MARKETS
ELECTRONIC TRADING SYSTEMS

May 6, 2005

British Columbia Securities Commission
Alberta Securities Commission
Manitoba Securities Commission
Ontario Securities Commission

c/o John Stevenson, Secretary
Ontario Securities Commission
20 Queen Street West
Suite 1903, Box 55
Toronto, ON M5H 3S8

And

Anne-Marie Beaudoin, directrice du secrétariat
Autorité de marchés financiers
Tour de la Bourse
800, square Victoria
C.P. 246, 22e étage
Montréal, Québec H4Z 1G3

Re: Concept Paper 23-402 *Best Execution and Soft Dollar Arrangements*

Thank you for the opportunity to comment on this important topic. As you rightly point out, Canada has lagged many other markets in establishing standards and practices regarding best execution. We commend the Canadian Securities Administrators (CSA) for initiating this important discussion.

Markets Securities Inc. is an operator of an alternative trading system known as BlockBook™. This system is designed to facilitate the matching of large trades without information leakage, thus reducing the occurrence of market impact. As such, our entire focus is to help investors achieve best execution.

Our comments on the questions and background are as follows:

1. Throughout the concept paper there appears to be an assumption that all orders are facilitated in some way by a dealer. We would like to point out that, while this has historically been true, it does not recognize the growing importance of direct market

access systems, such as ours. Increasingly, sophisticated investors are welcoming the opportunity to place their orders directly on an exchange or ATS, thereby retaining complete control of their orders and the information associated with them. This is a development that should be fostered by regulators as it eliminates the agency and conflict issues associated with using a dealer that have given rise to the bulk of the regulation surrounding order handling and best execution to date. The distinction of who places the order is very important when considering the next steps in regulation. We would request that the CSA ensure that whatever regulatory changes are contemplated with regard to best execution, they remain mindful of the evolution of markets and the different roles played under different market structures.

2. We agree that the definition of best execution needs to be understood as a concept that is much broader and more nuanced than simply best price. We also agree that the elements you have highlighted (price, speed, certainty, and total execution cost) are the main ones to be considered. We would like to emphasize that total execution cost, incorporating both implicit and explicit costs, is, perhaps, the most important of these factors. The weighting and combination of these elements will change based on investor objective and risk appetite. Therefore, we agree that a well-defined process is an appropriate standard to establish for best practice. However, whatever elements are included in the best execution process, all regulations and policies must clarify whether the best execution obligation is paramount over other obligations. We strongly urge the CSA to reduce regulatory uncertainty by clearly establishing the best execution obligation as the primary obligation to which all other obligations (best price, obligation to the marketplace, trade through) are secondary. In practice, this objective could be reasonably achieved by establishing an opt-out for institutions on best price/trade-through obligations.

3. In the same way that the concept of best execution needs to be broad enough to incorporate multiple elements whose application will change according to the situation, the measurement tools by which the execution will be evaluated require the same breadth and flexibility in application. Therefore, while post trade benchmarks such as VWAP or the closing price are useful in some circumstances, they are inadequate in others. There is general agreement that the concept of “implementation shortfall” (i.e. the difference between the expected execution cost and the actual execution cost) is the most complete measure of execution quality as it incorporates timing, market impact and market risk as well as all explicit costs. However, implementation shortfall can be a complicated analysis, so is generally more relevant for portfolio trading decisions or large trades rather than a retail-sized order. For simplicity in regulations, therefore, it might be preferable to delineate a trade size (similar to the order exposure rules) under which best price is a reasonable proxy for best execution, but beyond which a more sophisticated analysis, such as implementation shortfall, would be expected.

4. While we agree that a marketplace has an obligation to ensure the integrity of the trading mechanism and methodologies of that marketplace, we fundamentally disagree that a single marketplace can do any more than provide inputs to the best execution decision or measurement of an investor. As has been clearly described in the concept paper, best execution needs to incorporate multiple trading elements, including some, such as risk appetite, which can only be known to the investor or his or her agent. It would be impossible for a marketplace to take on a burden of determining best execution, which necessarily involves a choice of execution venue and an evaluation of trading opportunities across marketplaces. Therefore we propose that the only role appropriate to a marketplace in the best execution analysis is the one set out under National Instrument 21-101; namely fair access, public distribution of trading results and transparency of dealing model and costs.

Once again we thank you for the opportunity to comment on this important issue and look forward to the culmination of the efforts by the CSA to ensure best execution is properly implemented in the Canadian capital markets.

Yours truly,

Judith Robertson, CFA
President and CEO