September 19, 2005

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Re: CSA Discussion Paper 23-403
Market Structure Developments and Trade-Through Obligations
and
RS Proposed Amendments to UMIRs on Trade-Throughs

TriAct Canada Marketplace LP ("TriAct") appreciates this opportunity to comment on the above CSA discussion paper and Market Regulation Services (RS) rule proposal. TriAct is a new marketplace that is in the process of applying for registration under Rule ATS in Ontario and for related exemptions required to operate in other provinces. TriAct is particularly interested in these issues because we have developed a service that is based on offering dealers and their clients opportunities to obtain price improvement over the displayed bid and offer prices in the primary market. TriAct is the first and only Canadian marketplace to offer better execution for institutional, dealer proprietary and retail customers. Information about our market is set out in Figure 1.

TriAct believes that there is a significant business opportunity in facilitating the achievement of better prices, regardless of whether a trade-through obligation is imposed by regulation, because market participants have inherent incentives to seek out the best available price. However, TriAct supports the imposition of a trade-through obligation because we believe that such a requirement reinforces fundamental principles of fairness and efficiency in Canadian equity markets. Fairness and efficiency are the core principles that underlie market quality.

Fairness: For many years price priority has been accepted as a fundamental characteristic of fair markets in Canada. This standard has been adopted internationally as electronic auction markets based on price priority have gained virtually universal acceptance. The CSA paper notes that trade-throughs can create a perception of unfairness. We believe it is not simply a perception, but a fact. Fairness is compromised if your order is not filled when you are publicly bidding the highest price, while another investor who is bidding less gets filled. Investors understand the straightforward fairness of price priority. Any departure from this principle will create confusion among investors and lead them to conclude that the fairness of the market has been reduced, especially for small investors.

Efficiency: We believe that prohibiting trade-throughs will increase the efficiency of price discovery by encouraging limit orders to be exposed on Canadian public markets. Market orders and the "upstairs market" are primarily takers of liquidity and prices. If trade-throughs occur with any regularity, market participants will see even less value in posting limit orders which "make the market". Questions would also be raised about the policy behind mandatory exposure of small orders to the auction market (UMIR 6.2) which is designed to support both best execution and the pricing mechanism. A reduction in the flow of limit orders to the market will compromise the efficiency of the pricing mechanism, potentially leading to wider bid–ask spreads and/or less depth in the public order book.

Competition: The CSA paper notes that imposing a trade-through obligation may inhibit competition among market operators. TriAct is introducing competitive services as an ATS, and we do not believe that a trade-through obligation inhibits competition. In our view, competition must be based on robust standards of fairness and market integrity. Securities markets are heavily regulated in order to protect investors. Therefore competition in securities markets is subject to a range of requirements and minimum standards, from licensing to detailed rules of conduct. The operation of marketplaces is regulated for the same reasons. The TSX, for example, has a public interest responsibility, because regulated markets are designed to ensure that the interests of public investors are respected. However it is difficult to meet this responsibility if competing markets are permitted to undermine one or more of the primary market's core principles.

In TriAct's view, we should not create competition by lowering standards of market integrity. Specifically, we do not believe that the rules should be changed to improve the competitive position of trading services that cater to large players who may benefit from bypassing the public market in certain situations. Competition should improve trading services for customers, not create problems for customers or introduce practices that lead investors to question the basic fairness of the market.

Furthermore, competition should enhance the efficiency of the market, not detract from it. Competition that encourages more order flow to the markets and competes to establish the best available price will improve the pricing mechanism in Canadian markets. This in turn should improve the competitiveness of Canadian markets with foreign markets.

We are in an era where technology can easily provide order handling systems that uphold cross-market price priority, as illustrated by TriAct's own system and the interfaces that we have arranged with systems vendors that serve the dealer and institutional communities. It is not necessary to sacrifice price priority in order to foster competition today. Competition can flourish without compromising the traditional standards of fairness, efficiency and market integrity in Canadian markets.

Recently, trade-throughs have not been a problem in Canadian markets because multiple markets have not developed. Even when the TSX and Montreal Exchange competed directly for orders in the same securities, both exchanges took measures to prevent trade-throughs from occurring. If trade-throughs did occur, they resulted in complaints from clients and were a nuisance to member firms.

We do not believe that market participants generally favour creation of a 2-tier market where retail orders posted at the best available price can be bypassed. Based on our discussions with dealers about participating in the TriAct market, it is evident that investment dealers favour an environment that offers price improvement over one characterized by trade-throughs. Trade-throughs will create difficulties for dealers that increase costs and risks, namely:

- Dealers' branches and compliance departments will have to deal with questions and complaints from investors about not receiving fills when trades occurred at "worse" prices. This adds to administrative costs, but more significantly, it has a negative impact on customer relations since customers tend to believe that their order has not been handled correctly if they miss a fill.

- Imposing a trade-through obligation will simplify dealers' duty to obtain best execution because it will automatically include obtaining the best available price. Any question about whether the dealer should obtain the best available price will make order handling more complicated and can lead to misunderstandings with clients.

Permitting trade-throughs could also lead to increasing segmentation of equity markets into wholesale and retail segments. The requirement to honour the best available price on public markets such as TSX is the key ingredient that integrates the upstairs institutional market with the retail market. If equity markets become significantly segmented into wholesale and retail tiers, it is possible that they could resemble the debt markets, which are very segmented and have separate pricing mechanisms for wholesale and retail customers. Of course the debt markets are often considered to be unfair to small investors due to lack of access and transparency, and charging of significant mark-ups over wholesale prices for retail trades. Electronic trading and transparency rules are improving the situation, but we do not believe the equity markets should be moving towards the model for debt markets.

Specific Questions

Our responses to some of the specific questions posed in the CSA paper follow.

1. What factors or criteria should be considered in identifying the appropriate structure and requirements for the Canadian market?

The paper identifies 4 objectives which, in general, are reasonable. However as suggested in our comments above, we believe that the objectives boil down to the core objectives of fairness (or investor protection) and market efficiency. These objectives reflect the overall mandate of the OSC. The paper states that there is a need to "properly balance investor protection and fair and efficient capital markets". This statement suggests that the two objectives are in conflict. On the contrary, we believe they are mutually reinforcing objectives in the context of the trade-through issue.

4. Please provide comments on the RS proposal regarding trade-through obligations.

TriAct agrees with RS's view that the "status quo" position that trade-throughs not be permitted should be maintained. With respect to the issue of harm to the markets, we submit that the onus should be on advocates of permitting trade-throughs to demonstrate that they will not harm investors or the market, rather than on a regulator to demonstrate that a change will harm them, given that violation of price priority is intuitively unfair to investors posting the best price.

TriAct agrees that the RS proposal leaves a gap that would allow an Access Person to trade at any price if it accesses other marketplaces only by placing orders with a dealer. The rules should treat Access Persons with access to other markets, either directly via Canadian dealers' systems (Direct Access Clients) or indirectly by placing orders with one or more Participants, as having access for purposes of the trade-through obligation. In other words, non-Participants should not be able to take the position that they only have access to one or more ATSs (as an Access Person) if they can directly / indirectly access other markets through a Participant.

In effect, the rules should recognize two levels of direct access: 1) first-level access as a Participant or Access Person; 2) second-level access as a client of a Participant. Of course, all orders executed through second-level access would be subject to the trade-through obligation of each Participant. As such, there would be no need to extend the scope of the rules to include the activities of clients with only second-level access.

8. Will the trade-through obligation impact innovation and competition in the Canadian market?

We believe that there is plenty of room for competition and innovation within the existing standards of market integrity. Innovation should not be bought at the expense of fairness. Please see our comments above on the issue of competition.

9. Should the trade-through obligation remain an obligation owed by dealers to their clients or should all marketplace participants owe a general duty to the market?

The previous rules and policies of the TSX viewed it as a responsibility of members to the exchange, as well as part of a dealer's duty to obtain best execution for its clients. This is not a new concept in Canadian equity markets. The principle of price priority implicitly creates a duty to one or more markets and to other market participants who contribute liquidity.

10. If a trade-through obligation is imposed, should the obligation be imposed on the marketplace participants or the marketplace?

We believe the trade-through obligation should apply to participants, because not every participant will have access to every market. If a market re-routes an order for a participant that is not a participant of the destination market, a contractual and regulatory gap will be created which would be very complicated to address.

We acknowledge that there may be a "gap" in the trade-through obligation since all Participants and Access Persons may not have access to all markets that provide visible order prices in cross-traded securities. We believe this is acceptable, since no one can be forced to obtain access to all markets. Nevertheless, as a practical matter, their best execution duty will generally behoove dealers to obtain access to markets that provide competitive prices, and others would have similar incentives.

11. What solutions exist if the obligation is imposed, instead, on marketplace participants?

The order routing technology vendors such as IRESS KTG, E*Trade and Reuters are well-positioned to solve this problem by providing smart order routing systems as a core service. TriAct is already working with the vendors to facilitate its price improvement model and to ensure that orders flow through to the TSX if TriAct cannot provide price improvement. Similar services can be provided by vendors to participants, to avoid trade-throughs of public market prices. For example, a vendor's system could easily compare those markets to which a given user has access, send the order to the market with the best price(s), repeat the process until the order is no longer tradeable, and then book any remainder on one market.

15. If a trade-through obligation is imposed, should the obligation use a full depth-of-book approach or only a top-of-book approach?

All visible orders at better prices should be filled. In other words, price priority should *always* prevail. Technology is capable of facilitating this approach.

16. Should the solution developed to deal with trade-throughs include the ability to route sweep orders?

Under the scenario recommended in #11 above, vendors could implement the equivalent of a "sweep" order without the need for marketplaces to implement a new mechanism dictated by regulations. TriAct recommends that marketplace rules and policies focus on regulatory principles, and leave the mechanics by which compliance is achieved to the normal forces of competition. This approach would not only simplify the regulatory process; it would leave room for future market developments that might otherwise conflict with an entrenched, regulated mechanism.

17. Should the trade-through obligation apply to prices on markets that are not transparent?

It should apply only to markets with pre-trade transparency because a participant cannot be aware of a better price that is not visible. This could force all to use one or more non-transparent markets whether there is a perceived benefit or not. In the case of TriAct, we will ensure that any trades matched in our system provide price improvement over the public bid or ask, which guarantees that trade-throughs will not occur. (If necessary, TriAct intends to reference an NBBO based on all available public quotes.) Participation in non-transparent markets should be voluntary, and based on the competitive merits of each marketplace.

22. If a trade-through obligation is imposed, should it include an exemption for large block trades?

We believe that a narrow exemption for trades that are akin to distributions as opposed to secondary market transactions would be reasonable. For instance, an exemption along the lines of RS's proposal in its rule filing on off-marketplace trading would be suitable. The exemption should be limited to very large trades; otherwise a 2–tier market will result that will undermine the principle of price priority. A distribution type of trade requires placement with a wide range of clients at a fixed price.

26. Should participants be able to opt out of "trade-through protection"?

No because a trade-through obligation is not simply a protection of the right to best execution, it is also a duty to other market participants who post the best price. Any ability to waive or opt out would severely limit the effectiveness of a trade-through rule because institutions and intermediaries could opt out whenever it suits their interests. Retail investors would not have this option, practically speaking.

With respect to the issue of "manual marketplaces" we do not think this is an issue in Canada, so need not be addressed at this time.

Summary

Our understanding is that the CSA's core mandate is to protect the interests of the small investor. Small investors' orders are a primary source of established bid and offer prices on the TSX today, and are vital contributors to an efficient pricing mechanism. The primary negative impact of trade-throughs would be on the small investor. Small investors expect the regulators to maintain basic standards of fairness in the markets so that they can directly participate in the markets without being taken advantage of. We believe that allowing orders at the best price to be bypassed would undermine a fundamental tenet of fairness in the eyes of small investors. Large investors and intermediaries have the tools to protect their own interests, which may allow them to benefit from trade-throughs in certain situations. Small investors do not have those options.

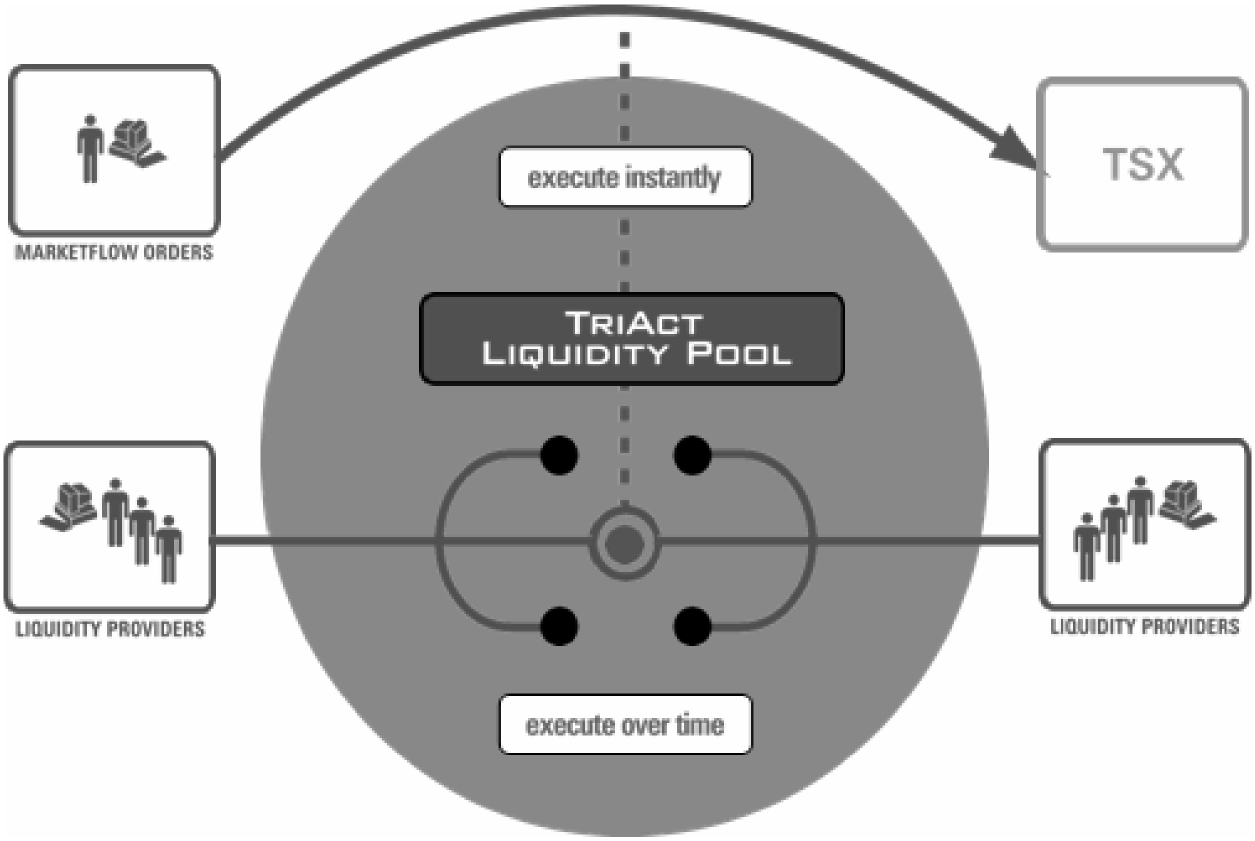
In conclusion, TriAct submits that any additional flexibility provided to large players or to competing marketplaces by permitting trade-throughs is not worth the cost in terms of reduced fairness and efficiency. Competition should be based on basic standards of market integrity. Technology provides the tools to support both competition and maintenance of long-held standards of fairness. Minor limits on the flexibility available to large players are a price worth paying in order to maintain market integrity and efficiency while encouraging competition.

Sincerely,

W. Rudd

Wendy Rudd
Chief Executive Officer

Figure 1
TriAct Canada Marketplace



TriAct guarantees price improvement to every participant on every trade. Buy and sell orders are submitted to the anonymous TriAct book by Canadian dealer Participants and their Direct Access Clients. These orders may be exposed to TriAct's liquidity pool and/or the TSX.

All trades executed by TriAct are made at a price inside the current TSX bid / ask as follows. Orders that are committed to the TriAct book are "liquidity providing" orders. Offsetting liquidity providing orders are matched at 30-second intervals at the midpoint of the TSX bid / ask spread. "Marketflow" orders are exposed continuously to the TriAct book for a match; the unmatched portion of each order is routed directly to TSX for execution. If a Marketflow order is matched in TriAct, it will receive price improvement over the TSX bid / ask spread, provided by the offsetting liquidity providing order.

TriAct's application demonstrates how marketplaces can work with vendors to enable participants to access multiple markets in a seamless way. We have worked with the major vendors to provide access to our market through existing trading workstations. Most importantly, TriAct continuously monitors TSX's real-time data feed to ensure that price improvement is guaranteed for trades matched in our system.