Shorcan ATS

November 14, 2005

Mr. John Stevenson
Secretary
Ontario Securities Commission
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Ontario Securities Commission
SECRETARY'S OFFICE

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Directrice du secretariat
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Dear Sirs and Mesdames:

Re: Public Forum on CSA Discussion Paper 23-403 "Market Structure Developments and Trade-Through Obligations" (the "Discussion Paper")

This letter serves as a follow-up commentary on the CSA Public Forum that was held on Friday, October 14th, 2005. It supplements the Shorcan ATS written response to the Discussion Paper (submitted on September 19th, 2005) as well as the Shorcan ATS Presentation that was made at the Public Forum.

In its handout at the Public Forum, Shorcan suggested (see Shorcan presentation slide Page 11) a number of questions that needed to be considered in connection with arriving at an appropriate trade-through outcome for Canadian marketplaces. With the benefit of hearing all of the presentations, Shorcan believes those questions can now be approached with greater certainty.

Trade-through does not seem to be a serious problem.

The proponents of a universal trade-through rule were unable to provide any evidence to validate the theory that investors have been harmed or disadvantaged by the trade-throughs that have occurred in BlockBook in Canada to date. Moreover, no research in the U.S. cited at the Public Forum has proven or demonstrated convincingly that investors have been discouraged from placing limit orders in NASDAQ securities because there is no trade-through rule currently in effect on that marketplace. In fact the superior liquidity of NASDAQ relative to the NYSE as implied by NASDAQ's higher annualized turnover of its total market capitalization suggests the opposite conclusion. The NASDAQ marketplace, without a trade-through rule, is arguably the best marketplace in terms of liquidity, accessibility, fairness, efficiency and overall market quality in the world right now.

The RS analysis of the trade-throughs on BlockBook in Canada also did not show that a trade-through rule is necessary. RS's analysis demonstrated that: (1) investors and limit orders were not harmed by trade-through, (2) the TSX market adjusted quickly to trade-through which illustrates the power of markets to respond to new information, and (3) transparency of trading information is a powerful tool enabling marketplaces to adjust.

The purpose of the "ATS Rules" (ie- NI 21-101) is "to create a framework that permits competitive operation of traditional exchanges and other marketplaces, while ensuring that trading is fair and transparent".[1] "The regulatory objectives of the ATS Rules are ... to provide investor choice, improve price discovery and decrease execution costs".[2] The evidence to date supports the conclusion that the BlockBook marketplace is helping in the achievement of these regulatory objectives without treating any investors unfairly. We believe that the equity dealer marketplace that Shorcan intends to introduce will bring similar benefits: enhanced choice for managing trading risk, improved price and size discovery and lower transaction costs.

Specific hard dollar technology and compliance costs of imposing a universal trade- through obligation remain unknown.

It is noteworthy that the cost of implementing an expanded trade-through obligation was not estimated except in a superficial way. Nor did any of the presentations propose an obviously appropriate methodology for determining who pays the costs associated with integration of the different marketplaces.

The proponents of a universal trade-through obligation have come to the conclusion that, although the obligation belongs to "participants", the cheaper and "easier to implement" solution is for regulators to force marketplaces to electronically link to each other. RS refers to this as the "marketplace-level solution". The thinking here is that since there are fewer marketplaces than participants, it must be less expensive and simpler to implement. To draw such a conclusion without research is inappropriate. A full and comprehensive

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[1] (2001) 24 OSCB (supp), August 17,2001- at page 89
[2] ibid

evaluation of the technology, compliance and enforcement costs, relative to the supposed benefits, should be undertaken prior to any further expansion of trade-through obligations. The complexity of an electronic link between different markets serving different investors in different ways has been, in our view, severely underestimated.

Specialized marketplaces in Canada are trying to more effectively service the varying trading needs of quite different market participants and investors. This is competition, innovation and expanded investor/trader choice.

A universal trade-through obligation creates a contingent liability.

In a principal trading environment, any trade that would create an obligation to do another trade can be seen as a contingent liability. A contingent liability creates trade uncertainty and increases the likelihood of gaming across markets which will restrict the ability to meet trading objectives that involve more than price. It will require all participants to either have access to all different marketplaces or force all marketplaces to connect to each other. Each of these creates more trading risk and, as such, reduces market quality.

In closing, Shorcan is opposed to a universal trade-through obligation that applies to all participants across all marketplaces. However, we are supportive of a trade-through obligation that applies when trading on an agency basis. Also, participants in specialized marketplaces should not owe a general duty to not trade-through another marketplace's orders. Their duty is to achieve "best execution". By eliminating this contingent liability, specialized marketplaces will develop to more effectively service investor's trading needs and to more efficiently serve the risk management needs of dealers. This will result in lower market risk and enhanced market quality. While market quality is affected by fragmentation and transparency, it is ultimately determined by market risk.

Yours truly,

J. P. Watts

Joie P. Watts, CFA
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