

September 19, 2005

British Columbia Securities Commission  
Alberta Securities Commission  
Saskatchewan Financial Services Commission  
Manitoba Securities Commission  
Ontario Securities Commission  
Autorité des marchés financiers  
New Brunswick Securities Commission  
Registrar of Securities, Prince Edward Island  
Nova Scotia Securities Commission  
Superintendent of Securities, Newfoundland and Labrador  
Registrar of Securities, Northwest Territories  
Registrar of Securities, Yukon Territory  
Registrar of Securities, Nunavut

c/o John Stevenson, Secretary  
Ontario Securities Commission  
20 Queen Street West  
Suite 1903, Box 55  
Toronto, Ontario M5H 3S8  
Fax: (416) 593-2318  
Email: [jstevenson@osc.gov.on.ca](mailto:jstevenson@osc.gov.on.ca)

- and -

Anne-Marie Beaudoin  
Directrice du secrétariat  
Autorité des marchés financiers  
Tour de la Bourse  
800 Victoria Square  
P.O. Box 246, 22<sup>nd</sup> Floor  
Montreal, Québec H4Z 1G3  
e-mail: [consultation-en-cours@lautorite.qc.ca](mailto:consultation-en-cours@lautorite.qc.ca)

Dear Sir and Madam,

**Re: CSA Discussion Paper 23-403 – Market Structure Developments and Trade Through Obligations**

We at Barclays Global Investors Canada Limited (“Barclays”) believe that the Canadian Securities Administrators (“CSA”) are taking an important and necessary step in commencing a discussion on

evolving market developments and, in particular, the issues related to enforcing an obligation to avoid trade-throughs in the context of multiple marketplaces.

We thank you for your invitation to comment on Discussion Paper 23-403 (the Discussion Paper). We continue to strongly believe in the value of meaningful dialogue between regulators and industry participants and commend the Canadian Securities Administrators for undertaking a thorough public consultation in connection with the Discussion Paper.

Barclays, which currently manages over \$50 billion in assets, is one of Canada's largest and fastest growing investment managers. Barclays is part of a global investment management business that manages over one and a half trillion dollars in assets and we therefore have very broad experience in regulatory approaches applied to this industry, including trading related matters. We support initiatives that are designed to promote competitive and open market structures that reflect best practices and maximize the opportunity for best execution of market participants' orders. Barclays has, throughout its history, encouraged innovation in markets, venues, and technology, provided these endeavors do not fragment the marketplace. Our view is that the competitive effects of multiple sources of liquidity are large.

### **Market Structure Objectives**

The CSA have identified the following objectives as factors that should be considered in identifying the appropriate structure and requirements for Canada: (1) balancing regulation and competition among all types of marketplaces; (2) recognizing and supporting the role of retail participation in the market; (3) promoting greater order interaction and displayed depth; and (4) encouraging innovation. These are worthy objectives. However, it is our view that the application of a displacement requirement for all better priced limit orders could further certain of these objectives, it would impede others.

Proponents of the trade-through rule often base their position on the belief that the rule protects investors from receiving anything other than the best price and encourages price competition and market transparency, while reducing the potentially harmful effects of market fragmentation. Critics of the rule believe that 'best-execution' encompasses not only price but also speed, certainty of execution, anonymity, size, and other factors and that a trade-through prohibition therefore may impede best execution. As discussed below, a balancing of these valid and competing perspectives is necessary.

### **Intra-market versus Inter-market Trade-Through Obligations**

Barclays supports regulation that encourages competition and efficiency, greater transparency, and the provision of liquidity in our capital markets. In particular, while we affirm the importance of price priority as a guiding principle, we believe that it is important to distinguish between intra-market competition and inter-market competition. Within a particular market, competition among orders on price encourages greater depth and tighter spreads resulting in reduced volatility and lower transaction costs. Competition among marketplaces may take other forms and encourages innovation in market structure that can also reduce transaction costs.

Barclays believes that in most cases order precedence within a marketplace should be determined by price time priority. Under normal circumstances, when trading on a marketplace it should not be possible to trade through better priced orders that are entered in the limit order book of that

marketplace. If “trade throughs” of better priced orders were frequent, investors could lose confidence in the market and would not have the incentive to enter orders in the limit order book resulting in less liquid, more volatile markets and less meaningful prices.

The question of a trade-through prohibition applicable across markets is very different. Apart from stifling competition, an obligation to displace limit orders across multiple marketplaces is, in many ways, impractical. Two examples of this are the following. (1) The TSX has an iceberg order type where there is a visible disclosed portion and an invisible undisclosed portion of the order. If the visible portion of the order executes, a portion of the balance of the order is automatically displayed. The undisclosed portion of the order has price but not time priority. The visible portion of an iceberg order has time priority established at the time the visible portion of the order is displayed. In the context of multiple marketplaces, iceberg order types and trade-through prohibitions imply that displacement requirements cannot be known with certainty. Operationally this means that traders must take the time to displace visible and invisible orders before trading the desired volume on another marketplace. In the time that it takes to execute the required series of orders it is possible that the volume that the trader could have immediately accessed at an acceptable price may no longer be available. (2) Another important example relates to markets that are created to facilitate the matching of large trades with anonymity and less information leakage. Typically such markets have large minimum order sizes that are required to enter into a negotiation on price. A requirement to displace small limit orders on other marketplaces could lead to a situation where an institution that could otherwise complete its order at an attractive price on a block marketplace no longer has sufficient size to participate in the block marketplace after displacing small orders on other marketplaces. Such situations lead to delayed or incomplete trades resulting in higher costs.

### **Portfolio Trading**

In the event that the CSA creates new regulations that impose a displacement obligation on access persons, it is important that portfolio trades (trades involving a basket of securities rather than a single security) are exempted from such requirements. A prohibition from trading through limit orders can be an obstacle to best execution for investment managers rather than helping to facilitate best execution. For example, displacement requirements are not practical for portfolio trades. Investors often use principal portfolio trades to receive immediate and complete execution of a trade list in exchange for a commission charge known as a bid premium. The investor accepts a certain cost and transfers all market trend and impact costs and timing risk to the broker.

Investors can implement portfolio trades on a ‘blind’ or fully disclosed basis. In a ‘blind’ portfolio trade the investor attempts to control information leakage and obtain the best price for the portfolio by providing several brokers with various characteristics of the list but not the individual security names and amounts and soliciting bids from those brokers based on these characteristics. The characteristics include the value of the list by side, the liquidity profile of the list, average spread, average share price, and tracking risk. The brokers determine their bid price for the trade list based upon the characteristics of the trade list as a portfolio. The investor executes the trade with the broker who submits the best bid price and sends the broker the actual trade list that details the side, security, and order size. If the investor is not permitted to opt-out from the application of the trade through rule and brokers have to displace limit orders in the order book then the broker may not be able to ‘get the trade on the tape’. This introduces additional risk for both the investor and the broker. Both the investor and the broker bear the risk of an incomplete fill such that the trade list executed could

have a different risk profile than implied by the apparent characteristics of the portfolio. The potential result is that brokers will build an additional risk premium into their bid prices or may be unwilling to bid at all. The result described above also holds, though to a lesser extent, for fully disclosed portfolio trades. In this context, the requirement to displace limit prices acts as an impediment to best execution.

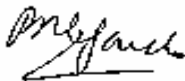
### **Meeting a Trade-Through Obligation**

The CSA contemplates several alternatives in applying a displacement requirement that applies to both participants and access persons. Namely, satisfying any displacement requirement before execution, simultaneously with execution, or after execution. In the event that the CSA creates a displacement obligation across multiple marketplaces Barclays strongly discourages a displacement obligation that arises after execution. Most Investment Managers do not have proprietary books where they manage the firm's capital. Therefore most investment managers are not in the position to use their firm's own capital to satisfy a duty to fill better-price orders that they traded through. Such a requirement would likely lead managers to refrain from using new marketplaces and restrict competition and stifle innovation.

### **Conclusion**

As stated above, Barclays continues to support regulation that helps to ensure that our capital markets function effectively. We believe that competition is essential to this objective and that innovation is essential to effective competition. The four objectives identified in the Discussion Paper are all consistent with an effectively functioning capital market. As noted however, in areas such as trade-through, these objectives may conflict and securities regulators are required to balance the competing costs and benefits. As discussed above, in reaching this balance we believe that intra-market trade-through requirements are appropriate but that an inter-market displacement requirement would have negative ramifications, particularly in stifling innovation, that outweigh the benefits. Finally, if the CSA settles upon a balance that includes inter-market trade-through rules, it is essential to the proper functioning of Canada's capital market that such rules account for portfolio trading activities and that such rules do not give rise to a post-execution displacement requirement. We thank you again for the opportunity to comment on the Discussion Paper. Please contact the undersigned or Warren Collier (416-643-4075 or [warren.collier@barclaysglobal.com](mailto:warren.collier@barclaysglobal.com)) if you have any questions, or would like additional information in respect of any of the points made in this letter.

Sincerely,



Rajiv Silgado  
President, CEO and CIO

Cc: Geoff Keith, Barclays  
Warren Collier, Barclays