CANADIAN VENTURE EXCHANGE

WILLIAM L. HESS, QC
PRESIDENT & CEO

October 19, 2000

Canadian Securities Administrators:
British Columbia Securities Commission
Alberta Securities Commission
Saskatchewan Securities Commission
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, Northwest Territories
Registrar of Securities, Yukon Territory
Registrar of Securities, Nunavut

c/o John Stevenson, Secretary
Ontario Securities Commission
20 Queen Street West
Suite 1903, Box 55
Toronto, Ontario M5H 3S8
jstevenson@osc.gov.on.ca

By Courier
and
By E-Mail

And to:

Claude St. Pierre, Secretary
Commission des valeurs mobilières du Québec
800 Victoria Square
Stock Exchange Tower
P.O. Box 246, 22nd Floor
Montréal, Québec H4Z 1G3
claude.stpierre@cvmq.com

Dear Sirs/Madams:

Re: Republication of Proposed National Instruments 21-101, 23-101 and Related Documents (Marketplace Operation Rule and Trading Rules) – the "Proposal"

The Canadian Venture Exchange (CDNX) offers the following comments in response to the Proposal.

CDNX strongly supports the goal of enhancing Canadian capital markets through the introduction of alternative trading systems (ATSs). The competition they will provide should increase the efficiency and liquidity of our markets. However, CDNX is concerned that the manner in which ATSs are to be introduced as set out in the Proposal will produce the opposite result, harming the efficiency and reputation of Canadian capital markets.

Our concerns are summarized as follows:

1. **Lack of Issuer Regulation.** The Proposal will allow Canada to be the principal trading jurisdiction for underregulated (unlisted anywhere) and unregulated (not a reporting issuer or equivalent) issuers in any jurisdiction, foreign or domestic.

2. **Underregulated and Unresponsive Trading Environment.** The Proposal will result in a rigid and static Canadian standard of trading rules considerably less stringent than those applicable to public markets today.

3. **Lack of Initial Data Consolidation and Market Integration.** Contemplating implementation without resolving the issues relating to data consolidation and market integration will delay the realization of the goals of the Proposal and may contribute to unfairness in the markets.

Lack of Issuer Regulation

ATSs may become significant participants in the Canadian capital markets, indeed even dominant players. In fact, under the Proposal one ATS alone could trade all the securities of a vast majority of Canadian based public companies before it might have to become an exchange. Even if ATSs do not capture a sizable share of the market, we have experienced how a problem in any Canadian market damages the reputation of all our markets. Therefore, the CSA should be concerned that it does not create regulatory gaps or voids. It is CDNX's position that by not requiring issuers to be listed on an exchange or registered with a securities regulator the potential for reputational damage is significant.

While there may be an assumption that all Canadian companies will be listed on a Canadian exchange and that all foreign stocks will be listed in a jurisdiction with comparable standards, CDNX believes that this is a dangerous assumption that puts at risk the reputation of the Canadian markets and one that ultimately will be proven incorrect. Compliance with listed company regulation can greatly increase the cost of capital particularly for smaller issuers, a result that they will be eager to avoid if sufficient, even if not necessarily equivalent liquidity is provided in a less regulated environment. Perhaps of even greater concern are those that will prefer the less regulated environment for purposes abusive to investors and the Canadian marketplace.

Undoubtedly the bulk of foreign stocks traded on Canadian ATSs will be in companies listed on world-class exchanges, but the Proposal allows those that want to avoid the scrutiny of both exchanges and securities regulators to make Canada their market of choice. It will be easy for companies to "go public" outside of the closed system (or similar regimes in other jurisdictions) and

make a Canadian ATS their principal or sole marketplace while avoiding the reporting issuer obligations in Canadian securities laws designed to protect investors. It will not take long for all Canadian markets to be tainted by the inevitable results.

From an exchange's point of view, listed company regulation including surveillance and enforcement, is a cost subsidized by trading fees and the sale of market data. As listings are lost to competing ATSs, the exchanges can be expected to address reducing this cost. With the Proposal encouraging the trading in unlisted securities, the message is that listed company regulation is not deemed necessary to protect the public, so exchange listing "regulations" will be driven by commercial rather than market integrity concerns.

The easiest solution to this problem is to amend the Proposal to restrict the trading on ATSs to issuers listed in an enumerated list of recognized jurisdictions. However the CSA would have to recognize that to do so will mean that in order to be competitive, an exchange would have to adjust its standards to world norms. This could mean significant change for CDNX which has the most significant (some would say "intrusive") regulation of any exchange.

Underregulated and Unresponsive Trading Environment

The development of trading rules should be organic and timely, responding to specific needs of specific marketplaces at specific points in time. Only those with the necessary expertise and experience of being on the "frontline" will be able to carry out that flexible, organic approach to rule development. This is consistent with IOSCO's *Objectives and Principles of Regulation,* which state that a securities regulatory regime should make appropriate use of SROs for their respective areas of competence. Adherence to this principle has served the Canadian marketplace well, and we do not believe it should be abandoned in favour of regulators making trading rules directly.

The minimal trading rules set out in the Proposal will become the Canadian standard. The CSA acknowledges that onerous trading rules are a competitive disadvantage as is illustrated by the fact that the CSA originally proposed an "uptick" rule on short sales to give adequate protection to investors in illiquid stocks. The Proposal then adopted a less stringent rule as commenters indicated market share would be lost (presumably, primarily in inter-listed, senior securities). Again, given the message that the minimal rules in the Proposal are sufficient to protect the public, there is no reason to believe that any exchange or ATS will pay the cost of exceeding the minimum unless there is a commercial reason to do so.

We believe that the most appropriate solution would be the establishment of a single market regulation SRO representing trading systems and the users of the systems. Working with the CSA, market participants should be able to quickly move to this result. Alternatively, there could be more than one SRO that would develop common rules and practices on core issues as was the case (and still is to a limited extent) in the area of member regulation.

Lack of Initial Data Consolidation and Market Integration

The Proposal does not require that data consolidation and market integration be operational when the National Instruments are implemented.

The stated regulatory objectives of the Proposal are to provide investor choice, improved price discovery and less expensive execution costs. For investor choice to be meaningful and to ensure price discovery, there must be a high level of transparency and visibility in the marketplace. Transparency and visibility are also important to encourage competition between marketplaces and thereby keep execution costs down. In order to achieve any of those objectives there must be data consolidation.

The CSA's objectives should also be to ensure best execution. Market integration is essential to ensure best execution. Further, if the market integration is not addressed prior to ATSs commencing their trading operations, investors (especially in illiquid securities) will see wider spreads and greater price fluctuation. That in turn could result in investors abandoning the Canadian markets for jurisdictions where they are more confident of better treatment.

Conclusion

We again emphasize that ATSs should have the opportunity to operate in the Canadian marketplace as soon as possible. We believe that the commercial realities as to how such organizations wish to operate and the benefits they could bring to the marketplace can be accomplished without the complete restructuring proposed and the resulting reduction in regulatory standards.

Much has changed since the CSA first commenced work on the Proposal. New issues have arisen and different approaches are being considered in other jurisdictions. Perhaps most importantly, the Canadian exchanges have undergone significant changes both in structure and attitude. Whereas the exchanges once viewed ATSs solely as competitors, they are now prepared to welcome them as customers as well. This is not surprising as increased global competition is having the same effect on other industries where one sees competitors that were once in all-out battles now continuing to be competitors in certain core businesses, forming alliances in search of other opportunities and sometimes even becoming customers of one another. While it is probably unlikely that venture level companies will figure prominently in the business plans of ATSs wishing entry to the Canadian market, we intend to encourage their participation in our market to add liquidity to this sector.

We believe that the CSA goal of allowing ATS participation can be accomplished quickly without the risks inherent in the Proposal. We encourage you to take into consideration the state of the markets today, which of course includes enhanced resources available to regulators and increased oversight of SROs. If anything, Canada needs to enhance its reputation for quality regulation in order to effectively compete for capital. We should therefore be building on what we have rather than putting our reputation at risk on wholesale changes not necessary to achieve the specific goal. We also note that the Proposal differs considerably from how these issues are addressed in the U.S. currently and will diverge even further if recent proposals there are adopted. Adopting the Proposal

and the diminished regulatory standards that will result will substantiate the perception of a gap in regulatory standards between Canada and the U.S.

We look forward to discussing these issues further and to working with the CSA and market participants to quickly achieve the goals underlying the Proposal.

Yours truly,

William L. Hess, QC
President & CEO
WLH/if

Enclosures

APPENDIX A

DETAILED COMMENTS AND EXAMPLES OUTLINING CDNX CONCERNS

Lack of Issuer Regulation

The Proposal allows ATSs to trade securities of issuers unlisted on any exchange, domestic or foreign, and unregistered with any securities regulator. This means that there will be instances of investors in Canada trading in securities in these markets without the benefit of the protection in Canadian securities legislation (and comparable provisions in other well-regulated jurisdictions) provided through the obligations imposed on reporting issuers, their insiders and those in special relationships.

The Canadian marketplace currently provides significant additional investor protection through listed company regulation by the exchanges. The body of these regulations has been developed over time with significant input from market participants and the regulators and contributes significantly to the quality and integrity of our markets.

Issuer regulation at the Canadian exchanges includes:

- monitoring for compliance with the terms of exchange listing agreements and supporting corporate finance policies and rules;
- monitoring and review of initial and continuous disclosure documents;
- assessing the suitability of people associated with listed companies;
- where appropriate, halting and suspending trading in securities and delisting companies for failing to comply with exchange requirements.

The emphasis is on proactive rather than reactive regulation so as to, wherever possible, prevent harm to investors and the marketplace before it occurs. A prophylactic approach is a distinctly Canadian approach worth preserving. It is far more effective than approaches (such as litigation) that favour providing redress after harm has been done.

The Canadian exchanges closely review directors and officers of potential and existing listed companies to ensure they have adequate public company experience and an appropriate corporate governance track record. This is particularly important with junior issuers. CDNX frequently requires changes to the boards and officers of its listed companies.

CDNX gathers information about how listed companies oversee treasury and management activities including share issuance, warrant issuance, employee stock options, hold periods after distribution, management remuneration, acquisitions, promotional materials and activities.

Share issuance, for example, is a material change. CDNX reviews share issuances to ensure companies are getting value and to ensure disclosure of the beneficial ownership of more than 5% in any distribution (failing which CDNX disallows the issuance). Once CDNX determines beneficial

ownership and who the control persons are, that information is checked against our records for any past regulatory concerns. If beneficial ownership is 10% or more, comprehensive research is conducted so CDNX can be satisfied investors are not at risk. CDNX takes regulatory action (halts/suspensions/requires resignations) when treasury or management abuses are detected. The Canadian securities commissions do not currently integrate extensive information about treasury and management activities in their issuer regulation processes.

CDNX also analyzes information about capital structures with a view to preventing “boiler-room” opportunities. For trading in securities through an ATS, capital could be concentrated so that one or two traders could manipulate the market.

CDNX applies prospectus level reviews to a number of transactions including reverse take-overs, qualifying transactions and changes of business. We also ensure appropriate corporate governance principles are upheld in related party transactions by requiring minority shareholder approval and adopting strict valuation principles. CDNX also applies the National Escrow Policy.

We cite some recent examples of actions taken by CDNX to illustrate the importance of a proactive and frontline approach to issuer regulation:

1. A trading halt was instituted because we detected inaccurate public disclosure. The company was required to correct misleading information, agree to an independent review and report on economic prospects before trading was resumed. This situation tends to occur more frequently with junior issuers.

2. Another trading halt was instituted because CDNX's review of investor relations and promotional materials revealed inaccurate information. The information to investors was corrected and the company was required to strengthen its board and its corporate governance before trading was resumed.

Even in the most egregious situations, ATSs will not have the ability to halt trading and investors will be able to continue to invest until the appropriate securities commissions issue cease trade orders.

Minimal Trading Rules

It is essential that a flexible, organic approach be adopted with regard to rulemaking. We refer to our comments above and the history of the short sale rule in the Proposal as an example of the dangers inherent with an inflexible, "one size fits all" approach. As noted above, the CSA originally proposed the "Uptick Rule". A less stringent rule was then adopted as a result of comments that market share would be lost. The result is an inflexible approach that the TSE believes will hurt the liquidity and efficiency of its market and that CDNX believes will put investors in the venture market at risk. An SRO would be best suited to evaluate both these concerns and perhaps develop, monitor and adjust rules that could address the concerns, for example by applying different rules based on liquidity.

The Proposal imposes only minimal trading rules on ATSs. Should the CSA implement the minimal trading rules proposed, those will become the industry standard. The expected race to the bottom will directly and negatively impact junior equity investors.

Specific examples of the minimal nature of the trading rules follow:

1. The proposed trading rule prohibiting price manipulation, deceptive trading and fraud is far less specific than is needed for less liquid equities. CDNX Rule F-2.10 deems several transactions to be manipulative or deceptive methods of trading for the purpose of the prohibition. The details are set out in full, providing exchange members specific information so that they know exactly where the boundaries of ethical market practices are and preventing breaches of those boundaries.

2. The Proposal contains display requirements but no cross-interference, or put-through, rule. Junior equity investors need the protection of a cross-interference rule which allows dealers to match orders within the existing bid-ask, but only if they are willing to give up 50% to the existing book if the aggregate value of the trade is $75,000 or less. For retail investors, their confidence in the integrity and fairness of the marketplace is preserved when they know their orders will have a fair opportunity of being filled on a price/time priority.

3. The Proposal is silent with regard to Pro Group Reporting. That initiative was considered crucial in order to address concerns held by the CSA and SROs relating to potential conflicts of interests by pros and the lack of adequate disclosure by pro groups to clients and potential clients. The CSA should ensure that Pro Group Reporting also applies to trading through ATSs.

4. Examples of other CDNX rules for trading in junior securities not found in the Proposal are:

    (a) market corner rule - prohibiting exchange members, approved persons and their employees from “cornering the market” by collaborating to trade back and forth with each other in a security so that the trading price is unduly influenced (F.2.11);
    (b) remuneration (no secret commissions) - requiring all remuneration received by members and their employees for securities trades be declared and recorded (F.2.12);
    (c) conflicts of interest - prohibiting members and approved persons acting as agents for clients from buying or selling for their own account, or otherwise engaging in activity either within or outside the context of their employment which creates the appearance of conflict between their interests and the investor’s (F.2.04); and
    (d) opposite side of the market - prohibiting members from making a practice of taking the opposite side of the market to the side taken by clients, whether directly or indirectly (F.2.05).

Pursuant to the Proposal, the only remedy an ATS can exercise over a non-compliant subscriber is exclusion from the marketplace. Approved agents will have no greater enforcement authority than the ATSs. Further, if problems are detected in the trading of securities through ATSs, they and their approved agents will not have the power to halt or suspend such trading.

In any event, pursuant to the Proposal, ATS's approved agents who are responsible for providing market regulation services, will not receive trade information until as late as 90 seconds following execution. Access to real time information is essential in order to ensure effective surveillance. The CSA should require real time order and trade data feeds.

APPENDIX B

RESPONSES TO CSA QUESTIONS

1. Should broker ID numbers be collected and disseminated by the data consolidator? If yes, should the customer decide whether the broker ID is disseminated?

Broker ID numbers should be collected and disseminated by the data consolidator. Customers should not be allowed to control the dissemination of broker IDs. At present, broker IDs are collected and disseminated for junior equities trading on CDNX.

In junior equity trading, with heavy retail investor participation, the display of broker IDs increases the possibility of the investor being able to identify and track the particular order in the marketplace. That gives junior equity investors confidence in the transparency of the marketplace.

In addition, the size of retail orders, as compared to the size of institutional orders, is not such as to cause, in and of itself, price fluctuation. Concerns about negatively impacting market activity by merely placing an order are not a factor in retail trading. Again, the display of Broker IDs will not, in that instance, cause unnecessary volatility for retail investors. The information is a major aid to finding liquidity quickly and efficiently. If one dealer is trading, rather than several, then there is less liquidity. Traders are better able to determine whether trading activity is fair to the marketplace as a whole when broker IDs are displayed. In secondary trading of junior securities, it is important to see that more than one dealer is trading (Pro-group concerns, etc.).

To exclude broker IDs now, therefore, would be a big step backwards in the eyes of retail investors.

2. Who should provide market regulation for ATSs? Provide reasons for your answer.

We refer to our general comments above. Ideally, a new national regulator or a few regulators formed by Canadian SROs with appropriate organizational structures to avoid both the perception and risk of conflicts of interests would provide market regulation for ATSs. The new regulators would be responsible for ensuring the CSA's broad goals and minimum standards are met. The CSA should rework the Proposal to set only broad goals and minimum standards, without detailing the means by which every marketplace achieves those goals. In the event that more than one SRO regulates ATSs, there should be the highest possible level of harmonization of market integrity rules among the different marketplaces. CDNX and the TSE have committed to developing harmonized market integrity rules between our two marketplaces. The ME has been invited to participate with us in that process.

13. Should there also be an exception [to display requirements] based on number of shares traded (in addition to value of shares traded - $100,000)? Are there any other exceptions to the display requirements that should be included?

There should be no exceptions to the display requirement. Full display requirements are very important to retail investors. As the CSA has recognized, retail investors do not generally have the same best execution opportunities as institutional investors. The playing field should be leveled as much as possible to rectify that imbalance. Further, it would be artificial to set exemptions based on dollar value - $100,000 in a stock trading over $100 is vastly different from $100,000 in a stock trading at $1. Finally, investors can avoid any adverse impacts of large orders by placing orders in increments.

16. Should special order audit trail requirements be adopted? Under what circumstances should the requirements be imposed? To whom should the requirements apply? What additional information should be collected?

Yes, special order audit trail requirements should be adopted. They should apply to all marketplaces as an ongoing requirement. CDNX has recognized that complete equity order audit trails are essential and, to the greatest extent possible, should be consistent among marketplaces. To that end, CDNX and the TSE have agreed to work together to develop consistent audit trail requirements for member firms.

17. Should the audit trail requirements be established by the CSA or should the requirements be determined by the exchange, approved agent or the IDA?

The new national regulator(s) responsible for providing market regulation (see response to Question 2, above) should establish the equity order audit trail requirements.

18. Should the display requirements for OTC orders and trades be expanded from market makers to all dealers?

Yes. More information available to investors results in more transparent markets and a level playing field. Transparency leads to liquidity.

19. Should the information [re: OTC orders/trades] be sent to the data consolidator or another party?

This information should be sent to the data consolidator in order to enhance the completeness of the consolidated market information the data consolidator offers.

20. Should short selling provisions be limited to trades facilitated on a marketplace or should they apply to dealers trading outside a marketplace?

They should also apply to dealers trading outside a marketplace. Short selling has the potential to drive the price of a security down, creating volatility and thereby harming investors. Junior equity investors are particularly vulnerable to the volatility that can result.