

**Notice of Proposed Amendments to
National Instrument 21-101 Marketplace Operation and
National Instrument 23-101 Trading Rules**

I. INTRODUCTION

The Canadian Securities Administrators (CSA or we) are publishing for comment proposed amendments (the Proposed Amendments) to National Instrument 21-101 *Marketplace Operation* (NI 21-101), National Instrument 23-101 *Trading Rules* (NI 23-101) (together, the ATS Rules) and the related companion policies.

The key part of the Proposed Amendments deals with trade-through protection (Proposed Trade-through Protection Rule). It proposes a framework to require all visible, immediately accessible, better-priced limit orders to be filled before other limit orders at inferior prices, regardless of the marketplace where the order is entered. Other parts of the Proposed Amendments include proposals relating to clock synchronization, technology requirements for marketplaces, information processor requirements, and best execution reporting requirements.

II. BACKGROUND

On July 22, 2005, the CSA published Discussion Paper 23-403 *Market Structure Developments and Trade-through Obligations* (2005 Discussion Paper).¹ The purpose of the Discussion Paper was to discuss evolving market developments and the consequential implications for the Canadian capital market, and in particular the obligation to avoid trade-throughs (trade-through obligation).

The 2005 Discussion Paper asked a number of questions to get feedback on what values and rules were important to Canadian market participants. Because of the importance of the issues relating to the trade-through obligation and their impact on the Canadian capital market, the CSA held a public forum on October 14, 2005 to permit all interested parties to participate in discussions relating to trade-through protection.²

The CSA received feedback on a number of issues identified in the 2005 Discussion Paper where there was often no clear majority opinion and the views on either side of a given issue were split. However, the majority of commenters stated that they believed that all visible orders at a better price should trade before inferior-priced orders.

¹ See (2005) 28 OSCB 6333 for background.

² The transcript of the trade-through forum is published on the OSC website at: http://www.osc.gov.on.ca/Regulation/Rulemaking/Current/Part2/rule_20051014_23-403_trade-through-forum.pdf.

On April 20, 2007, the CSA along with Market Regulation Services Inc. or RS (now the Investment Industry Regulatory Organization of Canada or IIROC) published the *Joint Notice on Trade-Through, Best Execution and Access to Marketplaces* (Joint Notice).³ The Joint Notice:

- outlined a proposal for a trade-through protection regime,
- proposed rule changes regarding access to marketplaces, and
- proposed rule changes regarding best execution.

The CSA published the amendments to best execution in their final form on June 20, 2008, and again on September 5, 2008, to be effective on September 12, 2008. We intend to re-examine the proposed rule amendments relating to direct market access and republish them for comment in 2009.

The Proposed Trade-through Protection Rule that is being published along with this Notice is based largely on the proposal outlined in the Joint Notice and the responses of the commenters who, for the most part, expressed support for the initiative.

We received nineteen comment letters in response to the request for comments published in April 2007. We have considered the comments received and thank all commenters for their submissions. A list of those who submitted comments, as well as a summary of comments pertaining to the trade-through proposal and our responses, are attached as Appendix A to this Notice.

For the CSA's cost-benefit analysis of the proposed amendments, please see Appendix B – “Cost Benefit Analysis – Proposed Amendments to National Instrument 21-101 *Marketplace Operation* and National Instrument 23-101 *Trading Rules*” (CBA).

III. TRADE-THROUGH PROTECTION

1. What is Trade-through Protection?

Trade-through protection ensures that all immediately accessible, visible, better-priced limit orders are executed prior to inferior-priced limit orders. Commenters generally agreed that the obligation not to “trade-through” (i.e. bypass better-priced limit orders in favour of inferior-priced limit orders) is an obligation owed by all marketplace participants to the market as a whole. Unlike the obligation for best execution, the obligation not to trade-through is not a fiduciary duty and cannot be waived.⁴ It is proposed that trade-through protection would apply whenever two or more marketplaces with displayed protected orders are open for trading.

2. Why is Trade-through Protection Important?

Trade-through protection is considered to be important to maintain investor confidence and fairness in the market, especially where there is a high degree of retail participation and a historical expectation of trade-through protection. Without it, it can be argued that there may not

³ (2007) 30 OSCB (Supp-3).

⁴ For a discussion about trade-through and best execution please see Part III 4(f) of this Notice.

be sufficient incentive to contribute to the price discovery process because investors who disclose their intentions will not be assured of the benefit of having their better-priced orders filled while others will be able to use that information to help in determining the prices at which they transact. This confidence encourages more liquidity in the market and a more efficient price discovery process.

3. The Current Regulatory Regime

Currently in Canada, trade-through protection is addressed as part of the best price obligation imposed by IIROC in its Universal Market Integrity Rules (UMIR), Rule 5.2 *Best Price Obligation* (UMIR Best Price Rule). The rule imposes a requirement on dealers that trade on marketplaces that have retained IIROC to use reasonable efforts to obtain the best price available. There are a number of exemptions available and the factors to be considered in determining if reasonable efforts have been used are broadly outlined.⁵

In the past, no issues arose under the UMIR Best Price Rule because:

- there had not been multiple marketplaces trading the same securities in Canada,
- the technology systems of marketplaces enforced the “best price” or trade-through obligation, and
- only dealers had direct access to the existing marketplaces.

The existence of multiple marketplaces trading the same security has refocused attention on the current rules relating to trade-through protection.

The UMIR Best Price Rule currently applies only to dealers, which results in different requirements for dealers and non-dealers who are subscribers of ATSS. In addition, the rule as it exists does not provide the necessary infrastructure to effectively prevent trade-throughs. For example, it does not provide for an inter-market sweep order that would allow marketplace participants to simultaneously route orders to various marketplaces.

When multiple marketplaces began trading TSX-listed securities, the dealers in Canada had difficulty complying with the UMIR Best Price Rule. Technology was not yet at a point where dealers could monitor multiple marketplaces and effectively route orders to where the best price was displayed. In addition, order data was not consolidated. In response, RS at the time, proposed an approach whereby the factors to be considered in determining if a dealer used “reasonable efforts” to obtain the best price were broadened. RS introduced an immediate implementation rule, effective on May 16, 2008⁶, that broadened these factors to include:

- whether the dealer has used an order router offered by it or a marketplace,
- whether the dealer relies on another dealer to route its orders,

⁵ See UMIR Rule 5.2 *Best Price Obligation* and the related policy.

⁶ The UMIR Best Price Rule was published for comment on May 16, 2008, MIN 2008-009.

- the timing of the launch of the marketplace,
- whether the marketplace has had a material malfunction or interruption of services,
- whether the data being transmitted by the marketplace is easily and readily used by dealers, and
- whether the marketplace executes an inordinate proportion of orders at an inferior price or there is no fill at all.

Under the UMIR Best Price Rule, dealers are required to introduce and comply with policies and procedures outlining how they will meet their best price obligations. It was intended that this solution be an interim solution until the CSA developed and implemented a trade-through protection rule. In the coming weeks, IROC will publish its proposed amendments to the UMIR Best Price Rule in response to the CSA's proposal of a trade-through protection rule.

4. The Proposed Trade-through Protection Rule

At this time, the CSA are proposing to amend the ATS Rules to create a full depth-of-book trade-through obligation on marketplaces. We have considered the comment letters received in response to the Joint Notice and the 2005 Discussion Paper and have also reviewed international developments in the area of trade-through. Particularly, we have looked at the Order Protection Rule in Regulation NMS developed by the U.S. Securities and Exchange Commission (SEC) and its implementation, and have examined the Markets in Financial Instruments Directive (MiFID) in Europe.

(a) Key Aspects of the Proposed Trade-through Protection Rule

(i) Marketplace Obligation

The Proposed Trade-through Protection Rule would require each marketplace to establish, maintain and enforce written policies and procedures that are reasonably designed to prevent trade-throughs on that marketplace. Marketplaces would be required to regularly review and monitor the effectiveness of these policies and procedures and act promptly to remedy any identified deficiencies. The purpose of this approach is to require marketplaces to eliminate trade-throughs that can reasonably be prevented, but also provide them with flexibility about how to do so. Marketplaces may choose how to implement the obligation in various ways including, for example, voluntarily establishing direct linkages to other marketplaces, or designing specific trade execution algorithms. However, marketplaces would not be able to avoid their obligations by establishing policies and procedures that instead require marketplace participants to take steps to reasonably prevent trade-throughs.

Question 1: Should marketplaces be permitted to pass on the trade-through protection obligation to their marketplace participants? If so, in what circumstances? Please provide comment on the practical implications if this were permitted.

Marketplaces would be required to provide their policies and procedures, and any amendments thereto, to the securities regulatory authority and their regulation services provider 45 days prior to implementation. It is expected that marketplaces would also maintain relevant information so that the effectiveness of its policies and procedures could be adequately evaluated by regulatory authorities.⁷

Placing the obligation on marketplaces was supported by a majority of the commenters to the 2005 Discussion Paper and the Joint Notice.

(ii) Protected Orders

Trade-through protection would only be applicable to certain orders (“protected orders”). A protected order would be defined as a “protected bid or protected offer.” A “protected bid” or “protected offer” would be an order to buy or sell an exchange-traded security, other than a derivative, that is displayed on a marketplace with automated functionality and about which information is provided to an information processor or information vendor.⁸ The CSA do not consider special terms orders that are not immediately executable or that trade in a special terms book, such as all-or-none, minimum fill, or cash or delayed delivery, to be orders that are protected.⁹ However, those executing against these types of orders are required to execute against all better-priced orders first. A marketplace that is considered to have “automated functionality” would have the ability to immediately and automatically:

- permit an incoming order entered on the marketplace electronically to be marked as fill-or-kill,
- execute a fill-or-kill order,
- cancel unexecuted portions of that order,
- transmit a response to the sender indicating the action taken, and
- display information that updates the displayed order.¹⁰

A marketplace would also be required to have policies and procedures relating to the handling and display of these orders (to be included in their policies and procedures required under section 6.1 of the Instrument) and would be required to immediately inform all regulation services providers and other marketplaces when it experiences a failure, malfunction or material delay of its systems or equipment.¹¹

⁷ Proposed section 6.1 of NI 23-101.

⁸ Proposed definition in section 1.1 of NI 23-101.

⁹ See subsection 5.1(3) of 21-101CP.

¹⁰ Proposed amendment to section 1.1 of NI 23-101.

¹¹ Proposed section 6.4 of NI 23-101.

(iii) Full Depth-of-book

The Proposed Trade-through Protection Rule would be applicable to all visible parts of orders entered into the book (i.e. full depth-of-book). This means that in order to execute an order at an inferior price, the marketplace would have to ensure that all protected orders that are visible at price levels better than that price have been executed. This approach is different from the one adopted in Regulation NMS in the United States, which provides protection only to the best bid and offer on each marketplace (top-of-book). In the 2005 Discussion Paper and the Joint Notice, commenters were asked for their views on whether to impose the obligation only at the top-of-book. The majority of commenters responded by supporting trade-through protection that would apply to all visible orders regardless of where they are in the book, which is consistent with the current UMIR Best Price Rule.

(iv) Visible Orders

The Proposed Trade-through Protection Rule would only apply to orders or parts of orders that are visible. In other words, the orders would have to be displayed by the marketplace and information about them would have to have been provided to an information processor or information vendor.

In addition, hidden orders or those parts of iceberg orders that are not visible would not be protected. Currently, the manner by which “dark” portions of orders in an otherwise transparent order book would be avoided is by using the “bypass” marker introduced by IIROC.¹² The bypass marker signals to the marketplace that the order routed to the marketplace should not execute against any hidden liquidity. It is intended that this marker will evolve into the marker used for an inter-market sweep order discussed below.

(b) “Permitted” Trade-throughs

The overall purpose of trade-through protection is to promote confidence and fairness in the marketplace where the visible portions of better-priced limit orders trade ahead of inferior-priced orders. It is important to acknowledge, however, that the issues relating to preventing all trade-throughs in a multiple marketplace environment have become highly complex, particularly with the advent of new types of orders and other developments in market structure in Canada.

As a result, we have proposed a number of circumstances where trade-throughs would be permitted.¹³ These “permitted” trade-throughs or “exceptions” are primarily designed to achieve workable inter-market trade-through protection while facilitating the use of trading strategies and order types that are useful to investors. They are intended to promote fairness, innovation and competition.

Although trade-through protection is an obligation owed by all marketplace participants to the market as a whole, in certain circumstances, the marketplace can trade through better-priced orders on other marketplaces where a marketplace participant has taken certain action (for example, routing an inter-market sweep order). In these circumstances, it is important that

¹² Market Integrity Notice 2008-008 approving amendment to UMIR regarding “Provisions Respecting Off Marketplace Transactions” was published on May 16, 2008.

¹³ The list of “permitted” trade-throughs is set out in proposed section 6.2 of NI 23-101.

marketplace participants create policies and procedures that will reasonably prevent trade-throughs and maintain relevant information so that the effectiveness of section 6.1 of NI 23-101 can be adequately evaluated by regulatory authorities.¹⁴

(i) Failure, Malfunction or Material Delay of Systems or Equipment

We are proposing an exception for any failure or malfunction of a marketplace's systems as well as any material delay (systems issues).¹⁵ If a marketplace repeatedly fails to respond immediately after receipt of an order, under the Proposed Trade-through Protection Rule, this would constitute a material delay. This is intended to provide marketplaces with flexibility when dealing with another marketplace that is experiencing a systems problem (either of a temporary nature or a longer term issue). The marketplace that is experiencing the failure, malfunction, or delay is responsible for informing all other marketplaces, its marketplace participants, and any regulation services providers when the failure, malfunction or delay occurs. However, if a marketplace fails repeatedly to provide an immediate response to orders received and no notification has been issued by the marketplace that may be experiencing systems issues, a routing marketplace or a marketplace participant may rely on paragraph 6.2(a) of NI 23-101, in accordance with its policies and procedures that outline processes for dealing with these systems issues. The marketplace or marketplace participant must immediately notify the marketplace that may be having systems issues, its own marketplace participants (where applicable) and all regulation services providers. This notification will enable the marketplace that may be experiencing systems issues to assess whether it is in fact experiencing systems issues.

Question 2: What length of time should be considered an “immediate” response by a marketplace to a received order?

(ii) Inter-market Sweep Order

We are proposing an exception to allow the execution of inter-market sweep orders. An inter-market sweep order (ISO) is an order that is marked to inform the receiving marketplace that it can be immediately executed without delay or regard to any other better-priced orders displayed by another marketplace.¹⁶ It may be marked “ISO” by a marketplace or a marketplace participant. The definition allows for simultaneous routing of more than one ISO in order to execute against protected orders. In addition, marketplace participants may send a single ISO to execute against the best protected bid or best protected offer. An ISO may enable participants to execute large block orders, provided that they simultaneously route one or more ISO's to execute against better-priced orders. This would facilitate compliance with the trade-through obligation.

(iii) Flickering Orders

With the growth of algorithmic and computer-generated trading, there has been a substantial increase in the number of short term orders generated (often generated and cancelled within seconds) for every trade executed. This has subsequently increased the number of times a better-priced order may be displayed. Given the speed with which orders change, there may be technical occurrences of trade-throughs, even though all reasonable precautions were taken and there was a legitimate attempt to execute a trade at the best available price. As a result, we are

¹⁴ Proposed subsection 6.1(3) of 23-101CP.

¹⁵ Proposed paragraph 6.2(a) of NI 23-101.

¹⁶ Proposed paragraphs 6.2(b) and (c) of NI 23-101.

allowing for a transaction that occurs when the marketplace displaying the best price that was traded through had displayed, immediately prior to execution of a trade that resulted in a trade-through, an order with a price that was equal or inferior to the price of the trade-through transaction.¹⁷

(iv) Non-Standard Orders

Non-standard orders have been included on the list of “permitted” trade-throughs. A non-standard order refers to an order for the purchase or sale of a security that is subject to non-standard terms or conditions relating to settlement that have not been set by the marketplace on which the security is listed or quoted.¹⁸ A marketplace participant, however, may not add a special settlement term or condition to an order solely for the purpose that the order becomes a non-standard order so that it qualifies for an exception from the Proposed Trade-through Protection Rule.

(v) Calculated Price Order

We are proposing to include an exception for orders where the price is not known at the time of order entry and is to be calculated based on, but will not necessarily be equal to, the price of the security at the time of execution.¹⁹ Orders that would be included under this definition are:

- call market orders – where the price of a trade is calculated by the trading system of a marketplace at a time designated by the marketplace,
- volume-weighted average price orders – where the price of a trade is determined by a formula that measures a weighted average price on one or more marketplaces,
- opening orders – where each marketplace may establish its own formula for the determination of opening prices,
- closing orders – where execution occurs at the closing price on a particular marketplace, but at the time of order entry, the price is not known, and
- basis orders – an order that must be approved by a regulation services provider to ensure that the price of the order is based on one or more derivative transactions executed in conjunction with securities where the securities transaction comprises at least 80% of the underlying interest of the derivative instruments.²⁰

(vi) Closing Price Order

We are proposing to also include an exception for an order entered on a marketplace for the purchase or sale of an exchange-traded security that would execute at the established closing price on that marketplace for that trading day for that security.²¹ Some marketplaces provide an after-hours trading session at a price established by that marketplace during its regular hours for

¹⁷ Proposed paragraph 6.2(d) of NI 23-101.

¹⁸ Proposed subparagraph 6.2(e)(i) of NI 23-101.

¹⁹ Proposed subparagraph 6.2 (e)(ii) of NI 23-101.

²⁰ Proposed section 2.3 of NI 23-101CP.

²¹ Proposed subparagraph 6.2(e)(iii) of NI 23-101.

marketplace participants who are required to benchmark to a certain closing price. Therefore, we propose to allow for trade-throughs resulting from the execution of transactions in these circumstances so that a better-priced order on another marketplace would not need to be accessed.

(vii) Crossed Market

We are proposing an exception for a transaction that occurred where the transaction that constituted the trade-through was executed at a time when the best protected bid was higher than the best protected offer (crossed market).²² Without this exception, no marketplace could execute transactions in a crossed market because it would constitute a trade-through. The CSA recognize that crossed markets may occur as a result of trade-through protection only applying to displayed orders or parts of orders, and not to hidden or reserve orders. Intentionally crossing the market to take advantage of this exception would be a violation of proposed section 6.5 of NI 23-101.

Question 3: Are any additional exceptions necessary?

(c) Access to Marketplaces

The Joint Notice asked a number of questions on the issue of access, including:

- whether there should be a threshold that would require ATs to permit access to all groups of marketplace participants, and
- whether specialized marketplaces should not prohibit access to non-members/subscribers or should provide direct order access to non-members/subscribers if members/subscribers do not provide this service.

Many commenters were supportive of a threshold that would require marketplaces to provide access. Rather than setting a threshold for ATs to permit access to all marketplace participants, we have proposed amendments to 21-101CP to enhance the fair access provisions in NI 21-101.²³ These provisions require marketplaces to provide fair access to all of their services. As well, marketplaces should permit fair and efficient access to their services for the purpose of complying with the proposed trade-through requirements. At this time, we think that the provisions relating to fair access and the proposed amendments to 21-101CP are sufficient to address fair access to a marketplace whether directly or indirectly. We will continue to monitor this issue.

With respect to issues relating to access to marketplaces by non-members/subscribers to a marketplace, we do not believe that a marketplace should be required to provide direct access to non-members/subscribers. It would be left to the marketplaces to determine how best to meet their trade-through obligations. We intend to further discuss access issues with the industry implementation committee (described below).

²² Proposed paragraph 6.2(f) of NI 23-101.

²³ Proposed amendments to sections 7.1 and 8.2 of 21-101CP.

Question 4: Please comment on the various alternatives available to a marketplace to route orders to another marketplace.

(d) Trading Fee Limitation

In the Joint Notice, we considered whether there should be a specified limit that a marketplace could charge for trade-through purposes. A number of commenters expressed concern about proposing a specified trading fee limit imposed on a trade-by-trade basis. They preferred a principle-based approach that would require marketplaces to set reasonable trading fees.

The CSA think it is important to prevent marketplaces from raising their fees substantially to try to take advantage of the trade-through protection regime. Consequently, we are proposing a rule that would prohibit a marketplace from imposing (i) a fee charged for the execution of an order to comply with the trade-through requirement that is equal to or greater than the minimum price increment that is described in IROC Universal Market Integrity Rule 6.1, as amended, or (ii) terms that have the effect of discriminating between orders that are routed to that marketplace to prevent trade-throughs and orders that originate on that marketplace.

Question 5: Should the CSA set an upper limit on fees that can be charged to access an order for trade-through purposes? If so, is it appropriate to reference the minimum price increment described in IROC Universal Market Integrity Rule 6.1 as this limit?

(e) Locked and Crossed Markets

A “locked market” occurs when there are multiple marketplaces trading the same security and a bid (offer) on one marketplace is at an identical price level to an offer (bid) on another marketplace. Had both orders been entered onto the same marketplace the bid and the offer would have matched and a trade would have been executed. In a locked market situation, there are two ways to unlock the markets:

- typically, more buyers and sellers appear resulting in subsequent trades and immediate correction; or
- one of the participants involved in the lock removes their order and places the order on another marketplace to immediately execute the trade.

A “crossed market” occurs when one participant’s bid (offer) on one marketplace is higher (lower) than another participant’s offer (bid) on a different marketplace. A crossed market condition between marketplaces usually does not last for a long period of time as someone will usually take advantage of the arbitrage opportunity.

Proposed section 6.5 of NI 23-101 prohibits a marketplace participant from intentionally locking or crossing a market by entering a bid at a price that is the same as or higher than the best protected offer or entering an offer at a price that is the same as or lower than the best protected bid. This section is meant to capture the situation where a marketplace participant enters an order intentionally to lock or cross a particular marketplace or the market as a whole. It is not intended to prohibit the use of marketable limit orders. An exception from the Proposed Trade-through

Protection Rule has been provided to allow for the resolution of crossed markets that occur unintentionally. An exception is not necessary to resolve locked markets.

Question 6: Should there be a prohibition against intentionally creating a “locked market”?

(f) Trade-through and Best Execution

There has long been debate about the interplay between the obligations of best execution and “best price” or trade-through protection. In addition, there is some concern that trade-through and best execution obligations may conflict. This section addresses these issues.

The rationale for a dealer’s best execution obligation and the obligation to prevent trade-throughs is different. The obligation of best execution is based on the fiduciary duty that a dealer or adviser has to its client. This duty has its origins in common law and is codified in securities laws and UMIR. As discussed above, trade-through protection is based on the obligation of a participant to the market as a whole. It is grounded in the desire to protect visible and accessible limit orders and to ensure that those who decide to display the prices they are willing to pay or receive for a particular security will obtain the benefit of that decision. The requirement to achieve best execution can be waived or overwritten by direction of a client, however the trade-through obligation would always have to be met except in the specific circumstances outlined in Part III 4(b) above.

Having a trade-through obligation does not diminish the obligation to achieve best execution, including having policies and procedures to look at data from multiple marketplaces to determine whether or not to access to those marketplaces. The decision of how and where to trade (best execution) is determined by the particulars of the order and needs of the client. However, all better-priced orders must be honoured at the time of execution (trade-through obligation).

The Proposed Trade-through Protection Rule does not propose to address trading on foreign markets. However, we reiterate that marketplace participants should consider foreign markets when addressing best execution. We have also included an anti-avoidance provision that prohibits a person or company from routing orders to foreign marketplaces only for the purpose of avoiding the trade-through protection regime in Canada.²⁴

There may be some additional costs associated with trading on multiple marketplaces and dealers may determine to take on those costs or pass them onto their clients as part of their commissions. These commissions are part of the factors considered in obtaining best execution. We think that these costs are balanced against the need to protect displayed limit orders and the need to ensure that the risks taken by those that display those limit orders are rewarded.

²⁴ Proposed section 6.7 of NI 23-101.

(g) Other Jurisdictions

(i) U.S. Approach

On April 6, 2005, the SEC implemented the Order Protection Rule in Regulation NMS.²⁵ It requires trading centers to establish, maintain, and enforce written policies and procedures that are reasonably designed to prevent trade-throughs, and, if relying on one of the exceptions, these policies and procedures must be reasonably designed to assure compliance with the exception. To be protected, a quotation must be immediately and automatically accessible. Trade-through protection will apply to the best bid and offer from every type of participant on all marketplaces. One of the impacts of this order protection is increased linkages between trading centers. Regulation NMS includes a number of exceptions from “order protection” obligations, such as exemptions for opening or closing orders, crossed markets, benchmark orders where the material terms are not known, inter-market sweep orders, delays in responses caused by systems problems, and flickering quotes.

(ii) European developments

The European Union (EU) implemented MiFID on November 1, 2007 to replace the existing Investment Services Directive as part of its Financial Services Action Plan designed to create a single market in financial services for EU member states.²⁶ MiFID does not impose a trade-through obligation that prohibits the by-passing of better priced quotes when executing transactions. Instead, MiFID introduces a best execution standard that requires firms to take “all reasonable steps to obtain the best possible result” for their clients, taking into consideration not only execution price, but also the cost, speed, size and nature of the order, the likelihood of execution and settlement when trading and any other factors deemed relevant to the execution of the order.

(h) Next Steps

Upon the publication of this Notice and the Proposed Amendments, we will establish an industry committee to discuss the implementation issues relating to the introduction of the Proposed Trade-through Protection Rule. The role of the committee will be to raise operational issues associated with implementing this rule and develop recommendations to be considered by the CSA and where appropriate, IIROC. The committee will be chaired by an industry representative and facilitated by the Investment Industry Association of Canada. It will be an open committee, made up of interested parties representing marketplaces, dealers, and buy-side investors.

If you are interested in participating on the committee, please send an e-mail to: [**marketregulation@osc.gov.on.ca**](mailto:marketregulation@osc.gov.on.ca).

IV. ADDITIONAL AMENDMENTS

Along with the Proposed Trade-through Protection Rule, we are also proposing some additional amendments to NI 21-101 and NI 23-101.

²⁵ “SEC Adopts Regulation NMS and Provisions Regarding Investment Advisers Act of 1940”, online: U.S. Securities and Exchange Commission, <http://www.sec.gov/news/press/2005-48.htm> on July 15, 2008.

²⁶ “Markets in Financial Instruments Directive – Background Information”, online: Financial Services Authority, <http://www.fsa.gov.uk/pages/about/what/international/pdf/MiFID.pdf> on July 8, 2008.

1. Reporting Requirements for Marketplaces and Dealers

In April 2007, we proposed reporting requirements for marketplaces and dealers that would require:

- a marketplace to report certain information on a monthly basis, including: number of orders, number of trades, and speed of execution, and
- a dealer to report certain information on a quarterly basis: percentage of orders executed at a location determined by the dealer, identity of marketplaces and percentage of orders routed to each marketplace, and disclosure of any material arrangements with a marketplace.

The comments that we received on the proposed requirements published in April 2007 were generally mixed. There was some feedback on specific aspects of the reporting requirements, such as spread-based statistics and securities traded on only one marketplace. A summary of the comments received on the best execution reporting requirements and our responses is included in Appendix A of this Notice.

When finalizing the best execution amendments in June 2008, the CSA decided to postpone the implementation of the proposed best execution reporting requirements for marketplaces and dealers due to intervening market developments. However, we are of the view that it is appropriate to republish them for comment with this package of amendments. A cost-benefit analysis of the implementation of reporting requirements for marketplaces and dealers was published with the Joint Notice.

The CSA continue to be of the view that this information is important to provide tools for assessing and complying with the best execution obligation. With respect to the proposed marketplace reporting requirement, we think this information would be useful for a dealer or adviser to assess best execution based on marketplace quality (for example, speed and certainty of execution). For the proposed dealer reporting, we think the reports would provide useful information to clients about order execution.

We have made a number of changes to the best execution reporting requirements from when they were published in April 2007, based on the comments received to further streamline the requirements. Specifically, we have removed the requirement for dealers to provide the percentage of total client orders and percentages that were market orders, limit orders and other order types as part of their report. In addition, we are proposing that marketplaces report by security only and not also by order type.

As the CSA understand that technology changes will be necessary to comply with these requirements, we are proposing that there would be a six month transition period after the instrument becomes effective.

We have set out below some questions on which we are specifically requesting feedback.

- Question 7:** Should the marketplace statistics focus on units of securities traded instead of orders and number of trades?
- Question 8:** Should the marketplace statistics require separate reporting on specific order types that would include market orders, intentional crosses, and pre-arranged trades?
- Question 9:** Should the focus of the liquidity measures be the number of orders or the cumulative number of shares?
- Question 10:** Would it be useful to have information about partially or fully hidden liquidity that is available on certain marketplaces? If so, what measures of that liquidity would be most informative?
- Question 11:** Would it be useful to include reporting similar to the near-the-quote orders required by the SEC in the United States?²⁷ What price increment away from the quote would be appropriate to use for the Canadian market?
- Question 12:** Are statistics regarding average realized and effective spreads useful without a consolidated best bid and offer?
- Question 13:** Are the time frames used to assess speed and certainty of execution on a marketplace in section 11.1.1 of NI 21-101 appropriate? If not, what time frames should be used?
- Question 14:** In addition to the proposed reporting requirements for marketplaces, would other information, such as the following, be useful to dealers or advisors to assess best execution:
- (a) a breakdown of the information by order size (i.e. 100-499 shares, 500-1999 shares, 2000-4999 shares, 5000 or more);
 - (b) the proportion of time that a marketplace had orders that were at the best bid or the best ask;
 - (c) the proportion of trades (in number of shares or number of trades based on our decision) executed inside the best bid and ask price?

2. Marketplace Systems

A number of changes are proposed to the systems requirements for a marketplace in Part 12 of NI 21-101. Most update the technical descriptions of the requirements and modify the requirements to better reflect what is taking place in practice.

²⁷ A “near-the-quote order” is defined by the SEC as non-marketable buy orders with limit prices that are lower by \$0.10 or less than the consolidated best bid at the time of order receipt, and non-marketable sell orders with limit prices that are higher by \$0.10 or less than the consolidated best offer at the time of order receipt.

Currently, Part 12 of NI 21-101 requires a marketplace to address specific issues related to capacity management, system development and testing, system vulnerabilities and business continuity. The defined scope of the annual independent systems review (ISR) is to provide assurance on these same issues. The proposed amendments broaden the requirement for a marketplace to develop and maintain and, for an independent review, assess the more comprehensive and integrated concept of a system of internal control.

Currently, NI 21-101 provides for an exemption from the independent review of an ATS that is below a certain trading volume threshold. The proposed amendments remove this threshold. ATSs will now be required to perform an ISR in accordance with established audit standards, unless granted an exemption under Part 15 of NI 21-101.

3. Transparency

Amendments are being proposed to Parts 9 and 10 of 21-101CP for the purposes of clarifying the requirements under sections 7.1, 7.2, 8.1 and 8.2 of NI 21-101 for marketplaces, inter-dealer bond brokers and dealers to provide accurate and timely order and trade information to an information processor, or to an information vendor that meets the standards set by a regulation services provider.

4. Information Processor Requirements and Systems

The CSA are continuing to work toward the selection of an information processor based on the applications received (for equity and debt securities). A summary of these applications was published with the Joint Notice as CSA Staff Notice 21-306. We note that on July 14, 2008, the Bourse de Montréal withdrew its application to be the information processor for debt and equity securities.

It is our view that the information processor for equity securities should disseminate a full depth-of-book market-by-price data feed and consolidated trade information for all marketplaces trading equity securities.

Question 15: Do you agree that an information processor should disseminate consolidated trade information along with a feed that contains the best bid and best offer and all orders at all price levels (along with the marketplace identifier/marker)? For practical reasons, should the price levels be limited? If so, to how many levels?

We are proposing some amendments to Part 16 of 21-101CP to clarify the requirements under subsections 14.4(2) and (5) of NI 21-101 regarding certain obligations that an information processor has towards its users and providers of order and trade information, in relation to the collection, processing, distribution and publication of that information. In addition, we have proposed changes to the systems requirements applicable to an information processor that are outlined in Part 14 of NI 21-101. The changes mirror those described above for a marketplace. However, an information processor will be required to conduct an annual independent systems review, unless an exemption is sought and granted.

5. Amendments to Sections 7.2, 7.4, and 8.3 of NI 23-101 - Agreement Between a Marketplace and a Regulation Services Provider

We have amended subsections 7.2(c), 7.4(c), and 8.3(d) to require that the agreement between a regulation services provider and a marketplace mandates that the marketplace provide the regulation services provider with the information that the regulation services provider considers necessary for the regulation services provider to effectively monitor the conduct of marketplace participants and if applicable, the marketplace. This amendment in no way changes the existing relationship between an exchange or quotation and trade reporting system and the regulation services provider that it has retained. Instead, it clarifies our expectations that the regulation services provider will be provided with the information it needs to effectively monitor trading on multiple marketplaces and to ensure that certain standards, such as clock synchronization, and use of markers, are uniformly met by all marketplaces that the regulation services provider surveils.

V. AUTHORITY FOR THE PROPOSED AMENDMENTS

In those jurisdictions in which the amendments to the ATS Rules are to be adopted, the securities legislation provides the securities regulatory authority with rule-making or regulation-making authority in respect of the subject matter of the amendments.

In Ontario, the Proposed Amendments are being made under the following provisions of the *Securities Act* (Ontario) (Act):

- Paragraph 143(1)10 authorizes the Commission to make rules prescribing requirements in respect of the books, records and other documents required by subsection 19(1) of the Act to be kept by market participants (as defined in the Act), including the form in which and the period for which the books, records and other documents are to be kept.
- Paragraph 143(1)11 authorizes the Commission to make rules regulating the listing or trading of publicly traded securities including requiring reporting of trades and quotations.
- Paragraph 143(1)12 authorizes the Commission to make rules regulating recognized stock exchanges, recognized self-regulatory organizations, and recognized quotation and trade reporting systems including prescribing requirements in respect of the review or approval by the Commission of any by-law, rule, regulation, policy, procedure, interpretation or practice.
- Paragraph 143(1)13 authorizes the Commission to make rules regulating trading or advising in securities to prevent trading or advising that it is fraudulent, manipulative, deceptive or unfairly detrimental to investors.
- Paragraph 143(1)39 authorizes the Commission to make rules requiring or respecting the media, format, preparation, form, content, execution, certification, dissemination and other use, filing and review of all documents required under or governed by the Act, the

regulation or the rules and all documents determined by the regulations or the rules to be ancillary to the documents.

VI. COMMENTS AND QUESTIONS

We invite all interested parties to make written submissions on the Proposed Amendments. We will consider submissions received by January 15, 2009. If you do not submit your comments by email, provide a diskette containing the submissions in Microsoft Word format.

Please address your comments to all of the CSA member commissions, as follows:

Alberta Securities Commission
Autorité des marchés financiers
British Columbia Securities Commission
Manitoba Securities Commission
New Brunswick Securities Commission
Nova Scotia Securities Commission
Registrar of Securities, Department of Justice, Northwest Territories
Registrar of Securities, Government of Yukon Territory
Registrar of Securities, Legal Registries Division, Department of Justice, Nunavut
Registrar of Securities, Prince Edward Island
Saskatchewan Financial Services Commission
Superintendent of Securities, Newfoundland and Labrador
Ontario Securities Commission
c/o John Stevenson, Secretary
Ontario Securities Commission
20 Queen Street West
Suite 1900, Box 55
Toronto, Ontario M5H 3S8
e-mail: jstevenson@osc.gov.on.ca

and

Me Anne-Marie Beaudoin
Corporate Secretary
Autorité des marchés financiers
800, square Victoria, 22e étage
C.P. 246, tour de la Bourse
Montréal, Québec H4Z 1G3
e-mail: consultation-en-cours@lautorite.qc.ca

We cannot keep submissions confidential because securities legislation in certain provinces requires that a summary of the written comments received during the comment period be published.

Questions may be referred to any of:

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Matthew Thompson
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