



PERIMETER FINANCIAL CORP.

*Investment Innovation*

September 23, 2005

Ontario Securities Commission  
20 Queen Street West  
Suite 1903, Box 55  
Toronto, Ontario M5H 3S8

Attention: Mr. John Stevenson, Secretary

Autorite des marches financiers  
800 Square Victoria, Tour de la Bourse  
C.P. 246, 22<sup>nd</sup> Floor  
Montreal, Quebec H4Z 1G3

Attention: Anne-Marie Beaudoin

Ladies and Gentlemen:

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

Perimeter Financial Corp. ("Perimeter") welcomes the opportunity to provide its input on the Canadian Securities Administrators' ("CSA") Discussion Paper 23-403 - *Market Structure Developments and Trade-Through Obligations* and commends the CSA for undertaking this review.

As investors in, and operators of new marketplaces, we have strong beliefs on many aspects of the debate surrounding trade-through. Each of our marketplaces is focussed on (i) enhancing transparency, and (ii) providing the best price available on a marketplace to our clients trading on that marketplace.

This letter is our response to the request for comments. We would like to be given the opportunity to participate in the public forum on October 14. In addition, we may be preparing a fuller response to the questions in the discussion paper to be submitted by the October 20<sup>th</sup> deadline.

-----

This submission focuses primarily on the retail side of the fixed income market. A recent report by Deloitte and Touche paints a stark and investor-unfriendly place for investors to trade in their debt survey of the retail bond market. We wish to add to these comments.

Best execution (and the associated fiduciary obligations) seem to be a forgotten concept in the fixed income market for investors who rely on dealers for advice and fair transaction pricing. In our view, if best execution (and its arguably associated best price and trade through requirements) are appropriate for the retail equity markets, then they should also be appropriate for the retail debt markets.

We also believe that reasonable and balanced best price and trade through requirements would also be appropriate for new issue, currency and other markets. For example, we don't believe that an issuer or dealer engaging in a primary issue should be permitted to ignore, a retail new issue order in favour of another retail order for the same security that has been placed on the TSX. The costs, both from the implementation and anti-competitive impact perspectives, need to be carefully considered to ensure that the benefits exceed such expenses, especially given the presence of arbitrageurs willing to eliminate pricing discrepancies rapidly.

We are concerned that there is no clear and unambiguous best execution obligation in the fixed income market. This obligation is fundamental tenet of any respected and liquid market, (in fact far more so than a trade-through obligation). Its existence is not entirely clear in Canada. The situation is exacerbated by the provisions of NI 23-101. Section 4.2 of NI 23-101 refers to a dealer acting as "agent", whereas almost all fixed income transactions with investors and dealers act as principal. Also, 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. This is unacceptable.

As a result, we think it is incumbent upon the CSA and/or the IDA to adopt clear best execution rules for the retail fixed income market that establish not only that such rules apply to principal transactions as well as agency transactions, but that the pricing and offerings of all freely accessible ATs providing a fixed income marketplace should be reviewed before transacting as principal with retail clients.

Such rules serve to support dealers' long-standing fiduciary obligations to their clients. These fiduciary obligations, and the associated best execution obligations, are even more intense when a dealer is trading as principal with a client. We note that "best execution" obligations, while not widely discussed in Canada until recently, have been considered as fundamental by the SEC and other US commentators. The 1996 Order Handling Rules released by 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 new presence of ATSs 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 such ATSs before internally satisfying their retail clients’ orders.

There is legal precedence for our view. 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.” And UMIR policy 8.2 clarifies that this applies equally to the principal situation. UMIR policy 10.8 further describes the fiduciary duty to clients as “fundamental to investor confidence in the integrity of the market”. UMIR policy 8.1 provides 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 8.2 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 virtual ubiquity 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 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. We believe that the adoption of mark-up rules, as apply in the U.S. retail fixed income market, would also be appropriate to insure market integrity and honesty.

We would be pleased to participate further in the development of an express best execution rule for the fixed income marketplace. Its time has come. And, as noted above, if best price and trade through obligations are appropriate in retail equity markets, then they too should apply (in a careful and balanced manner so that costs do not outweigh benefits) in transparent retail fixed income markets.

-----  
Yours truly,

PERIMETER FINANCIAL CORP.

A handwritten signature in black ink, appearing to read 'D Steiner', with a small '1' above the 'i'.

Doug Steiner  
Chairman and CEO