
PERIMETER FINANCIAL CORP.

May 25, 2005

Autorite des marches financiers
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Attention: Anne-Marie Beaudoin

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 1800
Toronto, Ontario M5H 3S8

Ladies and Gentlemen:

Re: Comments on Concept Paper 23-402

We apologize for the lateness of this letter.

We welcome the focus of the CSA on best execution, but are troubled by its very cursory discussion of the fixed income market.

In our view, if best execution (and its arguably associated best price and trade through requirements) are appropriate for the secondary equity markets, then they should also be appropriate for the secondary debt markets.

While we will only briefly touch on this, they may also be appropriate for new issue markets. Why should an issuer or dealer engaging in a primary issue be entitled to ignore, say, a retail order in favour of another retail order or an institutional order? Why is unequal treatment in allocation of new issues acceptable, but at the same time it is a grievous sin to ignore a better-priced retail order on the TSX even for good and proper reasons?

As noted though, our focus in this letter is on the fixed income market.

First, we are concerned that there is no clear and unambiguous best execution obligation contained in any applicable regulation.

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Some time ago, the CSA confirmed the IDA's status as the regulation services provider for marketplaces that trade unlisted debt securities. Given the rather stark and investor-unfriendly results of the recent Deloitte & Touche debt survey in the retail environment, we had anticipated that the IDA would move quickly to adopt clear and specific rules, much like those RS applies in the equity environment, for the unlisted debt securities market in Canada. This has not occurred, however. In fact, we understand that IDA compliance reviews in the fixed income market are a very recent phenomenon, despite its history as a bond dealers' organization.

The situation is exacerbated by the provisions of National Instrument 23-101. Firstly, section 4.2 of NI 23-101 refers to a dealer acting as "agent", whereas in almost all fixed income transactions dealers act as principal. Secondly, section 2.1 may well serve to exempt all stock exchange participating organizations since they are subject to the UMIRs of RS, and yet the UMIRs do not address unlisted fixed income trading!

As a result, we think it is incumbent upon the CSA and/or the IDA to adopt clear best execution rules for the fixed income market that establish clearly that such apply to principal transactions as well as agency transactions, and that the pricing and offerings of all ATs (including CBID) providing a fixed income marketplace should be reviewed before transacting as principal with clients.

Such rules would also serve to support dealers' long-standing fiduciary obligations to their clients. These fiduciary obligations, and the associated best execution obligations, are of course even more intense when a dealer is trading as principal with a client, which happens almost exclusively in the fixed income arena. We note that "best execution" obligations, while not widely discussed in Canada until now, have been considered as fundamental by the SEC and other US commentators. For example, in its 1996 Order Handling Rules release, the SEC stated:

"A broker's duty of best execution derives from common law agency principles and fiduciary obligations.... This duty of best execution requires a broker-dealer to seek the most favourable terms reasonably available under the circumstances for a customer's transaction. The scope of this duty of best execution must evolve as changes occur in the market that give rise to improved executions for customer orders, including opportunities to trade at more advantageous prices. As these changes occur, broker-dealers' procedures for seeking to obtain best execution for customer orders also must be modified to consider price opportunities that become 'reasonably available'."

The presence of ATs providing transparent and attractively priced executions represents such a change. The fixed income marketplace has changed, for the better, and in our view dealers should now have a clear obligation to review the prices available via CBID Markets (and other ATs) before internally satisfying their clients' orders.

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The well-respected former Chair of the SEC, Arthur Levitt, a well-known champion of investors' rights, described in November 1999 the best execution obligation as a principle that "must be at the very core of our promise of integrity to investors – a promise that brokers will act in their customers' best interest when they route and execute orders. It must reinforce competition, rewarding those markets that improve their execution quality, and punishing those that don't." To quote former Chairman Levitt's concluding remarks: "As markets around the world compete for customers and capital, one overriding principle will serve as our competitive advantage: the quality of our markets. And nothing honors this dedication to quality more than a commitment to achieving the best possible execution of any order, by any investor, from anywhere in the world."

While the best execution obligation does not appear to have been considered by Canadian courts, U.S. cases have clarified that the duty of best execution applies regardless of whether the broker-dealer is acting as agent or as principal (see, among other cases, *Merrill Lynch I*, 911 F. Supp. at 760).

In the equity context, the Canadian equity SRO, RS, via its UMIR rule 5.1, imposes a best execution obligation, requiring dealers to "diligently pursue the execution of each client order on the most advantageous terms for the client as expeditiously as practicable under prevailing market conditions." UMIR policy 8.1, which describes the fiduciary duty to clients as "fundamental to investor confidence in the integrity of the market", clarifies that this applies equally to the principal situation. UMIR policy 8.1(1) specifies that, when selling as principal, for retail orders, a participant must "take reasonable steps to ensure that the price is the best available price for the client taking into account the condition of the market." UMIR policy 8.1(2) further states that "a principal trade may be subject to attack if it appears that the participant did not act to the best advantage of its client even if the participant complies with the technical requirement of [the rule]."

Accordingly, given the frequency of principal transactions in the fixed income environment, we recommend that the CSA, and/or the IDA as the regulation services provider, adopt at the earliest possible opportunity a regulation requiring dealers to provide their clients, and especially their retail clients, with best execution in the fixed income market, and expeditiously advise dealers in the interim that such obligation exists as a fiduciary matter even in the absence of such a regulation.

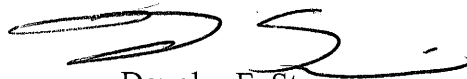
Of course, the presence of a transparent fixed income marketplace such as that offered by CBID Markets simplifies best execution obligations enormously. By

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participating in and sending client orders to that marketplace, except where they can improve its price (see, for example, UMIR s. 8.1, which allows dealers to trade as principal against retail client orders only where they can both provide a better price and ensure that it is the best available price), dealers will be able to objectively prove to their clients that they have satisfied their fiduciary and best execution obligations.

We would be pleased to participate further in the development of an express best execution rule for the fixed income marketplace including providing trading data to regulators. We feel that this trading data if examined would highlight the immediate need for dealers and other intermediaries to abide by their fiduciary obligations in this market. Its time has come. And, as noted above, if best price and trade-through obligations are appropriate in equity markets, then they too should apply in transparent fixed income markets, such as our ATS.

Yours truly,



Douglas E. Steiner
Chief Executive Officer, Perimeter Financial Corp.
Director, CollectiveBid Systems Inc.