

Chapter 13

SRO Notices and Disciplinary Proceedings

13.1.1 Notice of Amendments and Commission Approval Amendments to TSX Rules 1-101(2) and New Rule 4-107 and New Policy 4-107 Regarding Specialty Price Crosses

THE TORONTO STOCK EXCHANGE INC. (TSX) NOTICE OF AMENDMENTS AND COMMISSION APPROVAL AMENDMENTS TO TSX RULES 1-101(2) AND NEW RULE 4-107 AND NEW POLICY 4-107 REGARDING SPECIALTY PRICE CROSSES

On May 30, 2003, the Commission approved amendments to TSX Rules 1-101(2) and the new Rule 4-107 and new Policy 4-107 regarding Specialty Price Crosses. These amendments define Specialty Price Crosses and will allow Specialty Price Crosses to be executed on the Exchange during the Regular Session and the Special Trading Session. The amendments were initially published for comment on December 6, 2002 at (2002) 25 OSCB 8233. Seven comment letters were received. A summary of comments received and the response of the TSX is attached to this notice. In order to address the comments received, certain amendments were made and Policy 4-107 was added subsequent to the publication for comment of the original proposed amendments. Attached to this notice is a black lined version of the amendments, indicating the changes from the previously published version.

LIST OF COMMENTERS

1. BMO Nesbitt Burns (“BMO”)
2. Barclays Global Investors (“Barclays”)
3. Canadian Securities Traders Association (“CSTA”)
4. Market Regulation Services Inc. (“RS”)
5. Montreal Exchange (“ME”)
6. TD Asset Management (“TDAM”)
7. TD Newcrest Inc. (“TD Newcrest”)

SUMMARY OF COMMENT LETTERS AND RESPONSES

Capitalized terms used herein are as defined in the Specialty Price Cross Proposal that was published for comment in the Ontario Securities Commission Bulletin (2002), 25 OSCB 8233.

ISSUE AND COMMENTER	PUBLIC COMMENT	TSX RESPONSE
The Need For A Specialty Price Crossing Facility at TSX		
Barclays	Barclays believes that the Specialty Price Crosses proposal will significantly enhance the quality of the Canadian markets.	TSX believes that by proceeding with the proposal will permit the Exchange to offer trade execution alternatives that are consistent with the standards of other major international exchanges.
BMO	BMO supports the Specialty Price Crosses proposal and believes that it will facilitate the ability of participants to execute VWAP and Basis Trades.	See above response to Barclays in this section.
CSTA	The CSTA appreciates the need for the proposal, and encourages its development subject to the concerns noted below.	See above response to Barclays in this section.
ME	Fully favours the proposed amendments to the Rule and Policies of the Exchange to permit the execution of VWAP and Basis Trades. The ME believes that the implementation of the facility will provide greater market efficiency through improved execution of Canadian exchange-traded equity derivative products with their related underlying security or index. The ME is also of the view that the proposal will also align TSX with international trade execution best practices.	See above response to Barclays in this section.
TDAM	TDAM believes that permitting such Specialty Price Crosses at TSX will represent a positive step for the Canadian marketplace. Given that these types of execution alternatives are routine in other marketplaces, the commenter believes that their introduction into Canada will represent a welcome innovation.	See above response to Barclays in this section.
TD Newcrest	The commenter believes that permitting Specialty Price Crosses to occur outside the posted market represents a positive step in the Canadian marketplace. TD Newcrest notes that the proposal will allow for the development and implementation of trade execution solutions that are consistent with best execution practices, and are commonplace in other marketplaces, including basis trades, blind baskets and VWAP trades. Accordingly, the commenter fully endorses the initiative subject to certain issues identified below.	See above response to Barclays in this section.
Execution of Specialty Price Crosses		
TD Newcrest	The commenter notes that, under the current proposal, all Specialty Price Crosses will be executed in the Special Trading Session between 4:05 p.m. and 5:00 p.m. TD Newcrest believes that such trades should be permitted to be traded at any point between 9:30 a.m. and 5:00 p.m. TD Newcrest notes that it is important that these trades are printed and recorded at the time that they are executed (or at the time execution is completed). For example, VWAP trades may be guaranteed over a portion of the trading session (i.e.	Agreed. The proposal currently provides that Specialty Price Crosses may be executed during the Regular Session and the Special Trading Session at the Exchange.

ISSUE AND COMMENTER	PUBLIC COMMENT	TSX RESPONSE
	10:00 a.m. to 12:00 p.m.). TD Newcrest believes that these trades should be crossed at the time of completion, rather than waiting until the Special Trading Session at 4:05 p.m.	
CSTA	The CSTA is concerned that while these types of trades are currently executed in the United States, they are done only in the pre- and post-market sessions. The CSTA believes that allowing these crosses to happen during the regular trading hours, at prices outside the existing quote in a security causes unnecessary market price disruption. The commenter notes that it would erode investor confidence in TSX as it could be perceived as an unfair marketplace. The CSTA board believes that Specialty Price Crosses should only be permitted, as in the United States, during pre- and post-trading sessions.	<p>The London Stock Exchange currently permits these types of trades to be conducted on its market during their regular trading day. In addition, these types of trades can be executed in the United States at any point during the trading day for certain listed and over-the-counter securities utilizing "off board" print facilities (U.S. regional exchanges) or through NASDAQ. As noted by the commenter, the New York Stock Exchange also permits these types of trades to be executed in the pre- and post-trading sessions.</p> <p>The Exchange and RS believe that market participants should be permitted to execute Specialty Price Crosses during the Regular Session and the Special Trading Session. The reporting of such transactions during the trading day as they occur will facilitate the transparency of market information. Further, such transactions will be continuously monitored by the Exchange and RS to ensure that such trades are appropriate in the context of the market.</p>
Reporting of Specialty Price Crosses		
BMO	BMO seeks clarity on any additional compliance requirements for Specialty Price Crosses. The commenter notes that the proposal states that "specific definitions of the VWAP calculation vary among participants." As well, the proposal states "[Market Regulation Services Inc.] will also play a key role in monitoring the Specialty Price Crosses executed on the Exchange to ensure that such trades are fair within the context of the market. As noted above, VWAP Trades and Basis Trades will each be marked with a unique trade marker to enable such review to be performed." BMO seeks clarification as to the specific records of calculations or instructions that will be required to support regulatory review of these specialty transactions?	<p>Participating Organizations executing VWAP Trades and Basis Trades on the Exchange shall be required to report details of the transaction to a Market Surveillance Official at the Exchange and RS in the format and at the time required by the Exchange and RS.</p> <p>For VWAP Trades, such information shall include details of any time period used to calculate the volume-weighted average price, a description of any types of trades excluded from the volume-weighted average price and all relevant supporting documentation. For Basis Trades, such information shall include complete details relating to the calculation of the price of the Basis Trade and all relevant supporting documentation.</p> <p>The details of these reporting procedures are set forth in TSX Policy 4-107(2) and (4).</p>
Trade Markers		
Barclays, TD Newcrest	The commenters believe that TSX's Specialty Price Crossing facility would be enhanced if there were to be separate trade identifiers for each type of trade (e.g. VWAP Trades, Basis Trades, etc.) to bring greater visibility to the marketplace.	As noted in the proposal, unique trade markers will be introduced for both VWAP Trades and Basis Trades that are executed as Specialty Price Crosses.

ISSUE AND COMMENTER	PUBLIC COMMENT	TSX RESPONSE
BMO	BMO questions whether trading system vendors will be required to make system changes so that participating organizations can append the unique trade markers to the types of transactions contemplated in the proposal.	Vendors will be required to make required system modifications to facilitate the use of the VWAP and Basis Trades trade markers. TSX will provide advance notification of such changes prior to implementation.
VWAP Trades		
RS	<p>RS notes that, as proposed, each participant would be able to adopt its own method of calculating "average" price. For example, it would appear to be acceptable to exclude "block trades", "crosses" or "odd lot trades" from the volume. It would also be acceptable under the proposed TSX rule to base the price on the volume for a specified period of a trading day.</p> <p>RS' over-riding concern is that the ability to provide a unique definition of "average" price not be used to avoid better-priced orders displayed on a marketplace. For this reason, RS proposes that if the calculation is not to be based on all trades during the Regular Session on a trading day that the ability to report a Volume-Weighted Average Price Trade be subject to additional conditions as follows:</p> <ul style="list-style-type: none"> • The time period for calculating the average price must commence after the receipt of the order; • The types of trades to be excluded from the calculation must be agreed upon prior to the commencement of the calculation period; and • Details of the time period to be used in the calculation together with the description of any types of trades to be excluded from the calculation must be provided to both the marketplace on which the trade will be reported and the regulation services provider for that marketplace as soon as practicable following receipt of the order. 	The Exchange agrees with the conditions suggested by RS to be imposed on VWAP Trades. Such conditions have been included in TSX Policy 4-107(3) and (4).
Basis Trades		
TD Newcrest	TD Newcrest notes that typically the basket of securities involved in a Basis Trade will be a pure index basket. However, situations will arise where not all of the underlying securities within the index basket will be traded, and, instead an imperfect basket may be transacted against futures or exchange traded funds. This may arise because the client or executing participating organization may be restricted from trading one or more names in the underlying index. TD Newcrest believes that it would be useful if there was an explicit definition outlining what qualifies as a basket of securities (i.e. perhaps 75% of the names in the index representing at least 75% of the market capitalization of the index).	Agreed. TSX Policy 4-107(1) has been introduced to provide that a Basis Trade shall comprise of at least 80 percent of the component share weighting of the basket of securities or index participation unit that is the subject of the Basis Trade.
TD Newcrest	TD Newcrest would like to ensure that the SPC will apply to large Basis Trades that may be executed over multiple trading sessions. The commenter believes that it should be possible to maintain execution data over the time period in question that can then be used to	Agreed. TSX confirms that Basis Trades may be executed over multiple trading sessions provided that the participating organization maintains the records prescribed in TSX Policy 4-107(2).

ISSUE AND COMMENTER	PUBLIC COMMENT	TSX RESPONSE
	calculate the effective price of the underlying baskets, regardless if the trade is executed over multiple days.	
RS	<p>RS notes that, in the proposal's supporting material, it states that Basis Trades "involves sourcing liquidity from both the futures and equity markets to create (or offset) a position in an underlying security or index. To execute a Basis Trade, a trader must be able to print the trade at the average price paid for all futures and equities."</p> <p>The commenter notes that currently, if a dealer "accumulates" a position in a security in anticipation of an offsetting client order the dealer undertakes the accumulation as principal and must unwind the position to the client in a client-principal trade that must be undertaken in the context of the market. In the view of RS it would not be fair to allow a dealer that has accumulated a position through purchases in both the equity and derivative markets to make a cross of the effective equity position at a price which is outside the context of the prevailing market simply because the position has been accumulated in more than one type of market. On the other hand, if the dealer has made the purchases in both the equity and derivative markets as "agent" for the client, existing TSX rules provide a mechanism for dealing with offsetting trades in the equity market through provisions for exchange for physicals (in the case of futures) and contingent option trades (in the case of options). The procedure section out in Policy 4-1103 of the TSX requires that the trade in the listed security and the offsetting derivative trade be for the same account.</p> <p>RS recognizes that the procedures set out in TSX Policy 4-1103 may need to be updated to reflect that derivative trading on the Bourse de Montréal has migrated to an electronic platform. In the view of RS, since an exchange-traded derivative transaction is an integral part of a "Basis Trade", the Bourse de Montréal should be aware of the transaction and, ideally, the derivative trade would be capable of being marked so that it could be matched with the marked "Basis Trade" on TSX. In the absence of a co-ordinated solution with the Bourse de Montréal, RS' view is that the Participant reporting the Basis Trade should provide the details of the related derivative transactions to the TSX and to RS as soon as practicable following the entry of the Basis Trade.</p> <p>RS does not believe that exchange for physicals or contingent option trades should be executed outside of the context of the equity market.</p>	<p>To address RS' comments, the definition of Basis Trade in Rule 1-101(2) has been revised to reflect that the transaction must involve "a basket of securities or an index participation unit that is transacted at a price <i>calculated in the prescribed manner which represents the average accumulation (or distribution) price of the position, subject to an agreed upon basis spread</i>, achieved through the execution of related exchange-traded derivative instruments, which may include listed index futures, index options and index participation units in an amount that will correspond to an equivalent market exposure." RS believes that the addition of these restrictions to the definition of Basis Trade, in conjunction with the reporting obligations specified in TSX Policy 4-107(2), will ensure that Basis Trades are "fair" in the context of the marketplace.</p> <p>A Basis Trade executed by a Participating Organization ("PO") in the context of a client-principal trade will be required to comply with Rule 8.1 of UMIR ("Client-Principal Trading"). Rule 8.1 of UMIR generally requires for client orders of 50 standard trading units (as defined in Rule 1.1 of UMIR) or less of a security with a value of \$100,000 or less, a participant trading with one of its clients as principal must provide the client with a <i>better</i> price than the client could obtain on a marketplace. For the purposes of Rule 8.1 and the 50 standard trading unit threshold, a basket of securities will be measured on an aggregate security basis. Further, the value threshold in Rule 8.1 will be also be measured on an aggregate security value basis.</p> <p>Accordingly, in order for a PO to engage in a client-principal Basis Trade, the trade must either exceed the client order size/trade value thresholds exceptions in Rule 8.1 of UMIR specified above (it is anticipated that certain Basis Trades may exceed these thresholds for certain institutional trades), or offer the client a better price than the client could obtain on a marketplace. Basis Trades are to be conducted on the basis that a PO is utilizing the derivative markets (listed index futures, index options and index participation units) to offer its client a better price than the client could achieve solely in the equity markets. If the PO cannot offer a better price to the client (and does not</p>

ISSUE AND COMMENTER	PUBLIC COMMENT	TSX RESPONSE
		<p>otherwise qualify for any other exceptions in Rule 8.1), it will not be able to conduct the client-principal Basis Trade in compliance with UMIR. The pricing details and documentation reported by POs in connection with the reporting obligations specified in proposed TSX Policy 4-107(2), will enable the Exchange and RS to monitor Basis Trades on an ongoing basis, including compliance with UMIR.</p> <p>TSX is considering amending or repealing TSX Policy 4-1103 to reflect the fact that derivative trading on the Bourse de Montréal has migrated to an electronic platform, and given that exchange for physicals and contingent option trades may constitute Basis Trades under the Specialty Price Crosses proposal. The Bourse de Montréal is strongly supportive of the Specialty Price Crosses proposal and its staff have been consulted during its development.</p> <p>Pursuant to TSX Policy 4-107(2), a PO executing a Basis Trade on the Exchange will be required to report to TSX and RS complete details relating to the calculation of the price of the Basis Trade, and all relevant supporting documentation. Accordingly, complete details of the related derivative transactions will be required to be provided to TSX and RS on a timely basis.</p> <p>RS has been consulted and agrees with the recommended drafting changes.</p>
<p>Trading Statistics CSTA</p>	<p>The CSTA is concerned that the inclusion of Specialty Price Crosses may misconstrue daily trading volumes. The commenter notes that there is currently an inordinate amount of re-crossing being performed by some brokers to increase their market share, and the CSTA feels that including these crosses in the daily volume would only exacerbate the problem. The CSTA believes that once the trades are flagged as Specialty Price Crosses they should not be considered as part of the daily trading volume.</p>	<p>TSX does not intend to remove Specialty Price Crosses from the daily trading volume as such trades will represent a beneficial change of ownership. Specialty Price Crosses will be subject to ongoing reporting that is subject to RS' review, including any potential re-crosses that are inconsistent with the Universal Market Integrity Rules.</p>

SPECIALTY PRICE CROSSES

RULES	POLICIES
<p>Rule 1-101(2) shall be amended to add the following definitions:</p> <p>“Basis Trade” means a transaction whereby a basket of securities or an index participation unit is transacted at <u>a prices calculated in the prescribed manner which represents the average accumulation (or distribution) price of the position, subject to an agreed upon basis spread,</u> achieved through the execution of related exchange-traded derivative instruments, which may include <u>listed</u> index futures, index options and index participation units in an amount that will correspond to an equivalent market exposure.</p> <p>“Specialty Price Cross” means a Basis Trade or Volume-Weighted Average Price Trade, or such other trade that is <u>prescribed designated</u> by the Exchange from time to time, resulting from the entry by a Participating Organization of both the order to purchase and the order to sell a security.</p> <p>“Volume-Weighted Average Price Trade” means a transaction for the purpose of executing trades at a volume-weighted average price <u>calculated in the prescribed manner</u> of the security traded for a continuous period on or during a trading day on the Exchange.</p>	
<p>Division 1 of Part 4 of the Rules shall be amended to add the following provision:</p> <p>4-107 – “Specialty Price Crosses”</p> <p>(1) Execution – Specialty Price Crosses may be executed in the Regular Session and the Special Trading Session.</p> <p>(2) Restriction on Setting Last Sale or Closing Price – Specialty Price Crosses shall not be used in <u>the</u> calculation of either a last sale price or closing price for a stock for the Regular Session or the Special Trading Session.</p>	<p><u>4-107 – “Specialty Price Crosses”</u></p> <p>(1) <u>Qualifying Basis Trades</u></p> <p><u>A Basis Trade shall comprise of at least 80 percent of the component share weighting of the basket of securities or index participation unit that is the subject of the Basis Trade.</u></p> <p>(2) <u>Reporting of Basis Trades</u></p> <p><u>Participating Organizations executing Basis Trades on the Exchange shall report details of the transaction to a Market Surveillance Official at the Exchange and RS in the format and at the time required by the Exchange and RS. Such information shall include complete details relating to the calculation of the price of the Basis Trade and all relevant supporting documentation.</u></p> <p>(3) <u>Qualifying Volume-Weighted Average Price Trades</u></p> <p><u>A Volume-Weighted Average Price Trade that is not calculated based on all trades during the Regular Session on a Trading Day shall be determined in such a manner that the time period for calculating the volume-weighted average price must commence after the receipt of the order by the Participating Organization. In addition, the types of trades to be excluded from the calculation must be determined prior to the commencement of the calculation period.</u></p>

RULES	POLICIES
	<p><u>(4) Reporting of Volume-Weighted Average Price Trades</u></p> <p><u>Participating Organizations executing Volume-Weighted Average Price Trades on the Exchange shall report details of the transaction to a Market Surveillance Official at the Exchange and RS in the format and at the time required by the Exchange and RS. Such information shall include details of the time period used to calculate the volume-weighted average price, a description of any types of trades excluded from the volume-weighted average price calculation and all relevant supporting documentation.</u></p>
<p>Division 9 of Part 4 of the Rules of the Exchange shall be deleted and the following substituted:</p> <p>Rule 4-901 – “General Provisions”</p> <p>(1) All listed securities shall be eligible for trading during the Special Trading Session.</p> <p>(2) Except as otherwise provided, all transactions in the Special Trading Session shall be at the price of the last sale of the security on the Exchange during the Regular Session.</p> <p>(3) Except as otherwise provided, the normal rules of priority and allocation and all other Exchange Requirements shall apply to the Special Trading Session.</p>	