Chapter 5

Rules and Policies

5.1.1 Notice of Amendments to NI 21-101 Marketplace Operation, Companion Policy 21-101CP, NI 23-101 Trading Rules and Companion Policy 23-101CP

NOTICE OF AMENDMENTS TO NATIONAL INSTRUMENT 21-101 MARKETPLACE OPERATION AND COMPANION POLICY 21-101CP

AND TO

NATIONAL INSTRUMENT 23-101 TRADING RULES AND COMPANION POLICY 23-101CP

I. INTRODUCTION

The Canadian Securities Administrators (the CSA or we) have made amendments to the following instruments:

1. National Instrument 21-101 *Marketplace Operation* (NI 21-101), Forms 21-101F2 and 21-101F5 and

2. National Instrument 23-101 *Trading Rules* (NI 23-101).

We have also made amendments to the following policies:

1. Companion Policy 21-101CP to NI 21-101 (21-101CP) and

2. Companion Policy 23-101CP to NI 23-101 (23-101CP) (NI 21-101, Forms 21-101F2 and 21-101F5, NI 23-101, 21-101CP and 23-101CP are referred to as the ATS Rules).

(All the above amendments are referred to as the Amendments.)

The Amendments are expected to be made by each member of the CSA. In Ontario, the Amendments were delivered to the Minister of Government Services (Minister) for review on November 30, 2006. We requested an expedited review and decision by the Minister. If the Minister approves the Amendments by December 16, 2006, the Amendments will come into force in Ontario by December 31, 2006. If the Minister does not approve or reject the Amendments, or return them to the Commission for further consideration, they will come into force on February 13, 2007.

The Amendments are expected to be implemented by that date by the Alberta Securities Commission (ASC) and the Manitoba Securities Commission (MSC). As it may not be possible for the other jurisdictions to approve the Amendments by December 31, 2006, they may not become effective in all jurisdictions at the same time. For this reason, the Autorité des marchés financiers (AMF), the British Columbia Securities Commission (BCSC), the Nova Scotia Securities Commission (NSSC) and the Saskatchewan Financial Services Commission will issue blanket rulings to grant exemptive relief from certain sections of the ATS Rules to market participants between December 31, 2006 and the date the Amendments become effective in their respective jurisdictions. In New Brunswick, the ATS Rules are not currently in force, and they will be adopted, together with the Amendments, at a later date.

II. SUMMARY OF WRITTEN COMMENTS RECEIVED BY THE CSA

The ASC, AMF, MSC and OSC published proposed amendments to the ATS Rules (Proposed Amendments) with a request for comment on July 14, 2006. The BCSC published the materials on August 11, 2006, the New Brunswick Securities Commission on September 25, 2006, and the NSSC on July 19, 2006.

During the comment period and shortly after its expiry, we received fifteen submissions. We have considered the comments received and thank all the commenters for their submissions. A list of those who submitted comments, as well as a summary of comments and our responses to them, are attached as Appendix A to this Notice.

After considering the comments, we have decided to withdraw some of the Proposed Amendments and to make a change to existing provisions of the ATS Rules. The final Amendments are outlined in the next section.

III. SUBSTANCE AND PURPOSE OF THE AMENDMENTS

(a) Transparency for Government Debt Securities

Background and substance of proposed amendments

Currently, the ATS Rules require marketplaces and inter-dealer bond brokers (IDBs) to provide order and trade information on government debt securities to an information processor in real time.[1] However, an exemption from this requirement has been given to the IDBs and Alternative trading systems (ATSs) executing trades of government debt securities until December 31, 2006.[2]

Due to the expected expiry of this exemption, the CSA felt that it was important to review alternatives for transparency of government fixed income securities. As a result, in the Proposed Amendments, we had proposed an incremental approach for transparency for government fixed income securities instead of allowing the exemption to expire. They included a requirement that IDBs and ATSs provide to an information processor or, in the absence of an information processor, to an information vendor that meets standards set by the Investment Dealers Association of Canada (IDA), order and trade information for certain government fixed income securities.[3] Specifically, the reporting would have been as follows:

- by marketplaces and IDBs only (and not by dealers);
- only for designated benchmark government debt securities; and
- the volumes displayed by the information processor would have been capped.

In the notice published with the Proposed Amendments, we included our analysis supporting the proposed transparency approach and reviewed other options for dealing with transparency, including:

- mandating transparency for all government fixed income securities;
- giving a permanent exemption from transparency for government fixed income securities; and
- extending the current exemption from transparency requirements for government debt until December 31, 2011.

We also asked a number of questions to help us evaluate issues related to the government fixed income market.

Summary of responses

We received fifteen responses to the Proposed Amendments and our request for comments. A majority of respondents did not support mandatory transparency requirements at this time for a number of reasons, including their views that:

- there has been sufficient progress through industry initiatives towards greater price transparency and there is already adequate transparency in the government fixed income markets;
- enhanced transparency may negatively impact the level of liquidity;
- there is no evidence of market failure in the institutional market and no identified systemic transparency problems in the institutional market; and
- it was not clear how the proposal would address the information and transparency needs of the retail fixed income market.

Some commenters supported an extension of the existing exemption from transparency for government debt securities for an additional five-year period, and two did not support any regulatory intervention at all.

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1 NI 21-101, subsections 8.1(1), 8.1(2), 8.1(3), 8.1(4) and 8.1(5) and subsection 10.1(2) of 21-101CP.

2 Section 8.5 of NI 21-101.

3 These proposed amendments were made to subsections 8.1(1), 8.1(3), 8.1(4) and 8.1(5) of NI 21-101 and to subsections 10.1(1) and 10.1(2) of 21-101CP.

Two respondents supported the proposed transparency requirements. They acknowledged the progress that has been made regarding transparency in the institutional market, but thought that there has been insufficient progress in the retail market. They also noted that there remains a general lack of post-trade transparency in the Canadian fixed income market.

CSA response

We agree that the level of transparency in the government fixed income market has increased, and it is our expectation that this trend will continue. However, it is unclear whether the market has achieved an optimal level of transparency at this time or will achieve this level absent some mandatory transparency. As a result, we will continue to monitor the fixed income market and will continue to consult with industry participants and other regulators and stakeholders to determine whether regulation and guidance will be needed in the future. For these reasons, we have extended the exemption from the mandatory transparency requirements set out in NI 21-101 until December 31, 2011. The current transparency requirements for government fixed income securities included in NI 21-101 and the guidance in 21-101CP will not change at this time.

(b) Transparency for Corporate Debt Securities

Background

In the notice published with the Proposed Amendments, we took the opportunity to ask a number of questions regarding issues related to transparency of corporate fixed income securities, including certain processes already in place. Specifically, we asked:

- whether pre-trade transparency for corporate fixed income securities is required and, if so, to which market participants it should apply;
- whether the time for reporting corporate fixed income trades to the information processor should be reduced; and
- whether the process for designated benchmark corporate fixed income securities has been effective.

Appropriateness of pre-trade transparency for corporate fixed income securities

The majority of respondents noted they did not support pre-trade transparency in general, citing reasons including that:

- pre-trade information is a feature of auction-based equity markets that is not relevant in the fixed income markets;
- pre-trade information would include bids and offers made outside the context of the market, which could provide a misleading value for securities; and
- pre-trade transparency on the liquidity may have a negative impact on the liquidity of the market.

CSA response

Upon consideration of these comments, we did not include additional requirements for pre-trade transparency for the fixed income securities in NI 21-101. In addition, we believe that the information processor should have some flexibility, subject to regulatory oversight, regarding the information that should be reported and displayed, and whether this information would include pre-trade data for corporate fixed income securities.

Time for reporting trade information for corporate debt securities

Most respondents felt that the current reporting timelines were adequate and did not think they should be reduced at this time.

CSA response

We agree that there has been no evidence that more aggressive reporting timelines are needed, and will not make any further changes to the requirements applicable to corporate fixed income securities included in NI 21-101. In addition, we believe that the information processor should continue to have the flexibility to determine the appropriate reporting timelines.

Adequacy of process for designating benchmark corporate fixed income securities

Four commenters submitted that this process has been effective, while two identified weaknesses, such as the infrequency of the selection process, and the fact that the list of benchmark corporate bonds may not be representative of the market or trading activity.

CSA response

We agree that the process for designating benchmark corporate debt securities has been generally adequate, and resulted in a substantial increase in the number of corporate fixed income securities reported to the information processor over time. We will closely monitor this process and have added a new requirement in NI 21-101 that the information processor must report the process and criteria for selection of fixed income securities to the securities regulators. In addition, we will evaluate applicants for the information processor role on a number of criteria, including the frequency and adequacy of their selection process for designated corporate bonds. For additional information, please see section (e) below.

(c) Electronic Audit Trail Requirements

Background and substance of proposed amendments

The notice published with the Proposed Amendments provided an update on the status of the Transaction Reporting and Electronic Audit Trail System (TREATS) project and timelines associated with various related tasks. As a result of these timelines, we proposed amendments to the date for implementation of the electronic audit trail requirements currently set out in NI 23-101 to:

- extend the deadline for implementation of the electronic audit trail requirements from January 1, 2007 to January 1, 2010;[4] and
- provide an exemption to dealers and IDBs complying with similar electronic audit trail requirements established by a regulation services provider and approved by the applicable securities regulatory authorities, in order to provide flexibility for implementation.[5]

Summary of comments

Although the Proposed Amendments to this section relate to extension of timeframes and a clarification regarding the compliance obligations of dealers and IDBs, a few responses to our request for comment included queries about the TREATS project. Specifically, the commenters requested clarification on the architecture of the system and the implementation plan for a TREATS solution. There were also suggestions on the timing and process for conducting a cost-benefit analysis and the information that should be available to dealers through TREATS.

CSA response

As described in CSA Staff Notice 23-305 *Status of the Transaction Reporting and Electronic Audit Trail System (TREATS)*[6], we are currently examining the models that exist in other jurisdictions, and reviewing which aspects create the most benefits. We will complete the data modeling for the remaining securities under the project's scope. These actions will assist in deciding the appropriate structure for TREATS, including whether any solution should be dealer/marketplace-centric versus regulator-centric. The structure selected will impact the amount of information that will be available to dealers for their own compliance purposes.

A plan for implementation will be devised once all the data modeling is complete and any issues relating to the appropriate architecture for a TREATS facility have been resolved. A phased-in implementation is expected for each security class currently under the project's scope, commencing with equities.

We expect that this additional work, which will conclude with a cost benefit analysis, will be completed by December 2007.

(d) Clarification of Best Execution and Other Obligations in a Multiple Marketplace Environment

Substance of the Proposed Amendments

The Proposed Amendments to 23-101 CP clarified the CSA's existing expectation of the application of the current best execution requirements in section 4.2 of NI 23-101, and stated that dealers would take into account all relevant information when assessing best execution in a multiple marketplace environment (and would not just consider information from marketplaces where a dealer is a participant).

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4 This proposed amendment was made to subsection 11.2(6) of NI 23-101.

5 Proposed subsection 11.1(2) of NI 23-101.

6 Published on October 20, 2006 in English in the Ontario Securities Commission Bulletin at (2006) 29 OSCB 8222 and in French in Bulletin de l'Autorité des marchés financiers, Vol. 3 no. 42, 20 octobre 2006.

Summary of comments

We received a number of comments in response to this clarification. Some commenters did not believe that dealers should consider information from all marketplaces trading the same securities and indicated that best execution requirements would be more feasible with a market integrator or data consolidator. However, others believed that all marketplaces should be considered (otherwise a dealer could ignore better executions by simply choosing not to access a marketplace). One commenter noted that post-trade information regarding securities traded, size and price may also present relevant information that should be considered by dealers.

Some commenters cautioned that "best execution" should not be interpreted too narrowly, for example, by equating it with best price.

CSA response

Currently, subsection 4.2(1) of NI 23-101 requires that a dealer acting as agent for a client shall make reasonable efforts to ensure that the client receives the best execution price on a purchase or sale of securities. For cross-border inter-listed securities, there is existing guidance in 23-101CP that provides that a dealer, in making reasonable efforts, should also consider whether it would be appropriate in the particular circumstances to look at markets outside of Canada. The Proposed Amendments were intended to clarify best execution obligations in a multiple marketplace environment in Canada. It should be noted that "marketplace" (defined under NI 21-101) refers to a marketplace within Canada. Due to questions raised about the clarification and in response to comments received, we have made a number of further changes.

The Proposed Amendments provided that we expected dealers to take into account all relevant information from all marketplaces trading the same securities and not view their obligation as limited to marketplaces where they are participants. It was not our intention to set the expectation that a dealer must have access to real-time data feeds, but that it should have reasonable policies and procedures regarding best execution that include taking into consideration relevant information from all appropriate marketplaces in the particular circumstances, and monitoring these policies and procedures. We do not believe that a dealer could limit its best execution obligations by choosing to ignore certain marketplaces. Best execution is an assessment that is to be made by a dealer based on the particular circumstances in accordance with its policies and procedures.

We do not agree that a market integrator or data consolidator is necessary in order to comply. In determining that mandated market integration was not required, the CSA relied on the views of an industry committee that stated that best execution responsibilities and the availability of pre- and post-trade information would be sufficient. We do agree, however, that the existence of an information processor displaying consolidated data would be helpful for best execution purposes. We are in the process of reviewing information processor applications. For additional information, please see section (e) below.

We agree with the suggestion from one of the commenters that relevant information should include post-trade as well as pre-trade (order) information and reflected this in the amendment to 23-101CP.

We also agree with the comments received that price is only one element that dealers should consider when assessing best execution. Our review of trade-through and best execution generally is ongoing, and upon completion of this review, we will propose changes to current requirements to further clarify the best execution obligation.

(e) Requirements for and Status of Information Processors for Debt and Equity

Background

In the notice published with the Proposed Amendments, we noted the fact that no information processor for equity securities existed. We also noted our view that the availability of an information processor, which would consolidate pre-trade and post-trade information for the equity markets, would ensure that a central source of consolidated data that meets the standards approved by regulators exists.

In the fixed income market, there is an information processor in place for the corporate fixed income securities, CanPX Inc. (CanPX). In the notice, we reminded the public that CanPX's approval expires on December 31, 2006.

In order to seek interest from participants for being the information processor for equity and/or fixed income securities, we published, at the same time with the Proposed Amendments, CSA Notice 21-304 Request for Filing of Form 21-101F5 *Initial Operation Report for Information Processor by Interested Information Processors* to inform the public of the approval status of CanPX and of the opportunity for other entities to apply to be an information processor for equity and/or fixed income securities. We received a number of applications and are currently reviewing them and evaluating all applicants against a number of objective standards. We expect to make a decision by April 30, 2007 regarding whether any entity has been accepted as an information processor and thank all applicants for their interest.

In order to ensure a smooth transition to a new information processor if a new entity is selected for the role, and in order to respond to a request by CanPX, we have also decided to extend CanPX's approval until December 31, 2007.[7]

Summary of comments

Two commenters suggested that an information processor that consolidated equity data should be introduced based on market forces, and that the use of an information processor should not be mandated.

CSA response

We believe that, at this time, the availability of an information processor is a helpful tool for addressing best execution and market integrity issues based on consistent, reliable data. If market circumstances change in the future, we will reconsider the issue.

(f) Changes Made to the Amendments

In response to comments received, we made a number of changes to the Proposed Amendments, set out below.

- We did not proceed with proposed amendments to subsections 8.1(1), 8.1(3), 8.1(4) and 8.1(5) of NI 21-101.
- We did not proceed with proposed section 8.5 of NI 21-101 and substituted the following:

  8.5 **Reporting Requirements for the Information Processor** – (1) The information processor shall report, within 30 days after the end of each calendar quarter, the process and criteria for selection of government debt securities, as applicable, and designated corporate debt securities and the list of government debt securities, as applicable, and designated corporate debt securities.

  (2) The information processor shall report, within 30 days after the end of each calendar year, the process to communicate the designated securities to the marketplaces, inter-dealer bond brokers and dealers providing the information as required by the Instrument, including where the list of designated securities can be found.
- We added the following section to NI 21-101:

  8.6 **Exemption for Government Debt Securities** – Section 8.1 does not apply until January 1, 2012.
- We did not proceed with proposed amendments to subsection 10.1(1) of 21-101CP and substituted the following:

  10.1(1) The requirement to provide transparency of information regarding orders and trades of government debt securities in section 8.1 of the Instrument does not apply until January 1, 2012. The Canadian securities regulatory authorities will continue to review the transparency requirements, in order to determine if the transparency requirements summarized in subsections (2) and (3) below should be amended.
- We did not proceed with proposed amendments to subsection 10.1(2) of 21-101CP.
- We replaced proposed subsection 4.1(8) of 23-101CP with the following:

  4.1(8) In order to meet best execution obligations where securities trade on multiple marketplaces in Canada, a dealer should consider information from all marketplaces (not just marketplaces where the dealer is a participant). This does not necessarily mean that a dealer must have access to real-time data feeds from each marketplace but that it should establish reasonable policies and procedures for best execution that include taking into account order and/or trade information from all appropriate marketplaces in the particular circumstances. The policies and procedures should be monitored on a regular basis. A dealer should also take steps, where appropriate, to access orders which may include making arrangements with another dealer who is a participant of a particular marketplace or routing an order to a particular marketplace.

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7 CSA Staff Notice 21-305 *Extension of Approval of Information Processor for Corporate Fixed Income Securities* published on October 27, 2007 in English in the Ontario Securities Commission Bulletin (2006) 29 OSCB 8364 and in French in Bulletin de l'Autorité des marchés financiers, Vol. 3 no. 43, 27 octobre 2006.

In addition, we made a number of non-material changes to the Proposed Amendments to correct minor errors or omissions. These changes are set out below.

- We renumbered proposed section 7.6 of NI 21-101 as 7.5.
- We renumbered proposed section 7.7 of NI 21-101 as 7.6.
- In proposed section 6 of Form 21-101F5, we added "*Exhibit T"* after "**6.** - **Selection of securities reported to the information processor"**.
- We renumbered proposed subsection 10.1(6) of 21-101CP and 10.1(5).
- In NI 23-101, we did not proceed with the proposed amendments to subsection 11.2(5) and substituted the following:

  (5) **Transmittal of Order Information** – A dealer and inter-dealer bond broker shall record and shall transmit within 10 business days to a securities regulatory authority or a regulation services provider the information required by the securities regulatory authority or the regulation services provider, in electronic form, as required by the securities regulatory authority or the regulation services provider.
- In proposed section 8.3 of 23-101CP, we added "**Electronic Audit Trail**" before the proposed section that starts with "Subsection 11.2(6) of the Instrument requires dealers and inter-dealer bond brokers to transmit certain information to a securities regulatory authority or a regulation services provider …"

IV. Questions

Questions may be referred to any of:

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Alberta Securities Commission
(403) 297-3308

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APPENDIX A

SUMMARY OF COMMENTS WITH CSA RESPONSES AND LIST OF RESPONDENTS

I. Summary of Responses to Questions and CSA Responses

Question 1: Should there be a mandatory requirement to report and disseminate information related to designated government debt securities? What are the benefits and disadvantages of this and the alternative approaches?

The vast majority of commenters did not support a mandatory requirement to report and disseminate information related to designated government debt securities at this time. There were a number of reasons given, including views that: (1) there is already adequate transparency in the government fixed income marketplace; (2) there has been sufficient progress made towards greater price transparency through industry initiatives; (3) enhanced transparency may adversely affect the level of liquidity in the government securities market; (4) there is no evidence of a market failure in the fixed income market and no identified systemic transparency problems in the institutional market; (5) a regulator-mandated regime will create less innovation and specialization, lost information due to the consolidation process, and the de facto establishment of "price priority" in the bond market; (6) while the impetus for enhanced transparency is driven by issues regarding pricing in the retail fixed income market, the institutional and retail fixed income markets are different, and problems in the retail market should not be addressed at the expense of the institutional market; (7) while the focus of the proposed amendments is on transparency for benchmark government fixed income securities, most retail investor trading is not on benchmark government debt securities; and (8) there is a lack of evidence that the proposed amendments will achieve the desired results and more research must be done before transparency requirements are put in place.

Two respondents generally supported the transparency requirements proposed in NI 21-101. Their views were that: (1) while progress has been made in expanding access by large institutions to quoted government securities markets, there remains a general lack of post-trade transparency in the Canadian fixed income market; (2) there has been insufficient progress in delivering transparency to retail customer channels; (3) while the goals of IDA Policy 5 are to place an obligation of fair dealing on market providers, it is left to the provider, not the customer or regulator to make the determination of value to the investor, and customers have limited ability to judge the fair value, as they are typically faced with an offer from a single dealer; and (4) without a credible external benchmark price against which to measure executions, there is little basis for ascertaining the quality of the execution achieved. One of these commenters recommended that only comprehensive post-trade transparency should be mandated, and that a continued exemption should be granted for smaller dealers or marketplaces which do not capture 0.5% market share, to achieve the right cost/benefit balance for the new regulation. The other believed that there should be a mandatory requirement to report and disseminate information related to designated government debt securities on a pre-trade basis within the context of relevance to retail market participants. For example, regulators would receive information on an order and post-trade basis, but retail market participants would be provided with pre-trade transparency. This commenter believed that the provision of orders and post trade information to regulators is a positive step for regulation and the overall market. The information processor, in consultation with the industry and regulators, would determine the relevant securities and required information for the retail market participants.

One commenter sought clarification as to whether the amended requirements for the provision by inter-dealer bond brokers of accurate and timely information regarding orders for designated government debt securities to an information processor covers the non-electronic phone execution or other "work-up" methods.

Six commenters recommended that the CSA extend the current exemption for government debt until December 31, 2011 instead of adopting the proposed amendments. Two commenters did not support any regulation and noted that the preferred option would be for the regulators to establish the principle of increased transparency while leaving the design of transparency systems to the market. A few respondents suggested that the CSA defer any transparency decision until the impact of the recently adopted IDA Policy 5B, *Retail Debt Market Trading and Supervision* is known or until further research and consultation to identify the transparency and educational needs of the retail income market is completed.

Response:

We agree that there has been industry-driven progress towards greater transparency in the government fixed income market. This was reinforced by the comments received. However, it is unclear whether the markets, both retail and institutional, have reached an optimal level of transparency or will achieve this level without some mandatory transparency. As a result, we will extend the exemption from transparency requirements for government debt securities for an additional period of five years ending on December 31, 2011. During this additional exemption period, we will consult with industry and other regulators and stakeholders and will continue to monitor market developments to determine whether the level of transparency at the end of the exemption period has reached a level that is acceptable to regulators and what, if any, regulation or guidance is needed in this regard.

Question 2: Should dealers be subject to order and/or trade transparency requirements for government fixed income securities? If so, should they be required to report order information, trade data or both?

While most commenters were not in favour of enhanced transparency and did not believe that dealers should be subject to transparency requirements for government fixed income securities, some provided their views on this question. For example, one commenter noted that the value of monitoring pre-trade information is minimal, while another thought that disseminating pre-trade indications of interest between dealers and large investors may tip other market participants as to their intentions and enable them to use this information to the detriment of those dealers and their customers. One respondent, however, believed that legislated transparency that requires a request-for-quote ATS to report executed trades but excludes request for quote telephonic trade reporting will create an unfair environment.

Three commenters believed that all market participants, including dealers, marketplaces and IDBs be subject to the same trade reporting requirements, and one supported a requirement for dealers to report order and trade data for government securities, but not indications of interest since, in a dealer market, they do not represent orders. One commenter, without supporting a regulator-mandated solution, thought that dealers should be part of any solution and should be required to increase transparency of the dealer-to-customer market (institutional and retail).

In the absence of client order exposure requirements and off-marketplace trading restrictions, one commenter asserted that requiring a marketplace to disclose its subscribers' order information to non-subscribers creates a free-rider problem that is manifestly unfair and prejudicial to marketplace development.

Response:
As a result of the extension of the exemption from transparency requirements for government fixed income securities, we will not change the current requirements that only marketplaces and IDBs report pre-order and trade information for government fixed income securities. During the additional exemption period, we will continue to analyze and consult with the industry to determine what, if any, requirements should be applicable to dealers.

Question 3: What type of pre-trade information should be disseminated? Should it include indications of interest?

Although commenters who responded to this question were not in favour of disseminating pre-trade information, some offered their views. The majority thought that indications of interest should not be included in pre-trade information. Reasons given were as follows: (1) pre-trade activity is rare in the fixed income market and the nature of the fixed income market does not lend itself to most pre-trade reporting; (2) indications of interest provide little useful information and should not be included in pre-trade information; (3) disseminating pre-trade indications of interest between dealers and large investors may tip other market participants and deter dealers from providing competitive bids inside quoted prices; and (4) indications of interest should not be included until the industry agrees on what they are and until it is established that the inclusion of indications of interest information does not prejudice any execution venue type.

One commenter, while noting that compelling dealers to disclose information about a trade to the market could damage the market by increasing the risks associated with trading, thought that any information should be released, including indications of interest.

Response:
As a result of the extension of the exemption from transparency requirements for government fixed income securities, we will not change the current requirements of NI 21-101 at this time and will maintain the current definition of an order (i.e. a firm indication by a person or company, acting as either principal or agent, of a willingness to buy or sell a security).

Question 4: Are the reporting timelines appropriate – i.e. order information in real time and trade information within one hour of this time of the trade?

Most commenters believed that the reporting timelines are appropriate. One commenter did not support a regulatory requirement to disseminate order information in real time, or a requirement to report trade information within one hour of the trade, and believed that market forces should be permitted to determine and develop the optimal level of order and trade transparency and the reporting timeframes. Another was concerned that dissemination of trade information in real time may hinder a dealer's ability to lay off risk when taking on a position.

One respondent indicated that if trade reporting is mandatory for government fixed income securities, the CSA should maintain the current one hour delay. Another commenter indicated a preference for a requirement for immediate disclosure of trade information, but acknowledged that this short reporting time may be challenging to achieve. This commenter believes that, with respect to corporate bonds, reporting of trades within one hour would allow an acceptable level of compliance to be achieved and would provide a starting point for reductions in the time lag in the future.

Finally, another respondent noted that, with the roll-out of straight-through processing technology, timelines for reporting will become unnecessary.

Response:
As a result of the extension of the exemption from transparency requirements for government fixed income securities, we will not make changes to the provisions currently included in NI 21-101 and will maintain the provisions in the current form, requiring that marketplaces and inter-dealer bond brokers report order and trade information for government fixed securities in real time.

Question 5: Are the volume caps applicable to government fixed income securities set out in the Companion Policy to NI 21-101 adequate? Should there be further tiering for the different types of government bond securities?

Three commenters stated that all volume caps set out in the proposed amendments to 21-101CP were adequate. However, one of these respondents thought that the information could be specific to the particular market segment, for example, IDB information should be for dealers, while dealer-to-customer information should be for investors. Another submitted that the Government of Canada volume cap of $10 million was adequate, but suggested that the volume cap for other government securities be raised from $2 million to $5 million to better reflect a standard trade size for that sector.

One commenter believed that the proposed volume caps may not be appropriate when applied to government debt securities, for example, a $2 million cap could be appropriate for an Ontario bond, while the same cap for a PEI or municipal bond may represent in excess of ten percent of the entire issue. Another suggested that it may be misleading to disclose prices with volume caps since pricing on large fixed income trades are not generally relevant to smaller investors who cannot expect similar pricing on smaller orders and that optimal transparency may be achieved by excluding the reporting of all fixed income trades above certain volume levels.

One commenter believed that the proposed cap on designated government debt securities issued or guaranteed by the government of Canada should be significantly lower than $10 million total par value, and that a more appropriate cap is $100,000 for designated government debt securities to ensure that the retail market participants have visibility of the relevant order flow as an input in making their investing decisions. Another believed that the $2 million proposed cap for government debt securities other than those issued by the government of Canada was too high and a further tiering was desirable.

Three commenters did not believe that further tiering would add clarity for the average investor. One proposed that, should certain trade transparency in government bonds be mandated, all government bond trades up to $200,000 should be disclosed through IDBs.

Response:
As a result of the extension of exemption from transparency requirements for government fixed income securities, we will not change the current transparency requirements for government fixed income securities included in NI 21-101, which do not include volume caps.

Question 6: Should we require pre-trade transparency for corporate fixed income securities? If so, should the requirements be applicable to marketplaces only or should they also apply to dealers?

Many commenters did not support pre-trade transparency requirements for the fixed income securities in general, and their responses did not distinguish between government bond and corporate bond securities. One commenter cited that pre-trade, or order, information is a feature of auction-based equity markets that is not relevant in fixed income markets. The concern raised was that pre-trade reporting would include bids and offers which are not made in the context of prevailing market conditions and could provide a misleading value for a security. Other commenters noted the potential adverse effect of pre-trade transparency on the liquidity of the market and the adverse effect on confidentiality.

One commenter believed that a voluntary multi-dealer source of non-attributed best bid/ask price on corporate fixed income securities would be the best balanced solution to the needs of the market participants. Market participants would then be able to use this information to interact with the appropriate source of liquidity and negotiate a reasonable price for the proposed transaction.

Response:
Based on comments received, we will not make additional changes to require pre-trade transparency for corporate fixed income securities. As currently noted in 21-101CP, we will continue to allow the information processor the flexibility to make the determination of whether to require pre-trade information for corporate fixed income securities.

Question 7: Should the time for reporting the trades be reduced (for example, should all trades be reported and disseminated in real time?)

A majority of commenters were of the view that the time for reporting trades should not be reduced. Some commenters were concerned that the dissemination of trade information in real time would significantly increase costs without a material increase in transparency, while others felt that real-time displays of trades would have a detrimental effect on a dealer's willingness to provide liquidity. One commenter felt that real time reporting is not currently possible from an operational standpoint as firms are currently still working to ensure compliance with the one hour reporting requirement.

One commenter did not believe that immediate reporting of trade information would pose a significant operational burden once disclosure is mandated but noted that, if the CSA retains the one-hour time delay, other data elements, for example, trade time, should be included in the reported trade information in addition to the price and quantity.

Response:
Based on the comments received, we will maintain the reporting timelines of the existing information processor for corporate fixed income securities. We expect that the information processor will continue to review the adequacy of the reporting timelines and determine whether changes are necessary.

Question 8: Has the process for designating benchmark corporate fixed income securities been effective? Please explain your response.

Four commenters submitted that the current methodology for designating benchmark corporate fixed income securities has been effective. They noted that: (1) benchmark data is a good general indicator of the overall market; and (2) CanPX's process provides greater flexibility than setting requirements by regulation. One commenter, however, noted that the selection could be done more frequently, for example, on a monthly basis. Another identified a number of weaknesses in the current process, for example: (1) the list of bonds available to CanPX subscribers does not change in response to trade activity flowing from the supplying dealers or IDBs but is only updated on a quarterly basis; (2) CanPX does not include representation from all areas of the Canadian capital markets which have an interest in fixed income.

One commenter, while not aware of any issues with the current process, did not believe that corporate bond prices disseminated on CanPX are as widely used by market participants as other more relevant sources of bond prices.

Response:
We agree that an information processor provides greater flexibility than regulation. We also note that, over the years, the number of designated corporate fixed income securities reported to and by CanPX has almost tripled, which indicates that the process for designating corporate fixed income securities has generally been adequate. We will continue to monitor its effectiveness and have added a new requirement to NI 21-101 that the information processor report the process and criteria for selection of fixed income securities to the regulators. Applicants for information processor will be evaluated on a number of criteria, including the adequacy of their bond selection process.

Question 9: Has there been sufficient progress, both regulatory and industry-driven, regarding fixed income transparency to date? For retail investors? For large and small institutional investors?

A majority of commenters believe that there has been sufficient progress to date regarding fixed income transparency. However, two commenters noted that further progress may be required with respect to fixed income transparency for retail investors and that further research, analysis and a review must be conducted before the most appropriate means of achieving effective transparency for retail investors can be determined.

Two commenters noted that, while progress has been made in expanding access by large institutions to quoted government securities markets, there is a general lack of post-trade transparency in the Canadian fixed income market. One of them believed that there has been insufficient progress in delivering transparency to retail customer channels and that single provider markets dominate the retail landscape. This commenter noted that the 2002 IDA/CSA Market Survey on Regulation of Fixed Income Markets, while often cited to support continuation of the status quo with regard to transparency in the institutional market and ongoing need for transparency in the retail fixed income market, does no longer reflect current and evolving market conditions. Another respondent thought that retail investors need to be able to gain access to relevant pre-trade transparency and other information including disclosure of mark-up and commission structures for sell-side participants.

Response:
We agree that the level of transparency in the fixed income market has generally increased in the past few years. We also agree with some of the commenters that a further understanding of the information needs of the retail fixed income market participants is needed. In this regard, we acknowledge and support the initiatives led by the IDA, for example, its survey of Canadian debt market participants. We will continue to review developments in the fixed income market,

both on a domestic and international level, and will consult with the industry and work with other regulators to determine whether additional regulatory guidance or requirements are needed.

II. Other Comments and CSA responses

Clarification of Best Execution and Other Obligations in a Multiple Marketplace Environment

Several commenters questioned the proposed clarification that dealers must take into account order information from all marketplaces where a particular security is traded (not just those where a dealer is a participant) and take steps to access orders as appropriate. Some indicated that these best execution requirements would be more feasible with a market integrator and data consolidator. One commenter suggested that a marketplace should have a certain level of order flow before a dealer is required to access that market in order to avoid costs to dealers of accessing marketplaces with no demonstrated liquidity. Another believed that a more efficient and cost-effective method would be to require new marketplaces to connect with each other and the primary marketplace rather than to impose connectivity upon the dealers.

Several commenters suggested that best execution varies from market to market and as applied to retail client orders this term may not have the same meaning or treatment as for institutional client orders. These commenters cautioned the CSA not to interpret "best execution" too narrowly, for example, by equating it with best price, and one suggested the term "best execution" be reviewed in the context of the bond market. One respondent noted that a narrow definition of best execution reduces competition between execution venues because it compels trading activity based on the single criteria of price.

Other concerns noted were: (1) it may be more appropriate to address amendments such as this in the larger context of best execution regulation as opposed to trade transparency; and (2) the industry committee that was struck to look at these issues when the ATS Rules were first put into place, in its 2003 report, did not contemplate or recommend a regulatory requirement to have dealers access all marketplaces, or all orders on marketplaces where they did not have access or were not members. It was suggested that the CSA consider striking another industry committee to re-examine best execution, including execution and access costs, and trade-through obligations.

Two commenters supported the CSA's position that all marketplaces must be considered, as a dealer would otherwise be able to ignore better executions by choosing not to access different marketplaces. One of these commenters believed that, in practice, a dealer will need to have access to all marketplaces, either directly or indirectly, to properly provide best execution to their clients and suggested how this can be accomplished. The other thought that the lack of full visibility by a dealer into the order book of a marketplace should not alleviate its duty to consider that marketplace when fulfilling its duty of best execution for its clients. The same commenter added that post-trade information regarding securities traded, size and price may also include relevant information that should be considered by a dealer in order ensure the best possible execution, and suggested amending the proposed amendment to the Companion Policy to NI 23-101 to include post-trade as well as pre-trade (order) information on all marketplaces.

Response:

Currently, subsection 4.2(1) of NI 23-101 requires that a dealer acting as agent for a client shall make reasonable efforts to ensure that the client receives the best execution price on a purchase or sale of securities. For cross-border inter-listed securities, there is existing guidance in 23-101CP that provides that a dealer, in making reasonable efforts, should also consider whether it would be appropriate in the particular circumstances to look at markets outside of Canada. The Proposed Amendments were intended to clarify best execution obligations in a multiple marketplace environment in Canada. It should be noted that "marketplace" (defined under NI 21-101) refers to a marketplace within Canada. Due to questions raised about the clarification and in response to comments received, we have made a number of further changes.

The Proposed Amendments clarified our expectation that dealers should take into account all relevant information from all marketplaces trading the same securities and should not view their obligation as limited to marketplaces where they are participants. It was not our intention to set the expectation that a dealer must have access to real-time data feeds, but that it should have reasonable policies and procedures regarding best execution that include taking into consideration relevant information from all appropriate marketplaces, and monitoring these policies and procedures. We do not believe that a dealer could limit its best execution obligation by choosing to ignore certain marketplaces. Best execution is an assessment that is to be made by a dealer based on the particular circumstances, in accordance with its policies and procedures.

We do not agree that a market integrator or data consolidator is necessary in order to comply. In determining that mandated market integration was not required, the CSA relied on the views of an industry committee that stated that best execution responsibilities and the availability of pre- and post-trade information would be sufficient. We do agree, however, that the existence of an information processor displaying consolidated data would be helpful for best execution purposes. We are in the process of reviewing information processor applications.

We agree with the suggestion from one of the commenters that relevant information should include post-trade as well as pre-trade (order) information, and have reflected this in the amendment.

We also agree with the comments that price is only one element that dealers should consider when assessing best execution. Our review of trade-through and best execution is ongoing, and, upon completion of this review, we will propose changes to current requirements to further clarify the best execution obligation.

Electronic Audit Trail Requirements

One commenter noted that the electronic audit trail discussion in the notice of proposed amendments relates to a dealer/marketplace model and does not reflect the most recent thinking on how to implement TREATS. This commenter referred to comments it had previously provided on an alternate regulator-centric model for implementation over a dealer/marketplace centric model and noted it strongly endorses the proposed regulator-centric model. The commenter also believed that the timing for the cost-benefit analysis is premature and suggested that the cost benefit analysis be conducted only after requirements for all security classes have been finalized. The same respondent also sought clarification regarding the specific expectations regarding the revised exemption date of January 1, 2010, specifically, whether implementation will be completed for all security classes or it would be a phased-in implementation.

It was also suggested that Canadian regulators are seeking to achieve regulatory oversight objectives almost exclusively through technology solutions, and encouraged the regulators to invest in human resources to enhance their oversight capabilities.

One commenter highlighted the importance of dealers not only capturing order details at time of receipt, but also being able to compare market information at receipt of an order against standard industry benchmarks following completion of the order to allow dealers to know if they are meeting their fiduciary responsibility to achieve best execution. The commenter noted that it is important that institutional orders be captured electronically at origination.

One commenter urged the CSA to consider working through electronic audit trail requirements in the equity market first in a multiple marketplace environment before applying these requirements to the fixed income market, as the fixed income market has been successful with respect to reporting and record-keeping and that there is no urgency for regulatory intervention in this market.

Response:
We are currently considering the appropriate structure for TREATS, including whether any solution should be dealer/marketplace-centric versus regulator-centric. The structure will also have an impact on the amount of information that might be available to dealers for their own compliance purposes. At this time, dealer and marketplace data requirements for equities have been completed. The data requirements for the remaining securities classes under scope will be finished prior to the completion of the Cost-Benefit Analysis, expected by December 2007.

A plan for implementation will be devised once the data modeling is complete and any issues relating to they appropriate architecture for a TREATS facility have been resolved. A phased-in implementation is expected for each security class currently under the project's scope, commencing with equities.

Requirements for and Status of Information Processors for Debt and Equity

Two commenters suggested that an information processor that consolidates equity data should be introduced based on market forces. They were not supportive of mandating the use of an information processor but instead called for regulation that encouraged a market driven and competitive response to market data needs. One of them proposed that, once a threshold volume had been achieved, all vendors of consolidated market data be required to incorporate information from all marketplaces.

Response:
We believe that data consolidation and the availability of an information processor that meets the standards approved by regulators would ensure that a central source of consolidated data exists, and would help address best execution and market integrity issues. However, we will continue to monitor and re-visit the issues in order to determine whether a market-driven solution will be more appropriate in the future.

Deletion of Exemption from Information Transparency Requirements for Marketplaces Dealing in Exchange-Traded Securities that are Options or Foreign Exchange-Traded Securities that are Options

One commenter requested an extension, rather than the proposed deletion, of this exemption. The extension was requested until there is greater clarity as to the specific impact these transparency requirements may have on these types of securities.

Another commenter suggested that, in order to ensure a level playing field for all market participants, any synthetic or derivative type instruments (whether traded on or off a recognized exchange) that create an economic or risk exposure similar to those of fixed income instruments must be subject to the same reporting and transparency requirements of the equivalent cash instruments. This same commenter advocated the same pre-trade transparency requirements for all cash, derivative and synthetic instruments with orders, and recommended only sending post-trade information to the regulators.

Response:
We have decided to delete the section at this time and require transparency for exchange-traded securities that are options or foreign exchange-traded securities that are options. Currently, the Bourse de Montréal makes information available for exchange-traded securities that are options. There are no other marketplaces at this time trading exchange-traded securities that are options or foreign exchange-traded securities that are options.

Clarification That Marketplace Information Must Include Identification of the Marketplace and other Relevant Information

One commenter requested that the CSA clarify the implications of this proposed amendment. This commenter outlined the difficulty in specifying all of the marketplaces on a confirmation to investors in situations where an equity trade may be executed in part on several marketplaces as it may not be feasible to identify all marketplaces on a single confirmation slip, and the issuance of several confirmation slips relating to a single trade would be confusing to the investor. This commenter proposed that in this instance, a confirmation should be required to state "Multiple Marketplaces – details available upon request". This commenter was of the view that this proposed amendment does not apply to the fixed income market.

Response:
This amendment is intended to clarify that information provided by a marketplace to an information processor or information vendor must include all relevant information (including identity of the marketplace). This is distinguished from information to be included on a trade confirmation (which is not referred to in this amendment). With respect to a trade confirmation, if a trade is executed on multiple marketplaces, we are of the view that it is appropriate to state "multiple marketplaces – details available on request".

Other Amendments to 21-101CP

With respect to information regarding government debt securities and corporate debt securities to be sent to the information processor, one commenter requested clarification regarding the requirement that "the type of counterparty" be reported to the information processor.

Response:
The type of counterparty that would be reported to the information processor relates to the category of the counterparty to a trade. This may be "dealer", "client", etc. The collection of this information will help avoid double-counting of trades in a consolidated feed.

Registration Exemptions Not Available to an ATS

One commenter requested clarification on the legal purpose and effect of proposed section 6.2 of the Companion Policy to NI 21-101 since, in this commenter's view, an ATS registered as a dealer would not need dealer registration exemptions. This commenter assumed that the provision was not intended to restrict ATSs from engaging in trades executed by subscribers who are non-registered buy-side institutions.

The same commenter suggested that the amendment to section 6.2 of NI 21-101 and Companion Policy to NI 21-101 be reworded to clarify that non-ATS dealer activities are not impaired by this proposed section. [i.e. except as provided in this Instrument, the registration exemptions applicable to dealers under securities legislation are not available to an ATS in respect of its ATS activities.]

Response:
The intention of the proposed amendment is to clarify that, even though an ATS is registered as a dealer, the registration exemptions available to dealers are generally not available to an ATS (for example, the accredited investor exemption that is available to dealers is not available to an ATS). The only registration exemption contemplated in the ATS rules is that a securities regulatory authority may consider granting an exemption if an ATS is registered in one jurisdiction and only provides access to registered dealers in another jurisdiction(s).

Availability of Technology Specifications and Testing Facilities by a Marketplace Proposed amendments to NI 21-101, section 12.3

Some commenters were concerned about the practicality of the approach concerning the publication of technology requirements and testing facilities.

One commenter noted that the proposed changes represent a fundamental shift in the way the industry operates, which requires extensive effort and time to prepare. A few requested a longer timeframe for marketplaces to make any technology requirements regarding interfacing with or access to the marketplace available to the public. One commenter suggested that a new marketplace be required to publish its full technology requirements and provide testing facilities for a minimum of six months prior to operating. This commenter also submitted that it should be marketplaces, rather than dealers, who bear the costs of ensuring a marketplace's level of interconnectivity since this would better align development costs with potential benefits. In the alternative, it was suggested that the CSA strike an industry committee to examine the cost-benefits and efficiencies of the various alternatives.

One commenter noted that technology counterparties enter into agreements that protect intellectual property rights and suggested that consideration be given to an approach that incorporates counterparty agreements to accommodate this requirement.

Response:
We believe that requiring a marketplace to publish its technology specifications for two months prior to operating is an appropriate period. We do not agree that marketplaces, rather than dealers, should bear the costs of ensuring a marketplace's level of connectivity as this could be a barrier to entry for new marketplaces. Although intellectual property rights may be protected by agreements, we are of the view that appropriate technology specifications should be made available so that dealers are in a position to adequately prepare for new marketplaces.

Form 21-101F5 Amendments

With respect to adding the phrase "including validation processes" at the end of subsection 2 of the description of Exhibit G in Form 21-101F5, one commenter sought further clarification regarding the "data validation processes" as it had a concern that such processes may add latency and/or costs to the design, implementation and operation of the information processor system.

Response:
Section 14.4 of NI 21-101 requires an information processor to provide timely, accurate, reliable and fair collection, processing, distribution and publication of information for orders for, and trades in, securities. In order to comply with this requirement, the information processor may have data validation procedures and other processes to ensure data integrity. While we did not specify the type of data validation processes required, we will assess their overall adequacy in evaluating applications for the information processor role.

List of Commenters

1. Bank of Canada
2. Blackmont Capital Inc.
3. BMO Financial Group
4. CanDeal
5. CPP Investment Board
6. Inter Dealer Broker Association
7. Investment Dealers Association of Canada
8. Investment Industry Association of Canada
9. ITG Canada Corp.
10. Ministry of Finance, British Columbia
11. Perimeter Markets Inc.
12. RBC Financial Group
13. Scotia Capital Inc.
14. TD Securities Inc.
15. TSX Group Inc.