

May 12, 2005

No. 2005-016

Suggested Routing: Trading, Legal & Compliance

REQUEST FOR COMMENTS

INTERIM PROVISIONS RESPECTING TRADE-THROUGH OBLIGATIONS

Summary

On May 1, 2005, the Board of Directors (the “Board”) of Market Regulation Services Inc. (“RS”) confirmed the approval of amendments to the Rules and Policies under the Universal Market Integrity Rules (“UMIR”) to require a Participant or an Access Person to make reasonable efforts to fill better-priced orders on marketplaces prior to executing a trade at an inferior price on another marketplace or organized regulated market (the “Trade-Through Amendments”). These obligations would apply to:

- an Access Person when trading directly on a marketplace or an organized regulated market and the order is not being handled by a registered dealer; and
- a Participant when trading a principal order, non-client order or client order.

Rule-Making Process

RS has been recognized as a self-regulatory organization by the Alberta Securities Commission, British Columbia Securities Commission, Manitoba Securities Commission, Ontario Securities Commission and, in Quebec, by the Autorité des marchés financiers (the “Recognizing Regulators”) and, as such, is authorized to be a regulation services provider for the purposes of the National Instrument 21-101 – Marketplace Operation (the “Marketplace Operation Instrument”) and National Instrument 23-101 – Trading Rules (the “Trading Rules”).

As a regulation services provider, RS administers and enforces trading rules for the marketplaces that retain the services of RS. RS has adopted, and the Recognizing Regulators have approved, UMIR as the integrity trading rules that will apply in any marketplace that retains RS as its regulation services provider. Presently, RS has been retained to be the regulation services provider for: the Toronto Stock Exchange (“TSX”), TSX Venture Exchange (“TSX V”) and Canadian Trading and Quotation System, each as a recognized exchange (“Exchange”); and for Bloomberg Tradebook Canada Company and Liquidnet Canada Inc., each as an alternative trading system (“ATS”).

The Rules Advisory Committee of RS (“RAC”) reviewed the Trade-Through Amendments and recommended their adoption by the Board. RAC is an advisory committee comprised of representatives of each of: the marketplaces for which RS acts as a regulation services provider; Participants; institutional investors and subscribers; and the legal and compliance community. At the request of the Board, the Working Group on Access Persons, a group comprised of members of the Board, RAC and staff of RS formed in September of 2004 to review a number of issues surrounding the application of UMIR to persons with trading access to a marketplace, also reviewed the Trade-Through Amendments and recommended their adoption by the Board.

The Trade-Through Amendments will become effective upon the approval of the changes by the Recognizing Regulators following public notice and comment. Comments on the Trade-Through Amendments should be in writing and delivered by **June 30, 2005** to:

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Market Policy and General Counsel's Office,
Market Regulation Services Inc.,
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P.O. Box 939,
145 King Street West,
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Fax: 416.646.7265
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A copy should also be provided to Recognizing Regulators by forwarding a copy to:

Cindy Petlock
Manager, Market Regulation
Capital Markets Branch
Ontario Securities Commission
Suite 1903, Box 55,
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Monitoring Trade-Throughs and Future Actions

UMIR is built around the premise that a fair and orderly market is one which respects the notion that the best-priced orders should trade first as orders compete for execution. Investor confidence in the integrity of the marketplace can only be assured when individual investors

believe that their orders have achieved best price. The Board determined that the introduction of multiple competitive marketplaces in circumstances where this principle was not respected and enforced represented a substantial risk of material harm to retail and other investors, marketplaces and those persons having trading access to marketplaces. For this reason, notice was provided to the Recognizing Regulators that the Board intended to seek the immediate implementation of the Trade-Through Amendments. On May 12, 2005, the Recognizing Regulators provided notice that they do not agree that immediate implementation of the Trade-Through Amendments is necessary at this time.

As indicated in a press release issued by the Ontario Securities Commission on May 12, 2005, the Recognizing Regulators will undertake an initiative to study and to receive public comment on various aspects of “trade-through” obligations in Canada. The first step in this initiative will be the publication of a concept paper in June of 2005 for a 90-day comment period. While the Recognizing Regulators intend to identify a proposed solution by the fall of 2005, RS is concerned that implementation may not occur until mid-2006 or later. RS supports the initiative by the Recognizing Regulators and RS intends to be an active participant in the review. However, the Board is of the view that, pending the outcome of this initiative, steps should be taken to protect the orders of retail and other investors from the possibility of being traded-through. ***In the view of the Board, trade-throughs have not been a feature of equity trading in Canada and the practice should not be allowed to develop in the absence of the type of comprehensive review being contemplated by the Recognizing Regulators. The Trade-Through Amendments have been adopted as an interim measure that would, if approved by the Recognizing Regulators, remain in effect pending the implementation of any proposals resulting from the comprehensive review of trade-throughs undertaken by the Recognizing Regulators.***

Prior to the completion of the comprehensive review initiated by the Recognizing Regulators, RS will monitor the incidences of trade-throughs that occur on marketplaces regulated by RS. If the Board concludes, based on the level of trade-throughs or the patterns of trade-through activity that emerge, that material harm to retail and other investors, marketplaces or to those persons having trading access to marketplaces can be demonstrated to the Recognizing Regulators, the Board may request again that the Recognizing Regulators approve the immediate implementation of the Trade-Through Amendments if, at that time, the Trade-Through Amendments have not otherwise been approved by the Recognizing Regulators.

Background

UMIR was introduced to ensure the overall integrity of the Canadian equity trading markets by providing “marketplace neutral” regulation. The Board believes that UMIR as currently drafted does not ensure neutral application to investors of the UMIR provisions relating to “trade-through” obligations as the requirement to honour better-priced orders does not extend to a subscriber to an ATS who is not a registered dealer. Neutral application of trade-through obligations could be achieved either through amendments to UMIR to apply the obligation to all persons with access to the Canadian equity markets or by the securities regulatory authorities

imposing the obligation on marketplaces, including exchanges and alternative trading systems, through an applicable national instrument. In the absence of revisions to an applicable national instrument, the only manner in which the Board can address this situation directly is through the Trade-Through Amendments. The Trade-Through Amendments have been adopted as an interim measure that would remain in effect pending the outcome of any comprehensive review of trade-throughs that may be initiated by the CSA.

The substance of the Trade-Through Amendments was initially included in a package of proposals published by RS in Market Integrity Notice 2004-018 – Provisions Respecting “Off-Marketplace” Trades, issued on August 20, 2004. Given the importance of this particular issue, the Trade-Through Amendments have been separated from that package of proposals and are subject to this separate Request for Comments. The balance of the proposals, revised to take account of comments received, has been republished for comment in Market Integrity Notice 2005-012 – Provisions Respecting “Off-Marketplace” Trades, issued by RS on April 29, 2005 (the “Off-Marketplace Proposals”).

Trade-throughs have not been an issue in Canada since the “realignment” of Canadian stock exchanges in 2000. Under the realignment:

- the TSX became the sole market for senior equities;
- the TSX V, formed on the amalgamation of the Vancouver Stock Exchange and the Alberta Stock Exchange, became the sole market for venture securities; and
- the Montréal Exchange became the sole market for listed derivatives.

Prior to the realignment, each of the exchanges had requirements that prevented members from “trading through” better-priced orders on their market and provided that members had to honour better bids or offers on other Canadian exchanges. For example, on the TSX, Board of Governor Rule 90-08 provided:

Members are aware of their fiduciary duty to their client to obtain the best available price. The Exchange also recognizes that members have a duty to the market (and, therefore, a duty to other members) to honour better bids or offers on the Exchange. In order to preserve the integrity of the Exchange’s markets, the Board of Governors has rules that a member shall not trade through a better bid or offer by making a transaction on another exchange or market at a price inferior to the posted price on the [TSX]. ... Members are also reminded of their responsibility not to trade through better bids or offers on other Canadian exchanges.

With the prospect of multiple marketplaces trading the same securities, the Board adopted the Trade-Through Amendments to ensure that each person with access to the Canadian equity markets will be subject to the same obligation. In the opinion of the Board, the prohibition on trade-throughs, which prohibition has historically been a feature of Canadian markets, should be preserved until the completion of any review by the CSA.

Nature, Purpose and Effect of the Trade-Through Amendments

Rationale for Trade-Through Obligations

A “trade-through” occurs when an investor executes a trade on a marketplace or organized regulated market at a price that is inferior to a price available on another marketplace to which that investor has access. If the investor is selling a security, an inferior price is a price lower than a bid price available on a marketplace to which the investor has access. If the investor is buying a security, an inferior price is a price higher than an ask price available on a marketplace to which the investor has access. In completing the trade at the inferior price, the investor “trades through” the better bid or ask price.

The prices that are traded through usually represent limit orders. For example, an investor may place a limit order on a marketplace to buy a security with a limit price of \$20, meaning the investor is willing to pay up to \$20 for the security. If another investor sells the same security for \$19 on another marketplace or organized regulated market, that investor has traded through the \$20 limit order, receiving \$1 less than it would have had it traded with the limit order.

Investors may have *bona fide* reasons to execute trades at inferior prices, including greater depth, or perceived certainty or speed of execution, on one marketplace relative to another. However, the practice of trading-through discourages investors from placing limit orders because it reduces the likelihood that limit orders will be filled.

Limit orders are considered to be a necessary component of efficient, liquid markets and play an essential role in the price discovery process. Limit orders provide liquidity and depth to a market, thereby improving market quality for all investors, including investors who place market orders. As many commentators have noted, investors who place limit orders provide a “free option” to other market participants, who may elect to trade with displayed limit orders at any time to take the liquidity that those limit orders offer.

If, however, investors find that their limit orders are being regularly traded through and not filled, they will be less likely to provide this free option and liquidity to other investors because they will not derive any benefit from doing so. In other words, investors who trade through limit orders “free ride” on the price discovery that limit orders provide.

As fewer limit orders are placed, market quality declines for all investors. A market with reduced liquidity caused by fewer limit orders will attract fewer market orders, which in turn makes placing limit orders less attractive, perpetuating the cycle. In the absence of a large number of competitive limit orders, investors placing market orders, and investors negotiating large block trades, would be less confident that the market price represents an accurate benchmark for their orders or trades. Preventing trade-throughs therefore enhances market quality for all investors by encouraging greater use of limit orders. In addition, trade-throughs can damage market integrity by creating a perception of unfairness among investors who place limit orders that are not filled, or who place market orders that are filled at prices inferior to the best bid price or best ask price.

The Board believes that the order of an investor which has been exposed on a marketplace and has contributed to the functioning of the price discovery mechanism should not be intentionally bypassed by other investors prepared to trade at an inferior price. UMIR is built around the premise that a fair and orderly market is one which respects the notion that the best-priced orders should trade first as orders compete for execution. This is of particular concern to the Board because the most likely orders to be bypassed are small limit orders from retail investors. The Board is of the opinion that investor confidence in the integrity of the marketplace can only be assured when individual investors believe that their market orders have achieved best price.

Rationale for the Priority of Better-Priced Orders

In addition to the general rationale for trade-through obligations identified in the preceding section, a number of other UMIR provisions are premised on the expectation that the best-priced order will be executed first regardless of the marketplace on which that order is entered.

Use of “Last Sale Price” Under UMIR

A number of rules in UMIR (such as the rules on short sales, market stabilization and market balancing) employ the standard of the “last sale” price. In each of these cases, the premise underlying the particular rule is that the best-priced order executes first regardless of the marketplace on which that order is entered. This priority in the execution of orders ensures the working of the price discovery mechanism such that the last sale price disclosed on a consolidated market display represents the best approximation of market value of a security at that point in time. The ability of certain transactions to bypass better-priced orders on a marketplace calls into question the validity of the price discovery mechanism for Canadian marketplaces and the policy rationale for tying various trading restrictions to the last sale price. If trades can take place at any price without reference to the best bid price and best ask price, the last sale price loses any significance and merely complicates compliance with trading rules which are tied to the concept of a last sale price.

In approving recent amendments to the rules on market stabilization and market balancing (see Market Integrity Notice 2005-007 – Notice of Amendment Approval – Amendments Respecting Trading during Certain Securities Transactions – March 4, 2005), the Recognizing Regulators accepted that the last sale price represented a better measure of the current market for a security than the best bid price. Similarly, the Ontario Securities Commission adopted the last sale price as the test in OSC Rule 48-501 – Trading during Distributions, Formal Bids and Share Exchange Transactions, which contains similar trading restrictions to those adopted with the amendments to UMIR.

Order Exposure Obligations

Under UMIR, if a Participant receives a client order for 50 standard trading units or less with a value of \$100,000 or less the Participant must, subject to certain exceptions listed in Rule 6.3 of UMIR, enter the client order on a marketplace. (For the purposes of UMIR, 50 standard trading units would be: 5,000 units of a security trading at \$1.00 or more per unit; 25,000 units of a security trading at \$0.10 or more per unit and less than \$1.00 per unit; and 50,000 units of a security trading at less than \$0.10 per unit.)

In accordance with the provisions of Rule 6.3, the Participant may execute the client order upon receipt at a better price than orders indicated in a consolidated market display. If the Participant executes the client order against a principal order or non-client order at a better price, Rule 8.1 of UMIR requires that the Participant must have taken reasonable steps to ensure that the price is the best available price for the client, taking into account the condition of the market at the time.

The order exposure rule was designed to ensure that clients received the “best price” by:

- requiring their orders to be immediately exposed to the marketplace rather than being held by a Participant to be matched internally with future order flow; and
- supporting the price discovery mechanism.

The ability of certain transactions to bypass better-priced orders on a marketplace undercuts the policy rationale for the requirement for the exposure of certain client orders on a marketplace and complicates the ability of a Participant to satisfy its fiduciary obligations with respect to the handling of the client order.

Clarification of Application of Trade-Through Obligations to Principal Trading

One of the proposals outlined in Market Integrity Notice 2004-018 was to split the “trade-through” obligations of a Participant from its obligations to obtain “best price” when handling a client order. Under the Trade-Through Amendments, Rule 2.4 would specifically preclude a Participant from intentionally “bypassing” better-priced orders on any marketplace on the execution of an order on a marketplace or an organized regulated market at an inferior price. The obligation would apply when the Participant executes a client order, a principal order or a non-client order. This change would clarify an interpretation problem in that Part 2 of Policy 5.2 indicates that the policy provisions against trading through better-priced orders applied to “Participants’ principal (inventory) accounts”. The Policy also applies to Participants’ principal trades on foreign over-the-counter markets made pursuant to the “outside of Canada” exemption in clause (e) of Rule 6.4. However, the application of this aspect of the Policy is problematic in that Rule 5.2 is limited in its application to “client orders”. The Trade-Through Amendments would transfer the provisions related to principal trading from Policy 5.2 to Rule 2.4 in order to clarify the application of “trade-through” obligations to principal trading by a Participant.

Regulatory Inequality under the Current UMIR Trade-Through Provisions

Currently, Participants have an obligation to fill better-priced orders on a Canadian marketplace to which they have access before executing a trade at an inferior price on another Canadian or on a foreign marketplace. However, Access Persons are, in certain circumstances, not subject to the same trade-through obligations as Participants.

UMIR defines an “Access Person” as a person, other than a Participant, who is a subscriber to an ATS or the user of a recognized quotation and trade reporting system (“QTRS”). A “Participant” is defined essentially as a person registered as a dealer who is a member of an Exchange, user of a QTRS or a subscriber to an ATS. The Marketplace Operation Instrument does not limit who may become a subscriber to an ATS. Instead, the Marketplace Operation Instrument merely requires that an ATS must “establish written standards for granting access to trading on it”. Form 21-101F2 requires each ATS to provide “A description of classes of subscribers (e.g., dealer, institution, or retail).” As such, depending upon the standards established by an ATS, any person could qualify to be a subscriber and to obtain access to Canadian equity markets through the ATS.

Prospective ATSS have represented to RS that, based on various studies undertaken in the United States, between 90% and 98% of the trading on the ATS should take place “within the context” of prevailing market prices, in which case no trade-through obligations would arise. RS is not able to independently verify the incidence of trade-throughs that may emerge in the absence of the Trade-Through Amendments. Nonetheless, RS would note that the United States Securities and Exchange Commission (“SEC”) recently extended the trade-through rules in the United States to the trading of Nasdaq stocks even though their statistics show that less than one in 40 trades of a Nasdaq stock was executed at an inferior price as such level of trade-through was not considered acceptable by the SEC.

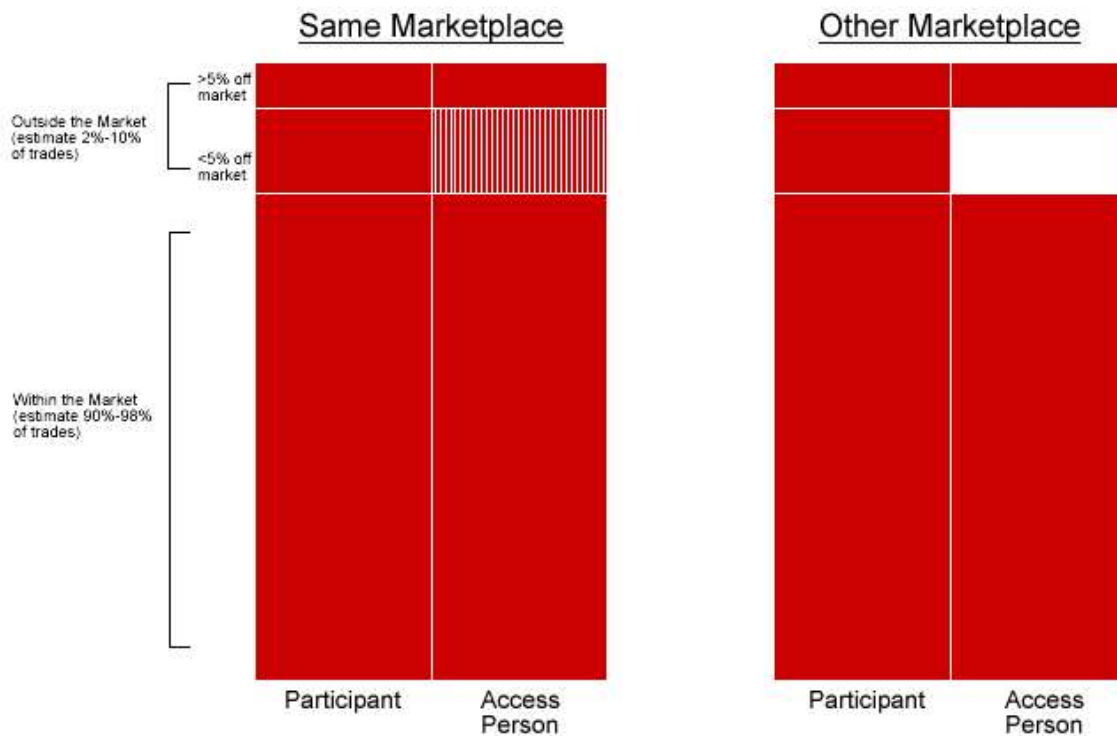
Trade-through obligations arise in connection with those remaining 2-10% of trades (based on the estimate above) that take place outside of prevailing market prices. Such trades are divided between trades above and below the threshold for triggering a “moving the market” obligation under UMIR. The current UMIR threshold is \$1 off market for a stock trading at less than \$20 and \$2 for a stock trading at \$20 or more.

For intended trades that are above this threshold, Part 2 of Policy 2.1 of UMIR requires both Participants and Access Persons to move the market price in an orderly manner and over a period of time. The guideline presently set out in the policy is 10 to 15 minutes for each movement of \$1 in price. The time period is designed to allow the market time to respond to the significant movement in price represented by the intended trade. Orders entered during this time period at better prices than the intended trade would be satisfied. The intended trade would only be executed at the intended price if all of the better-priced orders (including those indicated at the start of the trading to move the market and those entered during the time period required to move the market) had been filled. The undisclosed volume of any iceberg order which “emerges” during this time period is treated in the same manner as a new order entered onto a marketplace in response to the trading taking place to move the market price.

One of the provisions of the Off-Marketplace Proposals would change the threshold to more than 5% or 10 trading increments below the best bid price or more than 5% or 10 trading increments above the best ask price and would reduce the guideline for the time period for moving the market to 5 minutes for a price variation that is more than 5% but less than 10%. The time period for moving the market would be 10 minutes if the price variation is 10% or more. In addition, the Off-Marketplace Proposals would limit the obligation to a Participant or Access Person entering a pre-arranged trade or intentional cross (rather than “any” trade as is currently the requirement).

The following chart illustrates the current obligation of a Participant and an Access Person to trade with better-priced orders on the same or other marketplaces, using the new threshold in the Off-Marketplace Proposals.

Obligation to Trade with "Better-Priced" Order



As the chart illustrates, a Participant is required to trade with better-priced orders indicated on a consolidated market display whether it trades on the same marketplace or on another Canadian or on a foreign marketplace.

As the chart also illustrates, without the Trade-Through Amendments an Access Person intending to make a trade on a marketplace outside the market price on that marketplace by less than 5% or 10 trading increments (indicated by the vertically striped area), would have no obligation to move the market, but that marketplace’s allocation rules (as approved by the

applicable securities regulatory authority) would determine whether the Access Person is able to bypass better-priced orders on that marketplace when executing the trade.

The gap in this regime (indicated by the white area on the chart) is the absence of any obligation on an Access Person to honour better-priced orders on *other* marketplaces when trading an order on a marketplace at a price that is outside the best bid price or best ask price indicated in a consolidated market display, but less than the threshold to trigger the obligation to move the market.

As a result of this gap (and subject only to compliance with its obligation to move the market where applicable) an Access Person would be able to trade at any price on a marketplace or organized regulated market irrespective of prevailing prices on other Canadian marketplaces to which the Access Person has access. However, if the Access Person were to provide the same order to a Participant as a client order for execution on the same marketplace or organized regulated market, the trade would be subject to the trade-through obligation. RS is concerned that this difference will result in regulatory obligations being a factor in determining the method of trade execution, permitting regulatory arbitrage.

To demonstrate the seriousness that the Board attributes to this issue, the Board authorized the issuance on April 8, 2005 of RS Notice 2005-002 – Commitment to Neutral Trade-Through Protection, confirming its commitment to providing neutral trade-through protection and undertaking to introduce the Trade-Through Amendments. In the opinion of the Board, neither a Participant nor an Access Person would limit their access to multiple marketplaces solely to avoid the application of the Trade-Through Amendments.

“Opting Out” of Trade-Through Obligations

If an Access Person is trading as a client of a Participant, the Participant is under an obligation to obtain the “best price” for the Access Person in accordance with Rule 5.2 of UMIR. In accordance with Policy 5.2, this obligation applies even if the Access Person consents to trading on another marketplace at an inferior price. The Trade-Through Amendments would prevent an Access Person from doing directly what UMIR precludes if the Access Person’s order is handled by a Participant as agent for the Access Person. In other words, under the Trade-Through Amendments, Access Persons would not be able to opt out of trading at the best available prices.

The question of whether an opt-out should be permitted depends largely on whether the obligation to trade at the best available prices is considered to be a fiduciary obligation which is owed by a dealer to its client (who would be in a position to provide an informed waiver of compliance with that obligation), or is instead an obligation which is owed by a market participant to the markets themselves. The UMIR requirements, as embodied in Policy 5.2, are built upon the Canadian tradition that considered the obligation to trade at the best prices as a general obligation owed by market participants to the markets generally. For example, prior to the realignment of the Canadian stock exchanges in 2000, the TSX required members of the TSX to honour best prices on other Canadian exchanges (even though this requirement took trading activity away from the TSX). The inability of a client to opt out of this requirement

demonstrates that the obligation has been viewed historically, and is currently viewed under UMIR, as one that is owed to the markets rather than a fiduciary obligation owed to the client.

Regulatory Alternatives

UMIR Amendments versus Other Amendments

The Board believes that UMIR as currently drafted does not ensure neutral application to investors of the provisions relating to trade-through protection, and thereby creates an unfair situation where a Participant has a greater obligation to ensure that the better-priced orders of any investor are honoured than does an Access Person.

The Board recognizes that there are a number of ways to achieve the neutral application of trade-through obligations. Trade-through obligations could be equalized by the Trade-Through Amendments, which would amend UMIR to make them apply to all parties, including Access Persons, with access to Canadian marketplaces. Alternatively, trade-through obligations could be equalized by an amendment to the Marketplace Operation Instrument and/or the Trading Rules that would require each marketplace to implement policies and procedures to prevent trading through on that marketplace. Neither the Marketplace Operation Instrument nor the Trading Rules currently imposes any trade-through obligations on marketplaces and these instruments may be amended only by the applicable securities regulatory authorities.

As announced in the press release by the Ontario Securities Commission on May 12, 2005, the Recognizing Regulators will be undertaking an initiative to study and to receive public comment on various aspects of “trade-through” obligations in Canada. RS supports this initiative and intends to be an active participant in the review. However, the Board is of the view that, pending the outcome of this initiative, steps must be taken to curtail trade-throughs occurring in an environment of multiple, competitive marketplaces. In the view of the Board, trade-throughs are not presently a feature of equity trading in Canada and the practice should not be allowed to develop prior to the completion of the comprehensive review by the Recognizing Regulators. The only manner in which the Board could address this situation directly was by the adoption of the Trade-Through Amendments.

Applicable Trade-Through Provisions in the United States

Inter-market Trading System

In the United States, the Inter-market Trading System (“ITS”) currently provides extremely limited “trade through” protection for transactions occurring on a market in the United States. By the terms of the plan governing the operation of the ITS, each of the exchanges in the United States may trade any stock listed on any other exchange. Each exchange publishes the volume at the best bid and offer. If a trade is to be executed on an exchange outside the best bid and offer on another exchange, a “commitment” must be sent to the exchange with the better price for the disclosed volume. The specialist on the exchange with the better price has between 60 and 120 seconds (though this period has been reduced on a trial basis to 30 seconds) to either

accept or reject the commitment. Meanwhile, the trade may proceed on the original exchange at the intended price. “Better-priced” orders at or between the intended price and the disclosed “best” price are ignored.

If the intended trade is a “block trade” (being essentially 10,000 shares or with a value of US \$200,000 or more), the “best” priced orders from the other exchanges get filled at the price of the intended trade. The ITS Plan specifies a number of restrictions will apply if the intended trade is to occur prior to the opening of the security on each exchange when the intended price varies from the previous day’s closing price by more than a specified amount (which is either US \$0.10 or US \$0.25 depending upon the security).

NASDAQ, New York Stock Exchange (“NYSE”), American Stock Exchange and each of the regional exchanges are parties to the ITS Plan. However, other markets (such as Island and other alternative trading systems and electronic communications networks) are not parties to the ITS Plan. However, in addition to any “trade through” restrictions imposed by the ITS Plan, each market may have its own rules regarding the ability to execute trades outside of the prevailing bid and ask of orders on that market.

Regulation NMS (National Market System)

The following discussion of Regulation NMS is based on information publicly available as at May 11, 2005. As of that date, the text of Regulation NMS had not been released by the SEC.

The Trade-Through Amendments are consistent with the basic policy objectives of Regulation NMS approved on April 6, 2005 by the SEC. Regulation NMS will, upon implementation commencing in April of 2006, replace the ITS. Regulation NMS establishes a uniform trade-through rule for all market centres that affirms the fundamental principle of price priority. Specifically, Regulation NMS requires self-regulatory organizations (such as the New York Stock Exchange), as well as any market centre that executes orders (including alternative trading systems and electronic crossing networks), to establish procedures to prevent the execution of an order for a national market system stock at a price that is inferior to the best bid or offer displayed by another market centre at the time of execution. The rule would protect automated quotations that are immediately accessible.

During the opening statement on the approval of Regulation NMS, the Chairman of the SEC noted:

Under the trade-through rule as adopted, exchanges, ECNs and order-routers will be free to compete with one another on any basis they wish so long as they continually respond to the best prices that are immediately available in the market. A market center’s response to the best price can take more than one form – it can improve its price to match the best immediately accessible price or it can route all or a portion of its order to interact with the better quotation. The only thing the market center must not do is ignore the better price.

Under earlier SEC proposals for Regulation NMS, a broker-dealer would have been able to opt out of trading with the best displayed prices, as would clients that gave an “informed consent” to

do so. This exception has not been included in the final version of Regulation NMS. By prohibiting opt-outs, the SEC appears to have endorsed the approach that the obligation to trade at the best available prices is an obligation which is owed by a market participant to the markets themselves.

The approved version of Regulation NMS expands the scope of trade-through obligations in other ways. While the SEC acknowledged that less than one in forty trades in a Nasdaq stock was executed at an inferior price, the SEC concluded that this level of trade-through was not acceptable. For this reason, the trade-through rule under Regulation NMS will apply to all national market system stocks, including Nasdaq stocks, and will apply to orders for the account of a broker-dealer as well as for the account of a customer. In addition, Regulation NMS will eliminate existing exceptions allowed under the Inter-market Trading System for large transactions (e.g. 10,000 shares or more) and removes the ability to bypass 100-share quotations.

During his opening remarks on the approval of Regulation NMS, the Chairman of the SEC noted that Regulation NMS is not a “flat prohibition of trade-throughs” since, in a “dynamic marketplace, some level of trading through better quotations may be unavoidable.” However, the SEC expects that, over time, the level of trade-throughs will be reduced as market centers continue to modify their trading systems, procedures and requirements. The Trade-Through Amendments also do not impose a “flat prohibition” in that the compliance standard imposed on both Participants and Access Persons is one of “reasonable efforts” and is limited to the better-priced orders on the marketplaces to which they have access. In this way, the Trade-Through Amendments are consistent with the application of trade-through requirements that existed with multiple, competitive marketplaces prior to the realignment of Canadian exchanges in 2000. While Regulation NMS is designed to reduce the incidence of trade-throughs in the United States, the Trade-Through Amendments are intended to preclude the emergence of trade-throughs as a practice in the Canadian equity markets.

The SEC’s approach to trade-through obligations in Regulation NMS and RS’s approach in the Trade-Through Amendments differ in certain fundamental respects. First, while both Regulation NMS and the Trade-Through Amendments enforce the principle of trade-through protection, the obligation under Regulation NMS is limited to orders at the *best* price on other market centres rather than all orders at *better* prices as contemplated in the Trade-Through Amendments.

Second, Regulation NMS requires market centres to comply with the trade-through requirements. Given that UMIR applies to market participants (being Participants and Access Persons), the Trade-Through Amendments would make those market participants responsible for compliance and would not impose any trade-through obligations on individual marketplaces.

In order to foster discussion on the issue of trade-through protection, this Market Integrity Notice specifically requests comment on the most efficient and cost-effective means of ensuring compliance with the trade-through obligations. See “Specific Matters on Which Comment is Requested - *Role of Marketplaces in Trade-Through Protection*” at the end of this Market Integrity Notice for a listing of questions.

Summary Description of the Trade-Through Amendments

Under the Trade-Through Amendments, both a Participant and an Access Person would be subject to Rule 2.4 and Policy 2.4. Under the Trade-Through Amendments, a Participant or an Access Person would be required to make reasonable efforts to fill better-priced orders on marketplaces upon executing a trade at an inferior price on another marketplace. These obligations apply to:

- an Access Person when trading directly on a marketplace or an organized regulated market and the order is not being handled by a registered dealer; and
- a Participant when trading a principal order, non-client order or client order.

The Trade-Through Amendments would differentiate between the “trade-through” obligation imposed on each Participant and Access Person and the “best price” obligation imposed on each Participant when handling a client order. Part 2 of Policy 5.2 would be replaced and the amendments would confirm that the “best price” obligation imposed on a Participant when handling a client order arises on the entry of the client order on a marketplace and continues until such time as the client order is fully executed. If a client order does not fully execute on entry on a marketplace, a Participant would have an obligation to monitor the best ask price and best bid price on various marketplaces to which the Participant has access to determine if the client could achieve an overall better execution if the unfilled portion of the client order was entered on another marketplace.

The trade-through obligation that would be imposed on a Participant or Access Person by Rule 2.4 would arise upon execution of an order at an inferior price to that displayed in an applicable consolidated market display on a marketplace to which the Participant or Access Person has access.

“Access” to a Marketplace

The Trade-Through Amendments would introduce a new Policy 2.4, which would provide that, in determining whether a Participant or Access Person has undertaken reasonable efforts to satisfy the requirement to fill better-priced orders, consideration would be given to whether the Participant or Access Person has access to the marketplace with the better-priced orders.

In Market Integrity Notice 2003-014 issued on June 27, 2003, RS proposed an amendment to expand the definition of an “Access Person” to include a person who has been granted access rights to the trading system of an Exchange or a QTRS either directly or by means of an electronic connection to the order routing system of a member or user (a “Direct Access Client”). By Market Integrity Notice 2005-005, RS provided notice that it had withdrawn the proposed expansion of the definition from consideration for approval by the Recognizing Regulators. However, while a Direct Access Client is not presently an Access Person for the purposes of UMIR, for the purposes of Policy 2.4 an Access Person who is also a Direct Access Client

would have “access” to any Exchange or QTRS that is available to them as a result of the electronic connection.

TSX Policy 2-501 allows a Participant to grant access to the order routing system of the Participant to various domestic and foreign institutional clients and to retail clients through “Order-Execution Accounts” (essentially accounts in respect of which the Participant is not required to review orders for suitability). Effective May 31, 2004, the TSX V adopted “Direct Access Rules” which are substantially similar to the requirements of TSX Policy 2-501. A person who is able to access the TSX pursuant to TSX Policy 2-501 or the TSX V pursuant to the Direct Access Rules is also considered to have “access” to that marketplace for the purposes of Policy 2.4.

An Access Person would be considered to have access to a particular marketplace, if the marketplace is:

- an ATS and the Access Person is a subscriber of that ATS;
- a QTRS and the Access Person is a user of that QTRS; or
- an Exchange or QTRS and the Access Person is a Direct Access Client with access to the trading system of the Exchange or QTRS.

A Participant would be considered to have access to a particular marketplace, if the marketplace is:

- an ATS and the Participant is a subscriber of that ATS;
- a QTRS and the Participant is a user of that QTRS; or
- an Exchange and the Participant is a member of that Exchange.

In addition, a Participant would be considered to have access to a particular marketplace if the Participant has entered into a contractual arrangement as an “introducing broker” with another dealer as “carrying broker” and that other dealer is a subscriber, user or member of the marketplace.

“Reasonable Efforts”

In determining whether a Participant or Access Person has undertaken reasonable efforts to execute as against better-priced orders displayed in a consolidated market display, consideration would be given to whether:

- the Participant or Access Person has access to the marketplace with the better-priced order or orders and the additional costs that would be incurred in accessing such order or orders; and
- the Participant or Access Person has met any applicable obligation under Part 2 of Policy 2.1 to move the market.

For the purposes of compliance with the “trade-through” obligations, a Participant or Access Person would be considered to have taken reasonable efforts if the Participant or Access Person enters orders on a marketplace concurrent with, or immediately following, the trade on the other marketplace or organized regulated market and such orders have a sufficient volume and are at a price that would fill the disclosed volume on that marketplace. Part 3 of Policy 2.4 would clarify that the operation of the market making system on any marketplace on which orders are entered to comply with the “trade-through” obligation would reduce, but not increase, the volume which the Participant or Access Person must trade on that marketplace.

For the purposes of the “best price” obligation, a Participant would be considered to have taken reasonable efforts to obtain the best price for a client if, at the time of the entry of the client order on a particular marketplace or organized regulated market, the Participant enters orders on behalf of the client on each other marketplace and such orders have a sufficient volume and are at a price to fill the then disclosed volume on that marketplace. If following the entry of the client order on the particular marketplace or organized regulated market, the client order does not immediately execute in full, the Participant would be required to monitor the “best bid price” and “best ask price” displayed in a consolidated market display to determine if the unfilled portion of the client order should be entered on another marketplace.

“Disclosed Volume”

Presuming that the Off-Marketplace Proposals are adopted, the term “disclosed volume” will be defined in UMIR as the aggregate of the number of units of a listed security or quoted security relating to each order for that security entered on a marketplace and displayed in a consolidated market display that is:

- offered at a price below the intended price of a trade in the case of a purchase; or
- bid at a price above the intended price of a trade in the case of a sale.

The disclosed volume would be determined immediately prior to the execution of the particular trade on a marketplace, but would not include the volume of:

- a Special Terms Order unless the order could be executed in whole according to the terms of the order;
- a Basis Order;
- a Call Market Order;
- a Market-on-Close Order;
- an Opening Order; or
- a Volume-Weighted Average Price Order.

Excluded Orders

A Participant or Access Person would not have an obligation to make reasonable efforts to execute as against better-priced orders displayed in a consolidated market display if the order to be traded is a “specialty” type of order. Generally speaking, an order type that would be excluded from the calculation of “disclosed volume” would also be excluded from the obligation to make reasonable efforts to execute as against better-priced orders.

Call Market Orders, Market-on-Close Orders, Opening Orders and Volume-Weighted Average Price Orders would be excluded since the exact price of the trade is not known at the time of the entry or the execution of the order. Basis Orders would be excluded since their price is determined by reference to prices achieved in transactions in the derivatives market. Due to the presence of conditions attached to the execution of a Special Terms Order, the execution of the Special Terms Order would not be subject to the obligation unless:

- the Marketplace Rules governing the Special Terms Order provide otherwise;
- the order could be executed in whole, according to the terms of the order, on a marketplace; or
- the order is part of a pre-arranged trade or intentional cross.

The obligation also would not apply if the order of the Access Person is handled by a Participant or any dealer as agent for the Access Person. In these circumstances, the Participant who is handling the order of the Access Person would be subject to the obligation.

The following table summarizes the types of order which would be exempt from the obligation and the policy rationale for the exemption.

Order Type	Description of Order Type	Rationale for Exemption
Special Terms Order	An order for the purchase or sale of a security: (a) for less than a standard trading unit; (b) the execution of which is subject to a condition other than as to price or date of settlement; or (c) that on execution would be settled on a date other than in the ordinary settlement period or special period established by an Exchange or QTRS.	This exemption permits Special Terms Orders to trade outside the prevailing market because of the conditions which have been attached to the order or because the order is for less than one standard trading unit. (This exemption permits odd lot on the TSX V to trade at the established discount or premium to market prices.) The exemption does not apply if the Special Terms Order could be executed in whole in accordance with its terms or if the rules of the Exchange or marketplace otherwise provide (e.g. the rules of the TSX require odd lots to trade at the market price in accordance with obligations imposed on market makers.) This exemption is also not available if the Special Terms Order is part of a pre-arranged trade or intentional cross. This exclusion precludes a Special Terms Order being used simply to bypass “better-priced” orders.

Order Type	Description of Order Type	Rationale for Exemption
Basis Order	An order for the purchase or sale of listed securities or quoted securities for which notice has been provided to a Market Regulator prior to entry and the price of the resulting trade is determined in a manner acceptable to a Market Regulator based on price achieved in one of more derivative transactions.	This exemption recognizes that the trade undertaken on the “equity” marketplace is based on prices achieved in one or more transactions in a derivative instrument listed on an Exchange or quoted on a QTRS. As such, the reported price represents a “true market price” determined by the trading of securities in another marketplace, which currently is the derivatives market of the Montréal Exchange. A Market Regulator must be satisfied as to the manner of the determination of the price.
Call Market Order	An order for the purchase or sale of one or more particular securities that is entered on a marketplace on a trading day to trade at a particular time or times established by the marketplace during that trading day at a price established by the trading system of the marketplace.	On the entry of a Call Market Order the price at which the trade will occur is not known. The price of the trade will be calculated by the trading system of the marketplace at the time designated by the marketplace. Since the price at which the trade will occur is not known at the time of the entry of a Call Market Order and the determination of the price is beyond the direct control of the parties to the trade, the execution of a Call Market Order at a price other than the prevailing price is not considered an attempt to bypass the market.
Market-on-Close Order	An order for the purchase or sale of a security entered on a marketplace on a trading day for the purpose of executing at the closing price of the security on that marketplace on that trading day.	Execution of this type of order guarantees the parties that the trade will occur at the closing price on a particular market. At the time of the execution, this price is not determinable. Nonetheless, the closing price on a particular marketplace may be outside the prevailing market prices as indicated in a consolidated market display. This exemption permits these trades to be made at the last sale price.
Opening Order	An order for the purchase or sale of a security entered on a marketplace on a trading day for the purpose of calculating and executing at the opening price of the security on that marketplace on that trading day.	Each marketplace will be able to establish its own formula for the determination of opening prices. The so-called “calculated opening price” may vary right up to the time of the initial trade. In these circumstances, an order which has been specifically entered to trade on a particular marketplace at the opening may trade at a price which is different from the opening price on another marketplace that opens at the same time or the prevailing price on a marketplace that it then already open for business. At the time of the entry of the order, the “opening” price is not known (though “indications” of the opening price may be publicly disclosed). An Opening Order will not have been entered in an attempt to bypass a “better” market price.
Volume-Weighted Average Price Order	An order for the purchase or sale of a security entered on a marketplace on a trading day for the purpose of executing trades at an average price of the security traded on that trading day on that marketplace or on any combination of marketplaces known at the time of the entry of the order.	When a Volume-Weighted Average Price Order executes the price will be determined by a formula that measures average price on one or more marketplaces for trades occurring after the execution of the Volume-Weighted Average Price Order. As such, the final price may be outside the context of the market at the end of the trading session but this fact would not have been determinable at the time of the execution of the order.

Impact of the Trade-Through Amendments

The principal impact of the Trade-Through Amendments will be to:

- differentiate between the “trade-through” obligation imposed on each Participant and Access Person and the “best price” obligation imposed on each Participant when handling a client order;
- clarify that a Participant when trading a principal or non-client order must make reasonable efforts to execute as against better-priced orders displayed in a consolidated

market display before executing the order on a marketplace, over-the-counter or on an organized regulated market outside of Canada; and

- require an Access Person, when trading an order directly on a marketplace or organized regulated market and not as a client of a dealer, to make reasonable efforts to execute as against better-priced orders displayed in a consolidated market display.

An Access Person would be considered to be entering an order directly if the order is entered by them as a subscriber to an ATS, a user of a QTRS or a Direct Access Client. The Trade-Through Amendments would *not* impose any new obligation on Access Persons to trade on a Canadian marketplace. UMIR requires a Participant who has access to a Canadian marketplace to trade in securities only by means of the entry of an order on a Canadian marketplace unless the trade specifically is exempted from that requirement. This obligation applies whether the Participant is trading as principal or agent. Under UMIR, the requirement to trade on a Canadian marketplace unless exempted does not apply to an Access Person. Provided the Access Person complies with applicable securities legislation, the Access Person may conduct trading activity without the trade being:

- intermediated by a dealer registered in accordance with securities legislation; or
- executed on a marketplace in Canada or an organized regulated market outside of Canada.

The Trade-Through Amendments would not affect the ability of an Access Person to conduct trading activity in this manner. However, the Trade-Through Amendments would require an Access Person, when trading directly on a marketplace or organized regulated market (and not as a client of a dealer) not to intentionally bypass better-priced orders on another marketplace.

The Trade-Through Amendments have been adopted as an interim measure that, if approved by the Recognizing Regulators, would remain in effect pending the implementation of any proposals resulting from the comprehensive review of trade-throughs that is being initiated by the Recognizing Regulators. Upon completion of the review by the Recognizing Regulators, the Trade-Through Amendments, if implemented, may be modified or repealed.

Specific Matters on Which Comment is Requested

Comment is requested on all aspects of the Trade-Through Amendments. However, comment is specifically requested on the following matters:

Role of Marketplaces in Trade-Through Protection

1. In the United States, Regulation NMS requires self-regulatory organizations (which includes the New York Stock Exchange and Nasdaq), as well as any market centre that executes orders (including electronic crossing networks and ATSS), to establish procedures to prevent the execution of an order for national

market system stocks at a price that is inferior to the best bid or offer displayed by another market centre at the time of execution.

What is the most efficient and cost-effective means of ensuring compliance with the trade-through obligations by all parties with access to Canadian marketplaces?

Quantification of the Trade-Through Obligation

2. As presently drafted, a Participant or Access Person that executes an order at an “inferior price” on a marketplace has an obligation to make reasonable efforts to execute all “better” price orders on other marketplaces to which the Participant has access. Under Regulation NMS, the trade-through obligation will be limited to immediately accessible orders at the best price on other market centres (the “top of the book”).

Should the trade-through obligation be “unlimited”, capped at the volume of the trade which has occurred outside the market spread or limited to the top of the book?

Appendices

The text of the Trade-Through Amendments to the Rules and Policies under UMIR related to the trade-through obligations of an Access Person is set out in Appendix “A”. Appendix “B” contains the text of the relevant provisions of the Rules and Policies as they would read following the adoption of the Trade-Through Amendments. Appendix “C” summarizes the comments received by RS to the original publication of Market Integrity Notice 2004-018 – Provisions Respecting “Off-Marketplace” Trades relating to the application of “trade-through” obligations to an Access Person, together with the response to RS to those comments.

Questions

Questions concerning this notice may be directed to:

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Appendix “A”

Universal Market Integrity Rules

Amendments to the Rules and Policies Respecting Trade-Through Obligations

The Universal Market Integrity Rules are amended by adding the following as Rule 2.4:

2.4 Trade-Through Obligation

- (1) Upon the execution of an order on a marketplace or an organized regulated market, a Participant or Access Person shall make reasonable efforts to fill all orders displayed in a consolidated market display:
 - (a) in the case of a purchase by the Participant or Access Person, at a price below the execution price; and
 - (b) in the case of a sale by the Participant or Access Person, at a price above the execution price.
- (2) Subsection (1) does not apply to execution of an order which is:
 - (a) a Special Terms Order unless:
 - (i) the security is a listed security or quoted security and the Marketplace Rules of the Exchange or QTRS governing the trading of a Special Terms Order provide otherwise,
 - (ii) the order could be executed in whole, according to the terms of the order, on a marketplace or with a market maker displayed in a consolidated market display, or
 - (iii) the order is part of a pre-arranged trade or intentional cross; or
 - (b) entered on a marketplace as:
 - (i) a Basis Order,
 - (ii) a Call Market Order,
 - (iii) a Market-on-Close Order,

- (iv) an Opening Order, or
 - (v) a Volume-Weighted Average Price Order;
 - (c) entered on an organized regulated market by a Participant acting as:
 - (i) agent on behalf of a non-Canadian account, or
 - (ii) principal in a trade with a non-Canadian account; or
 - (d) an order of an Access Person that is handled as a client order by a Participant or by any dealer as agent for the Access Person.
- (3) For the purposes of subsection (1), the Participant or Access Person may take into account any transaction fees that would be payable to the marketplace in connection with the execution of the order as set out in the schedule of transaction fees disclosed in accordance with Marketplace Operation Instrument.

The Policies to the Universal Market Integrity Rules are hereby amended as follows:

1. The following is added as Policy 2.4:

POLICY 2.4 - TRADE-THROUGH OBLIGATIONS

Part 1 – Application

Unless an order is exempted by the provisions of subsection (2) of Rule 2.4, the requirement to make reasonable efforts to fill all orders displayed in a consolidated market display:

- in the case of a purchase by the Participant or Access Person, at a price below the execution price; and
- in the case of a sale by the Participant or Access Person, at a price above the execution price,

shall apply to the execution on a marketplace or an organized regulated market by a Participant of a principal order, a non-client order or a client order. The requirement shall also apply to an Access Person when that person is trading directly on a marketplace or organized regulated market and the order is not being handled by a Participant or any dealer as agent for the Access Person.

Part 2 – Determination of “Reasonable Efforts”

In determining whether a Participant or Access Person has undertaken reasonable efforts to satisfy the requirement to fill all orders as required, consideration will be given to whether:

- the Participant or Access Person had access to the marketplace with the better-priced order or orders and the additional costs that would be incurred in accessing such order or orders; and
- the Participant or Access Person has met the obligations required by Policy 2.1.

A Participant or Access Person will be considered to have taken reasonable efforts if the Participant or Access Person enters orders on a marketplace concurrent with, or immediately following, the trade on the other marketplace or organized regulated market and such orders have a sufficient volume and are at a price to fill the disclosed volume on that marketplace determined at the time of the execution of the trade on the other marketplace or organized regulated market.

Part 3 – Effect of Market Maker Obligations

If the marketplace on which the Participant or Access Person enters orders to satisfy the obligation of this Policy has a market making system, the market maker may participate in the trades as a result of automatic rights or entitlements in accordance with the applicable Marketplace Rules governing Market Maker Obligations provided such participation reduces the obligation of the Participant or Access Person. Orders of a market maker which are included in the disclosed volume are entitled to be filled.

2. Part 2 of Policy 5.2 is repealed and the following substituted:

Part 2 – Orders on Other Marketplaces

A Participant will be considered to have taken reasonable efforts to obtain the best price for a client if, at the time of the entry of the client order on a particular marketplace or organized regulated market, the Participant enters orders on behalf of the client on each other marketplace and such orders have a sufficient volume and are at a price to fill the then disclosed volume on that marketplace. If following the entry of the client order on the particular marketplace or organized regulated market, the client order does not immediately execute in full, the Participant shall monitor the “best bid price” and “best ask price” displayed in a consolidated market display to determine if the unfilled portion of the client order should be entered on another marketplace.

Appendix “B”

Universal Market Integrity Rules

Text of the Rules and Policies to Reflect the Trade-Through Amendments

Text of Provisions Following Adoption of Trade-Through Amendments	Text of Current Provisions Marked to Reflect Adoption of Trade-Through Amendments
<p>2.4 Trade-Through Obligation</p> <p>(1) Upon the execution of an order, a Participant or Access Person shall make reasonable efforts to fill all orders displayed in a consolidated market display:</p> <p style="margin-left: 20px;">(a) in the case of a purchase by the Participant or Access Person, at a price below the execution price; and</p> <p style="margin-left: 20px;">(b) in the case of a sale by the Participant or Access Person, at a price above the execution price.</p> <p>(2) Subsection (1) does not apply to execution of an order which is:</p> <p style="margin-left: 20px;">(a) a Special Terms Order unless:</p> <p style="margin-left: 40px;">(i) the security is a listed security or quoted security and the Marketplace Rules of the Exchange or QTRS governing the trading of a Special Terms Order provide otherwise,</p> <p style="margin-left: 40px;">(ii) the order could be executed in whole, according to the terms of the order, on a marketplace or with a market maker displayed in a consolidated market display, or</p> <p style="margin-left: 40px;">(iii) the order is part of a pre-arranged trade or intentional cross; or</p> <p style="margin-left: 20px;">(b) entered on a marketplace as:</p> <p style="margin-left: 40px;">(i) a Basis Order,</p> <p style="margin-left: 40px;">(ii) a Call Market Order,</p> <p style="margin-left: 40px;">(iii) a Market-on-Close Order,</p> <p style="margin-left: 40px;">(iv) an Opening Order, or</p> <p style="margin-left: 40px;">(v) a Volume-Weighted Average Price Order;</p> <p style="margin-left: 20px;">(c) entered on an organized regulated market by a Participants acting as:</p> <p style="margin-left: 40px;">(i) agent on behalf of a non-Canadian account, or</p> <p style="margin-left: 40px;">(ii) principal in a trade with a non-Canadian account; or</p>	<p><u>2.4 Trade-Through Obligation</u></p> <p><u>(1) Upon the execution of an order, a Participant or Access Person shall make reasonable efforts to fill all orders displayed in a consolidated market display:</u></p> <p style="margin-left: 20px;"><u>(a) in the case of a purchase by the Participant or Access Person, at a price below the execution price; and</u></p> <p style="margin-left: 20px;"><u>(b) in the case of a sale by the Participant or Access Person, at a price above the execution price.</u></p> <p><u>(2) Subsection (1) does not apply to execution of an order which is:</u></p> <p style="margin-left: 20px;"><u>(a) a Special Terms Order unless:</u></p> <p style="margin-left: 40px;"><u>(i) the security is a listed security or quoted security and the Marketplace Rules of the Exchange or QTRS governing the trading of a Special Terms Order provide otherwise.</u></p> <p style="margin-left: 40px;"><u>(ii) the order could be executed in whole, according to the terms of the order, on a marketplace or with a market maker displayed in a consolidated market display, or</u></p> <p style="margin-left: 40px;"><u>(iii) the order is part of a pre-arranged trade or intentional cross; or</u></p> <p style="margin-left: 20px;"><u>(b) entered on a marketplace as:</u></p> <p style="margin-left: 40px;"><u>(i) a Basis Order,</u></p> <p style="margin-left: 40px;"><u>(ii) a Call Market Order,</u></p> <p style="margin-left: 40px;"><u>(iii) a Market-on-Close Order,</u></p> <p style="margin-left: 40px;"><u>(iv) an Opening Order, or</u></p> <p style="margin-left: 40px;"><u>(v) a Volume-Weighted Average Price Order; or</u></p> <p style="margin-left: 20px;"><u>(c) entered on an organized regulated market by a Participants acting as:</u></p> <p style="margin-left: 40px;"><u>(i) agent on behalf of a non-Canadian account, or</u></p> <p style="margin-left: 40px;"><u>(ii) principal in a trade with a non-Canadian account; or</u></p>

Text of Provisions Following Adoption of Trade-Through Amendments	Text of Current Provisions Marked to Reflect Adoption of Trade-Through Amendments
<p>(d) an order of an Access Person that is handled as a client order by a Participant or by any dealer as agent for the Access Person.</p> <p>(3) For the purposes of subsection (1), the Participant or Access Person may take into account any transaction fees that would be payable to the marketplace in connection with the execution of the order as set out in the schedule of transaction fees disclosed in accordance with Marketplace Operation Instrument.</p>	<p><u>(d) an order of an Access Person that is handled as a client order by a Participant or by any dealer as agent for the Access Person.</u></p> <p><u>(3) For the purposes of subsection (1), the Participant or Access Person may take into account any transaction fees that would be payable to the marketplace in connection with the execution of the order as set out in the schedule of transaction fees disclosed in accordance with Marketplace Operation Instrument.</u></p>
<p><i>POLICY 2.4 - TRADE-THROUGH OBLIGATIONS</i></p> <p>Part 1 – Application</p> <p>Unless an order is exempted by the provisions of subsection (2) of Rule 2.4, the requirement to make reasonable efforts to fill all orders displayed in a consolidated market display:</p> <ul style="list-style-type: none"> in the case of a purchase by the Participant, at a price below the execution price; and in the case of a sale by the Participant, at a price above the execution price, <p>shall apply to the execution on a marketplace or an organized regulated market by a Participant of a principal order, a non-client order or client order. The requirement shall also apply to an Access Person when that person is trading directly on a marketplace or organized regulated market and the order is not being handled by a Participant or any dealer as agent for the Access Person.</p>	<p><i><u>POLICY 2.4 - TRADE-THROUGH OBLIGATIONS</u></i></p> <p><u>Part 1 – Application</u></p> <p><u>Unless an order is exempted by the provisions of subsection (2) of Rule 2.4, the requirement to make reasonable efforts to fill all orders displayed in a consolidated market display:</u></p> <ul style="list-style-type: none"> <u>in the case of a purchase by the Participant or Access Person, at a price below the execution price; and</u> <u>in the case of a sale by the Participant or Access Person, at a price above the execution price.</u> <p><u>shall apply to the execution on a marketplace or an organized regulated market by a Participant of a principal order, a non-client order or client order. The requirement shall also apply to an Access Person when that person is trading directly on a marketplace or organized regulated market and the order is not being handled by a Participant or any dealer as agent for the Access Person.</u></p>
<p><i>POLICY 2.4 - TRADE-THROUGH OBLIGATIONS</i></p> <p>Part 2 – Determination of “Reasonable Efforts”</p> <p>In determining whether a Participant or Access Person has undertaken reasonable efforts to satisfy the requirement to fill all orders as required consideration will be given to whether:</p> <ul style="list-style-type: none"> the Participant or Access Person had access to the marketplace with the better-priced order or orders and the additional costs that would be incurred in accessing such order or orders; and the Participant or Access Person has met the obligations required by Policy 2.1. <p>A Participant or Access Person will be considered to have taken reasonable efforts if the Participant or Access Person enters orders on a marketplace concurrent with, or immediately following, the trade on the other marketplace or organized regulated market and such orders have a sufficient volume and are at a price to fill the disclosed volume on that marketplace determined at the time of the execution of the trade on the other marketplace or organized regulated market.</p>	<p><i><u>POLICY 2.4 - TRADE-THROUGH OBLIGATIONS</u></i></p> <p><u>Part 2 – Determination of “Reasonable Efforts”</u></p> <p><u>In determining whether a Participant or Access Person has undertaken reasonable efforts to satisfy the requirement to fill all orders as required consideration will be given to whether:</u></p> <ul style="list-style-type: none"> <u>the Participant or Access Person had access to the marketplace with the better-priced order or orders and the additional costs that would be incurred in accessing such order or orders; and</u> <u>the Participant or Access Person has met the obligations required by Policy 2.1.</u> <p><u>A Participant or Access Person will be considered to have taken reasonable efforts if the Participant or Access Person enters orders on a marketplace concurrent with, or immediately following, the trade on the other marketplace or organized regulated market and such orders have a sufficient volume and are at a price to fill the disclosed volume on that marketplace determined at the time of the execution of the trade on the other marketplace or organized regulated market.</u></p>

Text of Provisions Following Adoption of Trade-Through Amendments	Text of Current Provisions Marked to Reflect Adoption of Trade-Through Amendments
<p><i>POLICY 2.4 - TRADE-THROUGH OBLIGATIONS</i></p> <p>Part 3 – Effect of Market Maker Obligations</p> <p>If the marketplace on which the Participant or Access Person enters orders to satisfy the obligation of this Policy has a market making system, the market maker may participate in the trades as a result of automatic rights or entitlements in accordance with the applicable Marketplace Rules governing Market Maker Obligations provided such participation reduces the obligation of the Participant or Access Person. Orders of a market maker which are included in the disclosed volume are entitled to be filled.</p>	<p><u><i>POLICY 2.4 - TRADE-THROUGH OBLIGATIONS</i></u></p> <p><u>Part 3 – Effect of Market Maker Obligations</u></p> <p><u>If the marketplace on which the Participant or Access Person enters orders to satisfy the obligation of this Policy has a market making system, the market maker may participate in the trades as a result of automatic rights or entitlements in accordance with the applicable Marketplace Rules governing Market Maker Obligations provided such participation reduces the obligation of the Participant or Access Person. Orders of a market maker which are included in the disclosed volume are entitled to be filled.</u></p>
<p><i>POLICY 5.2 – BEST PRICE OBLIGATION</i></p> <p>Part 2 – Orders on Other Marketplaces</p> <p>A Participant will be considered to have taken reasonable efforts to obtain the best price for a client if, at the time of the entry of the client order on a particular marketplace or organized regulated market, the Participant enters orders on behalf of the client on each other marketplace and such orders have a sufficient volume and are at a price to fill the then disclosed volume on that marketplace. If following the entry of the client order on the particular marketplace or organized regulated market, the client order does not immediately execute in full, the Participant shall monitor the “best bid price” and “best ask price” displayed in a consolidated market display to determine if the unfilled portion of the client order should be entered on another marketplace.</p>	<p><u><i>POLICY 5.2 – BEST PRICE OBLIGATION</i></u></p> <p><u>Part 2 – Orders on Other Marketplaces</u></p> <p><u>Subject to the qualification of the “best price obligation” as set out in Part 1, Participants may not intentionally trade through a better bid or offer on a marketplace by making a trade at an inferior price (either one-sided or a cross) on another marketplace or on an organized regulated market. This Policy applies even if the client consents to the trade on the other marketplace or the organized regulated market at the inferior price. Participants may make the trade on that other marketplace or organized regulated market if the better bids or offers, as the case may be, on marketplaces are filled first or coincidentally with the trade on the other marketplace or organized regulated market.</u></p> <p><u>This Policy applies to “active orders”. An “active order” is an order that may cause a trade through by executing against an existing bid or offer on a marketplace or an organized regulated market at a price that is inferior to the bid or ask price on another marketplace at the time. This Policy applies to trades for Canadian accounts and Participants’ principal (inventory) accounts. The Policy also applies to Participants’ principal trades on foreign over the counter markets made pursuant to the outside of Canada exemption in clause (e) of Rule 6.4.</u></p> <p>A Participant will be considered to have taken reasonable efforts to obtain the best price for a client if, at the time of the entry of the client order on a particular marketplace or organized regulated market, the Participant enters orders on behalf of the client on each other marketplace and such orders have a sufficient volume and are at a price to fill the then disclosed volume on that marketplace. If following the entry of the client order on the particular marketplace or organized regulated market, the client order does not immediately execute in full, the Participant shall monitor the “best bid price” and “best ask price” displayed in a consolidated market display to determine if the unfilled portion of the client order should be entered on another marketplace.</p>

Appendix “C”

Universal Market Integrity Rules

Response to Request for Comments

The substance of the Trade-Through Amendments was initially included in a package of proposals published by RS in Market Integrity Notice 2004-018 – Provisions Respecting “Off-Marketplace” Trades, issued on August 20, 2004. As part of that Market Integrity Notice, RS asked:

- Should an Access Person who is neither a dealer nor trading through a dealer be subject to the requirement to take reasonable steps to execute first as against better-priced orders on any marketplace to which the Access Person has access?
- Should the proposal apply to an Access Person who is a non-resident?

RS received responses to these questions from the following persons:

Barclays Global Investors (“Barclays”)
BMO Nesbitt Burns (“BMO”)
Canadian Securities Traders Association Inc. (“CSTA”)
Markets Inc. (“MI”)
TSX Markets (“TSX”)

The following table summarizes the responses received by RS to these questions. The table also provides a summary of the comments of RS on the responses.

Commentator and Summary of Comment	Response to Comment
<p>Barclays – Agrees that Access Persons should have various obligations to marketplaces including transacting ‘openly and fairly’ and not acting in a manner that is ‘manipulative or deceptive’ that could reasonably be expected to create a false or misleading appearance of trading activity or an artificial price for a security as outlined in UMIR Rule 2.2. However, states that an Access Person’s obligation to the “market” generally should not include an obligation to fill ‘better-priced’ orders on any marketplace to which the person has access. States that Access Persons who are institutional investors and manage assets on behalf of clients are fiduciaries who have a duty to seek ‘best execution’ for their orders. States that the responsibility of fiduciaries to seek to maximize the value of their clients’ portfolios subject to their goals and objectives are of paramount importance. Notes that an institution’s best execution obligation can conflict with the proposed obligation to displace ‘better-priced’ orders on any marketplace to which the institution has access and this conflict is exacerbated when marketplaces have different microstructures that affect the timeliness and certainty of order completion. Notes examples of different market structures are electronic markets that provide firm quotes and immediate execution and manual floor based markets where investors cannot immediately execute against the order book. Notes that, if a manual marketplace has posted a higher bid or a lower offer than an electronic marketplace and so displays the ‘best price’ as defined by UMIR then an Access Person may be forced to route their order to</p>	<p>At the request of the Recognizing Regulators, RS has deleted from the “Off-Marketplace” Proposals the provision to extend to an Access Person the obligation to take reasonable efforts to execute first as against better-priced orders on any marketplace to which they have access as an Access Person. The extension of the obligation to Access Persons is part of the Trade-Through Amendments covered by this separate Request for Comments.</p> <p>In September of 2004, RS established a Working Group comprised of members of the Board of RS, the Rules Advisory Committee of RS and staff of RS to study various questions surrounding the application of UMIR to Access Persons and their trading activity. The Working Group considered whether this requirement to access better-priced orders should be extended to an Access Person. The Working Group recommended the adoption of the Trade-Through Amendments and the publication of this Request for Comments.</p>

Commentator and Summary of Comment	Response to Comment
<p>the manual marketplace and accept slower and less certain executions that can compromise execution quality. Notes that these issues have been well debated in submissions related to Reg. NMS in the United States. Notes that a requirement to displace 'better-priced' orders on any marketplace that an institution has access to coupled with more restrictive short sale tick-rules could mean that the institution is not able to execute at all making it impossible for the institution to provide best execution and the extension of the trade-through rule to Access Persons introduces uncertainty whether an order is 'permitted or required to be entered or executed in a foreign market' and could delay trading decisions and hurt execution quality. Further notes that the amendment could require institutions who are Access Persons to monitor many marketplaces resulting in higher monitoring costs. Institutions cannot take comfort that they are not an Access Person of a marketplace because they do not have a direct connection to the marketplace. Notes that MIN 2003-014 expanded the definition of an Access Person to include a person who has been granted access rights to the trading system of an Exchange or a QTRS either directly or by the means of an electronic connection to the order routing system of a member or user. Notes that, if the Recognizing Regulators approve the expanded definition of Access Persons then many institutions could indirectly become Access Persons to marketplaces that they do not monitor if any counterparty that they have an electronic connection to also has a connection to a marketplace that displays quotes. Notes that the requirement would introduce uncertainty and delays that would result in lower quality of execution. States that many buy-side institutions wrongly believe that this Request for Comments only addresses the replacing of the current wide distribution rules. States that any extension of the obligations of an Access Person to the market such as a new displacement obligation should not be buried within a proposal that many investment managers believe to be unimportant. States that such an extension merits a separate Request for Comment.</p>	
<p>BMO – Is of the opinion that the rules as proposed are too restrictive. Notes that an informed consent opt-out provision is appropriate for Access Persons and for Participants engaging in proprietary trading. States that an order-by-order, case-by-case requirement would provide sufficient protection of the integrity of the market. Requests clarification of the word “access” in the phrase “access as an Access Person”. Notes that there are significant differences between being able to effect a transaction, by giving an order to an intermediary or by direct, electronic access. States that Commissions, settlement complexities, errors, f/x transactions, timing differences, disparate liquidity pools, and allocation algorithms for managers of multiple accounts may all contribute to an informed and reasonable decision to opt-out of the obligation to pursue a nominally best price bid or offer. Notes that an Access Person who is a non-resident should not be held to a different standard, in theory, but practically jurisdiction cannot be ignored. States that RS must be satisfied that it can enforce the regulations with respect to non-residents and that no entity will be disadvantaged by virtue of geographic location.</p>	<p>The question of whether an “opt-out” should be permitted depends largely on whether the obligation to trade at the best available prices is considered to be a fiduciary obligation which is owed by a dealer to its client (who would be in a position to provide an informed waiver of compliance with that obligation) or is an obligation which is owed by a dealer to the “markets”. In the United States, the SEC originally contemplated “opt-outs” as part of its proposed Regulation NMS. The SEC removed the provisions for “opt-outs” when the SEC republished the proposed Regulation NMS in December of 2004.</p> <p>In contrast, UMIR presently provides that a client may not opt out of the “best price” obligation. The current UMIR provision built upon the Canadian tradition that saw that obligation to trade at the best prices as general obligation owed to the markets. For example, prior to the realignment of the Canadian stock exchanges in 2000, the TSX required members of the exchange to honour best prices on other Canadian exchanges (even though this requirement took trading activity away from the TSX).</p>
<p>CSTA – Very concerned regarding the proposed amendments to Rule 2.1 concerning Access Persons. Strongly disagrees with the extension of the obligations of institutions to include displacing “better-priced” orders on any market where the institution meets the definition of Access Person. States that institutional investors</p>	<p>Securities legislation contemplates that institutional investors may undertake trading activity without the need for the trade to be intermediated by a dealer registered in accordance with securities legislation. UMIR recognizes this possibility and does not impose an obligation on an Access Person to</p>

Commentator and Summary of Comment	Response to Comment
<p>managing client investments have a fiduciary responsibility to seek best execution for their orders, which does not necessarily mean filling "better-priced" orders on any marketplace should the consequences mean missing liquidity on another. Notes that being obliged to fill 100 shares and therefore running the risk of missing a larger amount of stock on another market would go against this responsibility. Notes that orders might have to be routed to a manual market, showing a better price but offering slower and less certain execution, by-passing an electronic market that provides firm quotes and instant execution. States that if "Access Person" is expanded then institutions would indirectly become Access Persons to markets they do not monitor if any party they have an electronic connection to also has a connection to a marketplace that displays quotes.</p>	<p>conduct all trading activities on a marketplace. If an institution decides to avail itself of trading on a marketplace, then the institution should expect to "play" by the rules of the marketplace. Honouring better-priced orders becomes part of the "cost" of accessing the marketplace.</p> <p>Securities legislation requires that most investors undertake trading activity through a person registered as a dealer under applicable securities legislation. UMIR requires dealers who are Participants to conduct trading activity, when acting as principal or agent, through the entry of orders on a marketplace subject to certain exceptions and exemptions which are enumerated in UMIR. In addition, UMIR requires that a Participant immediately enter on a marketplace "small" orders received from clients. These persons and orders would be disadvantaged if an institutional investor could simply choose to "bypass" them.</p> <p>Institutions have always had "fiduciary responsibilities" to their clients. Prior to the realignment of exchanges in 2000, orders of an institution traded on a Canadian exchange were subject to the trade-through rules of the Canadian exchanges. Presumably, compliance with the requirements of the Canadian exchanges did not result in the breach of "fiduciary responsibilities".</p>
<p>MI – Agrees that all market participants should be required to abide by rules of marketplaces and securities laws, but strongly disagrees that this justifies extension of trade-through rule (i.e. obligation to fill orders on any marketplace) to Access Persons. States that trade-through is incorporated into best execution, making narrower best price obligation redundant and conflicting. Desire to ensure clients aren't misled by dealers with more information no longer applicable when institutions and individuals can access market data, control trading directly and make informed choices. Notes that justifications for trade-through may be applicable to dealers but not to institutions, as institutions only know their own trades and public information, whereas dealers are in the privileged position of cumulative knowledge of the market through their proprietary and client trades. States that, as trade-through is effectively a "tax" on this privileged position, it should not apply to institutions. Notes that fiduciary obligations to clients are primary; trade-through exists to protect "other people's orders" therefore should be secondary. Suggests that RS should not conclude that "economic self interest" is not sufficient motivator for institutions, but rather should note that intentional by-passing of better-priced orders is evidence that sophisticated investors may conclude that price is not the dominant factor in every trade. Trade-through favours marketplaces with published quotes. States that the rule as drafted may force institutions to avoid direct market access thus avoiding transparency and regulatory oversight and less liquidity. Suggests instead that such policy results in a decline in overall market quality. Recommends RS re-assess necessity of trade-through for both institutions and dealers, complete with cost-benefit analysis. Notes that UMIR trade-through rule is actually in UMIR policy 5.2 Part 2, while UMIR 5.2 states the best price obligation. States that trade-through must be stated as a rule (not a policy open to interpretation) with opt-out provisions. Suggests strongly that any extension of trade-through should be proposed as a separate rule with a new comment period.</p>	<p>Upon the introduction of Marketplace Operation Instrument, it was contemplated that, in the absence of a formal market integrator, each marketplace trading a security would be under an obligation to maintain an electronic connection to every other marketplace trading the same security. With amendments to Marketplace Operation Instrument that became effective on January 4, 2004, the need for each marketplace to maintain an electronic connection was deleted as part of the repeal of Part 9 on "Market Integration for Marketplaces". In making this change, the Canadian Securities Administrators added section 11.5 to the Companion Policy to the Marketplace Operation Instrument which states: "Although the Canadian securities regulatory authorities have removed the concept of a market integrator, we continue to be of the view that market integration is important to our marketplaces. We expect to achieve market integration by focusing on compliance with fair access and best execution requirements. We will continue to monitor developments to ensure that the lack of a market integrator does not unduly affect the market."</p> <p>The changes to the Marketplace Operation Instrument removed the mechanism which would have allowed orders to "migrate" to other marketplaces with "better-priced" orders. The Proposed Amendments are designed to address the "gap" which was created with the elimination of the electronic connection between marketplaces.</p> <p>The order and trade transparency requirements of Marketplace Operation Instrument are designed to ensure that all persons have access to certain basic information. The consolidated market display will provide information on better-priced orders on marketplaces which choose to disclose order information.</p> <p>See response to the comment of Barclays above.</p>

Commentator and Summary of Comment	Response to Comment
<p>TSX - Believes that, to the extent possible, UMIR and its related Policies should apply equally to participants who place orders on an exchange and to Access Persons that trade directly on an ATS. Agrees that an Access Person must be subject to the requirement to take reasonable steps to execute first as against better-priced orders on any marketplace to which the Access Person has access. States that this ensures that Access Persons who are able to trade securities that are inter-listed between an ATS and an exchange are subject to the same market integrity requirement. Notes that, if this requirement did not exist, retail customers' orders in the central order book of an exchange could be by-passed by an Access Person entering an order on an ATS at a price that is outside the best bid and best ask on the exchange. Is of the view that to allow such regulatory arbitrage to occur would not adequately ensure the integrity of the Canadian marketplace. Believes that Access Persons who are non-resident should be treated the same as resident Access Persons.</p>	<p>See response to the comment of Barclays above.</p> <p>Currently under UMIR, a Participant that acts on behalf of a non-resident client is able to execute the client's order without reference to the price for the security on a Canadian marketplace. This exemption recognizes that the execution of the order on behalf of the non-resident will be subject to requirements in the jurisdiction where the client resides. If a Access Person is a non-resident that person should have an obligation to honour the "better-priced" orders on a marketplace only if the Access Person trades directly and its order is not handled as a client order by a Participant or dealer.</p>