketplaces. However, the actions of current marketplaces suggest that, regardless of the rules, order routing capabilities may be required to be competitive.

The proposed rule would require that prior to executing a trade, marketplaces check:

- displayed quotes on other marketplaces to ensure that there are no better-price orders, or
- ensure that the order is marked as an ISO

This step could increase the amount of time it takes to process a trade. However, since all marketplaces would have to conduct these checks, any increased latency should not affect how marketplaces compete with one another.

We do not anticipate that the proposed rule would have any other effects on competition. Marketplaces would still be able to compete in areas other than the quoted price while taking steps to prevent trade-throughs from occurring.

(vi) *Impact on investors*

The proposed rule would reduce the opportunity for trade-throughs to occur. This could promote the perception of fairness in the market and encourage market participation. It would also reduce the likelihood of investors being affected as a result of having an order traded-through.

Any increased transaction costs experienced by institutional investors will ultimately be passed on to the institutions' clients (e.g. pension plan members, mutual fund investors, etc.). On a per-client basis, the additional transactions costs are expected to be limited.

Conclusion

While all three policy options address the regulatory asymmetry, they also all have associated costs. In our opinion, the costs of creating a trade-through rule for non-dealers or of removing the UMIR Best Price Rule would not be proportionate to our objective. As a result, we think the Proposed Trade-through Protection Rule is the most balanced way to meet our objective.

Complying with the proposed rule would involve costs, particularly for marketplaces. We anticipate that current efforts to develop and implement smart order routers should limit the incremental cost of the rule. Most of the compliance costs would be fixed costs related to policies, procedures and systems. In our view, marketplaces are better positioned to take advantage of economies of scale in managing these costs than dealers and non-dealers.

AMENDMENTS TO NATIONAL INSTRUMENT 21-101 MARKETPLACE OPERATION

PART 1   AMENDMENTS

1.1   Amendments

(1)   This Instrument amends National Instrument 21-101 *Marketplace Operation*.

(2)   The definitions in section 1.1 are amended as follows:

(a)   the definition of "IDA" is repealed and replaced by the following ""IIROC" means the Investment Industry Regulatory Organization of Canada";

(b)   the definition of "inter-dealer bond broker" is amended by:

(i)   striking out "IDA" and substituting "IIROC";

(ii)   striking out "By-law No. 36" and substituting "Rule 36"; and

(iii)   striking out "Regulation 2100" and substituting "Rule 2100"; and

(c)   adding the following definitions:

""effective spread" means,

(a)   for buy orders, double the amount of the difference between the execution price and the midpoint of the best bid price and best ask price as identified by an information processor, or if there is no information processor, on a particular marketplace at the time of order receipt; or

(b)   for sell orders, double the amount of the difference between the midpoint of the best bid price and best ask price as identified by an information processor, or if there is no information processor, on a particular marketplace at the time of order receipt and the execution price.

"realized spread" means,

(a)   for buy orders, double the amount of the difference between the execution price and the midpoint of the best bid price and best ask price as identified by an information processor, or if there is no information processor, on a particular marketplace five minutes after the time of order execution; or

(b)   for sell orders, double the amount of the difference between the midpoint of the best bid price and best ask price as identified by an information processor, or if there is no information processor, on a particular marketplace five minutes after the time of order execution and the execution price; and

Where, for orders that execute within the last five minutes of a marketplace's trading hours, the midpoint referred to in paragraphs (a) and (b) is the midpoint of the final best bid price and best ask price disseminated for the trading day.".

(3)   The following section is added after section 10.1:

"**10.2 Trading Fees for Trade-Through Purposes** – With respect to trading fees charged for the execution of an order to comply with section 6.1 of NI 23-101, a marketplace shall not impose

(a)   a fee that is equal to or greater than the minimum price increment described in IIROC Universal Market Integrity Rule 6.1, as amended; and

(b)   terms that have the effect of discriminating between orders that are routed to that marketplace to prevent trade-throughs and orders that originate on that marketplace."

(4)   Section 11.5 is repealed and replaced by the following:

"**11.5 Synchronization of Clocks** – (1) A marketplace trading exchange-traded securities, an information processor receiving information about those securities and a dealer trading those securities shall synchronize the clocks used for recording or monitoring the time and date of any event that must be recorded under this Part or NI 23-101 with the clock used by its regulation services provider, or if it has not retained a regulation services provider, any regulation services provider monitoring the trading of those securities.

(2) A marketplace trading corporate debt securities or government debt securities, an information processor receiving information about those securities, a dealer trading those securities and an inter-dealer bond broker trading those securities shall synchronize the clocks used for recording or monitoring the time and date of any event that must be recorded under this Part or NI 23-101 with the clock used by its regulation services provider, or if it has not retained a regulation services provider, any regulation services provider monitoring the trading of those securities.".

(5)   The following Part is added:

"**PART 11.1 REPORTING OF ORDER EXECUTION INFORMATION BY MARKETPLACES**

11.1.1 Reporting of Order Execution Information by Marketplaces – (1) A marketplace shall publish in a meaningful, readily accessible and usable electronic form and make available at no cost for downloading from a website, a monthly report containing the information set out below, but not including information relating to any non-standard order, calculated price order or closing price order:

Liquidity Measures:

(a)   for all orders that, when received by the marketplace, are at or within the best bid price and best ask price as identified by an information processor, or if there is no information processor, on a particular marketplace:

   (i)   the number of orders that the marketplace received;

   (ii)   the number of orders that were cancelled;

   (iii)   the number of orders that were executed on the marketplace;

   (iv)   if applicable, the number of orders routed to another marketplace for execution;

   (v)   the average volume of all orders executed on the marketplace;

   (vi)   the share-weighted average effective spread for order executions; and

   (vii)   the share-weighted average realized spread for order executions.

Trading Statistics:

(b)   the number of trades executed on the marketplace;

(c)   the volume of all trades executed on the marketplace;

(d)   the volume of all trades resulting from the execution of orders that are not displayed on the marketplace;

(e)   the volume of all trades resulting from the execution of orders that are partially displayed on the marketplace;

(f)   the value of all trades executed on the marketplace;

(g)   the arithmetic mean and median size of trades executed on the marketplace;

(h)   the number of trades that were executed on the marketplace with a volume of,

   (i)   for securities other than options,

       (A)   over 5,000 up to and including 10,000 units of securities, and
       (B)   over 10,000 units of securities, and

   (ii)   for options,

       (A)   over 100 up to and including 250 options contracts; and
       (B)   over 250 options contracts.

Speed and Certainty of Execution Measures:

(i)　　the number of orders that, when received by the marketplace, are at or within the best bid price and best ask price as identified by an information processor, or if there is no information processor, on a particular marketplace and that are executed:

　　　(i)　　within 1 second after the time of their receipt;

　　　(ii)　　more than 1 second and up to and including 10 seconds after the time of their receipt;

　　　(iii)　　more than 10 seconds and up to and including 60 seconds after the time of their receipt;

　　　(iv)　　more than 1 minute and up to and including 5 minutes after the time of their receipt; and

　　　(v)　　more than 5 minutes and up to and including 30 minutes after the time of their receipt.

(2) The reporting required in paragraphs (1)(a) through (i) shall be categorized by security.

(3) This section is effective on **[insert date six months after Effective Date]**.

(6)　　Part 12 is repealed and replaced with the following:

"**PART 12 CAPACITY, INTEGRITY AND SECURITY OF MARKETPLACE SYSTEMS**

12.1 System Requirements – For each of its systems that support order entry, order routing, execution, trade reporting, trade comparison, data feeds, market surveillance and trade clearing, a marketplace shall,

(a)　　develop and maintain

　　　(i)　　reasonable business continuity and disaster recovery plans;

　　　(ii)　　an adequate system of internal control over those systems; and

　　　(iii)　　adequate general computer controls, including controls relating to information systems operations, information security, change management, problem management, network support and system software support;

(b)　　consistent with prudent business practice, on a reasonably frequent basis, and in

4

any event, at least annually,

(i) make reasonable current and future capacity estimates;

(ii) conduct capacity stress tests to determine the ability of those systems to process transactions in an accurate, timely and efficient manner; and

(iii) test its business continuity and disaster recovery plans; and

(c) promptly notify the regulator, or, in Québec, the securities regulatory authority and, if applicable, its regulation services provider of any material systems failures.

12.2 Systems Reviews – (1) For each of its systems that support order entry, order routing, execution, trade reporting, trade comparison, data feeds, market surveillance and trade clearing, a marketplace shall annually engage a qualified party to conduct an independent systems review and prepare a report in accordance with established audit standards to ensure that it is in compliance with paragraph 12.1(a).

(2) A marketplace shall provide the report resulting from the review conducted under subsection (1) to

(a) its board of directors, or the audit committee, promptly upon the report's completion, and

(b) to the regulator, or, in Québec, the securities regulatory authority, within 30 days of providing the report to its board of directors or the audit committee.

12.3 Availability of Technology Requirements and Testing Facilities – (1) A marketplace shall publish all technology requirements regarding interfacing with or accessing the marketplace in their final form,

(a) if operations have not begun, for at least three months immediately before operations begin; and

(b) once it has begun operations, for at least three months before implementing a material change to its technology requirements.

(2) After the technology requirements set out in subsection (1) have been published, a marketplace shall make available testing facilities for interfacing with or accessing the marketplace,

(a) if operations have not begun, for at least two months immediately before operations begin; and

(b) once it has begun operations, for at least two months before implementing a material change to its technology requirements.

(3) A marketplace shall not begin operations until it has complied with paragraphs (1)(a)

and (2)(a).".

(7) Section 14.5 is repealed and replaced with the following:

"**14.5 System Requirements** – An information processor shall,

(a) develop and maintain

(i) reasonable business continuity and disaster recovery plans;

(ii) an adequate system of internal controls over its critical systems; and

(iii) adequate general computer controls, including controls relating to information systems operations, information security, change management, problem management, network support, and system software support;

(b) on a reasonably frequent basis, and in any event, at least annually, and in a manner that is consistent with prudent business practice,

(i) make reasonable current and future capacity estimates for each of its systems;

(ii) conduct capacity stress tests of its critical systems to determine the ability of those systems to process information in an accurate, timely and efficient manner; and

(iii) test its business continuity and disaster recovery plans;

(c) annually engage a qualified party to conduct an independent systems review and prepare a report in accordance with established audit standards to ensure that it is in compliance with paragraph (a);

(d) provide the report resulting from the review conducted under paragraph (c) to

(i) its board of directors or the audit committee promptly upon the report's completion, and

(ii) to the regulator, or, in Québec, the securities regulatory authority, within 30 days of providing it to the board of directors or the audit committee; and

(e) promptly notify the regulator, or, in Québec, the securities regulatory authority, and any regulation services provider, recognized exchange or recognized quotation and trade reporting system monitoring trading of the securities about which information is provided to the information processor of any material systems failures.

1.2   **Effective Date** – This Instrument comes into force on [**].

AMENDMENTS TO COMPANION POLICY 21-101CP – To National Instrument 21-101
Marketplace Operation

PART 1   AMENDMENTS

1.1   Amendments

(1)   This amends Companion Policy 21-101CP.

(2)   Part 1 is amended by adding the following section as section 1.4:

"**1.4 Definition of Regulation Services Provider** – The definition of regulation services provider is meant to capture a third party provider that provides regulation services to marketplaces. A recognized exchange or recognized quotation and trade reporting system would not be a regulation services provider if it only conducts these regulatory services for its own marketplace or an affiliated marketplace and does not provide these services to others.".

(3)   Subsection 2.1(7) is amended by:

(i)   striking out the reference to the "IDA" and substituting "IIROC"; and

(ii)   striking out "IDA By-law No. 36" and "By-law No. 36" and substituting "Rule 36"; and

(iii)   striking out "IDA Regulation 2100" and "Regulation 2100" and substituting "Rule 2100".

(4)   Subsection 3.4(5) is amended by striking out the reference to the "IDA" and substituting "IIROC".

(5)   Subsection 6.1(6) is amended by striking out "any change to the operating platform of an ATS, the types of securities traded, or the types of subscribers." and substituting "a change to the information in Exhibits A, B, C, F, G, I, and J of Form 21-101F2.".

(6)   Section 7.1 is amended by:

(a)   striking out "." at the end of the last sentence; and

(b)   adding the following at the end of the paragraph:

"and a person or company that obtains access through a member or user. The reference to "services" in paragraph (b) means all services that a marketplace provides including any services that may be offered to a member in the case of an exchange or a user in the case of a quotation and trade reporting system or anyone accessing orders directly or indirectly on the exchange or quotation and trade reporting system for purposes of the trade-through

requirements set out in Part 6 of NI 23-101. A recognized exchange or recognized quotation and trade reporting system should permit fair and efficient access for the purposes of complying with the trade-through requirements in section 6.1 of NI 23-101 to (a) a member or user directly, or (b) a person or company that is indirectly accessing the recognized exchange or recognized quotation and trade reporting system through a member or user.".

(7)   Section 8.2 is amended by:

(a)   striking out "." at the end of the last sentence; and

(b)   adding the following at the end of the paragraph:

"and a person or company that obtains access through a subscriber that is a dealer. The reference to "services" in paragraph (b) means all services that a marketplace provides including any services that may be offered to a subscriber or anyone accessing orders directly or indirectly on the ATS for purposes of the trade-through requirements set out in Part 6 of NI 23-101. An ATS should permit fair and efficient access for the purposes of complying with the trade-through requirements in section 6.1 of NI 23-101 to (a) a subscriber directly, or (b) a person or company that is indirectly accessing the ATS through a subscriber.".

(8)   Part 9 is amended by:

(a)   striking out the first two sentences of subsection 9.1(1) and substituting the following:

"(1) Subsection 7.1(1) of the Instrument requires a marketplace that displays orders of exchange-traded securities to any person or company to provide accurate and timely information regarding those orders to an information processor or, if there is no information processor, to an information vendor that meets the standards set by a regulation services provider. Section 7.2 requires the marketplace to provide accurate and timely information regarding trades of exchange-traded securities to an information processor or, if there is no information processor, an information vendor that meets the standards set by a regulation services provider."; and

(b)   repealing and replacing subsection 9.1(2) with the following:

"(2) In complying with sections 7.1 and 7.2 of the Instrument, a marketplace should not make the required order and trade information available to any other person or company on a more timely basis than it makes that information available to the information processor or information vendor. In addition, any information provided by a marketplace to an information processor or information vendor must include identification of the marketplace and should contain all relevant information including details as to volume, symbol, price and time of the order or trade.".

(9)   Part 10 is amended by:

(a)   striking out "; and" at the end of section 10.1(9); and

(b)   adding the following as section 10.2:

"**10.2 Availability of Information** – In complying with the requirements in sections 8.1 and 8.2 of the Instrument to provide accurate and timely order and trade information to an information processor or an information vendor that meets the standards set by a regulation services provider, a marketplace, an inter-dealer bond broker or dealer should not make the required order and trade information available to any other person or company on a more timely basis than it makes that information available to the information processor or information vendor.".

(10)   The following is added as section 12.2:

"**12.2 Trading Fees for Trade-Through Purposes** – Section 10.2 of the Instrument prohibits a marketplace from imposing fees for the purpose of complying with the trade-through requirements set out in Part 6 of NI 23-101 that (i) is equal to or greater than the minimum price increment that is described in IIROC Universal Market Integrity Rule 6.1, as amended, or (ii) has the effect of discriminating between orders that are routed to that marketplace to prevent trade-throughs and orders that originate on that marketplace. This prohibition would include any fees charged to access an order on a marketplace. Paragraph 10.2(b) of the Instrument is intended to ensure that a marketplace does not charge discriminatory fees to those routing orders to meet their trade-through obligations.".

(11)   Section 13.2 is repealed and replaced with the following:

"**13.2 Synchronization of Clocks** – Subsections 11.5(1) and (2) of the Instrument require the synchronization of clocks with a regulation services provider that monitors the activities of marketplaces, and, as appropriate, inter-dealer bond brokers or dealers trading the relevant securities. The Canadian securities regulatory authorities are of the view that synchronization requires continual synchronization using an appropriate national time standard as chosen by a regulation services provider. Even if a marketplace has not retained a regulation services provider, its clocks should be synchronized with any regulation services provider monitoring trading in the particular securities traded on that marketplace. Each regulation services provider will monitor the information that it receives from all marketplaces, dealers and, if appropriate, inter-dealer bond brokers, to ensure that the clocks are appropriately synchronized. If there is more than one regulation services provider, in meeting their obligation to coordinate monitoring and enforcement under section 7.5 of NI 23-101, regulation services providers are required to agree on one standard against which synchronization will occur. In the event there is no regulation services provider, a recognized exchange or recognized quotation and trade reporting system should coordinate with other recognized exchanges or recognized quotation and trade reporting systems regarding the synchronization of clocks.".

(12)   The Companion Policy is amended by adding the following Part after Part 13:

"**PART 13.1   REPORTING OF ORDER EXECUTION INFORMATION BY MARKETPLACES**

13.1.1 Reporting of Order Execution Information by Marketplaces – (1) Section 11.1.1 of the Instrument requires a marketplace to make available standardized, monthly reports of statistical information concerning the execution of orders. It is expected that this information would provide a starting point to promote visibility and best execution, in particular, relating to the factors of execution price and speed. It is also expected that this information would provide a tool for dealers and advisers to evaluate the quality of executions among marketplaces and aid in fulfilling their duty of best execution.

(2) Orders that are not immediately executable and orders that trade in special terms books, such as all-or-none, minimum fill or cash or delayed delivery are not considered to be orders for the purposes of this Part. As well, order information regarding pre-arranged trades and intentional or internal crosses is not required. In addition, marketplaces reporting trade information should only count each share traded once.".

(13)   Section 14.1 is repealed and replaced with the following:

"**14.1 Systems Requirements** – This section applies to all the systems of a particular marketplace that are identified in the introduction to section 12.1 of the Instrument.

(1) Paragraph 12.1(a) of the Instrument requires the marketplace to develop and maintain an adequate system of internal control over the systems specified. As well, the marketplace is required to develop and maintain adequate general computer controls. These are the controls which are implemented to support information technology planning, acquisition, development and maintenance, computer operations, information systems support, and security. Recognized guides as to what constitutes adequate information technology controls include '*Information Technology Control Guidelines*' from The Canadian Institute of Chartered Accountants (CICA) and '*COBIT*' from the IT Governance Institute.

(2) Paragraph 12.1(b) of the Instrument requires a marketplace to meet certain systems capacity, performance, business continuity and disaster recovery standards. These standards are consistent with prudent business practice. The activities and tests required in this paragraph are to be carried out at least once a year. In practice, continuing changes in technology, risk management requirements and competitive pressures will often result in these activities being carried out or tested more frequently.

(3) Subsection 12.2(1) of the Instrument requires a marketplace to engage a qualified party to conduct an annual independent assessment of the internal controls referred to in paragraph 12.1(a). A qualified party is a person or company or a group of persons or companies with relevant experience in both information technology and in the evaluation of related internal controls in a complex information technology environment. Before engaging a qualified party, a marketplace should discuss its choice with the regulator, or, in Québec, the securities regulatory authority.".

(14)   The following is added as section 14.2:

"**14.2 Availability of Technology Specifications and Testing Facilities** – (1) Subsection 12.3(1) of the Instrument requires marketplaces to publish their technology requirements regarding interfacing with or accessing the marketplace in their final form for at least three months. If there are material changes to these requirements after they are published and before operations begin, the revised requirements should be published for a new three month period prior to operations. The subsection also requires that an operating marketplace publish its technology specifications for at least three months before implementing a material change to its technology requirements.

(2) Subsection 12.3(2) of the Instrument requires marketplaces to provide testing facilities for interfacing with or accessing the marketplace for at least two months immediately prior to operations once the technology requirements have been published. Should the marketplace publish its specifications for longer than three months, it may make the testing available during that period or thereafter as long as it is at least two months prior to operations. If the marketplace, once it has begun operations, proposes material changes to its technology systems, it is required to make testing facilities available for at least two months before implementing the material systems change.".

(15)   Part 16 is amended by:

(a)   repealing and replacing subsection 16.1(2) with the following:

"(2) An information processor is required under subsection 14.4(2) of the Instrument to provide timely, accurate, reliable and fair collection, processing, distribution and publication of information for orders for, and trades in, securities. The Canadian securities regulatory authorities expect that in meeting this requirement, an information processor will ensure that all marketplaces, inter-dealer bond brokers and dealers that are required to provide information are given access to the information processor on fair and reasonable terms. In addition, it is expected that an information processor will not give preference to the information of any marketplace, inter-dealer bond broker or dealer when collecting, processing, distributing or publishing that information.

(3) An information processor is required under subsection 14.4(5) of the Instrument to provide prompt and accurate order and trade information, and to not unreasonably restrict fair access to the information. As part of the obligation relating to 'fair access', an information processor is expected to make the disseminated and published information available on terms that are reasonable and not discriminatory. For example, an information processor will not provide order and trade information to any single person or company or group of persons or companies on a more timely basis than is afforded to others, and will not show preference to any single person or company or group of persons or companies in relation to pricing.";

(b)   striking out "which are not unreasonably discriminatory" from paragraph 16.2(1)(b); and

(c)   adding the following as section 16.4:

"**16.4 System Requirements** – Section 14.1 of this Companion Policy contains guidance on the systems requirements as it applies to an information processor.".

AMENDMENTS TO NATIONAL INSTRUMENT 23-101 TRADING RULES

PART 1   AMENDMENTS

1.1   Amendments

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

(2)   The following definitions are added to section 1.1:

"automated functionality" means the ability to:

(a)   permit an incoming order that has been entered on the marketplace electronically to be marked as fill-or-kill;

(b)   immediately and automatically execute an order marked as fill-or-kill against the displayed volume;

(c)   immediately and automatically cancel any unexecuted portion of an order marked as fill-or-kill without routing the order elsewhere;

(d)   immediately and automatically transmit a response to the sender of an order marked as fill-or-kill indicating the action taken with respect to the order; and

(e)   immediately and automatically display information that updates the displayed order to reflect any change to its material terms;

"calculated price order" means an order for the purchase or sale of an exchange-traded security, other than a derivative, that is entered on a marketplace if the price of that security

(a)   is not known at the time of order entry; and

(b)   is to be calculated based on, but will not necessarily be equal to, the price of that security at the time of execution;

"closing price order" means an order for the purchase or sale of an exchange-traded security, other than a derivative, that is

(a)   entered on a marketplace on a trading day; and

(b)   subject to the conditions that

         (i)   the order be executed at the closing sale price of that security on that marketplace for that trading day; and

      (ii)   the order be executed subsequent to the establishment of the closing price;

"inter-market sweep order" means a limit order for the purchase or sale of an exchange-traded security, other than a derivative,

(a)   entered on or routed to a marketplace to be executed against a protected order; and

(b)   identified as an inter-market sweep order; and

at the same time that it is entered or routed, one or more additional limit orders are routed, as necessary, to a marketplace to execute against the displayed volume of any other protected order on that marketplace with a better price than the protected order referred to in paragraph (a);

"non-standard order" means an order for the purchase or sale of an exchange-traded security, other than a derivative, that is entered on a marketplace and is subject to non-standardized terms or conditions related to settlement that have not been set by the marketplace on which the security is listed or quoted;

"protected bid" means a bid for an exchange-traded security, other than a derivative,

(a)   that is displayed by a marketplace that has automated functionality; and

(b)   about which information is provided pursuant to Part 7 of NI 21-101 to an information processor or, if there is no information processor, to an information vendor that meets the standards set by a regulation services provider;

"protected offer" means an offer for an exchange-traded security, other than a derivative,

(a)   that is displayed by a marketplace that has automated functionality; and

(b)   about which information is provided pursuant to Part 7 of NI 21-101 to an information processor or, if there is no information processor, to an information vendor that meets the standards set by a regulation services provider;

"protected order" means a protected bid or protected offer; and

"trade-through" means the execution of a trade at a price that is,

(a)   in the case of a purchase, higher than any protected offer, or

(b)   the case of a sale, lower than any protected bid.

(3)   Part 4 is amended by adding the following as section 4.4:

"**4.4 Reporting of Order Routing by Dealer** – (1) A dealer shall publish, in a meaningful, readily accessible and usable electronic form and make available at no cost for downloading from a website, a quarterly report on its routing of orders when acting as agent during that quarter and shall include the following information if securities are traded on more than one marketplace:

(a)   the identity of marketplaces where orders are routed for execution, including the percentages of orders routed to each marketplace

        (i)   at the direction or instruction of the client, and

        (ii)   otherwise determined by the dealer; and

(b)   a discussion of any material aspects of a dealer's relationship with a marketplace including a description of any arrangements.

(2) A dealer shall, within 15 days of receiving a request from a client, disclose to the client the identity of any marketplace where the client's orders were routed for execution in the six months before the request, whether the dealer was specifically instructed to route to a particular marketplace for execution, and the time of the executions, if any, that resulted from such orders.

(3) This section is effective on **[insert date six months after Effective Date]**".

(4)   Part 6 is repealed and replaced by:

"**PART 6 – TRADE-THROUGH PROTECTION**

6.1 Trade-through Protection – (1) A marketplace shall establish, maintain and enforce written policies and procedures that are reasonably designed

(a)   to prevent trade-throughs on that marketplace other than the trade-throughs listed in section 6.2; and

(b)   to ensure that the marketplace, when executing a transaction that constitutes a trade-through listed in section 6.2, is doing so in compliance with this Part.

(2) A marketplace shall regularly review and monitor the effectiveness of the policies and procedures required by subsection (1) and shall take prompt action to remedy any deficiencies in such policies and procedures.

(3) At least 45 days before implementation, a marketplace shall provide to the securities regulatory authority and, if applicable, its regulation services provider the policies and procedures, and any material amendments to those policies and procedures, established under subsection (1).

6.2 List of Trade-throughs – The following are the trade-throughs referred to in paragraph 6.1(1)(a):

(a)   the transaction that constituted the trade-through was executed when there were reasonable grounds to believe that the marketplace displaying the protected order that was traded through was experiencing a failure, malfunction or material delay of its systems or equipment;

(b)   the transaction that constituted the trade-through was the execution of an order identified as an inter-market sweep order;

(c)   the transaction that constituted the trade-through was executed by a marketplace that simultaneously routed an inter-market sweep order to execute against the total displayed volume of any protected order that was traded through;

(d)   the marketplace displaying the protected order that was traded through had displayed, immediately before the execution of the transaction that constituted the trade-through, a protected order with a price that was equal or inferior to the price of the trade-through transaction;

(e)   the transaction that constituted the trade-through was the result of the execution of

        (i)   a non-standard order;

        (ii)   a calculated price order; or

        (iii)   a closing price order; and

(f)   the transaction that constituted the trade-through was executed at a time when the best protected bid was higher than the best protected offer.

6.3 Inter-market Sweep Order Requirements – A marketplace or marketplace participant responsible for the routing of an inter-market sweep order must take all reasonable steps to ensure that the order is an inter-market sweep order.

6.4 Systems or Equipment Failure, Malfunction or Material Delay – (1) A marketplace shall immediately notify all regulation services providers, its marketplace participants and other marketplaces if there is a failure, malfunction or material delay of its systems or equipment.

(2) When executing a transaction that falls within paragraph 6.2(a), and a notification has not been sent under subsection (1), a marketplace that routes an order to another marketplace shall immediately notify

(a)   the marketplace that it has reasonable grounds to believe it is experiencing a failure, malfunction or material delay of its systems or equipment;

(b)   all regulation services providers; and

(c)   its marketplace participants.

(3) When a marketplace participant has reasonable grounds to believe that a marketplace is experiencing a failure, malfunction or material delay of its systems or equipment and routes an order to execute against a protected order on another marketplace displaying an inferior price, the marketplace participant must notify

(a)   the marketplace that may be experiencing a failure, malfunction or material delay of its systems or equipment; and

(b)   all regulation services providers.

6.5 Locked or Crossed Orders – A marketplace participant shall not intentionally lock or cross a particular marketplace or the market as a whole by

(a)   entering on a marketplace a bid at a price that is the same as or higher than the best protected offer; or

(b)   entering on a marketplace an offer at a price that is the same as or lower than the best protected bid.

6.6 Trading Hours – Each marketplace shall set the hours of trading to be observed by marketplace participants.

6.7 Anti-Avoidance – No person or company shall route an order to an exchange, quotation and trade reporting system or alternative trading system that does not carry on business in Canada in order to avoid executing against better-priced orders on a marketplace.".

(5)   Part 7 is amended by:

(a)   repealing and replacing paragraph 7.2(c) with the following:

"(c) that the recognized exchange will transmit to the regulation services provider the information required by Part 11 of NI 21-101 and any other information the regulation services provider considers necessary for the regulation services provider to effectively monitor the conduct of marketplace participants, and if applicable, the recognized exchange; and"; and

(b)   repealing and replacing paragraph 7.4(c) with the following:

"(c) that the recognized quotation and trade reporting system will transmit to the regulation services provider the information required by Part 11 of NI 21-101 and any other information the regulation services provider considers necessary for the regulation services provider to effectively monitor the conduct of marketplace participants, and if applicable, the recognized quotation and trade reporting system; and"; and

(c)   amending section 7.5 by striking out "under this Part" and substituting "under Parts 7 and 8".

(6)   Paragraph 8.3(d) is repealed and replaced by:

"(d) that the ATS will transmit to the regulation services provider the information required by Part 11 of NI 21-101 and any other information the regulation services provider considers necessary for the regulation services provider to effectively monitor the conduct of ATSs and marketplace participants; and".

(7)   Section 9.3 is amended by striking out "IDA Policy No. 5 Code of Conduct for IDA Member Firms Trading in Domestic Debt Markets" and substituting "IIROC Rule 2800 Code of Conduct for Corporation Dealer Member Firms Trading in Wholesale Domestic Debt Markets".

1.2   Effective Date – This Instrument comes into force on [**].

AMENDMENTS TO COMPANION POLICY 23-101CP – **To National Instrument 23-101 Trading Rules**

PART 1   AMENDMENTS

1.1   Amendments

(1)   This amends Companion Policy 23-101CP.

(2)   Part 2 is amended by:

(a)   striking out the title of Part 2 and substituting "APPLICATION AND DEFINITIONS"; and

(b)   adding the following after section 2.1:

"**2.2 Definition of Automated Functionality** – Section 1.1 of the Instrument includes a definition of "automated functionality" which is the ability to: (1) act on an incoming order; (2) respond to the sender of an order; and (3) update the order by disseminating information to an information processor or information vendor. Automated functionality allows for an incoming order to execute immediately and automatically up to the displayed size and for any unexecuted portion of such incoming order to be cancelled immediately and automatically without being booked or routed elsewhere. Automated functionality involves no human discretion in determining the action taken with respect to an order after the time the order is received. A marketplace with this functionality should have appropriate systems and policies and procedures relating to the handling of fill-or-kill orders.

2.3 Definition of Calculated Price Order – The definition of "calculated price order" refers to any order where the price is not known at the time of order entry and is based on, but not necessarily equal to, the price of an exchange-traded security at the time of execution. This includes the following orders:

(a)   a call market order – where the price of a trade is calculated by the trading system of a marketplace at a time designated by the marketplace;

(b)   an opening order – where each marketplace may establish its own formula for the determination of opening prices;

(c)   a closing order – where execution occurs at the closing price on a particular marketplace, but at the time of order entry, the price is not known;

(d)   a volume-weighted average price order – where the price of a trade is determined by a formula that measures average price on one or more marketplaces; and

(e)   a basis order – where the price is based on prices achieved in one or more derivative transactions on a marketplace. To qualify as a basis order, this order must be approved by a regulation services provider.

2.4 Definition of Inter-Market Sweep Order – An inter-market sweep order must be marked to inform the receiving marketplace that it can be immediately executed without reference to better-priced orders displayed by other marketplaces. It may be marked "ISO" by a marketplace or a marketplace participant. The definition allows for simultaneous routing of more than one inter-market sweep order in order to execute against the best protected bid or best protected offer and any inferior-priced orders. In addition, marketplace participants may send a single inter-market sweep order to execute against the best protected bid or best protected offer.

2.5 Definition of Non-Standard Order – The definition of "non-standard order" refers to an order for the purchase or sale of a security that is subject to terms or conditions relating to settlement that have not been set by the marketplace on which the security is listed or quoted. A marketplace participant, however, may not add a special settlement term or condition to an order solely for the purpose that the order becomes a non-standard order under the definition.

2.6 Definition of Protected Order – (1) A protected order is defined to be a "protected bid or protected offer". A "protected bid" or "protected offer" is an order to buy or sell an exchange-traded security, other than a derivative, that is displayed on a marketplace with automated functionality and about which information is provided to an information processor or an information vendor, as applicable, pursuant to Part 7 of NI 21-101. The term "displayed on a marketplace" refers to the information about total disclosed volume on a marketplace. Volumes that are not disclosed or that are "reserve" or hidden volumes are not considered to be "displayed on a marketplace". The order must be provided in a way that enables other marketplaces and marketplace participants to readily access the information and integrate it into their systems or order routers.

(2) Subsection 5.1(3) of 21-101CP does not consider orders that are not immediately executable or that have special terms as "orders" that are required to be provided to an information processor or information vendor under Part 7 of NI 21-101. As a result, these orders are not considered to be "protected orders" under the definition in the Instrument and do not receive trade-through protection. However, those executing against these types of orders are required to execute against all better-priced orders first. In addition, when entering a "special terms order" on a marketplace, if it can be executed against existing orders despite the special term, then the trade-through obligation applies.".

(3)   Part 4 is amended by adding the following as section 4.2:

4.2 Reporting Requirements Applicable to Dealers – (1) Section 4.4 of the Instrument requires disclosure of the order routing practices of dealers that route orders for clients. As dealers owe a duty of best execution to their clients, dealers should review their order routing practices periodically to assure they are meeting this responsibility. It is expected that the information required by section 4.4 of the Instrument will bring transparency to this process and provide clients with the opportunity to monitor a dealer's order routing

activity. On request by a client, a dealer is required to disclose where an individual client's orders were routed.".

(4)   Part 6 is repealed and replaced with the following:

"PART 6 – TRADE-THROUGH PROTECTION

6.1 Trade-through Protection – (1) Subsection 6.1(1) of the Instrument requires a marketplace to establish, maintain and enforce written policies and procedures that are reasonably designed to prevent trade-throughs by orders entered on that marketplace. A marketplace may implement this requirement in various ways. For example, the policies and procedures of a marketplace may reasonably prevent trade-throughs via the design of the marketplace's trade execution algorithms (by not allowing a trade-through to occur), or by establishing direct linkages to other marketplaces. Marketplaces are not able to avoid their obligations by establishing policies and procedures that instead require marketplace participants to take steps to reasonably prevent trade-throughs.

(2) It is the responsibility of marketplaces to regularly review and monitor the effectiveness of their policies and procedures and take prompt steps to remedy any deficiencies in reasonably preventing trade-throughs and complying with subsection 6.1(2) of the Instrument. In general, it is expected that marketplaces maintain relevant information so that the effectiveness of its policies and procedures can be adequately evaluated by regulatory authorities.

(3) In certain circumstances, a marketplace participant should create policies and procedures and should maintain relevant information to track routing decisions. For example, if a marketplace participant regularly uses an inter-market sweep order or has a process for routing orders if a marketplace experiences a systems failure, it should maintain policies and procedures outlining when it is appropriate to use that order type or outlining its routing choices, respectively. If a marketplace participant regularly uses inter-market sweep orders or is sending an order to a marketplace that may be experiencing systems issues, it may also be appropriate for the marketplace participant to maintain relevant information so that compliance with Part 6 of NI 23-101 can be adequately evaluated by regulatory authorities.

(4) As part of the policies and procedures required in subsection 6.1(1) of the Instrument, a marketplace is expected to include a discussion of their automated functionality and how they will handle potential delayed responses as a result of an equipment or systems failure or malfunction experienced by another marketplace.

(5) Trade-through protection applies whenever two or more marketplaces with displayed protected orders are open for trading. Some marketplaces provide a trading session at a price established by that marketplace during its regular trading hours for marketplace participants who are required to benchmark to a certain closing price. In these circumstances, under paragraph 6.2(e), a marketplace would not be required to take steps to reasonably prevent trade-throughs of orders on another marketplace.

6.2 List of Trade-throughs – Section 6.2 of the Instrument sets forth a list of "permitted" trade-throughs that are primarily designed to achieve workable trade-through protection and to facilitate certain trading strategies and order types that are useful to investors.

(a) (i) Paragraph 6.2(a) of the Instrument would apply where there are reasonable grounds to believe that a marketplace is experiencing a failure or malfunction of its systems or equipment as well as any material delay (systems issues). If a marketplace repeatedly fails to respond immediately after receipt of an order, this would constitute a material delay. This is intended to provide marketplaces with flexibility when dealing with another marketplace that is experiencing systems problems (either of a temporary nature or a longer term systems issue).

(ii) The marketplace that is experiencing systems issues is responsible for informing all other marketplaces, its marketplace participants and regulation services providers when the failure, malfunction or delay occurs. However, if a marketplace fails repeatedly to provide an immediate response to orders received and no notification has been issued by that marketplace that it is experiencing systems issues, the routing marketplace or a marketplace participant that has reasonable grounds to believe that the marketplace is having systems issues may nevertheless rely on paragraph 6.2(a) . This reliance must be done in accordance with policies and procedures that outline processes for dealing with potential delays in responses by a marketplace and documenting the basis of its belief. If, in response to the notification by the routing marketplace or a marketplace participant, the marketplace confirms that it is not actually experiencing systems issues, the routing marketplace or marketplace participant may no longer rely on paragraph 6.2(a).

(b) Paragraphs 6.2(b) and 6.2(c) of the Instrument contemplate that a marketplace would immediately execute any order identified as an inter-market sweep order. A marketplace that receives an inter-market sweep order would not need to delay its execution to ensure the execution of better-priced orders at other marketplaces. A marketplace participant may send an inter-market sweep order to a marketplace for execution.

(c) Paragraph 6.2(d) of the Instrument allows for a transaction if the marketplace displaying the best price that was traded through had displayed, immediately prior to execution of the trade-through, an order with a price that was equal or inferior to the price of the trade-through transaction. The inclusion of "flickering orders" in paragraph 6.2(d) provides some relief due to rapidly moving markets.

(d) The basis for the inclusion of calculated price orders, non-standard orders and closing price orders in paragraph 6.2(e) of the Instrument is that these orders have certain unique characteristics that distinguish them from other orders. The characteristics of the orders relate to price (calculated price orders and closing

price orders) and non-standard settlement terms (non-standard orders) that are not set by an exchange or a quotation and trade reporting system.

(e)   Paragraph 6.2(f) of the Instrument includes a transaction that occurred when there is a crossed market in the exchange-traded security. Without this allowance, no marketplace could execute transactions in a crossed market because it would constitute a trade-through. With trade-through protection only applying to displayed orders or parts of orders, hidden or reserve orders will remain in the book after all displayed orders are executed. Consequently, crossed markets may occur. Intentionally crossing the market to take advantage of this paragraph would be a violation of section 6.5 of the Instrument.

6.3 Locked and Crossed Markets – Section 6.5 of the Instrument provides that a marketplace participant cannot intentionally lock or cross a market by entering a bid at a price that is the same as or higher than the best protected offer or entering an offer at a price that is the same as or lower than the best protected bid. This section is meant to capture the situation where a marketplace participant enters an order to lock or cross a marketplace or the market as a whole (for example, to take advantage of rebates offered by a particular marketplace instead of executing against already existing orders). It is not intended to prohibit the use of marketable limit orders. Paragraph 6.2(f) allows for the resolution of crossed markets that occur unintentionally.

6.4 Anti-Avoidance Provision – Section 6.7 of the Instrument prohibits a person or company from routing an order to an exchange, quotation and trade reporting system or alternative trading system that does not carry on business in Canada in order to avoid executing against better-priced orders on a marketplace in Canada. The intention of this section is to prevent the routing of orders to foreign marketplaces only for the purpose of avoiding the trade-through regime in Canada.".

(5)   Part 7 is amended by:

(a)   striking out "IDA Policy No. 5 Code of Conduct for IDA Member Firms Trading in Domestic Debt Markets" and substituting "IIROC Rule 2800 Code of Conduct for Corporation Dealer Member Firms Trading in Wholesale Domestic Debt Markets" in section 7.3; and

(b)   adding the following as section 7.5:

"**7.5 Coordination of Monitoring and Enforcement** – (1) Section 7.5 of the Instrument requires regulation services providers, recognized exchanges and recognized quotation and trade reporting systems to enter into a written agreement whereby they coordinate the enforcement of the requirements set under Parts 7 and 8. This coordination may include having regulation services providers monitor trading on all marketplaces that have retained them and reporting to a recognized exchange, recognized quotation and trade reporting system or securities regulatory authority if a marketplace is not meeting the terms of its own rules or policies and procedures. This monitoring includes monitoring clock synchronization, the inclusion of specific designations, symbols and identifiers,

and audit trail requirements. If a recognized exchange or recognized quotation and trade reporting system has retained a regulation services provider, the agreement to coordinate required in section 7.5 of the Instrument should be reflected in the agreement referred to in section 7.2 or section 7.4 respectively. If a recognized exchange or recognized quotation and trade reporting system has not retained a regulation services provider, it is still required to coordinate with any regulation services provider and other exchanges or quotation and trade reporting systems that trade the same securities.

(2) Currently, only IIROC is the regulation services provider for both exchange-traded and unlisted debt securities. If more than one regulation services provider regulates marketplaces trading a particular type of security, these regulation services providers must coordinate monitoring and enforcement of the requirements set.".