

May 6, 2005

BY E-MAIL and COURIER

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Dear Members of the Canadian Securities Administrators,

Re: Request for Comment – Concept Paper 23-402 - Best Execution and Soft Dollar Arrangements

TSX Group Inc. welcomes the opportunity to comment on behalf of both Toronto Stock Exchange (TSX) and TSX Venture Exchange on Concept Paper 23-402 - Best Execution and Soft Dollar Arrangements (the “Concept Paper”) published by the Ontario, British Columbia, Alberta and Manitoba Securities Commissions and the Autorité des marchés financiers du Québec (the “CSA”).

We have always been strong advocates of promoting best execution practices and are pleased that the CSA have provided this forum to further discussions on the issues related to best execution in the Canadian context. It is with this focus that we have responded to various questions outlined in the Concept Paper. For ease of reference, we have reproduced the questions related to best execution outlined in Parts 1 through 4 of the Concept Paper on which we have provided comments.

Question 1: Are there any changes to current requirements that would be helpful in ensuring best execution? Do you think that clients are aware of their role in best execution or would some form of investor education be helpful?

While finding the best price does not necessarily ensure the ultimate goal of best execution (in some cases there may be time limit or other constraints), we do believe that it is, in most cases, a significant contributing factor. Market regulators should continue their efforts at securing best execution for investors by strengthening regulation to prevent trade throughs on Canadian equity marketplaces.

TSX believes that although a general awareness about best execution exists, educational forums, peer reviews, establishing and publishing best practice standards are important tools to assist market participants, including clients in understanding their role in best execution.

The response that TSX received to the staging of the Best Execution Conference is a clear indication that there is significant interest in, if not a clear understanding of, the client's or agent's role in best execution. We also observed that while the investment community has a high level of awareness of the components of and issues surrounding best execution, there is considerable divergence among dealers and advisors as to the processes employed to measure and monitor the quality of trade execution. Vendors that provide pre- and post-trade analytics can assist registrants in measuring best execution and in educating clients about their role in this process.

Understanding the implications for trading desk structure and order flow will be important in developing tools for measuring best execution. This may highlight some of the larger issues that surround "block style" versus electronic and algorithmic driven execution and whether those strategies create barriers to best execution.

Question 2: Should there be more prescriptive rules than those which currently exist for best execution or should the methods for meeting the best execution obligation be left to the discretion of registrants?

TSX is of the view that preventing trade throughs is integral to providing a fair and level playing field in the Canadian equity market and supports market regulators' initiatives to effect this result. With regard to other elements of a best execution framework, however, the introduction of more prescriptive regulation will not necessarily lead to the best result in terms of ensuring that registrants are fulfilling their best execution obligations.

Best execution for a client cannot necessarily be achieved by the application of a bright line test, as what constitutes best execution will vary depending on the needs of the client, including its stated investment objectives. Therefore, we believe that the CSA should provide guidelines as to what constitutes best execution and on the elements and processes that must be in place in order to demonstrate after the fact that best execution has been achieved. Within this broad framework, it should be the responsibility of the registrant to ensure that it has the appropriate processes and tools in place to ensure that the best execution obligation can be discharged.

Question 3: Do you believe that there are other elements of best execution that should be considered? If so, please describe them.

In addition to the basic elements outlined in the Concept Paper, order size and marketplace liquidity should be included as elements of best execution. In addition, the interaction of these factors along with the human elements involved in the trade execution process should be considered. It would be helpful to engage vendors that build smart order routing systems that operate on best execution principles in this review. The result of this process should lead to general guidance as to what constitutes the “best net result” for the client.

Question 4: If audit trail information is not in easily-accessible electronic form, how is the information used to measure execution quality? Is there other information that provides useful measurement?

While electronic audit trails play an important role in measuring execution quality, the absence of automated information is more of an issue in dealer marketplaces and in a fragmented market. In the Canadian equities market, TSX provides a fully transparent central limit order book (CLOB) visible to market participants and therefore the lack of easy access to electronic audit trails should not create an impediment to best execution practices.

Question 5: Do you believe the suggested description emphasizing the process to seek the best net result for a client is appropriate and provides sufficient clarity and, if not, can you suggest an alternative description?

Subject to our comments in question 3 above, TSX agrees with the general elements of best execution outlined in the Concept Paper and agree with the approach emphasizing the process to seek best execution as opposed to determining more prescriptive rules.

Question 6: Do you believe that there are any significant issues impacting the quality of execution for:

- (a) Listed equities -- whether Canadian-only, inter-listed or foreign-only;*
- (b) Unlisted equity securities;*
- (c) Derivatives; or*
- (d) Debt securities?*

TSX provides one of the most transparent marketplaces in the world, with the CLOB facilitating best execution. The market integrity rules governing equity trading on Canadian marketplaces are designed to support best execution by offering trade through protection (specifically UMIR sections 5.2 and 6.4). All Canadian equity marketplaces and market participants trading in these securities should offer the same protection to investors. As long as investors have price protection and a market environment that provides liquidity and transparency, there are no significant barriers to trading listed Canada only securities.

Automation and increased transparency will help facilitate best execution when trading in, among others, unlisted securities and OTC securities.

Question 8: Do you think that internalization of orders represents an impediment to obtaining best execution?

The practice of internalization is well-established in the Canadian equity market and internalization systems are used by many dealers for risk management purposes. Trading on the “upstairs market” represents approximately 40% of the value traded on TSX.

The rules currently in place are adequate to address concerns that internalization may raise with respect to best execution. A dealer acting as agent on both sides of a trade or acting as principal on filling a client’s order owes a duty of best execution to its clients. Section 6.3 of UMIR provides the smaller investor with the benefit of price improvement as a dealer cannot trade as principal against client orders of less than 5,000 shares unless it provides a price at least one price increment better than the existing market quote.

We are of the view that internalization should not represent an impediment to best execution unless internalization practices take away from liquidity or trade throughs are allowed on these types of orders.

Thank you for providing us the opportunity to comment on the Concept Paper. We would be pleased to discuss with you any of the matters outlined in this letter.

Sincerely,

“Rik Parkhill”

Rik Parkhill
President
TSX Markets