

**Summary of comments and responses  
RS Inc. application for recognition**

**List of commentators**

We received the following comment letters in response to the Request for Comments on the application for recognition of Market Regulation Services Inc. (RS Inc.) published on October 12, 2001 (BCN 2001/69).

1. Barclays Global Investors
2. BMO Nesbitt Burns Inc.
3. Canadian Trading and Quotation System Inc.
4. ITG Canada Inc.
5. Bourse de Montréal Inc.
6. TD Securities Inc.
7. Instinet Canada Limited
8. Canadian Security Traders Association, Inc.

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<b>Reference</b>	<b>Commentators and Comments</b>	<b>Response</b>
<p><b>Question 1</b> – Do the proposed ownership structure and corporate governance rules of RS Inc. avoid or adequately manage conflicts of interest related to its status as a self-regulatory organization?</p>	<p><b>BMO Nesbitt Burns Inc. (“BMO”)</b> – The proposed ownership structure is acceptable; concerned that the corporate governance rules may become inadequate if there are significant shifts in the marketplace over time.</p> <p><b>Barclays Global Investors (“BGI”)</b> – Proposed ownership structure and corporate governance rules are appropriate; however, they should be subject to a preset review at a certain time in the future to address any potential changes in the marketplace.</p> <p><b>Canadian Trading and Quotation System Inc. (“CNQ”)</b> – Shareholding by a regulated party in the regulator inherently creates a conflict of interest. The proposals of the IDA, TSE and RS Inc. recognise this and the proposed ownership structure and corporate governance rules of RS Inc. probably adequately manage it.</p> <p><b>Canadian Security Traders Association, Inc. (“CSTA”)</b> – The potential for conflict of interest given the ownership format and the large TSE participation on the board is a major concern; CDN<sup>X</sup> should be added to the board of RS to have a broader board representation. Regardless of the structure instituted, there should be an initial trial period after which the OSC or another regulatory body should determine if the structure is adequate. Another concern is that RS is adding another layer of bureaucracy and fees.</p>	<p><b>We are of the view that the current corporate governance structure of RS Inc. adequately addresses conflicts of interests. We included a term and condition in the recognition order that requires RS Inc. to review its corporate governance model within 12 months from the date of recognition and periodically after that to ensure that the model appropriately reflects the market structure.</b></p>
<p><b>Question 2</b> – Is the calculation for determining Market Share appropriate (i.e. 25% trading value, 25% trading volume and 50% number of trades)?</p>	<p><b>BMO</b> – The 10% threshold for CDN<sup>X</sup>’s “Market Share” in Canadian equity securities (before CDN<sup>X</sup> is entitled to nominate a 5<sup>th</sup> independent Director) is too high. Recommends 5%.</p> <p><b>CNQ</b> – The perceived need to calculate Market Share to base entitlement to appoint directors to RS Inc. only heightens concerns about conflicts of interest and may undermine the perception of the independence of RS Inc. The</p>	<p><b>We required RS Inc. to review its corporate governance model within 12 months of recognition and periodically after that. This will include a review of the formula for calculating “Market Share”.</b></p>

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	<p>nomination of all directors (independent and non-independent) should be the responsibility of the corporate governance committee of RS Inc.</p> <p><b>Bourse de Montréal Inc. (“Bourse”)</b> – If a marketplace can trade in derivatives then the definition of “Market Share” should not be limited to the Canadian equity securities market, but should include some representation of the derivatives market representatives.</p> <p><b>CSTA</b> – How is the formula calculated? If CDNX attains 10% market share and appoints a fifth non-independent director what happens if CDNX then falls below 10%?</p>	<p><b>At the present time, RS Inc. will only be regulating the equity market. If RS Inc. becomes a market regulator for the derivatives market, the calculation will be revisited.</b></p> <p><b>If CDNX has 10% of the Market Share in a calendar year, it will be entitled to nominate the fifth non-independent director for the subsequent term. If, at the end of that term, CDNX’s position for that year does not reach or exceed 10% of the Market Share, then CDNX will not be entitled to representation in the subsequent term. In that case, the TSE and IDA will jointly nominate the fifth non-independent director who will be an individual who is associated with or experienced with the Canadian public venture capital market.</b></p>
<b>Question 3</b> – Does RS Inc.’s proposal for ensuring that there is at	<p><b>BMO</b> – Yes. Although the 10% threshold is too high. It should be 5%</p> <p><b>CSTA</b> – As long as the ATs are a significant part of the market share there</p>	<p><b>RS Inc. will have at least one ATS representative on its board at all times. In addition,</b></p>

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<p>least one ATS representative on its board at all times do so appropriately?</p>	<p>should be an ATS representative on the board; however, there should be a maximum number of ATS representatives and the ATS representative should be considered a non-independent director.</p>	<p><b>if an ATS were to reach 10% of the Market Share, it would be entitled to nominate a non-independent director. This is appropriate given the current structure of the equity market. If the structure of the market changes significantly, this will be reviewed. If the ATS representative is associated with an ATS, that individual will be considered to be a non-independent director.</b></p>
<p><b>Question 4</b> – Is the definition of “independent director” appropriate? Should there be a “cooling off” period before an individual who has been associated with any exchange, quotation and trade reporting system (QTRS) or ATS can be considered eligible to serve as an independent director of RS Inc.?</p>	<p><b>BMO</b> – The definition of “independent director” is appropriate. A “cooling off” period would also be appropriate.</p> <p><b>CNQ</b> – The definition of “independent director” is appropriate. No “cooling off” period is necessary for an individual to be considered eligible to serve as an independent director of RS Inc.</p> <p><b>CSTA</b> – The definition of “independent director” is not appropriate. The current definition excludes persons such as buy side participants, brokers and all institutional and retail investors who use an ATS; based on the definition’s current criteria it will be difficult to attract people with the right qualifications onto the board. There is no need for a “cooling off” period. If an individual has severed ties to a previous employer who qualifies as non-independent and resurfaces as an independent, this should be sufficient. Strongly agree that there should be independent directors on the board, but what are to be the credentials required?</p>	<p><b>The definition of “independent director” has been amended so that non-dealer subscribers are no longer excluded from being independent directors. The definition of “independent director” excludes the President of RS Inc., an associate, director, officer or employee of a marketplace to which RS Inc. provides regulation services, a marketplace participant that is a dealer, a shareholder of RS Inc. or an affiliated entity of either of them. The Governance Committee will be</b></p>

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		<p><b>responsible for selecting independent directors under the Governance Committee Guidelines. The Guidelines provide that the Committee will select individuals who are qualified to act as independent directors and ensure that the independent directors represent a variety of constituencies, including representatives of institutional investors, issuers and regional representatives.</b></p> <p><b>A specific cooling-off period is not necessary as the concept has been included in the Guidelines of the Governance Committee. Specifically, the Committee will consider any affiliations the candidate has had with any exchange, QTRS or ATS in determining whether the candidate is qualified to act as an independent director.</b></p>
<p><b>Question 5</b> - Please comment on the proposed fee model,</p>	<p><b>BMO</b> – The fee model is reasonable and should not create a barrier to entry for ATSS.</p>	<p><b>RS Inc. has revised its fee model. The fee model consists of: (1) a fixed annual fee of</b></p>

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<p>allocating costs on a market-by-market basis and, in particular, whether it would create a barrier to entry for ATSS.</p>	<p><b>BGI</b> – The proposed fee model is likely to create a barrier for entry to new ATSS. Any fee model that does not reflect the actual expense incurred by RS Inc. in regulating a given entity is inappropriate. Those marketplaces whose business model is more limited should not subsidize those marketplaces whose business models require more expensive regulation.</p> <p><b>CNQ</b> – It is appropriate that a separate cost calculation be performed with respect to regulation of each market subject to the assurance that the actual costs for each market are recovered and that one market is not subsidizing the cost of regulation of another. The apportionment and weightings are appropriate subject to RS Inc. reviewing the weighting allocations on a going forward basis. Do not believe that the allocation model will create a barrier to entry for ATSS's.</p> <p><b>CSTA</b> – Difficult to answer as the fee structure has not yet been made available. The ATSS and the other exchanges should have a common fee schedule; a trade on the TSE and a trade on an ATSS should cost the same.</p>	<p><b>\$5,000 to Participating Organizations and subscribers who are registered or who are institutional investors; and (2) a variable fee of 26.72 cents per 1000 shares traded. RS Inc. will operate on a cost-recovery basis. All new marketplaces will be charged a one-time fee for providing them with a connection to RS Inc. systems plus certain on-going costs. The cost will be approximately \$100,000 per ATSS.</b></p> <p><b>The fee model will be reviewed within 12 months to ensure that it is reasonable and appropriate. We included a term and condition in the recognition order that requires RS Inc. to review its fee model within 12 months from the date of recognition and periodically after that.</b></p>
<p><b>Question 6</b> - Is the fee model proposed by RS Inc. fair and reasonable with respect to</p>	<p><b>BMO</b> – The fee model regarding foreign securities is reasonable. If an ATSS trades foreign securities exclusively, a different regulation services provider may be a better solution.</p>	<p><b>RS Inc. has revised its fee model. The revised fee model no longer treats foreign securities as a distinct market.</b></p>

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allocating costs to ATSS that trade foreign securities?	<p><b>CNQ</b> – It would be inappropriate for Canadian exchanges or QTRS’ to subsidize the regulation of ATS’s that trade foreign securities, and accordingly the fee model is fair and reasonable.</p> <p><b>CSTA</b> – Foreign securities not traded on a Canadian exchange should be treated as a distinct market. Do not believe that regulating foreign securities traded outside of Canada is part of the RS mandate.</p>	<b>The 12-month review of the fee model would include foreign securities.</b>
<b>Question 7</b> - Please comment on whether a surcharge of up to 15% on the cost of the services the TSE will provide to RS Inc. is appropriate.	<p><b>BMO</b> – No surcharge is appropriate. Regulatory services should be at cost and should not create a profit for the TSE. In the absence of a description or estimate of the value of any service provided to RS Inc., it is impossible to know if any surcharge is reasonable.</p> <p><b>CNQ</b> – RS Inc. should be looking to obtain those services provided to it by TSE on the most cost effective basis. Since the TSE is a for profit enterprise it is reasonable for TSE to charge RS Inc. a mark up of up to 15%.</p> <p><b>CSTA</b> – A surcharge would not be appropriate at this time. Although charging for services is appropriate, the 15% mark-up is too high, especially at inception.</p>	<b>RS Inc. has agreed to investigate the costs of obtaining comparable services to those provided by the TSE from a third party and to keep track of the services it provides to marketplaces to ensure that its fee model is reasonable and appropriate. The TSE has also agreed to keep track of the costs of the services it charges to RS Inc.</b>
<b>Question 8</b> - What would be the approximate cost to an ATS of providing data in STAMP format initially? What would be an appropriate phase-in period for RS Inc. to accept data in FIX format?	<p><b>BMO</b> – Requiring all data feeds in STAMP format is a barrier to access, as STAMP is a TSE-specific application. U.S. ECNs should not be required to use STAMP. Marketplaces should be allowed to use FIX or XML.</p> <p><b>CNQ</b> – RS Inc. should support data feeds in STAMP format, FIX format or other functionally equivalent formats. Requiring data feeds in the format used by a market or the principal marketplace of a marketplace is reasonable, provided that format is reasonably state-of-the-art and available to all marketplaces in that market. If a market or principal marketplace is prepared to provide RS Inc. the technology to utilize data feeds in a functionally equivalent alternative format then RS Inc. should not require the marketplace to provide</p>	<b>We did not receive data on the approximate cost to an ATS of providing data in STAMP format; however, RS Inc. has indicated that it will accept data feeds in formats other than STAMP format. We understand that it may take 90 days or more for RS Inc. to create the software necessary to accept data in FIX format</b>

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	<p>data feeds in STAMP format merely to permit RS Inc. to utilize legacy systems.</p> <p><b>CSTA</b> – Unable to estimate the cost to an ATS of providing data in STAMP format at this time; eventually all data should be provided in FIX format, with a two year phase-in period.</p>	<p><b>once it receives a request from an ATS. Alternatively, an ATS may purchase software that translates data from FIX format to STAMP format.</b></p>
<p><b>Question 9</b> - Please comment on whether it is appropriate for RS Inc. to require that a marketplace give RS Inc. staff access to its systems to implement regulatory decisions.</p>	<p><b>BMO</b> – RS Inc. should have access to the systems of all marketplaces. Appropriate access to implement regulatory decisions should require: tightly defined regulatory conditions, economical and efficient solutions and ability of marketplace to isolate parts of its system subject to regulatory access.</p> <p><b>CNQ</b> – Subject to establishing a process for a marketplace and RS Inc. to arbitrate a regulatory decision made by RS Inc., it is appropriate for RS Inc. staff to have access to a marketplace’s system to implement regulatory decisions.</p> <p><b>CSTA</b> – It is inappropriate that all marketplaces be compelled to give RS Inc. staff access to their systems to implement regulatory decisions; it should be sufficient for RS Inc. to order all marketplaces to comply with regulatory decisions without invading their systems.</p>	<p><b>The same process for regulatory halts will apply to exchanges and ATSS. In general, RS Inc. will have the ability to instantaneously administer halts. This may be done by RS Inc. directly or by the marketplace at the direction of RS Inc. Staff.</b></p>
<p><b>Capacity and Integrity of Systems</b> – At least initially, RS Inc. intends to use the TSE’s surveillance systems.</p>	<p><b>BMO</b> – Acceptable.</p> <p><b>CNQ</b> – To the extent that a marketplace can provide surveillance systems to RS Inc., it is inappropriate for that marketplace to be obligated to utilize the TSE’s surveillance systems as this could result in significant costs to that marketplace. RS Inc. must be flexible as the TSE surveillance systems may be appropriate for the “markets” consisting of the TSE and any ATS trading in securities listed on the TSE, but not for other “markets” not utilizing the TSE trading platform.</p> <p><b>CSTA</b> – Strongly feel that RS Inc. must have their own surveillance systems or there will be a perceived conflict of interest.</p>	<p><b>At the outset, RS Inc. will use the TSE’s surveillance systems. RS Inc. has agreed to investigate the costs of obtaining comparable services to those provided by the TSE from a third party.</b></p>



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<b>UMIRs</b>	<p><b>BGI</b> – Concerned about the significant amendments to subsection 7.8 of the UMIRs with respect to restrictions on trading by a participant involved in a distribution. Concerned that the changes will have a negative impact on the development of new investment products and may limit future growth of exchange traded funds (ETF’s). Believe the UMIRs should be amended to include in the definition of “exempt security” - the security of any “mutual fund” qualified by a prospectus for sale in the relevant jurisdiction and listed on an Exchange as defined in the UMIRs.</p> <p><b>CNQ</b> – CNQ trading increments include increments of one-half cent for trading in securities with values under \$0.50 per share, and therefore ss.6.1(1) of the UMIRs should be amended to provide for half-cent increments. Section 7.3 “Proficiency Obligations” of the UMIRs omits any reference to receipt of approval of a quotation and trade reporting system (“QTRS”) for entry of orders to the trading system of the QTRS. Therefore, a QTRS which directly regulates its marketplace would not be able to exercise the same approval power as granted to an Exchange in 7.3(1)(d).</p> <p><b>Instinet Canada Limited (“ICL”)</b> – Reiterated its concern over the “one size fits all” approach that was reflected in the initial UMIRs. Noted other commentators also wondered if the ability of an ATS to compete with exchanges would be impaired by the UMIRs if adopted in their original form. Disappointed that the current version of the UMIRs as found in the RS Inc. application has not addressed these concerns. Urges the CSA to initiate in advance of the implementation of the new rules, a process whereby parties effected can discuss amendments to the proposed UMIRs. If nothing is done, the UMIRs may discourage others from operating in the Canadian market.</p> <p><b>TD Securities Inc. (“TDSI”)</b> – The TSE and CDNX continue to be strongly</p>	<p><b>The UMIRs will include the current TSE market stabilization rules (amended to reflect changes in terminology and a wider range of marketplaces). Amendments will be considered later after a full consultation period.</b></p> <p><b>The UMIRs will include trading increments of one-half of one cent.</b></p> <p><b>The UMIRs have been drafted for an equity auction marketplace. Amendments will be necessary for other types of marketplaces. Amendments to the UMIRs will be dealt with under the joint rule review protocol among the recognizing regulators. Under the protocol, the OSC will publish each rule amendment for comment (other recognizing regulators may also publish them) prior to</b></p>

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	<p>motivated to create a single “code” for market integrity rules governing marketplaces in Canada. This is at odds with the object of Rule ATS which is to produce competition among the marketplaces, as well as market integration. ATSS trading in equities are disadvantaged versus systems trading fixed income securities under the latest version of the UMIRs. Although the UMIRs are poorly suited for the debt market, the UMIRs must have flexibility to enable equity ATSS to compete with exchanges. Some means must be found to adapt the UMIRs to meet future requirements of ATSS; a way to achieve this might be for the CSA to explicitly recognise that the UMIRs will not be static and will evolve by exemption or amendment to encourage the development of ATSS.</p> <p><b>ITG Canada (“ITG”)</b> – The UMIRs overall are straightforward and intuitive. However, ITG take issue regarding the mechanics and timing of the new designations and identifiers included. Specifically, it is not clear how some of the new order types that have been defined will be implemented, such as: Opening orders, Volume weighted Average Price, Market-on-Close orders, orders for insiders, orders for significant shareholders and regular sales changed to short sales.</p>	<p><b>approval.</b></p> <p><b>A marketplace may require certain exemptions from the UMIRs. When a marketplace requests an exemption from the UMIRs, the following process will apply:</b></p> <ul style="list-style-type: none"> <li>• <b>If an exchange or QTRS requests an exemption, it will submit the request to RS Inc. for comment and to its lead regulator for approval under the applicable rule review protocol.</b></li> <li>• <b>If an ATS requests an exemption, it will submit the request to RS Inc. who must submit it to the recognizing regulators for approval under the RS Inc. joint rule review protocol.</b></li> <li>• <b>We will publish requests for exemption for comment as provided in the applicable rule review protocol.</b></li> <li>• <b>If the securities regulatory</b></li> </ul>

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		<p><b>authorities approve an exemption, they will require RS Inc. to amend the UMIRs accordingly.</b></p> <p><b>We are aware that the UMIRS contain new designations and identifiers. To the extent they require systems changes, we will ensure that there is an appropriate implementation period.</b></p>