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Alberta Securities Commission
British Columbia Securities Commission
Manitoba Securities Commission
New Brunswick Securities Commission
Securities Commission of Newfoundland and Labrador
Registrar of Securities, Department of Justice, Government of the Northwest Territories
Nova Scotia Securities Commission
Registrar of Securities, Department of Justice, Government of Nunavut
Ontario Securities Commission
Prince Edward Island Securities Office
Saskatchewan Financial Services Commission
Registrar of Securities, Government of Yukon

c/o John Stevenson, Secretary
Ontario Securities Commission
20 Queen Street West, Suite 1900, Box 55
Toronto Ontario M5H 3S8

- and -

Mme. Anne-Marie Beaudoin
Directrice du secretariat
Autorité des marchés financiers
800, Square Victoria, 22e étage, C.P. 246, Tour de la Bourse
Montréal QC H4Z 1G3

**RE: CANADIAN SECURITIES ADMINISTRATORS (“CSA”) NOTICE 21-305 NOTICE OF FILING OF
FORMS 21-101F5 INITIAL OPERATION REPORT FOR INFORMATION PROCESSOR — REQUEST FOR
COMMENT**

Canadian Trading and Quotation System Inc. (“CNQ”), operator of the CNQ stock exchange and its Pure Trading facility, appreciates this opportunity to respond to the above-noted request for comment.



General Comments

Before we respond to the specific questions asked, we would like to take this opportunity to make some general observations. Technology used in the trading of securities is evolving at an ever-increasing pace. Over the last while, it is CNQ's observation that most of the objectives of an information processor have already been achieved, and all of them can be achieved in a short period of time. This evolution has happened largely in response to the latest electronic trading systems requiring an instantaneous response when entering and canceling orders in multiple marketplaces.

We believe that the appointment of an information processor has been motivated by concerns expressed by some market participants about the difficulty of managing their order handling responsibilities in an environment where different suppliers may have different information concerning "Canadian Last Sale" or "Canadian Best Bid/Offer". The truth of the matter is that even if a single, "exclusive", information processor were appointed to provide these data elements to the marketplace, differences in the speed of the trading technologies used by the different marketplaces, connection technologies, geography, network speed, and software efficiency from the different vendors presenting the data to users will result in potentially important differences in the timeliness of delivery of the data to end users. CNQ submits that the focus of compliance activities should be on what the market participant did with the information in its possession at the time that an action was taken. Whether there are one or more information processors or none at all, should not have an impact on this principle.

Any regulatory action by the CSA must be carefully tailored. Otherwise, it risks becoming a hindrance to innovation. The proposal appears to be modeled on the Consolidated Tape Association in the United States, which has become largely irrelevant as third party vendors replicate its function much more efficiently with data supply arrangements direct from individual marketplaces, while the SEC is still required to grapple with issues such as whether Nasdaq can use three-character stock symbols.¹ To the extent that any CSA proposal introduces additional latency to the Canadian trading system, the capital markets as a whole will be seriously harmed. Electronic traders (including Canadian-based ones) who currently ignore the Canadian markets because they are too slow will continue to avoid them if they cannot access trade and price information quickly and efficiently.

With these observations in mind, we believe that mandated information processing is not needed to achieve the CSA's policy goals and carries a reasonably high risk of becoming a barrier to innovation. Should the CSA decide to pursue this course, we believe that appointing a single information processor (whether for all securities or a single processor for equities) virtually guarantees that the infrastructure will not be responsive to the continuing evolution of the capital markets. This is particularly a concern if use of the information processor is mandated, as additional latency will be built into the market structure, making it far less efficient and responsive in comparison with competing international venues, driving away potential new participants and stifling market innovation.

If the CSA determines that a formal information processing function is required, it should promote

¹ See e.g. Letter of NYSE to SEC (March 22, 2007) available at <http://www.sec.gov/rules/sro/4-534.pdf>.

competition among multiple processors, as this will ensure they are responsive to customer and marketplace needs. The criteria should be relatively straightforward: does the entity have the ability to provide complete and accurate data in a timely manner? We believe that competition will ensure that processors have sufficient staff, information and technology and the CSA should not attempt to mandate specifics.

Background

The CSA summarizes the rationale for implementing an information processor in the request for comment as follows: "...we agreed that the existence of an information processor that provides consolidated data could be a helpful tool for meeting best execution and other regulatory requirements. That is, an information processor would ensure the availability of a source of consolidated data that meets regulatory standards and which users, including dealers, could use, at their choice, to demonstrate how they met their best execution obligations."

No one disputes that the availability of "consolidated data" from multiple marketplaces will assist the dealer, exchange, and ATS community in meeting their respective regulatory obligations in the new trading environment. The sole issue is how to best ensure that the required data feed products and screen displays are delivered by the vendors to their customers. In the respectful view of CNQ, as the CSA's Industry Committee on Data Consolidation and Market Integration predicted in its 2003 report, the market data, order entry, order management and execution management vendors are stepping up to the challenge of delivering the information products and other tools designed to meet the trade through avoidance and execution quality management tools required by the Canadian dealer community. Although there may have been some uncertainty in various quarters in July 2006 when the *Request for Filing of Form 21-101F5* was issued by the CSA, advancements over the last eleven months have, in our view, obviated the need for a regulatory response in the form of the appointment of an information processor. In CNQ's view, the imposition of an "information processor" would only serve to add additional cost and latency to the acquisition of real time market data by end-user customers of all kinds, without any corresponding business benefit.

Order Entry and Management System Developments

The OE and OMS systems are the principal tools being used by the dealers to manage their order flow in the new multiple marketplace environment. To the best of CNQ's knowledge, all of the order entry system vendors active in the Canadian market are developing consolidated pre- and post-trade information services to support the work of their customers. It is our understanding that these vendors have all entered into satisfactory commercial relationships with the operators of the marketplaces to obtain and re-distribute real time market data to their end users, primarily the professional trading community on the buy- and sell-sides. As in the days when a substantial number of Canadian issues were inter-listed among the Vancouver, Montreal and Toronto exchanges, the services delivered will concentrate on two areas: last sale information with the standard data elements (symbol, volume, price, buying broker, selling broker, etc.) and marketplace identifiers, and consolidated market depth displays including market by order and market by price information. Over and above these information displays, order flow from these systems, whether connected directly to the marketplace through the vendor, or integrated with an order management system, will be intermediated by a smart order routing technology. These order routing services are

being delivered to dealer customers in a number of ways:

- Bundled with the workstation package: several vendors have integrated proprietary order routing technology into their basic order entry and order management package.
- Vendor contracts with a service bureau provider to intermediate order flow from their client systems: at least one Toronto-based vendor is offering access to a service bureau purpose-built to deliver smart order routing technology. Several vendors and dealers have contracted with this party to send order flow from their trader products into the marketplaces via the smart order router.
- Licensed Technology: several vendors are offering to license their smart order routing technology to OE vendor and dealer customers. In this instance, the licensee is responsible for integrating the system into their proprietary order entry and management systems.

The common denominator with these systems is that they will all receive broadcast trading feeds from the marketplaces providing pre-trade transparency so as to route orders in accordance with best execution and trade through avoidance principles. These smart order routing service vendors are strongly incented to reduce latency to ensure the most accurate routing of orders. If experience from the United States market is any guide, it is extremely unlikely that they would opt to receive their input data from anywhere but from the marketplaces directly. Given this, at a practical level, it is difficult to see what role an "information processor" would play in facilitating the delivery of smart order routing services to the Canadian dealer community.

We support the view originally expressed by the industry committee that creation of an information consolidator (or processor, in the present version of the CSA proposal), when the vendor community has stepped up to meet the data display and data feed requirements of the trading and investment community in Canada, only serves to duplicate costs and effort without adding to the transparency or effectiveness of the equity markets.

Market Data Developments

Developments on the traditional market data front (providers such as Reuters, Thomson and Bloomberg) are not at the same level as progress on the OE front. While all of the major vendors in Canada are in the process of making arrangements with individual marketplaces to obtain and re-distribute their real time market information, at this point, only Bloomberg has confirmed to their customers that they will be providing consolidated last sale and market depth displays concurrent with the launch of the new marketplaces. There are several reasons for this lack of progress:

- The vendors are uncertain about the outcome of the CSA's information processor appointment, and the impact on their business arrangements. As a result, there is a reluctance to commit to a product development strategy until the rules are clear.
- The pending Thomson-Reuters transaction has had an impact on the pace of new development at both organizations.
- Clients are reluctant to specify the delivery of new services from their vendors until they are clear on the regulatory and commercial direction with respect to data services in Canada.

All this said, the principal market data vendors in Canada are obtaining access to the data services of the marketplaces that exist or will launch shortly. Once the regulatory direction is clear, and the client base specifies the range of required services, CNQ believes that the vendors will be in a position to deliver the required screen display services in a relatively short period of time to their clients.

On the feeds front, a number of vendors are competing with one another to deliver the lowest latency data feeds to their customers implementing next generation electronic trading systems. Again, driven by the need from the dealer community to have access to pre-trade information from the new auction market services, the vendors providing these services (most prominently Reuters in the Canadian market, with a smaller role played by Bloomberg and Interactive Data Corporation) have plans to include the data from all of the new marketplaces intending to operate in Canada. Given the substantial customer pressure on the vendors to provide data with the lowest latency, there is a strong likelihood that these data feeds, rather than whatever product is generated by the information processor(s), will represent the state of the art for the trading community. What is not clear at this point, is the extent to which there is client demand for a "consolidated feed" which, in addition to having individual order and trade information from each of the marketplaces, would have additional data elements such as "national last sale", "national best bid/offer", national tick, trading activity summaries from across all of the marketplaces, and market share statistics. At this point, the vendors providing data feeds have all of the elements required to provide these services. CNQ believes that the industry is waiting for the conclusion of the "information processor" process prior to committing to a product development strategy for these data elements.

Response to Specific Questions

1. What are the advantages and disadvantages associated with each proposal summarized in Schedule A?

CNQ restricts its comments to the applicants proposing to provide Information Processor services for the equity markets.

Without getting into the specific advantages and disadvantages associated with the proposals, CNQ has a general reservation about the governance measures set out in each of the proposals:

Governance

When compared to the governance model set up to manage the operations of the Consolidated Tape Association in the United States, each of the proposals is deficient. With the advent of the National Market System in the US in 1975, the SEC helped bring about marketplace competition by, among other things, fostering the creation of a facility (the "Consolidated Tape") designed to give each of the recognized exchanges access to a national trade reporting facility. In addition to the individual trade reports, the system also calculated a "National Last Sale Price" and a "National Best Bid/Offer". Revenues and costs associated with operating the facility were shared amongst the participating exchanges on the basis of a formula that was subject to SEC approval. To ensure that the dominant exchanges (NYSE and AMEX at the time) did not abuse their market position, the original operating model (including the choice of technology provider) was reviewed and approved

by the SEC. Ordinary changes were typically subject to a majority vote, with each exchange entitled to a single vote. Major changes to the CTA Plan, including cost and revenue allocation, customer pricing and terms and conditions, technical changes and governance changes, were subject to SEC approval (following notice and public comment opportunities) **after** a unanimous vote of the CTA participants.² In addition, the CTA periodically conducts system and process reviews of the designated technology provider, SIAC. While the focus of the audit is to ensure that SIAC has provisioned sufficient capacity and system redundancy, the system is also reviewed to determine that access to the tape system is equal for all participating markets. The SEC is provided with a copy of the review and recommendations arising from the review.³

CNQ submits that, in view of the competitive environment amongst the new and pending marketplaces in Canada, it is imperative that stringent governance safeguards and CSA oversight be imposed on any party supplying information processor services, especially if the party is a competitor of marketplaces supplying data. CNQ submits that membership on a committee with "input" into key questions regarding pricing, business terms and conditions, technology operations, and product development would be a highly unsatisfactory result.

2. Are the criteria used for evaluation of the applications adequate? Should other factors be considered by the CSA in reviewing the applications?

CNQ believes that, in addition to the criteria set out in the notice, a rigorous cost/benefit analysis should be conducted by the CSA prior to appointing one or more parties as a provider of information processing services.

3. Should an information processor be required to create and disseminate a standardized, consolidated display of data? Alternatively, should the information processor disseminate consolidated data feeds that may be accessed by market participants to create their own displays?

As indicated above, it is CNQ's view that vendors wanting access to real-time data are in a position to make arrangements directly with each of the marketplaces to access the feeds. While there may be value to some third parties wanting access to the feeds at a common point, in CNQ's view the additional latency imposed in the creation of the "consolidated feed" and the costs of developing and maintaining the consolidation facility, outweigh the convenience of establishing a common collection point. The distribution of consolidated screen displays would require the information processor to develop an Application Protocol Interface ("API") that would have to be integrated by third parties into their service offering. While it is possible that such a service would be of use to niche players in the information distribution business, it is extremely unlikely that the major suppliers of market information services in the Canadian market would opt to use the "look and feel" of the service developed by the information processor. Each of the players will, instead, develop services that match their proprietary information displays. If we look to the United States, for example, the information processors (SIAC for the listed market and NASDAQ for OTC securities) provide a raw feed to third party customers only. The SEC, in turn, has imposed

² See, for example, Article IV (b) of the CTA Plan

³ See Article V (d) of the CTA Plan

“display requirements” on the vendors to ensure that information from all participating marketplaces is fairly represented to the end user. As discussed above, with the explosion of message traffic from the National Market System in the US, and the increased focus on latency reduction, the information processors have found that vendors are increasingly going directly to the participating markets for their (in particular) real-time market depth information. CNQ submits that the Canadian market should learn from the US experience and avoid mandating marketplace creation of consolidated market depth feeds and related displays.

4. **What would be the advantages and disadvantages of having one versus multiple information processors? For example, how would each alternative impact market participants’ ability to achieve best execution or comply with trade-through or other obligations? Should the information processors for the fixed income and equity markets be different?**

CNQ submits that the pace of development to date suggests that the appointment of one or more information processors is unlikely to have any effect on the ability of market participants to meet their regulatory obligations. As indicated above, parties delivering smart order routing services have already made arrangements to receive and process pre- and post-trade information from operating markets in Canada. Latency concerns will likely ensure that this means of data acquisition will continue even in the event that consolidated feeds are created by one or more information processors. It is CNQ’s expectation that all of the order flow sent to the Pure Trading marketplace after its launch will have been intermediated by such order routers.

We thank you for this opportunity to comment. If you have any questions, please feel free to telephone me at 416.572.2000 x2326 (Richard.Carleton@cnq.ca) or Timothy Baikie, General Counsel and Corporate Secretary at 416.572.2000 x2282 (Timothy.Baikie@cnq.ca).

Yours truly,

CANADIAN TRADING AND QUOTATION SYSTEM INC.



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