Shorcan Brokers Limited

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British Columbia Securities Commission
Alberta Securities Commission
Saskatchewan Securities Commission
The Manitoba Securities Commission
Ontario Securities Commission
Office of the Administrator, New Brunswick
Registrar of Securities, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland
Registrar of Securities, North West Territories
Registrar of Securities, Yukon Territories
Registrar of Securities, Nunavut
c/o John Stevenson
Secretary, Ontario Securities Commission
20 Queen Street West
Suite 800
Box 55
Toronto, Ontario
M5H 3S8

And To:

Claude St. Pierre
Secretary
Commission des valeurs mobilières
du Quebec
800 Victoria Square
Stock Exchange Tower
P.O. Box 246
22nd Floor
Montreal, Quebec
H4Z 1G3

Dear Sirs/Mesdames:

Re: Proposed National Instrument 21-101 Market Place Operation, National Instrument 23-101 Trading Rules, Ontario Securities Commission Rule 23-501, Designation as Market Participant and Discussion Paper entitled "Consolidation Plan for a Consolidated Canadian Market" and related companion policies and forms (the "New Proposal")

I *Introduction*

Shorcan Brokers Limited ("Shorcan") is pleased to respond to the New Proposal. Shorcan is a leading interdealer broker, which has been providing fixed income broker services to the dealer market since 1977.

The Canadian Securities Administrators ("CSA") have received submissions from the Investment Dealers Association of Canada ("IDA") and the Bank of Canada (the "Bank"). Shorcan has reviewed these submissions.

II *Shorcan's General Comments*

1. Shorcan concurs with the suggestion made in both the IDA and Bank submissions that the application of Rule ATS to the fixed income market should be delayed so that more consideration can be given to the current proposal.

2. The New Proposal is an ambitious one in which basic principles of pre-trade and post-trade transparency are sought to be applied to both the equities markets and the fixed income markets. Yet the underlying nature of these markets is fundamentally different. It would appear the equities markets are much better suited to the concept of an integrated limit order book than the fixed income markets. This observation is at the root of the Bank's objection to a "one size fits all" approach to market regulation in Canada.

3. Shorcan has provided broker services for a number of fixed income markets over the years and, based on our first hand experience of such markets, our conclusion is that the various segments of the fixed income market each demand a specialized approach. Customer type, market depth, technology requirements and economics differ significantly from market segment to market segment. Within the Canadian fixed income market, the level of diversity is surprisingly high. The market for a currant federal government fixed income instrument, for example, has high

volume and relatively high liquidity. But the market for "off the run" federal government fixed income instruments is much less liquid as is the market for provincial debt which is driven by a new issue calendar.

The relatively small corporate market is even less liquid. The repurchase agreement market (or "repo market") is unique because it requires direct settlement between counter parties and therefore the sacrifice of anonymity in the trading process.

These different market characteristics imply a need for a flexible transparency delivery model.

4. The CanPX transparency initiative has to be understood in the context of the specific market segment of the Canadian fixed income market it was designed to serve. CanPX, like GovPX in the US market, is designed to provide an appropriate transparency solution for the highly liquid high volume market for federal fixed income instruments.

5. The utility of a CanPX approach for another segments of the market has not been tested nor was CanPX designed to serve the needs of such markets. It is for this reason that the transparency solution advocated in the New Proposal needs to be revisited.

6. Another interesting issue raised by the Bank is the possibility (indeed the likelihood) that increased transparency in the non-broker sphere of the most liquid market for federal government instruments would produce migration of trading volume to other venues. Shorcan along with other interdealer brokers (IDBs) is of course affected by the transparency introduced by CanPX to the brokered segment of the market. Over the years, industry statistics in Canada have shown that 40% of trades in Canadian government debt security occur through IDB systems with the balance occurring in the non-broker market, that is, dealer/account trades plus dealer/dealer direct trading. If the impact of the CanPX system is to drain away trading volume from the brokered (visible) segment of the market, to the non-brokered segment there will be important implications. The disparity in transparency requirements between the brokered and non-brokered segments of the market will have to be addressed. If the effect of transparency in one market is to drain liquidity off in favour of the other, the regulatory approach would have to be revisited not only on grounds of fairness but also because the objective of transparency would have been undermined by the drain off in liquidity in favour of the less transparent market.

7. The securities commissions will also have to be alert to the impact of enhanced technology on the market for fixed income issues. If electronic trading vehicles emerge which choose not to regulate themselves as IDBs and therefore escape having to contribute data to the CanPX system, the burden of providing transparency will have been shared inequitably among market participants with the IDBs shouldering a relatively large burden and other market players a lesser or no burden. The CSA needs to decide now how such an equality would be addressed in the future.

III Response to CSA Questions

Shorcan has elected to respond to three questions only having regard to its particular business and expertise.

Question 3

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

Shorcan believes that the IDA certainly has a natural and long-standing interest in the organization of the Canadian debt markets. To the extent that the debt market had been directly or indirectly regulated, the IDA has played the most significant role in this regulation.

If the IDA is ultimately to assume the role of market regulator, it must publicly confront and satisfactorily address the potential for conflicts presented by the fact that IDA members are intimately involved in the debt market, are likely to be sponsors of alternative trading systems operating in the fixed income market in competition with IDBs and may take part in IDA committees that directly regulate or propose rules for the regulation of the fixed income market. Some means (e.g., the use of independent directors, independent staff) have to be introduced to assure fairness to all stakeholders in the fixed income markets if the IDA is to become the market regulator.

Historically, the IDA has indirectly regulated the IDB sphere of the fixed income market through By-law 36 and Regulation 2100. Also, CanPX was brought into being with substantial support from the IDA. Members of the IDA must openly suggest solutions to reconcile conflicts that may arise from simultaneously participating in the formulation of regulation, the establishment of transparency vehicles such as CanPX and acting as customers and owners of IDBs.

Question 11:

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

Shorcan submits that the role of the information processor should be strictly enough circumscribed that it does not emerge as a competitor of the very participants who are supplying the data that it makes transparent. The information processor should not have a means or an incentive to use its role as information processor to enjoy an advantage over other market contributors with whom the processor may directly or indirectly be in competition.

Question 12:

Is regulation 2100 of the IDA still appropriate?

Regulation 2100 is specific to the market as it exists today. If alternative trading systems emerge which give institutional purchasers of fixed income instruments greater participation in the wholesale market for debt instruments than they currently enjoy, it is quite likely that Regulation 2100 will have to be significantly overhauled or abandoned in favour of the new ATS policy.

We would be pleased to discuss any of the comments in this letter with the Commission. If we can be of further assistance to the Commission in this regard, please contact the undersigned at (416)360-2500.

Yours very truly,

James P. Magee
President