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John Stevenson, Secretary  
Ontario Securities Commission  
20 Queen Street West  
Suite 1900, Box 55  
Toronto, Ontario M5H 3S8  
[jstevenson@osc.gov.on.ca](mailto:jstevenson@osc.gov.on.ca)



Anne-Marie Beaudoin  
Directrice du secrétariat  
Autorité des marchés financiers  
800 square Victoria, 22e étage  
CP 246 tour del la Bourse  
Montréal Québec H4Z 1G3  
[consultation-en-cours@lautorite.qc.ca](mailto:consultation-en-cours@lautorite.qc.ca)

James E. Twiss  
Market Regulation Services  
Suite 900  
145 King Street West  
Toronto, Ontario M5H 1J8  
[jim.twiss@rs.ca](mailto:jim.twiss@rs.ca)

Dear Sirs and Madame:

**Re: Joint CSA and RS Inc. Notice on Trade-through Protection, Best Execution, and Access to Marketplaces**

On behalf of Scotia Capital Inc., please accept our comments in relation to the proposed amendments to the National Instruments, UMIR and their Companion Policies regarding Trade-Through Protection, Best Execution, and Access to Marketplaces.

We support a regulatory environment that fosters open and flexible market-driven solutions that are fair and efficient. In general, regulations should be crafted to respond to rather than dictate the direction of market development, and should be reasonable and relevant to the particular market, carefully balancing the legitimate interests of all market participants.

## **TRADE-THROUGH**

**Question 1: In addition to imposing a general obligation on marketplaces to establish, maintain and enforce written policies and procedures to prevent trade-throughs, would it also be necessary to place an obligation on marketplace participants to address trade execution on a foreign market?**

There are a number of issues that are of concern with imposing a requirement to consider foreign markets. First, to the best of our knowledge there is no requirement for US Broker/Dealers to access Canadian Marketplaces to satisfy a Trade-through obligation for interlisted securities.

Second, most Canadian dealers that trade securities on foreign marketplaces use a Broker/Dealer in the local jurisdiction to conduct their trading because they are not a member of the foreign exchange. The result is that Canadian dealers in effect, do not have direct control over the routing of their orders and rely on the foreign Broker/Dealer to ensure they comply with their local regulations. Forcing Canadian dealers to go to foreign marketplaces introduces a level of complexity that leads to issues of increased costs, inefficiencies and even potential conflicts due to the difference in regulatory requirements. We feel that accessing foreign marketplaces should not be a mandatory requirement imposed through a Trade-through obligation, rather it is a factor Broker/Dealers may consider within the context of achieving Best Execution for clients.

**Question 2: What factors should we consider in developing our cost-benefit analysis for the trade-through proposal?**

One of the concerns the industry has expressed is that the cost of developing "smart order routing" technology on a dealer by dealer or vendor by vendor basis will ultimately result in higher costs to the clients. When conducting your cost benefit analysis you should look at the aggregate cost to the industry rather than on a dealer by dealer basis. Each Participant has already spent, and will have to continue to spend, varying degrees of time, effort and money in developing policies, procedures and technology to accommodate the trade-through rules with the introduction of each new marketplace. In conducting your cost benefit analysis it is important that you compare the aggregate costs to dealers in developing their own smart order routing technology vs. the marketplaces having to develop a single uniform and consistent smart order routing solution. You must consider various intangible costs, including inefficiencies arising from dealers developing different routing technology platforms and having to link up to different marketplace systems. Clearing and settlement fees and the increased cost of surveillance and monitoring within the dealers compliance units must also be taken into account. The cost and effort incurred by dealers in accessing these marketplaces must be accounted for in the cost benefit analysis. In addition, each marketplace will have to design its own connectivity protocol, trading rules and service levels, which may not be consistent as between the different marketplaces. Finally, regulatory costs of the market regulator(s) must also be taken into consideration.

**Question 3: Would you like to participate in the cost-benefit analysis by providing your input?**

Yes, Scotia Capital would very much like to participate in the cost-benefit analysis.

**Question 4: Should trade-through protection apply only during “regular trading hours”? If so, what is the appropriate definition of “regular trading hours”?**

Trade-through protection should only apply during a marketplace's regular trading hours provided their orders are fully transparent. It should not apply to unfilled orders that remain in the book after a marketplace has closed. For example, an unfilled order to buy stock at \$10 that remains in the TSX's central limit order book after 4pm should not be subject to Trade-through protection against a sell order that trades at \$8 during the regular trading session of an ATS at 5pm.

Participants should be required to clearly disclose to their clients the parameters under which their orders will be considered to be active and hence when Trade-through protection will be afforded to their orders (as previously stated in MIN 2006-020). The alternative (moving orders between books en mass) would impose tremendous technology and administrative costs as well as heighten the risk of non-compliance.

**Question 5: Should the consolidated feed (and, by extension, trade-through obligations) be limited to the top five levels? Would another number of levels (for example, top-of-book) be more appropriate for trade-through purposes? What is the impact of the absence of an information processor to provide centralized order and trade information?**

Trade-through obligations should apply to all displayed levels of the order book. If an order has been entered into a fully transparent marketplace then we can see no reason why that order should be excluded from Trade-through protection, regardless of how far outside the current quotes it is. Frequently quotes are moved more than 5 ticks (levels) to put up block trades. If the trade-through obligation only applied to the top five levels, clients with limit orders in the book more than 5 ticks outside the quote might not have their orders filled and hence would not in our opinion be treated fairly.

If the intention is to encourage order display and protect displayed orders from trade-through then we see a requirement for a new order type that would only trade against displayed order volume. This type of order would not trade against any dark pools or hidden iceberg volume. By sending this type of order it would be possible to satisfy all displayed volume when trading through several levels of the book without the concern that un-displayed volume will trade against your order, potentially causing lower priced displayed orders to be traded through. It

also removes the issue of effectively extending price protection to un-displayed orders.

**Question 6: Should there be a limit on the fees charged on a trade-by-trade basis to access an order on a marketplace for trade-through purposes?**

If a dealer does not, through the normal course of its business, place orders on a particular Exchange or ATS but from time to time is required to route orders to it based on trade-through obligations, there should be a mechanism in place to protect dealers from becoming captive to unreasonable marketplace fees.

We believe that the right approach is not to regulate how marketplaces price their services, but rather to require an ATS to demonstrate both relevance and technical readiness before dealers would be required to protect the market on a trade-through basis. It is important that marketplaces provide value for their product offering. The costs associated with connecting to a given marketplace (subscribing, connecting, internal system integration etc.) demand that a marketplace not be able to hold the dealer community captive based on limited and infrequent displays of best price. Clearly there is a need for a mechanism to determine the relevance of a marketplace. Given that there are a number of different ways to determine a marketplace's relevance for the purpose of complying with trade-through rules and that each proposal can have significant implications for market participants, we feel a more detailed discussion to identify all the issues should be initiated.

We also continue to support the creation of a market integrator. A market integrator would control both the costs to the dealer community for integration to new ATS and lower barriers to entry for new ATS since integration costs would be predictable and controlled. Successful integration with a market integrator could also be used as a measure of relevance for a new ATS.

**Question 7: Should the CSA establish a threshold that would require an ATS to permit access to all groups of marketplace participants? If so, what is the appropriate threshold?**

Please see number 6 above.

**Question 8: Should it be a requirement that specialized marketplaces not prohibit access to non-members so they can access, through a member (or subscriber), immediately accessible, visible limit orders to satisfy the trade-through obligation?**

- **Should an ATS be required to provide direct order execution access if no subscriber will provide this service?**
- **Is this solution practical?**
- **Should there be a certain percentage threshold for specialized marketplaces below which a trade-through obligation would not apply to orders and/or trades on that marketplace?**

Please see number 6 above.

**Question 9: Are there any types of special terms orders that should not be exempt from trade-through obligations?**

At this time we feel the current exempted orders are appropriate,

**Question 10: Are there current technology tools that would allow monitoring and enforcement of a flickering quote exception?**

At this time we are not aware of any monitoring tools that would assist with the enforcement of a flickering quote exception

**Question 11: Should the exception only apply for a specified period of time (for example, one second)? If so, what is the appropriate period of time?**

Recognizing that as the Canadian Capital Markets evolve and ATS's develop, there will be advances made in routing technologies. Currently, in order to accommodate the differences in speed and accuracy of these technologies, we feel that it is not practical or desirable to specify a specific period of time after the trade that would provide for a safe harbor from trade-throughs. Instead we suggest that dealers be required to demonstrate through either system documentation or through their audit trail that, at the time of order entry, their orders were routed to the best priced marketplace given their current view of market data. Slow quotes will never constitute a competitive advantage and we believe that market forces and client demand will require dealers to have in place the fastest quotes that they can.

**Question 12: Should this exception only be applicable for trades that must occur at a specific marketplace's closing price? Are there any issues of fairness if there is no reciprocal treatment for orders on another marketplace exempting them from having to execute at the closing price in a special facility if that price is better?**

As noted above in 4, we support the concept of trade-through protection only being applicable to marketplaces that are fully transparent and during their regular trading hours. For marketplaces that provide trading during specialty sessions at a price established during its regular trading hours (closing price orders for example), we are supportive of an exemption from the trade-through rules being applicable to these trades.

**Question 13: Should a last sale price order facility exception be limited to any residual volume of a trade or should it apply for any amount between the two original parties to a trade? What is the appropriate time limit?**

Generally we would not be supportive of a last sale price order facility exception being granted for residual volume of a trade. Both parties should have been

willing to trade their full amount at the time of execution. By allowing for an exception to trade "follow on volume" for a period of time after the last sale (i.e. a large volume cross), you are allowing the parties to trade additional volume with the knowledge of the first trade which may or may not have a material impact on the stock once it is disseminated. Trades should be encouraged to take place in the current context of the market.

**Question 14: Should trade-throughs be allowed in any other circumstances? For example, are there specific types or characteristics of orders that should be subject to an exemption from the trade-through obligation?**

At present the TSX is of the opinion that Normal Course Issuer Bids are restricted to the exchange on which the issues are listed. We are concerned that dealers conducting NCIB's will have to provide their own capital in order to displace orders on other markets before they can buy for the NCIB on the listing exchange. Dealers should follow the listing exchanges NCIB rules when purchasing for an issuers NCIB but they should be able to purchase the securities on any marketplace that they are required to access for regulatory purposes.

All-or-none and minimum size orders that are already in the book should not be subject to Trade-through obligations where the trade is triggered by the marketplace algorithm.

### **BEST EXECUTION**

As a general comment we feel it is very important that best execution is defined as a principle-based policy that dealers are required to develop, adhere to and disclose to its clients. It should not be an obligation applicable or determined on a trade by trade basis.

**Question 15: Are there other considerations that are relevant?**

Generally, price, speed of execution, certainty of execution and overall cost of the transaction are the appropriate considerations for best execution, however, many clients may take into consideration other components that affect the risk and cost structure of their trading strategy. We feel that Best Execution should be adopted as a principle-based rule where dealers can demonstrate that the objectives of their clients are being met through documented policies, procedures and practices.

**Question 16: How does the multiple marketplace environment and broadening the description of best execution impact small dealers?**

Depending where the requirement falls for obtaining best price (at the marketplace level or the dealer level), there will be an increase in costs to small dealers for the technologies to route orders as well as additional compliance

costs associated with trade desk monitoring, surveillance and post trade determination of possible liquidity of dark markets. The aggregate costs associated with the above additional activities could prove to be prohibitive for some small dealers to remain competitive.

**Question 17: Should the best execution obligation be the same for an adviser as a dealer where the adviser retains control over trading decisions or should the focus remain on the performance of the portfolio? Under what circumstances should the best execution obligation be different?**

At this time, we see no reason to impose a best execution obligation on advisors. Advisors, have the ability to choose the dealer they wish to execute their trades through based on the service level the dealer provides and benefit that provides to their clients' overall needs. The dealers that execute these transactions should remain responsible for the best execution of their clients (advisors) orders in accordance with the applicable regulations. [Chris –what about advisors who have DMA ?]

**Question 18: Are there any other areas of cost or benefit not covered by the CBA?**

Please see our answer in 2.

**Question 19: Please comment on whether the proposed reporting requirements for marketplaces and dealers would provide useful information. Is there other information that would be useful? Are there differences between the US and Canadian markets that make this information less useful in Canada?**

The information to be provided by the marketplaces should prove to be very useful in assisting the dealer community in assessing whether there is a requirement to access a particular marketplace for best execution. With respect to the CSA's proposal for the dealers to report certain transactional data, we fail to understand how this information could be used and what the tangible benefit would be. Our view is that this would be an additional cost with marginal to no benefit. Additional information that would be useful for marketplaces to provide include a flag or marker for principal transactions.

**Question 20: Should trades executed on a foreign market or over-the-counter be included in the data reported by dealers?**

Please see our answer to 19.

**Question 21: Should dealers report information about orders that are routed due to trade-through obligations?**

Please see our answer to 19

**Question 22: Should information reported by a marketplace include spread-based statistics?**

At this point we view volume statistics as being the most critical of the data. They will assist the dealer community in assessing the liquidity in a particular market. Review of spread based statistics will not assist us in determining speed of execution, certainty of execution and over-all cost to the transaction.

**Question 23: If securities are traded on only one marketplace, would the information included in the proposed reporting requirements be useful? Is it practical for the requirement to be triggered only once securities are also traded on other marketplaces? Would marketplaces always be in a position to know when this has occurred?**

If a security trades on only one marketplace, this information would not be useful.

**DMA**

**Question 24: Should DMA clients be subject to the same requirements as subscribers before being permitted access to a marketplace?**

It is our understanding that the requirements imposed on subscribers were put in place to address situations where a party desired access to an ATS without the involvement of a dealer. These were necessary because in this type of arrangement there would be no party that was regulated by and responsible to RS. It was necessary that someone be responsible for ensuring adherence to UMIR provisions, monitoring requirements etc.

It is also our understanding that there are three primary goals behind regulating DMA clients, whether through existing agreements or by classifying them as access persons. These goals are to ensure that persons entering orders have adequate training and knowledge of the applicable UMIR rules; that a party is responsible for ensuring adequate supervision and monitoring procedures are in place; and that RS or other regulators are able to get access to the information that they require in the course of any investigation.

In the case of dealer sponsored access we believe that these requirements are already being addressed. Imposing additional requirements on the end client would result in unnecessary duplication of cost and effort. This may also introduce confusion over who is ultimately responsible for ensuring compliance with various rules.

We believe that considering DMA clients to be access persons and in particular requiring them to sign an agreement directly with RS could be a significant issue, particularly for foreign clients. This requirement may very likely result in foreign clients foregoing access to the Canadian markets, preferring to trade interlisted securities on other markets where they can trade without the requirement of a direct agreement with a foreign SRO.



We believe that the specific issues around DMA access can be addressed without defining DMA clients as access persons or requiring them to become directly regulated by RS.

The training requirement for DMA clients is currently addressed in the exchange rules and enforced through DMA agreements with POs. We do note that there is a lack of standardization and direction as to what constitutes adequate training for a DMA client. We do not believe that the Canadian Securities Institutes' Trader Training Course is appropriate as a requirement to prove adequate training. The course is often out of date and covers more material than is relevant for DMA clients. Either a less extensive form of that course adapted for DMA clients or clearer guidance from RS and the exchanges on what constitutes adequate training would help to address this issue. We do support the training requirement for DMA clients, however we note that this training must be relevant and deliverable in an efficient and reasonable way so as not to become an impediment to clients seeking access to our markets.

The monitoring, supervision and system requirements for DMA clients are currently handled by the POs. This is the core of the gatekeeper responsibility imposed on the POs and is monitored and enforced through trades desk reviews and similar audits. We believe that given the fact that the PO is responsible for the bulk of the technology and infrastructure required to ensure that orders are routed correctly and compliant with various exchange and UMIR rules, including best price obligations, it makes sense to leave the responsibility to monitor and enforce these requirements with them as well. A DMA client may not be in a position to ensure that their orders are ultimately routed and marked correctly since they must first pass through the PO's systems. Requiring each individual client to maintain systems and procedures for supervision and monitoring of their trading activity, would appear to be both wasteful from an overall cost perspective and a potential barrier to access for many clients.

Finally, access by regulators to information required for investigations can be achieved through existing means. Record retention by DMA clients and access to those records by both the sponsoring PO and RS in the case of an investigation are standard requirements in DMA agreements. If the client were to refuse access to those records, there are existing avenues through the OSC or other appropriate regulatory agencies (including foreign regulators such as the SEC) through which those records can be obtained. We do not believe that a direct agreement with RS would be any more effective than the existing agreement with the PO in the case where the client is attempting to not provide information. The ultimate recourse will still be to the applicable regulator or ultimately the courts.

***Question 25: Should the requirements regarding dealer-sponsored participants apply when the products traded are fixed income securities? Derivatives? Why or why not?***

It is our belief that, in general, the same DMA requirements should apply to all exchange listed products when they trade on an exchange or ATS. Specific

products may require additional supervision or training if the nature of those products or markets warrant it, but the general requirements should be the same.

The requirements regarding dealer-sponsored participants should not apply to non-exchange listed fixed income and derivative products. The structure of these marketplaces is fundamentally different than equities and they should be independently reviewed to determine if the same requirements are necessary.

***Question 26: Would your view about the jurisdiction of a regulation services provider (such as RS for ATS subscribers or an exchange for DMA clients) depend on whether it was limited to certain circumstances? For example, if for violations relating to manipulation and fraud, the securities commissions would be the applicable regulatory authorities for enforcement purposes?***

The current regulatory framework can be confusing and often leads to inconsistencies. We believe the jurisdiction over all levels of market trading activities should fall under the oversight of RS. This will help to ensure a consistent approach to the rule making process and enforcement activities.

***Question 27: Could the proposed amendments lead dealer-sponsored participants to choose alternative ways to access the market such as using more traditional access (for example, by telephone), using foreign markets (for inter-listed securities) or creating multiple levels of DMA (for example, a DMA client providing access to other persons)?***

As noted in our response to Question 24, we are concerned that the proposed amendments may prove to be a barrier to access for many clients. The increased liability associated with being directly regulated by RS along with the increased cost in monitoring and supervision requirements to ensure compliance may dissuade many clients from seeking direct access to the Canadian markets. Some of these clients may use alternative routes such as traditional phone orders which may be more costly and less efficient. However a good number of these clients, particularly foreign clients, may choose not to trade in Canada or to simply trade our interlisted securities on foreign markets.

***Question 28: Should there be an exemption for foreign clients who are dealer-sponsored participants from the requirements to enter into an agreement with the exchange or regulations services provider? If so, why and under what circumstances?***

As noted in our responses to Questions 24 and 27, we do not believe that the requirement for a direct agreement between DMA clients and RS is warranted. In particular we note that it may have a significant impact on the number of foreign clients seeking direct access to Canadian markets.

We are particularly concerned that the amendment would deem foreign dealers who have been granted DMA access to be Participants. We believe that this is

an unnecessarily onerous requirement and one that may cause a significant barrier for foreign dealers and clients to access our markets. It is not necessary or appropriate to extend the full Gatekeeper responsibilities to these dealers when the monitoring and supervision systems are already in place and being performed by the dealers extending the access in the first place.

The result of this requirement will be either that foreign dealers will not seek access to our markets, or that they will become full-fledged Participants and not require the services provided by our domestic dealer community. We do not see either of these outcomes as being desirable and believe that this would only serve to marginalize the Gatekeeper role that our domestic dealer community currently performs.

We do understand that there are particular issues that arise when foreign dealers who are granted DMA in turn extend this access to their clients. However we believe that these concerns can be addressed within the existing framework with the addition of specific requirements for those foreign dealers. For example foreign dealers could be required to maintain a certain level of monitoring and supervision of their clients, to cooperate with the sponsoring PO and RS in any investigation and to ensure their clients receive a certain level of training. These requirements in particular would serve to extend some of the sponsoring PO's requirements onto the foreign dealer.

International access to the Canadian Marketplaces is vital not only to the Domestic dealer community but also to the Canadian Capital Markets and in turn the Canadian Economy. By restricting access, the proposed rules will only lead to an erosion of liquidity in the Canadian marketplace.

***Question 29: Please provide the advantages and disadvantages of a new category of member of an exchange that would have direct access to exchanges without the involvement of a dealer (assuming clearing and settlement could continue to be through a participant of the clearing agency).***

We do not believe that the creation of this category of member would be advisable. Different categories imply different standards, which may ultimately erode overall market integrity. A member of an exchange that is not subject to the gatekeeper oversight provided by a dealer could pose a significant risk to market integrity unless the member were to put into place all of the required supervision and monitoring procedures, the necessary routing and connectivity technology and be subject to the same level of auditing and oversight by RS as a traditional dealer.

If, however, a client of sufficient size was willing to put all of those systems in place and assume the associated regulatory risks, then this could potentially be acceptable. Alternately if an ATS were to fulfill all of those requirements for the client, this may also prove acceptable, however at that point they may essentially become a dealer.

We believe that the Gatekeeper role played by the dealer community is a valuable one and is important in maintaining market integrity. Any changes to the existing Gatekeeper function should be approached with caution and with a careful examination of the potential consequences.

In closing, we appreciate the opportunity to submit our comments and to participate in the review of these significant proposed amendments relating to the Canadian Capital Markets. We would be pleased to discuss these issues further and would invite you to attend at our premises to gain a better understanding of how our markets operate from a dealer's perspective. Should you have any questions regarding our comments, please do not hesitate to contact Chris Hill at (416) 945-4256.

Yours truly,  
Scotia Capital Inc.