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September 19, 2005

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

- and –

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

Dear Sirs and Mesdames:

RE: REQUEST FOR COMMENTS — CANADIAN SECURITIES ADMINISTRATORS ("CSA") DISCUSSION PAPER 23-403

Canadian Trading and Quotation System Inc. ("CNQ") appreciates this opportunity to respond to the above-noted request for comments. CNQ strongly believes that an across-the-board prohibition on trade-throughs will foster liquidity and efficiency and protect public investors. In addition to filing this comment letter, we wish to appear at the public forum on October 14, 2005.

CNQ was recognized as a quotation and trade reporting system by the Ontario Securities Commission ("OSC") on February 28, 2003 and as a stock exchange by the OSC on May 7, 2004. It is the first new marketplace to be recognized since the implementation of National Instrument 21-101 — Marketplace Operation. Two of CNQ's listed issues are currently interlisted on the TSX Venture Exchange.

Canada's New Stock Exchange

The Purpose of Trade-Through Regulation

The discussion paper questions whether trade-throughs are an obligation to the customer or to the marketplace as a whole. In our view, trade-through prohibitions have always been viewed as an obligation to protect orders in the public markets. It is a distinctly different obligation from best execution and exists to protect the passive orders in the book, not the active order trading.

Although a dealer's best execution obligation would normally require the taking out of better priced orders, this is not always the case as price is not the sole determinant of execution quality. An institution may wish a single price on a large block and not care that there are smaller better-priced orders available as they cannot fill the block order. An investor may prefer a market that offers certainty of execution over one that may offer a better price but which does not provide immediate execution. Because of this, traditionally customers could not consent to a trade through.

The Need for Marketwide Trade-Through Protection

Fairness to Investors

A prohibition on trade-throughs is intended to foster efficient price discovery by ensuring that limit orders are filled if trades occur at inferior prices. If they are not, investors will lose confidence and will not see the value in committing liquidity to the market.

All investors benefit from efficient price discovery. An institutional trader placing a value on a block order will not expect to get the public bid or ask price, but will use those prices as a reference in determining the appropriate price for the block.

As the Market Regulation Services Board of Directors has said, "individual investors will have confidence in the integrity of this evolving market only when they can be assured that all investors are subject to the same rules and that their orders will be treated fairly... Trading through discourages the investors who place limit orders — typically retail investors trading in small amounts — from placing them in the future because the practice of trading-through reduces the likelihood that their limit orders will be filled."[1]

Trade-through prohibition also promotes fairness to all investors. Protecting limit orders, particularly those of retail investors, was also the rationale of the SEC in adopting Regulation NMS, which prohibits trade throughs of any better bid or offer in another marketplace.

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[1] RS Notice 2005-003, May 12, 2005.

In response to the question asked in the Discussion Paper, we believe the obligation should extend to all better-priced orders, subject to the exceptions noted below.

Fairness to Marketplaces

Furthermore, trade-through prohibitions will not hinder the development of competitive alternative marketplaces. Marketplaces attract order flow by offering better, lower-priced trading opportunities. If a new marketplace has a better price, participants in the existing markets should not be permitted to bypass it. This is particularly a concern given that a new marketplace is likely to begin operations with a small subset of the established market's participants. If orders in the new marketplace are frequently traded through, investors will question why their orders are being placed there. In fact, it may not be best execution if an order is placed in that market, as it could be executed in the market that is trading through, though perhaps at an inferior price.

There is a rationale for exceptions in certain circumstances. Some marketplaces may not provide pre-trade transparency. If the information is not available, a participant should be permitted to bypass better-priced orders in that marketplace. If a marketplace is only available to institutional investors, dealers should be permitted to bypass better-priced orders as the marketplace has made a conscious decision to exclude them.

Similarly, a better-priced order should be bypassed if it has conditions that cannot be met. For example, if a marketplace only trades in blocks of 10,000 shares, an order for 100 shares cannot be filled there.

Also, marketplaces may have different trading methodologies that make it impractical to apply the rule. A marketplace might be open for continuous trading while the TSX is in a market-on-close session. Participants who want the TSX closing price should be permitted to trade there even if better prices are available in the other market; similarly, a participant who wants to trade immediately should be permitted to do so in the other market even if the TSX is showing a better price in the MOC session, as that price could change.

There may also be outliers, such as a marketplace with excessive charges for its data or excessive trading fees incurred when taking out a better-priced order. Today, we do not believe this is the case with any marketplace operating in Canada. These should be dealt with on a case-by-case basis.

There would also need to be exceptions such as those contained in Regulation NMS to deal with marketplaces that are slow to update market information and "fast market" situations where the order book changes as an order is being entered.

Fairness to Dealers

Applying a cross-market prohibition on trade-throughs will create a level playing field for all dealers. We do not believe that it will require a participant to become a member of all marketplaces. It can make arrangements with a member of another market to handle jitney orders or it can choose to enter orders at prices that will not cause trade-throughs. Alternatively, the CSA can adopt a rule that requires a marketplace to give access to participants of other marketplaces for the purposes of fulfilling their trade-through obligations, while requiring the participant to abide by the rules of the marketplace when taking out better-priced orders.

Such a rule will require a participant to have access to data from all marketplaces, but this is readily available at a reasonable cost. Dealers are required to have such data in any event in order to comply with the customer-principal trading rule, which requires the dealer to give the client a better price than could be obtained on *any* Canadian marketplace.

Enforcing the Rule

The SEC has imposed the obligation to enforce the trade-through rule on marketplaces, i.e. a marketplace cannot allow an order to execute if a better price exists on another market (subject to exceptions). The CSA questions whether this should be adopted in Canada.

We very strongly believe that this should not be adopted, as it will not add to market efficiency, adding to latency. Rather, orders will be rejected, held up or rerouted before being executed. To give an example:

Marketplace 1									**Marketplace 2**						
A	1000	10.00		10.15	20000	B			C	1000	10.00		10.10	10000	D

Member E enters a client order to buy 20,000 shares at $10.15 on Marketplace 1. Because it would trade through the offer on Marketplace 2, it would be booked at $10.10, creating a locked market ($10.10 bid on Marketplace 1, $10.10 offered on Marketplace 2). Member F enters an order to buy 10,000 at $10.10 on Marketplace 2 and 20,000 at $10.15 on Marketplace 1. This will not create a trade-through as Member F is filling the better-priced order in Marketplace 2 concurrently will placing the order in Marketplace 1. Member F will take out the offers in both markets ahead of Member E, who should have had priority. An alternative would be for Marketplace 1 to route Member E's order to Marketplace 2 (potentially missing the offers in both markets in the time it takes to go back and forth) or queue all orders until the trade through situation is cleared so that the original priority is maintained (and potentially creating new trade-throughs when the queue drains).

It would be more efficient to require participants to comply with the trade-through rule at the time the order is entered. In the example above, if Member E had split the client order between the marketplaces, it would have obtained a better fill for the client immediately and avoided a locked market. There are “smart” order routers available that can allow the process of finding the best market and routing the order to be automated.

We believe that obliging marketplaces to enforce a trade-through rule will be a burden to competition and to the development of new marketplaces as they will have to bear the cost of developing the infrastructure. This is particularly true if, as is the case in the U.S., the marketplace must not only stop trade-throughs but be able to recognize when the dealer has assumed responsibility for compliance (by sending a “sweep” order) and allow an apparent trade-through to occur. It will also necessarily delay implementation of the rule, as it will take considerable time to program solutions or establish cross-market routers. It also calls into question the liability of a marketplace if an order should be lost in transit to another marketplace or otherwise receive a poor fill.

Smart order routers are available today. Vendors offer them at low cost or at no cost as part of the basic order entry system. Many, if not most, dealers have them for trading in U.S. markets, so the costs will be limited to any customization for the Canadian market. In addition, clients who are participants do not access marketplaces directly, but through order entry systems provided by dealers (including dealers that operate alternative trading systems) which can provide this order routing.

In conclusion, we believe that extending trade through protection across markets to all participants will foster fairness to investors (as it will reward providers of liquidity with executions), marketplaces (as it will remove barriers to new entrants) and dealers (as it will treat them all equally). It will also contribute greatly to the efficiency of the price discovery process and the overall efficiency of the markets, but this could be compromised if compliance is a marketplace responsibility.

We thank you for this opportunity to comment. Please direct any questions to Mark Faulkner, Director Listings & Regulation (416.572.2000 x2305, Mark.Faulkner@cnq.ca) or Timothy Baikie, General Counsel & Corporate Secretary (416.572.2000 x2282, Timothy.Baikie@cnq.ca).

Yours truly,

Timothy Baikie