July 20, 2007

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

c/o John Stevenson, Secretary
Ontario Securities Commission
20 Queen Street West
Suite 1903, Box 55
Toronto, ON M5H 3S8

- and -

Anne-Marie Beaudoin
Directrice du secretariat de l'Autorité
Autorité de marchés financiers
Tour de la Bourse
800, square Victoria
C.P. 246, 22e étage
Montréal, Québec H4Z 1G3

- and to –

James E. Twiss
Market Regulation Services Inc.
Suite 900
145 King Street West
Toronto, Ontario M5H 1J8

Re: Joint Canadian Securities Administrators/Market Regulation Services Inc. Notice on Trade-through Protection, Best Execution and Access to Marketplaces

We thank you for the opportunity to comment on these important proposals. We appreciate the thoughtful work that has been undertaken to resolve the competing viewpoints in these crucial areas of marketplace regulation.

We are filing this letter today to highlight our main comments, together with an alternative proposal for satisfying CSA/RS policy objectives on trade-through. We will follow-up shortly with our more complete responses to the questions contained in the Joint CSA/RS Notice as well as the related RS requests for comments and CSA request for comments regarding selection of an Information Processor.

I. Trade-through Protection

We have, in past comment letters, elaborated on philosophical and practical objections to regulations like trade-through which impose constraints on the free flow of willing buyers and sellers transacting on regulated marketplaces. However, we appreciate that an industry consensus has emerged in favour of trade-through protection and so wish to focus on how to meet the policy objectives behind trade-through protection in a manner that neither inhibits legitimate trading activity nor imposes undue cost on industry participants.

At this point, we would highlight three main issues of concern with the trade-through proposal as currently drafted, and offer an alternative method of arriving at a reasonable solution which would be responsive to both CSA/RS policy concerns and the practical constraints of marketplace integration.

1. Lack of Data Consolidation and Marketplace Integration

First, the draft CSA language presumes a degree of inter-marketplace integration that simply does not exist and may never exist. In addition, as is acknowledged by the CSA's request for comments on applications for an Information Processor, a consolidated data feed which amalgamates all quotes from all marketplaces currently does not exist. Both of these are necessary conditions for the implementation of a trade-through regime that does not seriously constrain legitimate trading activity.

The Proposal recognizes this shortcoming and offers six examples of policies and procedures marketplaces could adopt "without requiring mandatory linkage".

We believe the first three[1] would result in reduced trading activity and a decrease in the price discovery dynamic of the overall Canadian marketplace. We do not agree that the

[1] (1) Preventing orders from being entered into the marketplace when they are not at the best available prices. (2) Preventing orders from being executed if not at the best price. (3) Providing price improvement so that the transaction is executed at the same or a better price to that available on another marketplace.

prevention of legitimate trading activity is an acceptable outcome of any regulatory initiative.

In addition, while these three procedures would not require full marketplace-to-marketplace linkages, they would, in the absence of an Information Processor, require a real-time "pegging" function whereby each marketplace would purchase a live data feed from *all* other marketplaces with fully displayed orders in order to determine the current best bid/ask. Aside from being extremely expensive in aggregate, the creation of multiple instances of consolidated data would also result in differences across marketplaces created by latency or differences in methodology. This lack of uniformity would result in trade-throughs appearing to occur, perhaps creating more confusion and concern than would be the case without a trade-through regime.

The fourth suggested procedure[2] would simply push out to marketplace participants the obligation to receive and consolidate live data feeds from *all* relevant marketplaces. The impact as far as overall cost and dampening of legitimate trading activity would remain the same for the Canadian market.

The last two suggested procedures[3] envision marketplaces constructing "voluntary linkages" to other marketplaces. This anticipates a more complete (and complex) integration, whereby a marketplace would not only ascertain, at a precise moment in time, the best price or prices (depending on the volume of the entered order) for a particular stock, but then immediately route one or more orders to the better priced destination or destinations for immediate execution.

We believe we are the first marketplace in Canada to offer any form of voluntary integration through our recently announced "Melting" feature. The experience of this development effort gives us a unique understanding of the cost and effort in such a complex technological development, both of which are substantial. Moreover, the integration effort we undertook was with respect to only one other marketplace (the TSX). Our research has concluded that without a consolidated data feed, we cannot predict with any certainty how and when we will develop similar linkages to other marketplaces.

Without an industry-wide data consolidator and without an existing multi-marketplace "smart order routing" capability, we have a very real concern that marketplaces and market participants will largely undertake a passive "pegging" strategy for the foreseeable future. This will very likely result in significant dampening of trading activity in Canadian public equity markets – in other words,

---

[2] (4) Requiring participants to take certain specified actions or to more generally confirm their own policies and procedures.

[3] (5) Allowing the entry of "intermarket sweep orders". (6) Establishing voluntary linkages (direct or indirect through an entity that has access to other marketplaces) to the other marketplaces to route orders to the best available visible limit orders.

trade-through prevention by way of trade prevention. We believe this is a sub-optimal policy outcome for Canadian investors.

2. Lack of accommodation for large investors

Institutional investors and others who trade equities in large sizes face particular challenges that are not well accommodated by marketplaces operating standard public centralized limit-order books. The potential for negative price impact resulting from the leakage of information around a large order has been well-established in the academic literature. The need for facilities for private negotiation of both price and trade volume is recognized in the existing regulatory regime and demonstrated by the proliferation of "dark" or "semi-dark' trading facilities. It has been similarly recognized that the price for 100,000 shares may be very different than the price of 100 shares. This pricing discrepancy is particularly prevalent in less liquid securities.

The Proposal provides no guidance for how the specific and legitimate needs of this market segment would be addressed. Institutional investors, in particular, have constraints against short selling or over buying that would prevent them from trading on a specialized marketplace if they were required to "take out" orders on another marketplace. Without some accommodation for this segment, the result of implementing trade-through regulation along the lines of the draft Proposal would be to inhibit the legitimate trading and price discovery activities of an important element of the Canadian capital markets.

3. Public Policy Objectives Misconstrued as a Duty

Third, the concept of marketplace participants owing a "duty to the market" to respect better priced orders may lead to serious, unintended consequences for market participants. The CSA/RS Proposal leaves open the theoretical but real possibility of a future class action claim by investors whose orders have been traded through against the dealers, institutions or even marketplaces "responsible" for the trade through. In other words, regulatory and industry language about a "duty owed" under statute could invite creative lawsuits alleging violation of a common law duty of care.

The public policy objectives of (i) incenting investors to post better-priced limit orders in order to enhance price discovery, and (ii) ensuring fair treatment of investors placing better-priced limit orders, are just that - public policy objectives. In substance, the CSA/RS Proposal aims to use marketplace design as a means by which to meet these public policy objectives. This is akin to the order exposure rule attendant on dealers or the post-trade information transparency rule attendant on marketplaces – both are simply market design requirements intended to enhance price discovery. It would be conceptually clearer to dispense with language regarding a "duty owed to the market" and state simply that marketplaces are obligated, as a condition of operation, to meet these two public policy objectives in the manner by which they operate and grant trading access to their facilities.

4. Our Process Proposal

Since marketplaces are the entities most directly affected by the CSA/RS Proposal on trade-through regulation, we strongly urge the CSA/RS to invite the formation of a working group of representatives from all existing and proposed marketplaces (the "Working Group") and give this group a relatively short period of time (say, six months) in order to draft a "model" form of a Marketplace-level Trade Through Regime (an "MTTR"). If acceptable, this model MTTR then would be published for comment by the CSA/RS. If the Working Group was unwilling or unable to reach a consensus regarding a form of MTTR, or the CSA/RS otherwise disagreed with the proposed form of the MTTR, the CSA/RS would then proceed with publishing for comment its own form of trade-through regulation.

Assuming a model MTTR was drafted by the Working Group and accepted by the CSA/RS, each marketplace would implement its own, tailored MTTR respecting the parameters of the model MTTR.

Critically, dealers and institutions would have a complete "safe harbour" in respect of any trade-through resulting from an execution on an approved MTTR marketplace. This would provide an important benefit to all market participants and eliminate redundant replication of trade-through safeguards by dealers and institutions.

We believe that all marketplaces would respond positively to a formal invitation from the CSA/RS (together with a limited time period in which to propose an alternative MTTR) and that this collaborative effort will result in a superior regulatory proposal that meets CSA/RS policy objectives without jeopardizing the aggregate level of trading activity in Canada or unduly impacting marketplace operations.

II. Best Execution

We agree that expanding the definition of Best Execution beyond best execution price is an important, positive regulatory development. We further agree with the considerations that are put forward in the CSA/RS Proposal. We have two substantive comments in this area.

First, related to our "safe-harbour" comment above, we would like to see more clarity around the intersection between the Best Execution obligations and the best price obligations implied by the trade-through proposal. As discussed above, we believe that it will be critical for all market participants to be able to rely on the trade-through policies and procedures of marketplaces in order to satisfy both the "best price" portion of their best execution obligations and the policy objectives of trade-through protection. That will be the only way to avoid redundant and overlapping price checks by both participants and marketplaces.

Second, while we believe that the reporting of order and market quality information is important, we also believe that not every measure is applicable to every marketplace. With the increasingly diverse array of matching methodologies and business models, it will be important to retain some flexibility in the reporting requirements, in the form of exemptions or special requests, to reflect those data elements that are relevant to each marketplace. We will provide some specific recommendations in our follow-up submission.

III. Direct Access Issues

We agree with the general principle that market participants should be treated equally under securities regulation and trading rules, regardless of whether they trade through the services of a DMA provider or whether they trade directly on a marketplace.

We express some hesitation as to imposition of a regulation services agreement to be signed by each institutional customer. Our experience in launching BlockBook was that institutions will often question the need for a separate regulation services agreement – that is, if RS already has jurisdiction to enforce UMIR (as it does when a subscriber signs-on to an ATS and conducts trading activity on that regulated marketplace), then why is a separate contract with RS needed to that effect? Many will also question the specific wording of the agreement and request drafting changes; however, the introduction of even slightly different versions of a regulation services agreement will lead to the perception that the regulator is applying different standards of regulation to different market participants. We therefore strongly urge the CSA and RS to (a) limit such agreement to a brief statement of general principles (*eg*., an acknowledgement that RS has authority to enforce the UMIR in respect to marketplace trading, and a release of RS from the consequences of its good faith enforcement of UMIR), and (b) ensure such agreement is not open to negotiation as to its content.

We also appreciate the CSA's and RS's concern with having appropriate tools to detect patterns of activity across subscriber accounts. However, we do not believe that a solution requiring more active ATS monitoring of subscriber account activity will be very effective in detecting trading violations disguised through multiple accounts. Our own experience strongly suggests that each institutional subscriber to our marketplace operates from within a single account (and not through multiple, separate accounts) and manages its trading independently from other institutional subscribers; what we do not have the ability to ascertain is the extent to which an institutional subscriber trades, directly or indirectly, on other marketplaces. Accordingly, we are supportive of efforts to assist RS in cross-referencing trading by institutional customers on multiple marketplaces.

Finally, we support the concept of a Trader Training Course for institutional customers, as it would ensure a common level of trading proficiency. We recommend that this course include a complete training in such UMIR rules and policies as are applicable to Access Persons. Currently, UMIR 7.2(2) imposes this requirement on marketplaces, and

there is no assurance that multiple marketplaces will apply a consistent level of UMIR training to their Access Person subscribers.

* * * * *

Yours very truly,

"Judith Robertson"

Judith Robertson
Executive Vice President, *Perimeter Financial Corp.*

"Mario Josipovic"

Mario Josipovic
Vice President, General Counsel and
Chief Compliance Officer, *Perimeter Markets Inc.*