

Scotia Capital Inc.
Scotia Plaza
40 King Street West
Box 4085, Station "A"
Toronto, Ontario
Canada M5W 2X6



September 26, 2005

John Stevenson, Secretary
Ontario Securities Commission
20 Queen Street West
Suite 1903, Box 55
Toronto, Ontario M5H 3S8
jstevenson@osc.gov.on.ca

Anne-Marie Beaudoin, Directrice du secretariat
Autorite des marches financiers
Tour de la Bourse
800, square Victoria
C.P. 246, 22e etage
Montreal, Quebec H4Z 1G3
Consultation-en-cours@lautorite.qc.ca

Dear Mr. Stevenson and Ms. Beaudoin;

Re: PROVISIONS RESPECTING TRADE-THROUGH OBLIGATIONS

On behalf of Scotia Capital Inc., please accept our comments addressing MIN 2005-021 and the issues raised in the CSA's Discussion Paper 23-403 – Developments in Market Structure and Trade-Through Obligations. We are pleased to be able to participate in these discussions and are cognizant of the profound implications and importance these issues have in determining the direction and manner in which our capital market continues to develop and evolve. The introduction of multiple marketplaces in Canada is in its nascency. This is an opportune time for all stakeholders in the Canadian market to collectively pause to consider and discuss in an open public forum the principles, attributes and characteristics of the Canadian market today and going forward. While the introduction of competitive marketplaces is generally viewed as a favorable development, marketplaces should not be permitted to compromise market integrity, liquidity, efficiency or investor protection. Innovations should contribute to, rather than detract from, the efficiency and liquidity of the market. We believe that collectively, we can resolve difficult issues such as trade-through obligations across multiple marketplaces in an efficient and cost-effect manner that recognizes and preserves the particular attributes of the Canadian capital market.

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

Certain defining features or characteristics of the Canadian market have evolved over time, such as: (i) a centralized electronic platform that is equally accessible to all market participants / participating organizations; (ii) a centralized limit order book that acts to increase liquidity, narrow spreads and enhance the depth-of-book; (iii) a best-price obligation that is largely system-enforced; and (iv) trade-through protection, albeit only intra-market up to now. These characteristics act to promote investor protection, fairness and market efficiency and thus, should be preserved across all marketplaces as the Canadian market continues to evolve. In order to achieve this, it should be mandatory for all marketplaces to be electronically integrated with a consolidated market feed and display, a centralized limit order book and a single, or at least a compatible, allocation algorithm for inter-marketplace order routing. This way, buy orders can be automatically and consistently routed and matched to the best corresponding sell orders irrespective of which marketplace the orders were originally entered on and thereby minimizing the need for manual intervention by market participants and Access persons. Certain rules, such as for example trade-through protection, best-price obligation, etc. could be system-designed by marketplaces to be enforced automatically and efficiently. Further, the development of new market surveillance systems, to monitor for insider trading or for compliance with cease trading orders for example, could be facilitated more efficiently and effectively by marketplaces, rather than by dealers, through an integrated system. We would not support a market structure that purports to accommodate competition among multiple marketplaces if it compromises investor protection, fairness, transparency, market efficiency or results in the fragmentation of a centralized limit order book across marketplaces.

2. *What market structure issues should be considered as part of the discussion on the trade-through obligation?*

Essential market structure features pertinent to the discussion of trade-through obligations across multiple marketplaces include a centralized limit order book, subject to limited exceptions, such as special terms orders, and a centralized electronic display and order routing platform connecting all marketplaces. A centralized system would facilitate the development of a system-enforced inter-marketplace best price and trade-through protection rules, thereby ensuring investor protection, fairness and market-neutrality. Orders entered on a centralized limit order book, whether by a small retail investor or a large institution, are committed orders that contribute to the price discovery process and thus, should not in the ordinary course be disadvantaged or “traded-through” by inferior orders entered on that marketplace or another marketplace. Further, the trade-through obligation should apply to all orders, whether such orders are facilitated through a dealer or entered directly on a marketplace by a non-dealer Access Person. Where exceptions to these rules are sought, RS should be contacted and can grant an exception on a case-by-case basis depending on the circumstances.

3. *Should the discussion about trade-throughs consider trading of non-exchange traded securities on marketplaces other than exchanges (for example, fixed income securities trading on more than one ATS)?*

Discussions regarding trade-throughs should be limited in scope to exchange traded securities and should not extend to fixed income securities trading over-the-counter. We believe it would be premature and overly complicated to consider extending trade-through discussions to include fixed income securities at this time. Current efforts should focus on carefully crafting a workable trade-through regime for equity securities first, before considering the fixed income or other markets.

4. *Please provide comments on the RS proposal regarding trade-through obligations. Which elements do you agree or disagree with and why?*

We are in agreement with certain aspects of RS's trade-through proposal. In particular, we agree that the trade-through obligation should apply to all orders, whether entered on a particular marketplace by a dealer or a non-dealer Access person. The actual genesis of the trade-through obligation is largely irrelevant as it has since evolved over time to become a characteristic feature of the Canadian market. Investors expect that their better-priced orders in the book will not be by-passed by an inferior order. We believe the trade-through obligation should be a system-enforced requirement for all marketplaces that trade the same security. Placing the onus on marketplaces will largely eliminate the uncertainty surrounding the applicability and enforceability of a trade-through rule on different marketplace participants with direct or indirect access to one or more marketplaces. Dealers and Access persons should not be able to avoid trade-through obligations by simply electing to limit their access to a single marketplace. An electronic interlink between marketplaces is the most efficient and feasible means of implementing and enforcing a trade-through rule across multiple marketplaces. Other alternatives proposed by RS would require extensive manual intervention by dealers, and potentially non-dealers, in the order flow process, which would invariably diminish market efficiency. Without a means for system-enforcement of the rule, RS would have no feasible way of monitoring non-dealers for compliance with trade-through obligations. Finally, the trade-through obligation should apply to all better-priced orders, including iceberg orders. Iceberg orders entered into the central limit order book are committed orders that contribute to the price discovery process. In our view, there is no principled reason why these orders should be disadvantaged or by-passed, whether in whole or in part, by an inferior order, block trade or cross. The obligation to fill better-priced orders committed in the book should not be capped at the disclosed volume of the iceberg but should include the non-visible portions of the better-priced iceberg. Traders bumping up against an iceberg order will immediately recognize the situation and can contact the client to obtain further instructions whether to continue to trade against the iceberg or not, or alternatively clients can provide these instructions beforehand when placing their trade. A client order trading against an iceberg is unlikely to be disadvantaged, rather the client will receive a better fill because it will have obtained more stock at a better-price. If iceberg orders are not protected, investors will cease using them as there will be no incentive for them to contribute to the price discovery process. Ultimately, this will

diminish transparency, liquidity and investor confidence in the Canadian market. We refer you to our prior comment letters on this issue submitted to RS and the OSC on June 2 and July 18, 2005.

5. If a trade-through obligation is imposed, what differences between Canadian and United States markets should be considered?

There are significant differences between the Canadian market and the U.S. market, the most obvious being that Canada does not currently have as many marketplaces. This suggests that it would be less complex and costly, and far more efficient, to place the obligation on marketplaces, rather than on individual dealers and Access persons, to have to facilitate inter-marketplace trade-through protection of orders. The number of linkages required to electronically connect all marketplaces would be considerably fewer than the number of linkages required to connect all dealers and Access persons with all marketplaces. With increasing globalization of securities markets, it makes sense to require Canadian marketplaces to be electronically inter-connected. Another difference is that the Canadian market is largely centralized whereas the U.S. market is highly fragmented. Centralization is particularly important because the Canadian market is considerably less liquid. Fragmentation of the Canadian market, and fragmentation of the central limit order book in particular, will undoubtedly diminish liquidity, transparency and ultimately, investor confidence in our market. Finally, the Canadian market does not generate the same magnitude of revenues as the U.S. market. The average Canadian dealer may not be in a position to spend on technology to the extent that an average U.S. dealer is able to. On the other hand, exchanges / marketplaces in Canada have enjoyed a relative monopoly up until recently and are in a superior position to create a solution to ensure trade-through protection across all marketplaces.

6. Should trade-throughs be treated differently on derivatives markets than equity markets?

We have not yet formulated a firm position on this issue. However, similar to our response to Question 3 regarding non-exchange traded fixed income securities, we would suggest that current efforts should focus first on crafting a workable trade-through regime for equity securities. A single trade-through protection rule may not be appropriate for all types of securities and all types of markets, although we would suggest that exceptions to a "best price" obligation should be relatively limited.

7. Should trade-through protection be imposed where there are multiple marketplaces trading the same securities? Why? Why not? What are the advantages and disadvantages?

Trade-through protection should definitely be imposed where there are multiple marketplaces trading the same securities. There would be an erosion of investor confidence in the market, particularly from retail or foreign investors, without trade-through protection across multiple marketplaces. We do not support the fragmentation of the Canadian market where some orders are "frozen out" from participating in certain

trades even though they are better-priced orders. As Access persons or marketplace participants, large institutional investors are required, or certainly should be required, to transact their business openly and fairly and in accordance with just and equitable principles of trade. It would be “unfair” if large institutions are permitted to by-pass better-priced orders by conducting their institutional trades on another marketplace that is not transparent and is likely to be inaccessible to ordinary investors. Fragmentation fails to protect ordinary investors and will ultimately diminish confidence and liquidity in the market as a whole. While new marketplaces are striving to distinguish themselves, they should not be permitted to compete at the expense of investor protection by avoiding trading-through obligations.

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

The existence of a trade-through obligation will undoubtedly impact and shape innovation and competition in the Canadian market because all new marketplaces will have to comply with the obligation. Marketplaces will have to create new ways to compete that do not compromise investor protection and market liquidity. Marketplaces can compete on price, services, order types, technology and so forth. It is open for marketplaces to create new systems or services that can monitor for insider trading or cease trade orders, for example, or that can perform certain market surveillance or screening functions in a more efficient and cost-effective manner. The imposition of a trade-through obligation will not stifle competition, but it may well influence and even direct some areas of innovation by marketplaces.

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 trade-through obligation should be a general duty owed to the market by all marketplace participants. As indicated in our response to Questions 4, the origins of the trade-through obligation is largely irrelevant as it has since evolved over time to become a characteristic feature of the Canadian market. Investors expect that their better-priced orders in the book will be protected and will not be by-passed by an inferior order.

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

The trade-through obligation should be imposed on the marketplaces. It would be less complex and costly, and far more efficient, to place the obligation on marketplaces rather than on individual dealers and Access persons to have to facilitate inter-marketplace trade-through protection of orders. The number of linkages required to electronically connect all marketplaces would be considerably fewer than the number of linkages required to connect all dealers and Access persons with all marketplaces. With the increasing globalization of securities markets, it makes sense to require Canadian marketplaces to be electronically inter-connected and to have a system-enforced trade-through obligation.

11. What technology solutions exist or need to be developed if a trade-through obligation is imposed on marketplaces? What solutions exist if the obligation is imposed, instead, on marketplace participants?

Technology will have to be developed to electronically integrate all marketplaces. A consolidated data display, a centralized limit order book and a common, or compatible, allocation algorithm for order routing would also have to be developed. Similar technology may already be available since the U.S. has already imposed similar a trade-through obligation on U.S. marketplaces. Recently, NADAQ announced its transition to a BRUT smart routing technology in place of the Intermarket Trading System in order to capture additional liquidity in NYSE-listed securities. Technology currently exists to connect multiple marketplaces. On the other hand, we are not aware of existing technology that can facilitate a trade-through obligation imposed on market participants. Market participants would have no alternative but to try to comply manually until a technological solution can be created.

12. Does the absence of a data consolidator affect whether and how the trade-through obligation should be imposed?

A data consolidator would likely facilitate the trade-through obligation whether imposed on the marketplaces or on the marketplace participants. We believe that competitive marketplaces should bear the onus of having to develop a data consolidator or market integrator as a part of their entry in the market.

13. Does a regime imposing a trade-through obligation need to address access fees?

The issue of access fees should be examined as a part of an over-all cost-benefit analysis. Imposing a trade-through obligation on marketplaces, as opposed to dealers and Access persons, could largely alleviate the issue of access fees since a market integrater or order-routing algorithm would automatically allocate orders to better-priced fills across marketplaces. This would ensure equal accessibility for large and smaller market participants.

14. If a trade-through obligation is placed on marketplace participants, what other access issues need to be addressed?

Technology issues and costs will definitely have to be examined in the context of a comprehensive cost-benefit analysis. If a trade-through obligation is placed directly on marketplace participants, some dealers and marketplace participants may determine that it is cost prohibitive for them to compete in their own Canadian 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?

The trade-through obligation should use a full depth-of-book approach. This is consistent with current practice and offers the most investor protection. A top of book approach would lead to greater fragmentation of the market.

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

A sweep order may offer a solution to dealing with trade-throughs across multiple marketplaces. The sweep order should execute using a full depth-of-book approach. In other words, all better-priced orders on all marketplaces should be “swept” first. The remainder of the order that has not yet been filled should then receive priority to those orders at the same price.

17. Where marketplace participants are trading on a marketplace where they do not know if their orders will match and the order book is not transparent, upon execution of an order outside the bid/ask spread of another marketplace, should the participant have to satisfy better-priced orders available on other marketplaces? If so, how? Should this be restricted to visible orders?

As stated previously in response to Question 4, we are of the view that all better-priced orders committed in the central limit order book should have to be satisfied under a trade-through obligation, including the non-visible portions of an iceberg order. Better-priced iceberg orders are fully committed orders that have contributed to price discovery. As such, they should be protected from being traded-through. A marketplace participant should be required to satisfy all better-priced orders on all other marketplaces, not just visible orders, or the visible portion of a better-priced iceberg order. It may be argued that non-visible orders that do not contribute at all to the price-discovery process should not merit full trade-through protection. We would support the general principle that all better-priced committed orders in the book should be protected, and would suggest that perhaps some minimal transparency requirement for all limit orders might be considered. A sweep order could ensure all committed better-priced orders are satisfied across all marketplaces at the time of execution.

18. If a trade-through obligation is imposed, should it occur at, simultaneously to or immediately after execution of the inferior-priced trade? Should the model accommodate all three solutions?

A trade-through obligation imposed on marketplaces should occur at the time of execution. An order routing algorithm should be designed to identify, and satisfy, all better-priced orders existing at the time of execution across all marketplaces. On the other hand, if it is contemplated that the trade-through obligation could occur immediately after the execution of an inferior-priced trade, then all better-priced orders existing at the time of execution, including iceberg orders, should still have to be fully satisfied after the fact.

19. If a trade-through obligation is imposed, should it apply to all better-priced orders existing when the obligation is discharged, all better-priced pre-existing orders (at the time of execution) or should it be limited to amount of the trade at the inferior price?

The trade-through obligation should apply to all better-priced orders existing at the time of execution. As stated above in response to Question 18, if it is contemplated that the trade-through obligation could occur after the execution of an inferior-priced trade, then all better-priced orders up to the price of the inferior trade, including any iceberg orders, should have to be satisfied even if this exceeds the amount of the inferior trade.

20. If a trade-through obligation is imposed, should exemptions be provided for special terms orders? Which ones and why?

All orders should be subject to the trade-through rule. As a general principle, all better-priced committed orders in the central limit order book should be protected. Any exemptions should be raised on a case-by-case basis with RS for specific approval. Marketplace participants should not be able to circumvent a trade-through obligation by adding special terms to an order. If an exemption for special terms orders is provided, it may be too difficult to distinguish legitimate special terms orders from those seeking to avoid the rule.

21. If a trade-through obligation is imposed, should an exemption be provided for orders for which the price or other material terms cannot be determined on order entry?

Order execution rather than order entry should be the relevant reference point in determining the extent of the trade-through obligation and any exceptions thereto. Price and other material terms will be known at the time of execution. RS should be specifically contacted and consulted for any one-off exemptions and special circumstances surrounding a particular trade. For example, for a V-WAP order, the trade-through obligation should be imposed on each individual execution attributable to that order rather than on the final contracted V-WAP price.

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

Large block trades which constitute a “wide distribution” should be exempt. Otherwise, block trades should not in the normal course be exempt from trade-through obligations. Exception may be obtained from RS where special circumstances warrant.

23. Should the size threshold for a block trade exemption for the same security traded on multiple marketplaces be the same across marketplaces? If not, what would the impact be?

There should be no exemption for block trades in the ordinary course unless it constitutes a “wide distribution” or has been specifically approved by RS.

24. If a trade-through obligation is imposed, will sweep orders facilitate the execution of block orders? How?

A sweep order could facilitate the execution of block orders by taking out all better-priced orders across all marketplaces trading the same security at the time of execution.

25. If a trade-through obligation is imposed, should it apply to any non-visible portions of a trading book?

As previously stated in response to Questions 4 and 17, better-priced orders should have to be satisfied under a trade-through obligation, including the non-visible portions of an iceberg order. Better-priced iceberg orders are committed orders that contribute to price discovery even though the full extent of the volume is not transparent. It may be argued that orders that are not transparent and have not contributed to the price-discovery process do not merit trade-through protection. Nevertheless, we are of the view that better-priced orders that are committed in the central limit order book should prevail, whether visible or not, and that perhaps some transparency requirement for all limit orders could be considered.

26. Should we provide the ability to opt out of routing orders to marketplaces where the better-priced order is on a manual marketplace or should the rule be drafted to apply to protect only those orders that are immediately and automatically accessible.

Since we are of the view that the trade-through obligation should be imposed on marketplaces, we believe the marketplaces will have to develop an order routing algorithm to satisfy all better-priced orders wherever situated. An option to opt out of manual marketplaces should not be considered unless a technological solution cannot be achieved or created.

27. What is the impact of imposing a trade-through obligation on non-dealers?

Arguably, there is no impact from imposing a trade-through obligation on non-dealers because up to now, non-dealers have been complying with a trade-through obligation by virtue of having to enter their orders through a Participating Organization. Thus, even though a formal rule has not been articulated or imposed, non-dealers currently comply with trade-through obligations. On the other hand, a determination that non-dealers are not subject to trade-through obligations would constitute a material change to current practices. A consequence of imposing a trade-through obligation on non-dealers is that RS will have to create a way to somehow monitor and enforce this obligation, unless it can be system-enforced by marketplaces.

28. Does the introduction of multiple marketplaces trading the same security cause a conflict between what is needed to meet best price obligations and what is needed to meet best execution obligations if the latter is defined as something different from best price only? How can this conflict be resolved? Is one obligation, best price or best execution more important than the other? Why? Why not?

Best price is a component of best execution. For the vast majority of investors, best price is the most significant element of best execution. If best execution is determined as between client and dealer-agent to be something other than best price, then that should be a matter of contract or agreement as between the parties rather than regulation.

29. How should locked or crossed markets be treated? Should procedures be set up to limit the occurrence of locked or crossed markets? If so, upon whom should the obligation be placed?

Procedures should be set up to limit the occurrence of locked or crossed markets and the obligation should be placed on the marketplace that locks the market. A market integrator or order routing algorithm would largely eliminate the possibility of locked or crossed markets.

30. Should the method of trade allocation (price priority or price-time priority or some entirely different method) be the same for all marketplaces or should the marketplace be allowed to determine its own procedures for allocation of trades? Why or why not?

We believe a market integrator or order routing algorithm that ensures best-price and trade-through protection across all marketplaces should take precedence. Thereafter, a marketplace should be allowed to determine its own procedures for allocating trades, provided such procedures are fair and transparent and other regulatory obligations are complied with.

31. Should the last sale price reflect trading on all marketplaces or should each marketplace have a separate last sale price? Why or why not?

There should be a single last sale price across all marketplaces.

In closing, we would once again thank you for the opportunity to participate in these important discussions and for the brief extension of time to submit our comments. Should you have any questions regarding the forgoing or require further clarification, please do not hesitate to contact Gina Yee at (416) 863-7459.

Yours truly,

Scotia Capital Inc.

cc. James E. Twiss, Chief Policy Counsel
Market Policy and General Counsel's Office
Market Regulation Services Inc.
P.O. Box 939
145 King Street West, Suite 900
Toronto, Ontario
M5H 1J8
(416) 646-7265 (fax)
james.twiss@rs.ca

Cindy Petlock, Manager Market Regulation
Capital Markets Branch
Ontario Securities Commission
Suite 1903, Box 55
20 Queen Street West
Toronto, Ontario
M5H 3S8
(416) 595-8940 (fax)
cpetlock@osc.gov.on.ca