

Chapter 13

SRO Notices and Disciplinary Proceedings

13.1.1 TSX Inc. - Request for Comments - Amendments to the Direct Access Rules

TSX INC.

REQUEST FOR COMMENTS

AMENDMENTS TO THE DIRECT ACCESS RULES

The Board of Directors of TSX Inc. (TSX) has approved amendments (Amendments) to the Rules of the Toronto Stock Exchange (TSX Rules). The Amendments clarify the connectivity requirements for direct access trading on Toronto Stock Exchange.

The text of the Amendments, shown as blacklined text, is attached at Schedule A. Discussion of the Amendments is provided in Part II below. The Amendments will be effective upon approval by the Ontario Securities Commission (Commission) following public notice and comment. Comments on the proposed amendments should be in writing and delivered by June 12, 2006 to:

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Legal Counsel, Market Policy & Structure
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A copy should also be provided to:

Cindy Petlock
Manager, Market Regulation
Capital Markets Branch
Ontario Securities Commission
Suite 1903, Box 55
20 Queen Street West
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Terms not defined in this Request for Comments are defined in the TSX Rules.

I. Overview

During the summer of 2005, TSX undertook a review of direct access trading. The review was focussed on ensuring that direct access providers were complying with the trading rules. The review also enabled us to survey the various connectivity options that are used by industry participants who participate in direct access trading. Based on the results of this review, we believe that the connectivity portion of the direct access rules should be amended to clarify the connectivity requirements for direct access trading on Toronto Stock Exchange.

II. Discussion of the Amendments

TSX Rule 2-502 is being amended to confirm that orders of eligible clients can be transmitted either through the infrastructure of a Participating Organization (PO) or through a third-party system contracted by the PO and approved by TSX. TSX Policy 2-502(1)(c) is being amended to confirm that the system of the PO must include a facility to either receive an immediate report of, or view on a real time basis, the entry or execution of orders. TSX Policy 2-502(1)(d) is being revised to confirm that the system of the PO can employ order parameters or filters that will reject orders over a certain size or value. TSX Policy 2-502(1)(e) is being revised to delete the requirement that information about anonymous orders must be transmitted to the PO's compliance

staff. Instead, the PO must know, on a real time basis, the identity of an eligible client who has entered an anonymous order. TSX Policy 2-502(3)(3) is being revised to conform to the changes that are being made to TSX Policy 2-502(1)(c).

III. Amendment Process

TSX received comments from POs that offer direct access services during the 2005 direct access trading review. Proposed changes based on those comments and our review were raised for discussion at the October 2005 meeting of the Trading Advisory Committee (TAC). In December 2005, the Amendments were reviewed and approved by TAC. On February 1, 2006, the TSX Board of Directors approved the Amendments.

IV. Other Jurisdictions

Competitors to Toronto Stock Exchange such as the New York Stock Exchange, NASDAQ, London Stock Exchange and Euronext offer direct access connectivity to their exchanges. These exchanges do not have rules that specify connectivity requirements.

V. Public Interest Assessment

The Amendments are designed to clarify the connectivity requirements for direct access trading on Toronto Stock Exchange. This clarification will benefit POs that provide direct access services as well as their eligible clients. For these reasons, we believe that the Amendments are not contrary to the public interest.

We submit that in accordance with the Protocol for Commission Oversight of Toronto Stock Exchange Rule Proposals, the Amendments will be considered "public interest" in nature. The Amendments would, therefore, only become effective following public notice, a comment period and the approval of the Commission.

VI. Questions

Questions concerning this notice should be directed to Katherine Brown, Legal Counsel, Market Policy & Structure, TSX Group Inc. at (416) 947-4366.

Schedule A

RULES (as at August 26, 2005)	POLICIES
<p>DIVISION 5 – CONNECTION OF ELIGIBLE CLIENTS OF PARTICIPATING ORGANIZATIONS</p> <p>***</p> <p>2-502 Conditions for Connections</p> <p>A Participating Organization may transmit orders received electronically from an eligible client directly to the trading system provided that the Participating Organization has:</p> <ul style="list-style-type: none"> (a) obtained prior written approval of the Exchange that the system of the Participating Organization meets the prescribed conditions; (b) obtained prior written approval of the Exchange for a standard form of agreement containing the prescribed conditions to be entered into between the Participating Organization and an eligible client and the Participating Organization has entered into an agreement in such form with the eligible client; and (c) met such other conditions as prescribed. <p><u>These orders can be transmitted through the infrastructure of a Participating Organization or through a third-party system contracted by the Participating Organization and approved by the Exchange.</u></p>	<p>2-502 Conditions for Connections</p> <p>(1) System Requirements</p> <p>For the purposes of Rule 2-502(a), the system of the Participating Organization is required to:</p> <ul style="list-style-type: none"> (a) support compliance with Exchange Requirements dealing with the entry and trading of orders by all eligible clients who will have direct access (for example, it must support all valid order information that may be required, including designation of short sales); (b) ensure security of access to the system (for example, through a password that will only enable persons at the eligible client authorized by the Participating Organization to have access to the system); (c) comply with specific requirements prescribed pursuant to Rule 2-502, including a facility to receive an immediate report of, <u>or to view on a real time basis</u>, the entry or execution of orders; (d) enable the Participating Organization to employ order parameters or filters <u>(which parameters can be customized for each eligible client on the system)</u> that will route<u>reject</u> orders over a certain size or value, <u>or route these orders</u> to the Participating Organization's trading desk (which parameters can be customized for each eligible client on the system); and (e) enable the Participating Organization to transmit information concerning unattributed orders entered by eligible clients to the Participating Organization's compliance staff on a real time basis. <u>on a real time basis, to know the identity of an eligible client who has entered an unattributed order.</u> <p>(2) Standard Form of Agreement</p> <p>For the purposes of Rule 2-502(b), the agreement between the Participating Organization and the client shall provide that:</p> <ul style="list-style-type: none"> (a) the eligible client is authorized to connect to the Participating Organization's order routing system, eVWAP Facility, or the POSIT Call Market; (b) the eligible client shall enter orders in compliance

RULES (as at August 26, 2005)	POLICIES
	<p>with Exchange Requirements respecting the entry and trading of orders and other applicable regulatory requirements;</p> <ul style="list-style-type: none"> (c) specific parameters defining the orders that may be entered by the eligible client are stated, including restriction to specific securities or size of orders; (d) the Participating Organization has the right to reject an order for any reason; (e) the Participating Organization has the right to change or remove an order in the Book and has the right to cancel any trade made by the eligible client for any reason; (f) the Participating Organization has the right to discontinue accepting orders from the eligible client at any time without notice; (g) the Participating Organization agrees to train the eligible client in the Exchange Requirements dealing with the entry and trading of orders and other applicable Exchange Requirements; and (h) the Participating Organization accepts the responsibility to ensure that revisions and updates to Exchange Requirements relating to the entry and trading of orders are promptly communicated to the eligible client. <p>(3) Additional Requirements</p> <p>For the purposes of Rule 2-502(c), the following additional conditions shall apply:</p> <ol style="list-style-type: none"> 1. Any changes to the standard system interconnect agreement shall be approved by the Exchange in writing before becoming effective. 2. If required by the terms of the agreement between the eligible client and the Participating Organization, the Participating Organization shall ensure that its eligible clients are trained in the appropriate Exchange trading rules, as well as the use of the terminal and system. Training materials regarding Exchange trading rules that the Participating Organization proposes to use must be reviewed by the Exchange prior to use. 3. The Participating Organization shall have the ability to receive an immediate report of <u>or to view on a real time basis</u>, the entry <u>and/or</u> execution of orders. The Participating Organization shall have the capability of rejecting orders that do not fall within the designated parameters of authorized orders for a particular client. 4. The Participating Organization shall designate a specific person as being responsible for the System Interconnect. Orders executed through System Interconnects shall be reviewed for compliance and

RULES (as at August 26, 2005)	POLICIES
	<p>credit purposes daily by such designated person of the Participating Organization.</p> <p>5. The Participating Organization shall have procedures in place to ensure that only eligible clients use System Interconnects and that such eligible clients can comply with Exchange Requirements and other applicable regulatory requirements. The eligibility of eligible clients using System Interconnects shall be reviewed at least annually by the Participating Organization.</p> <p>6. The Participating Organization shall make available for review by the Exchange, as required from time to time, copies of the system interconnect agreements between the Participating Organization and its eligible clients.</p> <p>(4) Order-Execution Account Requirements</p> <p>If the agreement required by Rule 2-502(b) is between a Participating Organization and a client in respect of an Order-Execution Account, the agreement:</p> <ul style="list-style-type: none"> (a) may be in written form or be in the form of a written or electronic notice acknowledged by the client prior to the entry of the initial order in respect of such Order-Execution Account; and (b) may omit provisions that would otherwise be required by Policy 2-502(2)(c), (g) and (h) if the order routing system of the Participating Organization: <ul style="list-style-type: none"> (i) enforces the Exchange Requirements relating to the entry of orders, or (ii) routes orders that do not comply with Exchange Requirements relating to the entry of orders to an Approved Trader for review prior to entry to the trading system. <p>(5) eVWAP Facility Requirements</p> <ul style="list-style-type: none"> (a) Notwithstanding Policy 2-501(1)(i), for the purposes of Rule 2-501, clients eligible to transmit orders to the Exchange's eVWAP Facility exclude: <ul style="list-style-type: none"> (i) a client that is the resident in the U.S., and (ii) a client entering orders through and Order-Execution Account. (b) If the agreement required by Rule 2-502(b) is between a designated Participating Organization and a client with respect to the eVWAP Facility, the agreement may omit provisions which may otherwise be required by Policy 2-502(1)(d), 2-502(2)(d) and (e), and 2-502(2)(3)3 if the system through which the order is transmitted: <ul style="list-style-type: none"> (i) enforces Exchange Requirements relating

RULES (as at August 26, 2005)	POLICIES
	<p>to the entry of orders,</p> <ul style="list-style-type: none"> (ii) enforces the credit limits imposed by the designated Participating Organization, and (iii) has the ability to transmit a trade report to both the client and the designated Participating Organization. <p>(6) POSIT Call Market Requirements</p> <p>The agreement required by Rule 2-502(b) between a Participating Organization and a client with respect to the POSIT Call Market may omit provisions otherwise required by Policy 2-502(1)(d), 2-502(2)(d) and (e), and 2-502(3)3 if:</p> <ul style="list-style-type: none"> (a) the agreement provides that any person, other than the Exchange, who provides software, hardware or services to the Exchange ("Third Party Provider") to support the operations of, or the services or information accessible through, the trading system which shall include without limitation, the POSIT Call Market, shall not be liable to the Participating Organization or the eligible client or any other person for any loss, damage, cost, expense or other liability or claim (including loss of business, profits, trading losses, loss of anticipated profits, business interruption, loss of business information or for indirect, special, punitive, consequential or incidental loss or damage or other pecuniary loss) of any nature arising from any use or inability to use the trading system, howsoever caused, including by the Third Party Provider's negligence or reckless or wilful act or omissions, even if the Third Party Providers are advised of such possibilities; and (b) a system through which the order is transmitted: <ul style="list-style-type: none"> (i) enforces Exchange Requirements relating to the entry of POSIT Orders; and (ii) has the ability to generate a trade report to the client and, for the purposes of disseminating the trade report to eligible clients outside of Canada, to the designated Participating Organization; and (c) the Participating Organization has the ability to access an eligible client's trade report through the STAMP query.