

13.1.2 TSX Inc. – Request for Comments – Deletion of Rule 4-804

**REQUEST FOR COMMENTS
DELETION OF RULE 4-804 – MARKET MAKER AND PRINCIPAL ACCOUNT ORDERS**

The Board of Directors of TSX Inc. (TSX) has approved an amendment (Amendment) to the Rules of the Toronto Stock Exchange (TSX Rules). The Amendment provides for the deletion of Rule 4-804 Market Maker and Principal Account Orders (Rule 4-804).

The Amendment will be effective upon approval by the Ontario Securities Commission (Commission) following public notice and comment. Comments on the proposed Amendment should be in writing and delivered within 30 days of the date of this notice to:

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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
Toronto, Ontario M5H 3S8
Fax: (416) 595-8940
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Terms not defined in this Request for Comments are defined in the TSX Rules.

I. Overview

The deletion of Rule 4-804 is a natural consequence of the evolution of the Canadian capital markets. With the movement to a multiple-marketplace environment (where equivalents to Rule 4-804 do not exist in the other marketplaces), Rule 4-804 is no longer relevant as it can no longer effectively protect market makers on the Exchange from risks relating to their provision of size guarantees through the Exchange's Minimum Guaranteed Fill (MGF) facility.

II. Discussion

Rule 4-804 provides that "All orders for listed securities for a Market Maker account or a principal account that better the bid or the ask shall be for at least the amount of the MGF for that listed security."

Rule 4-804, or the "Professional Order Handling Rule", was introduced to protect market makers from other professional (pro) traders, who could potentially improve the posted bid/ask with a small pro order and create a large liability for the market maker. This liability arises because the market maker is obliged to honour the best posted price up to the MGF quantity on client orders (even if that best price was based on minimal posted volume and was not indicative of true market value). For example, a pro order could significantly improve the best bid with a single board lot order, and this could be followed by a large client order to sell. The market maker would be obliged to take the opposite side of this large order and buy a quantity of shares, up to the MGF less the one posted board lot, at the new "top of book" price.

Rule 4-804 protects the market maker and controls the risk associated with providing a size guarantee to the marketplace. By requiring pro orders to commit at least the MGF quantity on orders that improve the best bid/ask, Rule 4-804 ensures that the pro order takes on the exposure and relieves the market maker from having to guarantee any remainder. However, the ongoing evolution of the Canadian capital markets is rendering the protection afforded by Rule 4-804 ineffective.

Rule 4-804 is a marketplace-specific protection. New marketplaces, which do not have an equivalent to Rule 4-804 and which trade Exchange-listed securities, will allow pro orders that are below the MGF quantity to improve the best bid offer posted by market makers, and provide a means to bypass the protection offered by Rule 4-804.

Given the anticipated adoption of intermarket best-price protection in Canada, pro orders could create liabilities for Exchange market makers by improving the bid/ask in a small increment on other marketplaces. Market makers on TSX will not be able to compete for order flow unless they are willing to honour MGF quantities at the new "NBBO" (National Best Bid and Offer) and thereby exposing themselves to the risks that Rule 4-804 would otherwise address.

The deletion of Rule 4-804 in the context of a Canadian multiple-marketplace environment is consistent with other multiple-marketplace environments. The Exchange is not aware of any equivalents to Rule 4-804 or the Exchange's MGF facility in the other major exchanges.

In light of the evolving Canadian capital markets, Rule 4-804 is no longer able to effectively protect market makers from risks relating to their MGF obligations. As a result, the Exchange is proposing to delete Rule 4-804 to allow pro orders to better the posted bid/ask spread for any size below the market maker's size.

III. Proposed Amendment

The proposed Amendment deletes Rule 4-804 in its entirety. The text of Rule 4-804 is set out in Appendix A.

IV. Amendment Process

In April 2006, the Amendment was reviewed and approved by the Exchange's Trading Advisory Committee (TAC). On April 26, 2006, the Board of Directors of TSX approved the Amendment.

V. Public Interest Assessment

In light of today's evolving Canadian capital markets, Rule 4-804 does not provide the necessary protections to the Exchange's market makers. That is, the protections offered by Rule 4-804 have been negated, with the natural consequence being the deletion of the ineffective rule. If Rule 4-804 continues to exist in the multiple marketplace environment, order flow between marketplaces could well be driven by differences in market rules rather than market efficiencies.

For these reasons, the Exchange believes that the deletion of Rule 4-408 is not contrary to the public interest.

We submit that in accordance with the Protocol for Commission Oversight of Toronto Stock Exchange Rule Proposals, the Amendment will be considered "public interest" in nature. The Amendment 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 Blair Morrison, Legal Counsel, TSX Group Inc., at (416) 947-4211.

APPENDIX A

The proposed Amendment deletes Rule 4-804, the text of which is set out below, in its entirety.

“4-804 Market Maker and Principal Account Orders

All orders for listed securities for a Market Maker account or a principal account that better the bid or the ask shall be for at least the amount of the MGF for that listed security.”