CSA Discussion Paper 23-403
Market Structure Developments and Trade-Through Obligations

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I. INTRODUCTION

The purpose of this discussion paper is to discuss evolving market developments and the consequential implications for our market, in particular the obligation to avoid trade-throughs (trade-through obligation).

The review of market structure and the policy response began in the 1990's with the interest in allowing new types of marketplaces which were then known as proprietary electronic systems (now known as alternative trading systems) to operate in Canada. The public policy discussion considered the benefits and concerns brought on by having multiple marketplaces. The discussions also examined how new marketplaces brought competition and choice for investors regarding where to execute trades and how to execute them, while at the same time the development of multiple marketplaces can cause fragmentation of the price discovery process and market surveillance.

In December 2001, the Canadian Securities Administrators (CSA or we) introduced National Instrument 21-101 *Marketplace Operation* (NI 21-101) and National Instrument 23-101 *Trading Rules* (together, the ATS Rules). The objectives of the ATS Rules were to: (1) facilitate competition and thereby investor choice; (2) identify and implement the requirements that maintain and improve market integrity when there are multiple marketplaces trading the same securities; and (3) minimize the impact of any fragmentation caused by competition through transparency and other requirements. The ATS Rules introduced a regulatory structure for the regulation of marketplaces[1], including the need for an ATS to contract with a regulation services provider. They imposed transparency requirements for orders and trades of exchange-traded securities and unlisted debt securities.[2] The purpose of the provisions on best execution, fair access, and prohibition against manipulation and fraud was to strengthen market integrity across all marketplaces.

Since 2001, new types of marketplaces with different types of trade execution methodologies have been introduced in Canada. These developments have raised issues regarding the application of current market conduct rules, treatment of non-dealer industry participants who have direct access to marketplaces, whether the same level of transparency is appropriate for different types of marketplaces, whether data consolidation is necessary in light of technology developments, and most recently the role of the trade-through obligation. This paper will focus on the trade-through obligation.

A "trade-through" occurs when a quote or "an order exposed on a marketplace" that is at a better price is by-passed and a trade is executed at an inferior price. Trade-throughs can occur intra-market (within one marketplace) or inter-market (between multiple marketplaces trading the same security). "Trade-through obligation" refers to an obligation to ensure that better-priced orders on any marketplace are executed prior to, simultaneously with or immediately after the

[1] A "marketplace" is an exchange, quotation and trade reporting system or an alternative trading system.
[2] The transparency requirements are in Parts 7 and 8 of NI 21-101.

execution of a trade. In other words, a full trade-through obligation requires that an entity ensure that its orders do not by-pass better-priced orders already in the book.[3]

Recent changes in the capital markets have led regulators and self-regulatory organizations (SROs) both in and outside of Canada to introduce proposals on this issue. On January 31, 2005, the Bourse de Montréal implemented a rule related to block trading. Market Regulation Services Inc. (RS) has published a proposal relating to block trading and trade-through obligations.[4] In the United States, the Securities and Exchange Commission (SEC) has just adopted Regulation NMS (Reg NMS), which introduced changes to the trade-through obligation (Order Protection Rule), access (Access Rule), decimalization and data fees.[5]

The CSA request comment on the issues and questions raised in this discussion paper regarding market structure developments and trade-throughs.

The CSA believe it is time to initiate a discussion to consider how market structure should generally evolve, and specifically, the role of the trade-through obligation. As part of the discussion, we believe it is important to identify the objectives we are trying to achieve and any problems that we are trying to avoid or minimize. The CSA have identified the following objectives as the factors that should be considered in identifying the appropriate structure and requirements for Canada: (1) balancing regulation and competition among all types of marketplaces; (2) recognizing and supporting the role of retail participation in the market; (3) promoting greater order interaction and displayed depth; and (4) encouraging innovation.

1. *What factors or criteria should be considered in identifying the appropriate structure and requirements for the Canadian market?*

We encourage all types of participants in the market to participate in the discussion to ensure that all of the issues are explored, so that the results will properly balance investor protection and fair and efficient capital markets. Investor protection requires us to examine the position of all investors, large and small. Ensuring fair and efficient markets requires that we consider the implications of implementing a policy on all participants.

This paper will discuss the current structure of the Canadian market (Part II), role and scope of a trade-through obligation (Part III), exemptions from a trade-through obligation (Part IV), implications of a trade-through obligation (Part V), impact on markets (Part VI), and the conclusions (Part VII).

II. THE CURRENT STRUCTURE OF THE CANADIAN MARKET

A. Current Structure for Exchange-Traded Securities

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[3] We note that costs, including access fees, would have to be taken into account when determining on which marketplace the better prices are located.
[4] These changes are discussed in detail in section II.C.2. below.
[5] Securities and Exchange Commission, Release No. 34-51808; File No. S7-10-04 *Regulation NMS*, issued June 16, 2005 (SEC Final Release).

Historically, in Canada, trading of listed equity securities could only occur on exchanges. Since 1999, each security has been traded on only one domestic marketplace.[6] The exchanges' technology systems have created trade-through protection within their own marketplaces (i.e. intra-market trade-through protection). We are discussing these issues mainly in the context of listed equity securities, although the same issues may be applicable to any securities trading on multiple marketplaces, for example, corporate debt trading on multiple alternative trading systems (ATSs).

We have seen that the introduction of the ATS Rules has facilitated competition and innovation in the Canadian market by accommodating new marketplaces that have diverse models of trading. New trading technologies are being established to enable dealers and non-dealers alike to trade directly on a marketplace. Marketplaces can now compete by trying to improve upon existing trading alternatives by differentiating on price, cost of execution, liquidity and speed of execution, among others. This competition benefits all investors in that they are provided with more choice, better services and potentially cheaper execution costs.

The Universal Market Integrity Rules (UMIRs) administered on behalf of the stock exchanges and for ATSs by RS were introduced to regulate trading on marketplaces. They were initially drafted based on the existing structure of the equity exchanges. However, with the introduction of new ATSs and innovative trading methodologies, RS has recently undertaken a strategic review of the UMIRs to ensure that the provisions are market-neutral and do not favour one structure over another.

2. *What market structure issues should be considered as part of the discussion on the trade-through obligation?*

3. *Should the discussion about trade-throughs consider trading of non-exchange traded securities on marketplaces other than exchanges (for example, fixed income securities trading on more than one ATS)? If so, please identify market structure issues that need to be reviewed.*

B. Current Rules in Canada Relating to Trading Through

The existing rules relating to trade-through are tied to best execution and best price obligations and are summarized below. These rules were developed as part of the codification of the fiduciary duty of a dealer to its client. They were not developed to facilitate a separate obligation on all participants to the market and to orders already in the book. Until recently, no issues arose under the rules because

- there haven't been multiple marketplaces trading the same securities in Canada,
- the technology systems of existing marketplaces enforced the best price obligation, and
- only dealers had direct access to the existing marketplaces.

[6] This does not include those that are inter-listed on foreign exchanges. In 1999, Canadian exchanges entered into an agreement whereby the Toronto Stock Exchange would trade senior equity securities, the Canadian Venture Exchange (now TSX Venture Exchange) would trade junior equity securities and the Bourse de Montréal would trade derivatives.

1. National Instrument 23-101 Trading Rules

In Part 4 of National Instrument 23-101 *Trading Rules (*NI 23-101), a dealer acting as agent for a client must make reasonable efforts to ensure that the client receives best execution.[7] Notwithstanding this requirement, the dealer must not execute a transaction on a marketplace that could be filled at a better price on another marketplace or with another dealer.[8] The obligations in NI 23-101 apply only to dealers "acting as agent for a client" and do not extend to any non-dealers or dealers acting as principal.

These requirements do not specifically impose a trade-through obligation. However, the implication of having a best price obligation is that there are constraints on how the dealer must execute the order, i.e. at the best price available, and the dealer must not trade through better-priced orders.[9]

2. Universal Market Integrity Rules – Part 5

The UMIRs also tie trade-through to best execution and best price obligations.

UMIR Rule 5.1 *Best Execution of Client Orders* requires a Participant[10] to "diligently pursue the execution of each client order on the most advantageous terms for the client as expeditiously as practicable under prevailing market conditions." UMIR Rule 5.2 *Best Price Obligation* reads:

> (1) A Participant shall make reasonable efforts prior to the execution of a client order to ensure that:
> (a) in the case of an offer by the client, the order is executed at best bid price; and
> (b) in the case of a bid by the client, the order is executed at the best ask price.

Subsection 5.2(2) provides for exemptions from the "best price" obligation:

- where required or permitted by a Market Regulator pursuant to clause (b) of Rule 6.4[11] to be executed other than on a marketplace in order to maintain a fair and orderly market;

[7] Subsection 4.2(1) of NI 23-101.
[8] Subsection 4.2(2) of NI 23-101.
[9] See section V.C.1 below for a discussion on best execution and the trade-through obligation. We acknowledge that current views differ on how to define best execution and how much it should focus on best price. Even if price is the main focus, many factors are considered in determining best execution, including volumes, direction of movement of prices, the size of the spread and overall liquidity. Institutional investors may seek speed of execution, or certainty, and may specify a particular exchange or facility (e.g. market-on-close), or want to trade in a particular way (e.g. anonymously). Concept Paper 23-402 *Best Execution and Soft Dollar Arrangements* was published on February 4, 2005 at (2005), 28 OSCB 1362. See page 1367 of Concept Paper 23-402 for additional discussion of best execution.
[10] "Participant" is defined in section 1.1 of the UMIRs as "a dealer registered in accordance with securities legislation of any jurisdiction and who is (a) a member of an Exchange, user of a QTRS, or a subscriber of an ATS; or (b) a person who has been granted trading access to a marketplace and who performs the functions of a derivatives market maker."
[11] UMIR Rule 6.4 requires trades by a Participant to be on a marketplace except in certain circumstances. Subsection (b) allows a trade in a security outside of a marketplace if required or permitted by a Market Regulator in order to maintain a fair and orderly market.

- for a Special Terms Order[12] 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, or

    (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; and

- for Call Market Orders, Volume-Weighted Average Price Orders, Market-on-Close Orders, Basis Orders or Opening Orders where directed or consented to by the client to be entered on a marketplace.[13]

Part 2 of UMIR Policy 5.2 *Best Price Obligation* references the trade-through obligation as part of the "best price obligation" and states that "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 a stock exchange or organized market. This Policy applies even if the client consents to the trade... at an inferior price. Participants may make the trade...if the better bids or offers...on marketplaces are filled first or coincidentally with the trade on the other stock exchange or organized market. The time of order entry is the time that is relevant for determining whether there is a better price on a

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[12] "Special Terms Order means 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:
(i) the third business day following the date of the trade, or
(ii) any settlement date specified in a special rule or direction referred to in subsection (2) of Rule 6.1 that is issued by an Exchange or QTRS."

[13] These orders are defined in section 1.1 of the UMIRs as follows:
"Call Market Order means 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."
"Volume-Weighted Average Price Order means 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."
"Market-on-Close Order means 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."
"Basis Order means an order for the purchase or sale of listed securities or quoted securities:
(a) Where the intention to enter the order has been reported by the Participant or Access Person to a Market Regulator prior to the entry of the order;
(b) that will be executed at a price which is determined in a manner acceptable to a Market Regulator based upon the price achieved through the execution on that trading day of one or more transactions in a derivative instrument that is listed on an Exchange or quoted on a QTRS; and
(c) that comprise at least 80% of the component security weighting of the underlying interest of the derivative instruments subject to the transaction or transactions described in clause (b)."
"Opening Order means 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."

marketplace." The Policy applies to "active orders" – such an order defined as "an order that may cause a trade-through by executing against an existing bid or offer on another stock exchange or organized market at a price that is inferior to the bid or ask price on a marketplace at the time."

As described above, the UMIRs imposing best execution and best price obligations apply only to agency activity by a dealer and do not apply to dealers acting as principal or to non-dealers. The trade-through obligation is in the UMIR Policy and is linked to best execution and best price obligations. However, Part 2 of Policy 5.2 *Trade-Through of Marketplaces* goes further, as it provides that "the Policy applies to trades for Canadian accounts and Participants' principal (inventory) accounts."

C. Recent Developments and Changes

There have been recent developments and proposed changes that have necessitated a review of the issue of trading-through and current requirements. These developments and changes are discussed below.

1. Introduction of ATSs in Canada that trade Canadian listed securities

Until 2005, ATSs that operated in Canada under the ATS Rules were foreign-based and they did not execute trades in Canadian exchange-traded securities. Trading in Canadian exchange-traded securities only occurred on the Toronto Stock Exchange (TSX), TSX Venture Exchange and, more recently, the Canadian Trading and Quotation System (CNQ). These exchanges only permit access through dealers (even when institutional clients are using "Direct Access Facilities").[14] Their systems enforce price priority, and this, in combination with best execution obligations, *de facto*, results in trading taking place at the best price at any given time.

An ATS that trades Canadian-listed securities has been registered to carry on business in a number of jurisdictions in Canada. Both institutional investors and dealers will have direct access to the trading system. The operation of this ATS has refocused attention on the current rules relating to trade-through protection – again, that dealers are subject to a trade-through obligation, whereas non-dealer marketplace participants[15] (institutions or other investors) are not. By virtue of this, some of the participants in this ATS, under the current rules, will not have a trade-through obligation.

The existence of multiple marketplaces without system-enforcement of the best price obligation (which is the current definition of best execution) opens the possibility for tension between best price obligations and preferred execution strategies. Realizing that different participants - dealers acting as agent, dealers acting as principal and non-dealers - have different trading objectives and fiduciary duties, the method used to meet the best price obligation and trading objectives may differ. At times, trading at what may be the best price could be in direct opposition to the desires

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[14] "Direct Access Facilities" and "intermediated direct market access" refer to TSX Rule 2-501 and similar access. Throughout this paper, when we refer to "direct access", we are not including Rule 2-501-type access.
[15] "Marketplace participants" is used in this paper to apply to anyone directly accessing the markets, whether dealers or institutional or retail clients. This does not include TSX Rule 2-501 clients, as they access the markets through dealers who are responsible for the trading that occurs.

of the client with respect to preferred execution, especially when considering all the factors that go into a trading decision.

2. Proposed UMIR amendments

(a) Off-Marketplace Trades

In August 2004, RS proposed amendments to deal with the intentional by-passing of better-priced orders on a marketplace when executing a large block trade.[16] A revised proposal was refiled and published on April 29, 2005[17] without the trade-through portion (the trade-through proposal is discussed below). The amendments were introduced partially in response to a circumstance where a large block of shares was traded "off-marketplace" as a result of concerns around being able to properly assess the risks of trading the block in light of the existence of "iceberg" orders[18] (a portion of which are undisclosed orders).[19]

Included in the proposed amendments are:

- clarification that the "best price" obligation applies at the time of order execution, instead of at order entry;
- guidance on what will constitute "reasonable efforts" expected of a Participant under that obligation; and
- a mechanism to cap the obligation to fill better-priced orders to the disclosed volume in certain circumstances.[20]

The amendments are currently under review by the British Columbia Securities Commission, the Alberta Securities Commission, the Manitoba Securities Commission, the Ontario Securities Commission and the Autorité des marchés financiers (Recognizing Regulators).

(b) Trade-through Proposal

RS filed with the Recognizing Regulators a request for comment on amendments to the UMIRs relating to trade-throughs.[21] The purpose of the amendments is to provide an interim solution to address the issue of trade-throughs in multiple marketplaces. The current UMIR rule applies a best price obligation only on Participants.[22] Under the amendments, the trade-through obligation would be separated from best price and a stand alone trade-through obligation would be applied to non-dealers and dealers alike. The amendments would require a Participant, when trading a principal, non-client

[16] Published at (2004), 27 OSCB 7355.
[17] Republished at (2005), 28 OSCB 4091.
[18] For a discussion of "iceberg orders", see section IV.C below.
[19] Normally, when trading a block on the TSX, the dealer must "clear out the book", including the undisclosed portion of iceberg orders, making it very difficult to quantify the obligation.
[20] If the price of the pre-arranged trade or intentional cross is not less than the lesser of 95% of the best bid price and the best bid price less 10 trading increments, and not more than the greater of 105% of the best ask price and the best ask price plus 10 trading increments, then the order may be marked as a "designated trade" and needs only to execute against the disclosed volume on the marketplace prior to execution.
[21] Published at (2005), 28 OSCB 5064.
[22] See section B.2. above.

or client order, or an Access Person[23], when trading directly on a marketplace or regulated market, to make reasonable efforts to fill better-priced orders on marketplaces upon executing a trade at an inferior price on another marketplace. In determining whether a Participant or Access Person has undertaken "reasonable efforts" to execute better-priced orders, 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 orders or orders; and
- the Participant or Access Person has met any applicable obligation under Part 2 of Policy 2.1[24] to move the market.

The Recognizing Regulators of RS published a Notice on June 3, 2005 stating that they will review the proposal in the context of this paper.[25]

It should be noted that the RS proposal would not eliminate trade-throughs. Under the proposed amendments, an Access Person is subject to the "reasonable efforts" test where they are only required to fill better-priced orders on marketplaces to which they have access. As a result, an Access Person that wants to trade on multiple marketplaces, but chooses to have direct access to only one ATS, can trade at any price on that ATS if it accesses other marketplaces (the TSX or other ATSs) only by placing orders with a dealer. This creates a gap, where an Access Person can determine when and if the trade-through obligation applies to their orders.

Also, no analysis was provided about the cost of the proposal on Access Persons or the costs, generally, for RS to monitor and enforce such obligations on non-dealers. Placing the obligations on marketplace participants, including non-dealers, has practical implications for marketplace participants and for market structure, which have not been addressed.

The RS proposal would extend rules to marketplace participants who currently are not subject to them. The RS proposal starts at the point of deciding that all direct marketplace participants should be subject to trade-through obligations, without first asking the questions:

- who should be subject to trade-through obligations?
- to what extent?

4. Please provide comments on the RS proposal regarding trade-through obligations. Which elements do you agree or disagree with and why?

3. U.S. developments and international considerations

(a) U.S. developments

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[23] Section 1.1 of the UMIRs defines Access Person as "a person other than a Participant who is:
(a) a subscriber; or
(b) a user.

[24] Policy 2.1 relates to just and equitable principles of trading.

[25] Published at (2005), 28 OSCB 5064.

On April 6, 2005, the SEC approved Reg NMS which will significantly alter the current trade-through rules in the United States. Historically, trade-through rules were established in the U.S. on a marketplace-by-marketplace basis. The US exchanges, including the New York Stock Exchange (NYSE), adopted a rule for exchange-listed securities but NASDAQ did not follow suit. The U.S. exchanges used a specialist system where the quotes were not immediately accessible. This, at times, could result in delayed execution and reporting of trades. The ATSs trading NASDAQ securities complained that timing latencies in the quotation and trade data put them at a significant disadvantage if they were required to send orders to the U.S. exchanges to meet trade-through obligations.

In response to this and other issues, the SEC issued a release in February 2004, which received significant comments, and a second release in December 2004. Reg NMS, including the Order Protection Rule, was adopted on April 6, 2005. The Order Protection Rule requires trading centers[26] to "establish, maintain, and enforce written policies and procedures that are reasonably designed to prevent trade-throughs on that trading center of protected quotations[27] in NMS stock that do not fall within an exception..., and, if relying on one of the rule's exceptions, that are reasonably designed to assure compliance with the terms of the exception."[28] 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.

Given the fragmented structure of the United States equity market, placing the obligation on the marketplaces rather than marketplace participants has reduced the number of linkages needed and is a solution that places the measurement of the obligation on the marketplaces rather than the participants. In addition, the obligation applies equally to all orders – whether dealer, institution or retail, if applicable. The SEC release also clearly states that trade-through and best execution obligations are separate and the adoption of the order protection rule "in no way lessens a broker-dealer's duty of best execution."[29]

The Order Protection Rule includes a number of exceptions from "order protection" obligations[30], including:

(a) A "self-help" exception where the transaction that constituted a trade-through was effected when the trading center displaying the protected quotation that was traded-through was experiencing "a failure, material delay or malfunction in its systems or equipment".

(b) Where the transaction that constituted the trade-through was:

[26] "Trading Center" under Reg NMS "means a national securities exchange or national securities association that operates an SRO trading facility, an alternative trading system, an exchange market maker, an OTC market maker, or any other broker or dealer that executes orders internally by trading as principal or crossing orders as agent."
[27] A "protected quotation" is a "protected bid or protected offer" which is defined as a quotation displayed by an automated trading center, disseminated pursuant to an effective national market system plan and is the best bid or best offer of a national securities exchange ... NASDAQ Stock Market... or another national securities association. See footnote 5, SEC Final Release, Rule 242.600(b)(57).
[28] See footnote 5, SEC Final Release, Rule 242.611(a).
[29] See footnote 5, SEC Final Release at page 159.
[30] See footnote 5, SEC Final Release, Rule 242.611(b).

(i) a single-priced opening, reopening or closing transaction;

(ii) executed at a time when a protected bid was priced higher than a protected offer (i.e. crossed markets);

(iii) the execution of an order identified when routed to the trading center as an inter-market sweep order[31];

(iv) a transaction effected by a trading center that simultaneously routed an inter-market sweep order to execute against the full displayed size of any protected quotation that was traded through[32];

(v) the execution of an order at a price that was not based, directly or indirectly, on the quoted price of the NMS stock at the time of execution and for which the material terms were not reasonably determinable at the time the commitment to execute the order was made (i.e. benchmark orders, such as VWAP orders); or

(vi) the execution by a trading center of an order for which, at the time of receipt of the order, the trading center had guaranteed an execution at no worse than a specified price (stopped order) where the stopped order was for the account of a customer, the customer agreed to the price on an order-by-order basis, and the price of the trade-through transaction was lower than the national best bid (for a buy order) or higher than the national best offer for a sell order at the time of execution (i.e. underwater stop order).

(c) The trading center displaying the protected quotation that was traded through had displayed, within one second prior to execution of the transaction that constituted a trade-through, a best bid or offer with a price that was equal or inferior to the price of the trade-through transaction (i.e. flickering quotation)

In contrast to the United States, Canada does not have as many marketplaces. As a result, if the regulators decide that trade-through rules are required, implementing inter-market trade-through protection may be less complex.

We note that the SEC Final Release also includes a dissenting opinion written by two Commissioners. The dissenting Commissioners questioned whether the policy changes were appropriate and necessary and whether it had been established that existing trade-through rates

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[31] An "inter-market sweep order" is defined as "when routed to a trading center, the limit order is identified as an intermarket sweep order; and simultaneously, with the routing of the limit order identified as an intermarket sweep order, one or more additional limit orders are routed to execute against the full displayed size of any ...protected [quotation] for the NMS stock with a price that is superior to the limit price of the limit order identified as an intermarket sweep order. These additional routed orders must also be marked as intermarket sweep orders." This exception applies when the broker-dealer routes the order as an intermarket sweep order. See footnote 5, SEC Final Release, Rule 242.600(b)(30).

[32] This exception allows trading center itself to route intermarket sweep orders and thereby allow for immediate internal executions at the trading center. This exception will facilitate the immediate execution of block orders by dealers on behalf of their institutional clients (See footnote 5, SEC Final Release at page 153).

indicate a significant investor protection problem.[33] They expressed concern that the trade-through rule would limit competition and stifle innovation and that implementation would be costly. They argued that a "wiser and more practical approach to improve efficiency of U.S. markets for all investors would have been to improve access to quotations, enhance connectivity among markets, clarify the duty of best execution and reduce barriers to competition."[34]

5. *If a trade-through obligation is imposed, what differences between Canadian and United States markets should be considered?*

(b) International considerations

The CSA is also examining trade-through issues in international markets besides the United States (such as Europe and Australia). During the comment period, we will be gathering information on how these other markets deal with trade-throughs. We seek your comment on the treatment of trade-through obligations in marketplaces and regulatory regimes outside of North America and their applicability to Canadian markets.

4. Derivatives markets

A growing trend in derivatives marketplaces is the introduction of block trading facilities that enable block trades meeting a certain size threshold to trade through better-priced orders in the order book. Some of the derivatives marketplaces that allow large block trades to trade outside the spread include the Bourse de Montréal, Euronext, Globex, Eurex, Sydney Futures Exchange, Eurex US, Chicago Board of Options and the International Securities Exchange. The recent introduction of such facilities has sparked a trade-through debate similar to that concerning equity securities. In the United States, the Commodity Futures Trading Commission (CFTC) received many different comments from varying marketplace participants on the decision to allow block trading facilities for derivatives marketplaces.

In Canada, the recent rules adopted by the Bourse de Montréal (the Bourse) to introduce a block trading facility on some products did not attract the same level of attention that equity market trade-through is attracting. Effective January 31, 2005, the Bourse introduced new rules and procedures to allow block transactions on certain derivative products.[35] The amendments exempt large block trades from having to satisfy best price obligations and allow block trades meeting a substantial size threshold to trade through better-priced orders on fixed income derivatives.

To date, the impact of block trading facilities on the derivatives marketplace is largely unknown due to the infrequency of and lack of historical data regarding such large trades. However, the approval of the Bourse's rules by the Autorité des marchés financiers (AMF) was subject to conditions.[36] One of these conditions required the Bourse to conduct a study on the market impact of block trades for the first six months of operations and file monthly statistical reports

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[33] Securities and Exchange Commission, *Dissent of Commissioners Cynthia A. Glassman and Paul S. Atkins to the Adoption of Regulation NMS*, dated June 9, 2005, at page 10 (SEC dissent).
[34] See footnote 33, SEC dissent at page 2.
[35] Bourse de Montréal Circular no. 014-2005 dated January 27, 2005.
[36] Decision No. 2004-SMV-0191, published in the AMF Bulletin, 2005-01-28, Volume 2 no. 04.

with the AMF on block trades carried out in its markets. Also, the CFTC is currently conducting a study using market data to determine the impact of block transactions on marketplaces they regulate, before and after execution.

6. *Should trade-throughs be treated differently on derivatives markets than equity markets? Why or why not?*

III. ROLE AND SCOPE OF A TRADE-THROUGH OBLIGATION

A. Nature of any Trade-Through Obligation

1. Balancing investor confidence and competition and innovation

Many market participants believe that some form of trade-through obligation is important to maintain investor confidence in the market, especially in markets such as ours where there is a high degree of retail participation and an expectation of trade-through protection. Without it, they argue, there is no incentive to contribute to the price discovery process, because investors who disclose their intentions will not be assured 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. They also argue that trade-through obligations create an incentive for investors to put their limit orders into a marketplace's book because they have the confidence that if their order is at the best price, it will be protected and their order will be filled before orders at inferior prices. This fosters confidence and encourages more liquidity in the market. This view is consistent with the newly adopted Order Protection Rule in the US, and while we must consider how our markets differ in determining the appropriate rules, we cannot ignore the impact of having different rules in this area.[37]

However, others say that a full trade-through obligation is not appropriate. They argue that certain investors, specifically institutions, are sophisticated enough to determine for themselves whether they want to trade against orders at the best price available. Many factors can go into a decision to execute a trade including price, speed of execution, certainty of getting the execution, opportunity costs, commissions and other transaction costs, and the most important factor to such investors in trade execution may not be price.

In addition, some believe that if new marketplaces are designed to allow institutions to trade with each other directly, they should not have to "take out" better-priced orders on the traditional marketplace, especially if it has monopolistic position, because such a requirement would affect their ability to execute their trade on the marketplace of their choice. They argue that (a) any duty to the market should only be placed on the dealers, and (b) institutional investors that trade for themselves should have no such duty, especially due to the average size of their trades and their need to act in the best interests of those whose money they invest. In addition, imposing the obligation on marketplaces or marketplace participants could interfere with the ability to execute large blocks efficiently.

[37] Reg NMS is discussed above in section II.C.3.

Further, some argue that enforcing trade-through protection may stifle competition and innovation. By implementing a trade-through obligation on all marketplaces, new marketplaces may be forced to adopt the same business model as the existing exchanges, functionally eliminating innovation.[38] They argue that these new marketplaces are providing a niche for certain participants and it is wrong to force them to adopt an existing model. Innovative ideas and different business models are the way to attract participants and market share and a trade-through obligation may not enable these models to flourish.[39] By imposing a predetermined architecture on the structure of the market by forcing technological linkages and rules on participants to eliminate the occurrence of trade-throughs, such measures may be successful initially at eliminating them but may serve as a deterrent to further innovation and new marketplace competition. Some argue that this lack of competition and innovation may lead to a decrease in investor confidence in the market as a whole. In addition, the fact that to date in Canada ATS activities have been limited must be considered.

There is a need to maintain a balance between competition among marketplaces, so that efficient trading services are promoted, and integrating competition among orders which promotes more efficient pricing of individual securities. Therefore, the regulatory structure should seek to avoid the extremes of isolated marketplaces trading the same security without regard to trading in other marketplaces and a totally centralized system that loses the benefits of competition and innovation among marketplaces.[40]

7. *Should trade-through protection be imposed where there are multiple marketplaces trading the same securities? Why? Why not? What are the advantages and disadvantages?*

8. *Will the trade-through obligation impact innovation and competition in the Canadian market? How?*

2. Trade-through as an obligation to the client

UMIR Policy 5.2 directly links trade-through to the best price obligation owed to clients and was seen as part of the fiduciary duty owed by an intermediary to its clients. This characterization of the trade-through obligation has implications on whom the obligation should be placed as well as the scope of the obligation. If it is part of the duty to act in the best interests of clients, then it is limited to those intermediaries who have such obligations either under statute, common law, the Quebec civil code or the rules of a self-regulatory organization. It could also mean that a client should have full discretion on whether the client's trading objective is best price or some other factor such as immediacy.

3. Trade-through as an obligation to the market

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[38]Peterffy and Battan, "Why Some Dealers and Exchanges Have Been Slow to Automate", *Financial Analysts Journal*, Volume 60, Number 4 at page 16.
[39]Lee, Ruben, *Capital Markets that Benefit Investors - A Survey of the Evidence on Fragmentation, Internalisation and Market Transparency*, September 30, 2002.
[40]See footnote 5, SEC Final Release at pp. 12-13.

As described above, trade-through obligations have been limited to dealers as part of their obligations to their clients and were not imposed on investors as a general duty. However, if one accepts the view that trade-through protection is essential to the market as a whole, then it should be an obligation that either all direct participants (whether they are dealers or not) or marketplaces have to the market. Imposing this duty ensures fairness to all market participants and allows price to be the key determinant as to whether an order gets executed or not. Part B below discusses the implications of placing the obligation on the participants versus the marketplace.

9. *Should the trade-through obligation remain an obligation owed by dealers to their clients or should all marketplace participants owe a general duty to the market?*

B. On Whom Should a Trade-Through Obligation be Imposed?

If the trade-through obligation is no longer characterized as resulting from a duty to the client and is seen more as an obligation to the market, then to whom should the obligation be extended and how?

1. Should the obligation be on the marketplace participant?

As described above, Part 2 of UMIR Policy 5.2 *Best Price Obligation* currently places responsibility on the Participant and states that "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 a stock exchange or organized market." Historically, only dealers could access the equity markets and trade-through protection wasn't an issue because the TSX platform enforced best price allocation. The recent proliferation of intermediated direct market access coupled with ATSs interested in providing direct access to institutional investors requires us to examine the issue.

If the general duty and thus a trade-through obligation is imposed on all marketplace participants, it may be difficult to implement for a variety of reasons. First, investors and dealers have different resources and capabilities. One of the primary business functions of a dealer is trading securities and they have professional traders whose job is to execute trades in certain securities and who have developed various tools to facilitate this, including tools for monitoring marketplaces for the best price available. Institutional investors, on the other hand, may also have professional traders but trading is not the institutions' primary business. They may not have the tools or the ability to monitor all marketplaces for the best available price. It is even less likely that a retail investor would have these tools.

Currently, there is no "standard" of proficiency needed to gain access to marketplaces. The requirements necessary for the access to one marketplace may differ significantly from those of another. If a trade-through obligation is placed upon marketplace participants, they must have the ability to monitor, measure and execute trades to ensure compliance with the trade-through obligation. It is likely that most non-dealers currently do not have this ability and, to the extent parallel obligations are placed on different marketplace participants, consideration should be given to whether consistent proficiency requirements should be applied.

In addition, the regulator would have to take steps to monitor and ensure compliance with trade-through obligations for a much larger group. Dealers and non-dealers alike would have to institute policies and procedures that would have to be reviewed. This could also necessitate reviews of institutions or retail investors for compliance with trading rules, something that has not been traditionally performed.

RS's proposal published on June 3, 2005 recommends placing the obligation on the marketplace participants, both dealer and non-dealer, to "make reasonable efforts to fill all orders displayed in a consolidated market display".

2. Should the obligation be on the marketplace?

An alternative to placing the obligation on the marketplace participants, as the UMIRs currently do, is to place the obligation on the marketplaces.

Requiring the marketplaces to establish procedures to satisfy the trade-through obligation eliminates the concern over different participants' ability to identify, measure, and execute in accordance with the obligation. Placing an obligation on the marketplace, rather than the participant, also allows more freedom to adapt quickly to market innovations and new technology, as marketplaces are in a better position to respond quickly to new developments in the market than marketplace participants.

In contrast to the RS proposal, in the United States, the SEC has imposed the obligation on the trading center to "establish, maintain, and enforce written policies and procedures that are reasonably designed to prevent trade-throughs, and, if relying on one of the rule's exceptions, which are reasonably, designed to assure compliance with the exception."

Although the Canadian equity market is not as complex as that in the U.S., if a trade-through obligation is adopted to help protect investors or the integrity of Canadian equity markets, then imposing the trade-through obligation on marketplaces appears to be the better alternative. Differences in proficiency requirements, access, and ability to measure and determine trade-through obligations among participants in the market could lead to an inconsistent approach to trade-through protection if the obligation is imposed on the marketplace participant instead of the marketplace. A marketplace solution could largely be instituted through technological linkages, either directly between marketplaces or indirectly through use of smart order-routers, and could provide an objective means of routing orders to the best price.

Another advantage of placing the obligation on the marketplace is that it would be easier to monitor and enforce. In addition, it appears that imposing the obligation on the marketplace participant would be more costly. Specifically, having every marketplace participant connect to every marketplace, directly or indirectly, in order to comply with a trade-through obligation would cost more overall than if a smaller number of marketplaces were required to create such connections to each other.

Placing the obligation on the marketplace allows the marketplace to determine the best means for achieving its trade-through obligation. The marketplace could address the issues through the

design of its trade execution algorithms (e.g. all orders must be within the bid/ask spread of the orders being shown), direct linkages, or the use of indirect means. However, there are some disadvantages to this approach. First, there is a question of whether requiring a marketplace to route orders to another marketplace would affect innovation and the ability of marketplaces to design creative models of execution or limit their access to particular participants. Second, there may be a large cost to the marketplace to establish the systems necessary to enforce trade-through protection.

10. If a trade-through obligation is imposed, should the obligation be imposed on the marketplace participant or the marketplace? Why?

C. Meeting a Trade-Through Obligation

Under the current UMIR provisions, a dealer is expected to take out better-priced orders before executing an order at an inferior price. However, internal and intentional crosses[41] on the TSX have been dealt with differently. TSX Rule 4-802 describes when certain trades entered or the trade execution will be subject to interference from orders in the book. This suggests that those orders have been matched and the obligation to take out better-priced orders arises after the matching.[42] Thus different trade allocation methodologies pose different challenges for when and how the trade-through obligation is met.

We note that, in the United States, the SEC states that the Order Protection Rule takes a substantially different approach than that which was taken by The Intermarket Trading System plan (ITS) applicable to exchange-listed securities. The ITS provisions provided for an after-the-fact complaint procedure pursuant to which the aggrieved market would seek satisfaction from the market traded through. In contrast, the Order Protection Rule is designed to “prevent” trade-throughs, or if a marketplace is relying on an exception, to assure compliance with the exception.[43]

This section discusses the issues related to when and how to meet a trade-through obligation. We note that these solutions are not mutually exclusive.

1. Satisfying the trade-through obligation before or simultaneously with execution

Implementing a trade-through obligation could require an entity to fill all better-priced orders, including those on other marketplaces before the trade occurs, or simultaneously if an exception for sweep orders is included. This approach is similar to the market model that the Canadian equity markets currently use where all better-priced orders are filled before an execution occurs

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[41] An “intentional cross means a trade resulting from the entry by a Participant of both the order to purchase and the order to sell a security, but does not include a trade in which the Participant has entered one of the orders as a jitney order.” An “internal cross means an intentional cross between two client accounts of a Participant which are managed by a single firm acting as a portfolio manager with discretionary authority to manage the investment portfolio granted by each of the clients and includes a trade where the Participant is acting as a portfolio manager in authorizing the trade between the two client accounts.” UMIR section 1.1.

[42] It is not clear whether it is technically before the actual execution in that it is before the cross is printed.

[43]See footnote 5, SEC Final Release at pp. 22-24.

at a lower price.[44] However, this model may not be effective for all marketplace structures, especially in circumstances where there is no pre-trade price or volume transparency.

Implementation issues relating to this approach are not as complex as the post-matching approach (see below). The issues that arise in implementing the preventative approach depend on whether the obligation is imposed on the marketplace or the marketplace participant and relate to how the obligation is determined, the level of execution and whether participants must have access to all marketplaces.

(a) How the obligation is determined

To implement the "preventative" trade-through obligation, an entity needs to determine which marketplaces have the best-priced orders and the volume that needs to be executed.

Technology solutions may be required to monitor other marketplaces to determine where the better-priced orders are located so they can be executed first in a timely manner. In addition, there would need to be an easily discernable audit trail to evaluate how the obligation is being met. The SEC, in its final release of Reg NMS, stated that it has instructed its staff to develop a rule proposal that would require trading centers to publicly disclose standardized and comparable statistics on the incidence of trade-through transactions that do not fall within an exception to the rule.[45]

In our view, the solution regarding how to monitor and satisfy a trade-through obligation that applies to all marketplace participants is a much more difficult task than that which applies to a marketplace. Marketplace participants with different skills may have difficulty in determining if there are better-priced orders available and the size of those orders, especially if the quote information from multiple marketplaces is not consolidated. The cost of meeting the obligation may be higher than if the obligation was on the marketplace.

11. What technology solutions exist or need to be developed if a trade-through obligation is imposed on marketplaces? What solutions exist if the obligation is imposed, instead, on marketplace participants?

12. Does the absence of a data consolidator affect whether and how the trade-through obligation should be imposed?

(b) Impact on access requirements

NI 21-101 acknowledges the importance of access to marketplaces. Sections 5.1 and 6.13 of NI 21-101 provide that recognized exchanges and ATSs shall establish written standards for granting access to trading and shall not unreasonably prohibit, condition or limit access to services provided by it. Consideration needs to be given to the impact of extending the trade-through obligation for marketplaces or market participants on access requirements.

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[44] For example, in the upstairs market if participants agree to a price on a block trade at an inferior level to the bid or offer, all better-priced orders on the TSX must be filled before the trade can occur.
[45] See footnote 5, SEC Final Release at page 150.

The RS proposal limits the trade-through obligation on marketplace participants to only those marketplaces to which they have direct access. As mentioned earlier, a marketplace participant could avoid the trade-through obligation simply by obtaining direct access to only one marketplace, and indirectly accessing the other marketplaces through a dealer. By doing so, it would be able to take advantage of the dealer's obligation to trade at the best price available when it chooses to do so, creating a gap that could be exploited to a marketplace participant's advantage.

On the other hand, there are issues with placing the obligation on marketplace participants and requiring them to have direct access to *all* marketplaces. Forcing participants in the market to access all marketplaces means greater cost and complexity for the marketplace participants because they would have to access multiple marketplaces including marketplaces where they may seldom trade and which may employ execution methodologies they prefer not to use. In addition, requiring all marketplace participants to have access to all marketplaces could affect each marketplace's ability to design its own business model, particularly where a marketplace is structured to allow for access by only one type of marketplace participant (for example, institutional investors) or where marketplace participants have to meet strict criteria in order to obtain access.

As stated above, the SEC's Order Protection Rule requires trading centers to establish, maintain and enforce written policies that are reasonably designed to prevent trade-throughs. It also addresses the issue of access to marketplaces through the Access Rule[46]. The SEC describes the intended effect of the Access Rule as follows:

> "First, it enables the use of private linkages offered by a variety of connectivity providers, rather than mandating a collective linkage facility such as ITS, to facilitate the necessary access to quotations. The lower cost and increased flexibility of connectivity in recent years has made private linkages a feasible alternative to hard linkages, absent barriers to access. Using private linkages, market participants may obtain indirect access to quotations displayed by a particular trading center through members, subscribers, or customers of that trading center. To promote this type of indirect access, Rule 610 prohibits a trading center from imposing unfairly discriminatory terms that would prevent or inhibit the access of any person through members, subscribers, or customers of such trading center."[47]

Placing the obligation on marketplaces helps to avoid creating additional access issues for the participants. However, it remains possible for a marketplace to meets its trade-through obligation by transferring it to its participants.

13. Does a regime imposing a trade-through obligation need to address access fees?[48]

[46]See footnote 5, SEC Final Release, Rule 242.610.
[47]See footnote 5, SEC Final Release at page 27.
[48]The Access Rule includes a portion that limits the access fees that can be charged for access to protected quotations and manual quotations at the best bid and offer.

14. If a trade-through obligation is placed on marketplace participants, what other access issues need to be addressed?

(c) Depth-of-book or best bid/ask

Historically, equity marketplaces in Canada have enforced best price obligations and, by implication, trade-through protection, for all orders at a better price. The ability to offer protection to all orders in the order book was, until recently, simplified by the fact that securities were each traded on only one marketplace and equity marketplaces in Canada were fully automated.

In contrast, in an environment like the United States with securities trading on multiple marketplaces and fragmentation of order flow, applying protection to depth-of-book is much more complicated. Not all marketplaces in the United States are automated and some exchanges had adopted a specialist system where orders could be filled manually. This led to a difference in the timing of execution of orders that were entered onto a manual market versus an electronic market. As a result, in the United States, trade-through protection has focused on an approach that only requires the execution of the level of the national best bid and offer (NBBO), or "top-of-book", and not full depth-of-book.

The Canadian equity market does not have the same structure and related issues with manual versus automated markets. In particular, all marketplaces in Canada are currently fully automated electronic trading systems and there are only a handful of marketplaces. As a result, implementing the U.S. top-of-book approach lends itself to less trade-through protection than has historically existed in Canada.

15. If a trade-through obligation is imposed, should the obligation use a full depth-of-book approach or only a top-of-book approach?

(d) Sweep orders

One way to facilitate the implementation of a trade-through obligation is to allow for "sweep orders." Under the Order Protection Rule, a trading center is exempt from the trade-through obligations if it receives an inter-market sweep order or routes an order as an inter-market sweep order. Sweep orders would allow a marketplace participant to route orders to multiple marketplaces simultaneously in order to execute both the better and inferior prices at the same time. A sweep order would require systems changes at the marketplace level to allow for a "sweep marker" so that the system could recognize that orders were simultaneously sent to execute both the better-priced and inferior priced orders.

If a trade-through obligation is imposed on the marketplaces, they would need to establish policies and procedures for an order to be routed to another marketplace with a better price. An order marked "sweep" would tell the receiving marketplace not to reroute the order because the participant had also sent simultaneous multiple orders to meet the trade-through obligation.

16. *Should the solution developed to deal with trade-throughs include the ability to route sweep orders?*

2. Trade-through obligation for marketplaces with limited pre-trade transparency or other unusual execution characteristics

In some marketplaces, a participant may have submitted an order with a set price and volume but may not know if there will be a match until the match actually occurs because the quotes on the marketplace are not transparent. Other marketplaces may allow participants to negotiate directly by communicating orders to each other until there is a match. Because of their structures, these systems may not enable an entity to meet the trade-through obligation before or simultaneously with, an execution at an inferior price.

One potential solution would be to implement a post-matching approach, similar to a cross-interference mechanism, which imposes a duty on an entity to satisfy the "better-priced" orders after trade matching occurs. This approach can be used whether the obligation is on the marketplace or the marketplace participant. Using the post-matching approach may be necessary for marketplace models that do not have pre-trade transparency. In these models, it is impossible to fulfill the trade-through obligation prior to the match because marketplace participants do not know if there are orders in the book that will match with theirs nor do they know the price at which the match will occur. Only once the matching occurs is there certainty as to whether the price is inferior to the prices available on other marketplaces and only AFTER the execution could the better-priced orders on other marketplaces be filled.

As discussed below, implementation of the post-matching obligation approach is more complicated than a preventative approach and raises a number of issues that depend on both the particular market model and the regulatory model we choose.

17. *Where marketplace participants are trading on a marketplace where they do not know if their orders will match and the order book is not transparent, upon execution of an order outside the bid/ask spread of another marketplace, should the participant have to satisfy better-priced orders available on other marketplaces? If so, how? Should this be restricted to visible orders?*

(a) Depth-of-book or best bid/ask?

The post-matching approach requires that the person with the trade-through obligation determine the amount of the displacement that must occur after a trade is executed at an inferior price. This, along with the issues identified below, make the post-matching approach more complicated than the pre-execution approach.

To implement the post-matching approach, the volume of the orders that must be displaced and a method of executing those orders must be determined. The determination of the amount of the post-matching obligation may be difficult to ascertain because the market for the particular security may be moving quickly and it may be difficult to measure the actual amount of the obligation at a particular moment in time.

There are a number of different methods of establishing the amount of the post-matching obligation and we discuss several here. One option is to limit the amount of the post-matching obligation to the volume of the original trade. This approach would not necessarily clear out all the better-priced orders and could allow for trade-throughs. However, it would also allow for the determination of the liability associated with a particular trade.

Another option is to require the marketplace participant to fill all orders at better prices, regardless of the volume immediately after the trade. This approach would ensure that better-priced orders on all marketplaces are filled at the time the inferior-priced trade is executed. However, this approach leads to unlimited liability for those executing inferior-priced trades and may inhibit less sophisticated marketplace participants from entering the market because the risk associated with unlimited liability may outweigh the benefits of trading.

Finally, the model may allow for a snapshot of the marketplaces to be taken at a particular point in time, such that the volume of all better-priced orders is fixed at that moment. Any orders entered after the snapshot is taken would not be filled. This approach would fix the liability of a particular marketplace participant and ensure that all better-priced orders that existed at the time of execution of the inferior-priced order are filled. This approach would also eliminate the ability of speculators to benefit from the expected entry of post-execution orders. The questions that arise when considering the use of a snapshot are who would take it, how it would be taken and what technological changes would be necessary to implement it.

18. *If a trade-through obligation is imposed, should it occur at, simultaneously to or immediately after execution of the inferior- priced trade? Should the model accommodate all three solutions?*

19. *If a trade-through obligation is imposed, should it apply to all better-priced orders existing when the obligation is discharged, all better-priced pre-existing orders (at the time of execution) or should it be limited to amount of the trade at the inferior price?*

IV. EXEMPTIONS FROM A TRADE-THROUGH OBLIGATION

Regulators that have imposed a trade-though obligation have also allowed for certain exemptions from the obligation. This section discusses those exemptions.

A. Exemptions Related to the Determination of Price or Special Terms

As described above in section II.B.2, the UMIRs set out a number of exemptions from the existing best price obligation. The basis for an exemption for some of these types of orders is that the price of execution is not known with certainty at the time of order entry because the trading system uses a predetermined algorithm to calculate the execution price of such orders and the price is therefore not known by the marketplace participant at the time of order entry (order types that are calculated by an algorithm, e.g. VWAP orders) or is not based on the quotes currently displayed in the marketplace. In these circumstances, marketplace participants cannot determine if there will be a trade-through obligation before deciding to enter the order on a marketplace.

There are also exemptions granted to Special Terms Orders[49] that exclude them from executing as a normal order because the counterparty to the trade may only be inclined to accept the terms if the execution is done at a discount to the best available price. As a result, the price of execution of Special Terms Orders may occur outside the best available bid and ask price.

20. If a trade-through obligation is imposed, should exemptions be provided for special terms orders? Which ones and why?

21. If a trade-through obligation is imposed, should an exemption be provided for orders for which the price or other material terms cannot be determined on order entry?

B. Block Trade Exemptions

One of the developments that has focused attention on the trade-through debate has been the difficulty and uncertainty created when handling large orders. When marketplace participants are considering trading a large block of a particular security they want to know the exact volume that may be executed in any venue and a reasonable estimate of the price of the trade. With a trade-through obligation in place, marketplace participants may not be able to readily discern this information. There is additional complexity when iceberg orders are allowed on the marketplace because it becomes impossible for participants to know the volume available at a particular price.[50]

In addition, the presence of a large order often results in increased price volatility, as other participants, not involved in the block transaction, may see indications of buying or selling pressure and may place additional orders at better prices that need to be filled before the execution price of the block is reached causing further interference in the execution of the block. Participants that engage in large block transactions are concerned with uncertainty relating to prices and volumes. They believe that such uncertainty discourages trading activity and reduces the amount of liquidity provided for certain securities. In response to these concerns, realizing that large block trading represents a significant amount of volume and business, marketplaces have been creating facilities or providing exemptions to facilitate large volume block transactions.[51]

However, the ability of large block transactions to trade through better-priced orders that have been previously entered onto a marketplace may dissuade or prevent smaller participants from participating in the marketplace. In addition, some argue that if the size of a block transaction is very large, it should not be a problem to displace those smaller orders already in the book.

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[49] See footnote 12 for definition of “Special Terms Order”.

[50] See section C below for a discussion of iceberg orders.

[51] Some examples include the Bourse de Montréal block trading facility and the TSX’s iceberg order type. In the Bourse block trading example, these trades are permitted to be executed outside of the bid-ask spread (i.e. not subject to trade-through obligations). The existence of iceberg orders has implications for any trade-through obligation, as discussed below.

The SEC, in its final release of Reg NMS, did not provide for an exemption for block trades. Instead, they indicated that "the use of the inter-market sweep order will facilitate the immediate execution of block orders by dealers on behalf of their institutional clients."[52]

Another exemption from the trade-through obligation is provided to a "wide distribution" in certain circumstances.[53] This exemption is granted on a similar basis to the exemption granted for large block transactions on the derivatives markets – i.e., that such a large order will create unwanted price volatility and discourage participants from placing orders.

If some accommodations for large block transactions are appropriate, the key will be determining the appropriate size threshold. The threshold must strike a balance between excluding trades that would have minimum price impact on the book and being large enough that it applies to trades that could be potentially disruptive to the marketplace. At present, the marketplaces that offer facilities or exemptions from trade-through obligations determine the amount for the size threshold. As competition between marketplaces grows, there may an incentive to facilitate block trades, by lowering the amount of the size threshold to capture business.

22. If a trade-through obligation is imposed, should it include an exemption for large block trades?

23. Should the size threshold for a block trade exemption for the same security traded on multiple marketplaces be the same across marketplaces? If not, what would the impact be?

24. If a trade-through obligation is imposed, will sweep orders facilitate the execution of block orders? How?

C. Exemption for Non-Visible Parts of an Order

One issue that arises when developing a trade-through obligation is whether the obligation should apply to any undisclosed portions of orders in the book. An "iceberg order" is a type of order that allows a large single order entered onto the marketplace to be divided into smaller visible amounts for the purpose of hiding the actual size. This allows other market participants to see only the small disclosed portion of the order. Once the small disclosed amount has been displaced another small portion of the order immediately appears; this process repeats until the total amount of the order has been filled. By hiding the large size of the order, iceberg orders reduce the information leakage and minimize the price impact of disclosing such a large order.

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[52] See footnote 5, SEC Final Release at page 153.

[53] In an effort to facilitate the distribution of listed securities to a large number of investors, the Toronto Stock Exchange allows participants to distribute large blocks off exchange to investors at a fixed price. TSX Rule 4-103 defines a "wide distribution as a series of distribution principal trades to not less than 25 separate and unrelated client accounts, no one of which participates to the extent of more than 50% of the total value of the distribution." A "wide distribution" is an exception to the rule that listed securities must be traded on exchange. Participants are required to set aside up to 20% of the amount of the distribution to satisfy any additional orders to purchase the security in the book on the exchange and the Market Maker on the security is entitled to up to ten times the minimum guaranteed fill for the security as long as the 20% maximum has not been violated.

A marketplace that has permitted iceberg orders may require that within that market, the undisclosed portion of the iceberg must be filled to meet a trade-through obligation. However, between markets, it is questionable whether the non-visible portion should be protected by a trade-through obligation. The existence of iceberg orders causes difficulties with determining the volume that would need to be displaced to comply with a trade-through obligation. If an iceberg order is entered onto a marketplace, marketplace participants cannot determine the exact volume of better-priced orders that would have to be displaced in meeting their trade-through obligation. Visible orders in the book help provide liquidity and help in the price discovery process. The introduction of iceberg orders is one type of facilitation for trading large orders and should not result in uncertainty for marketplace participants that wish to execute orders on other marketplaces. Therefore, it is harder to argue that the undisclosed portion of iceberg orders should be given trade-through protection. Further, the lack of trade-through protection for iceberg orders is consistent with not extending such protection to orders in marketplaces with no pre-trade transparency.

A practical result of not protecting non-visible portions of an order is that a technology change would be required that permits a type of "tagged order" or "sweep order" that would facilitate the displacement of a better-priced order on another marketplace and enable the order to by-pass iceberg orders.

We note that in its "Off-Marketplace Trades" proposal, RS indicates that certain orders that are within a specific band are required to execute against only the visible orders in the book.[54]

25. *If a trade-through obligation is imposed, should it apply to any non-visible portions of a trading book?*

D. Issues Considered By the SEC

1. Fast markets vs. slow markets

As discussed in Section II.C.3, in the United States, issues arose because of the fact that certain marketplaces were electronic or "fast" and others were manual markets or so-called "slow" markets. In response to complaints about the length of time execution took on manual markets and how it placed electronic markets at a disadvantage, the original amendments proposed in Reg NMS provided an "opt-out" feature that allowed clients to waive their trade-through protection if the better-priced order was on a manual marketplace. The rationale behind the opt-out was that the risks caused by uncertainty when executing on a slow market and the speed it took to receive an execution on a fast market may for some clients outweigh the benefits of potentially achieving that "better-priced" order on the manual market. However, the SEC adopted the Order Protection Rule without this "opt-out" but with the clarification that order protection applies only to those quotations that are immediately and automatically accessible. In other words, order protection is not available to manual quotes.

The introduction of multiple marketplaces in Canada allows for the possibility of the introduction of a slow marketplace, where orders are not immediate executable. Currently, all

[54] See discussion of "Off-Marketplace Trades" above in section II.C.2(a).

marketplaces provide electronic, immediately executable quotes. If we adopt trade-through protection we will need to consider whether we should provide the ability to trade-through a slow market.

26. *Should we provide the ability to opt out of routing orders to marketplaces where the better-priced order is on a manual marketplace or should the rule be drafted to apply to protect only those orders that are immediate and automatically accessible?*

2. General ability to opt out

One possible exception is to provide marketplace participants with the ability to opt out of trade-through protection if they have provided informed consent. The intention of this exemption would be to provide investors with the opportunity to opt out in a variety of circumstances, including executing block transactions without moving the market. The SEC had considered including an opt-out in Reg NMS. However, the SEC, in its final release, adopted the Order Protection Rule without an opt-out because in their view, "such an exception could severely detract from the benefits of inter-market order protection."[55]

V. IMPLICATIONS OF A TRADE-THROUGH OBLIGATION

The imposition of a trade-through obligation will likely have operational and technological costs for marketplace participants and marketplaces and may require consequential amendments to current rules.

A. Operational Issues

If the obligation is placed on marketplace participants, both dealers and non-dealers will have to develop policies and procedures to ensure that the obligation is met. There also could be pressure to connect to each marketplace in order to ensure that they have access to the best price available on all marketplaces in order to meaningfully meet the obligation. In addition, regulators will have to develop compliance programs and will have to conduct reviews of all marketplace participants to ensure compliance with the requirement. This includes reviews of participants that have not historically been reviewed – specifically, institutions and, potentially, retail investors.

If the obligation is on marketplaces, the marketplaces will have to determine how to ensure that the obligation is met. This may be done by creating linkages to other marketplaces or other technology solutions or by placing obligations on their participants. They will also have to implement policies and procedures to ensure compliance with the requirements.

27. *What is the impact of imposing a trade-through obligation on non-dealers?*

[55] "Instead, Rule 611 addresses the concerns of those who otherwise may have felt that they needed to opt-out of protected quotations in a more targeted manner. In particular, the Rule incorporates an approach that seeks to serve the interests of both marketable orders and limit orders by appropriately balancing these interests..." See footnote 5, SEC Final Release at page 119.

B. Trading Increments

With the introduction of trade-through protection, there is a possibility that marketplace participants may “front” a large order (identify a large order and place better-priced orders of a smaller size ahead of the large order). This is especially true when a price can be improved by one penny. One potential consideration when imposing a trade-through obligation is whether trading increments should be greater than a penny to balance the interests of block trades and limit order protection.

C. Consequential Issues Related to Multiple Marketplaces Trading the Same Securities

The existence of multiple marketplaces that are trading the same securities causes some additional technical issues not specifically addressed by the implementation of a trade-through rule. For example, there are additional concerns raised by locked and crossed markets, the difference between price priority and price-time priority, and the determination of the last sale price. In May 2005, RS proposed amendments to UMIR to accommodate the introduction of multiple and competitive marketplaces.[56] The amendments address some of the issues discussed in the following section, including amendments to the definition of last sale price.

1. Best Execution

The assurance that the best-priced orders on a Canadian exchange would trade first led, historically, to two practical outcomes:

- Marketplace participants were encouraged to use limit orders and they could be certain that price alone was the basis for execution of orders.
- One of the primary fiduciary obligations owed to clients, to obtain the best price, was guaranteed by simply placing an order on the system.

With the automation of best price execution, dealers were left to focus on factors other than price in achieving best execution for their clients’ orders. This combination of automated best price execution once an order was directed to a particular exchange, and the dealer determining which other variables were important for execution, allowed dealers to meet all of their execution objectives at the same time.

Recent improvements in technology and the introduction of new marketplaces have provided institutional investors with direct access to certain marketplaces without the need for an intermediary, and have raised issues about the role of best price obligation in best execution. In addition, a recent review of the meaning of best execution prepared by some of the CSA jurisdictions, and renewed interest in the United States and the United Kingdom as part of their review of appropriate use of commissions, have complicated the issue.

Concept Paper 23-402 *Best Execution and Soft Dollar Arrangements* suggested as a description that best execution means the best net result for the client, considering relevant elements (including price, speed of execution, certainty of execution, and total transaction cost) in light of

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[56] Published at (2005), 28 OSCB 5297.

the client's stated investment objectives.[57] The CSA is considering this description in light of comments received.

In this context, the introduction of multiple marketplaces will likely complicate the dealer's ability to ensure that both best price and best execution obligations (if different from best price) are met. For example, when a dealer is handling a client order it will have to determine which marketplace is providing the best available price. Historically, the dealer knew that by placing an order on the equity marketplace it was guaranteed the best price because of system enforcement of the obligation. With the introduction of multiple marketplaces, the dealer cannot be assured without taking additional steps that the best price is obtained. In addition, it is possible that trading at what may be the best price may conflict with achieving best execution, if best execution is defined to include other relevant factors that may go into a trading decision (including the speed of execution, opportunity cost, and risk of missing the trade).[58]

While dealers are subject to best execution, client priority and best price obligations, most institutional investors are not. Some institutional investors may have a responsibility to their members, beneficiaries or clients to act in good faith (registered advisers[59]) or with prudence and care (for example, pension funds, trustees of other trust funds); however, that standard is not applied to all institutional investors. Many institutional investors trade for themselves and as a result, are not subject to the existing best price and client priority rules and, consequently, historically, trade-through obligations have not applied to them. However, the focus of a trade-through obligation is broader, and encompasses a general duty of all marketplace participants to the market as a whole.[60]

The SEC in the final release of Reg NMS emphasizes that the adoption of the Order Protection Rule does not lessen a dealer's duty of best execution. The SEC states:

> "The Commission has not viewed the duty of best execution as inconsistent with the automated routing of orders or required automated routing on an order-by-order basis to the market with the best quoted price at the time. Rather, the duty of best execution requires broker-dealers to periodically assess the quality of competing markets to assure that order flow is directed to the markets providing the most beneficial terms for their customer orders. Broker-dealers must examine their procedures for seeking to obtain best execution in light of market and technology changes and modify those practices if necessary to enable their customers to obtain the best reasonably available prices....The protection against trade-throughs... undergirds the broker-dealer's duty of best execution, by helping to ensure that customer orders are not executed at prices inferior to the best protected quotations. Nonetheless, the Order Protection Rule does not supplant or diminish the broker-dealer's responsibility for achieving best execution, including its duty to evaluate the execution quality of markets to which it routes customer orders, regardless of the exceptions set forth in the Rule."

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[57] Published at (2005), 28 OSCB 1367.

[58] Letter to SEC regarding Reg NMS from Citadel Investment Group L.L.C. dated July 9, 2004, p.6-7.

[59] Institutions that are registered advisers have duties to act in good faith (OSC Rule 31-505).

[60] See footnote 5, SEC Final Release at pp. 160-161.

28. *Does the introduction of multiple marketplaces trading the same security cause a conflict between what is needed to meet best price obligations and what is needed to meet best execution obligations if the latter is defined as something different from best price only? How can this conflict be resolved? Is one obligation, best price or best execution more important than the other? Why? Why not?*

2. Locked or crossed markets

A "locked market" occurs when there are multiple marketplaces trading the same security where 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.

The ability of participants to be aware of better prices and to place orders on other marketplaces varies greatly. If the order is subject to best execution, e.g. an order a dealer is working as agent, the dealer should place the order on the marketplace where it is likely to get executed immediately. However, other orders are not subject to best execution, e.g. institutional or market maker orders, and those participants may not want to place their orders on another exchange, i.e. they may be trying to have the other participant move their order. To prevent the occurrence of locked or crossed markets and to facilitate trading, rules could be established to prevent these situations from occurring. In large part, the frequency of locked or crossed markets occurring will depend on whom the trade-through obligation is imposed (the marketplace or the participants). If the trade-through obligation is imposed upon the marketplaces they will need to establish procedures to eliminate the trading-through of better-priced orders. Whichever solution is decided upon could also be used to facilitate the unlocking of securities. If the obligation is placed upon the marketplace participant, the marketplace participant may not be obligated or have the desire to unlock the markets if trading as principal or for non-client accounts.

29. *How should locked or crossed markets be treated? Should procedures be set up to limit the occurrence of locked or crossed markets? If so, upon whom should the obligation be placed?*

3. Method of trade allocation: difference between price priority and price-time priority

As noted above, the current UMIR provision applying a price priority obligation on participants, UMIR Rule 5.2 – Best Price Obligation, states that:

> A Participant shall make reasonable efforts prior to the execution of a client order to ensure that:
> (a) in the case of an offer by the client, the order is executed at the best bid price; and
> (b) in the case of a bid by the client, the order is executed at the best ask price.

The Participant is prohibited from trading at an inferior price given the prevailing best bid and offer. Price priority ensures that the last executed trade occurs at the best price.

For example, the current trading system of TSX and TSX Venture allocates trades based on a price-time priority allocation. That is, if multiple orders are received all with the same price the order that is received first is given priority over orders received later. This is to encourage the placement of orders in the book. One exception to this rule is when there are two orders that would result in a matched trade from the same participant; such an "in house" cross occurs regardless of the orders' time priority.

The existence of multiple marketplaces trading the same security creates the possibility of older orders entered on one marketplace being by-passed by newer orders of the same price that are placed on another marketplace. In addition, marketplaces may create new innovative ways to allocate trades that are different from the existing price priority or price-time priority allocations.

30. Should the method of trade allocation (price priority or price-time priority or some entirely different method) be the same for all marketplaces or should the marketplace be allowed to determine its own procedures for allocation of trades? Why or why not?

4. Last sale price

The definition of "last sale price" is defined in the UMIR as "the price of the last sale of at least one standard trading unit of a particular security displayed in a consolidated market display but does not include the price of a sale resulting from an order that is a Call Market Order." With the introduction of multiple marketplaces, the definition of the last sale price in a security, as this price is used as a limit for a number of trading rules, including short selling, may have to be reviewed.

31. Should the last sale price reflect trading on all marketplaces or should each marketplace have a separate last sale price? Why or why not?

VI. EVALUATING THE IMPACT ON MARKETS

A. SEC Study on Rates and Impact of Trade-Through

In the United States, the central issue of the trade-through debate was whether inter-market protection of displayed quotes was needed to promote the fairest and most efficient markets for

investors.[61] The comments received were divided on the issue; some believed full protection was necessary across markets while others felt that no protection was needed as competition among markets, the economic self-interest of the participants, and dealers' existing best execution duties would ensure that better-priced orders were traded first.[62] In an effort to address the comments and determine the rates and impact of trade-throughs on the American markets, the SEC conducted several studies by comparing trade data from inter-listed securities on the ITS (NYSE and the regional exchanges) and the NASDAQ. The SEC studies examined the trade data looking at the following criteria:

- Rates on trade-through on ITS/NASDAQ as a percentage of number of trades,
- Size of quotes traded through as a percentage of total share volume,
- Type of orders that trade-through. Block trades larger than 10,000 shares represent 50% of total trade-through volume,
- Percentage of share volume of trades less than 10,000 shares,
- Percentage of total share volume of traded-through quotations,
- Overall percentage of trades that get executed at an inferior price,
- Examination of fill rates on large orders as a proxy for the efficiency of trading on ITS and NASDAQ.[63]

The SEC's task of determining the rates and impact of trade-throughs was made easier by the existing market structure in the United States in two areas:

- Multiple marketplaces have existed for many years and the SEC could use trade data from a period before its announcement to examine the trade-through issue to ensure there was no bias in the data.
- The market structure provided two samples of marketplaces: the ITS system where there existed a limited trade-through rule and the NASDAQ where there was no trade-through protection. This allowed for the comparison of not only the different approaches but also allowed the SEC to examine the impact on securities listed in both types of marketplaces.

B. Status of Trade-Through Data in Canada

In Canada, since 1999, the same securities have not traded on multiple marketplaces[64]; as a result, there is no prior trade data to examine. The effect or impact of trade-throughs will largely be determined by the extent of trade-throughs that occur on Canadian marketplaces. This can

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[61] See footnote 5, SEC Final Release at page 38.
[62] See footnote 5, SEC Final Release at page 40.
[63] As discussed in Section II.C.3 above, there was a dissent to the SEC Final Release and the dissenters published a companion decision to the majority decision. In it, the dissenters make points that may be relevant in the Canadian public debate about trade-through. The dissenters

- were not convinced that the data collected supported the conclusion that trade-through represents a full 8% of all trades and concluded that trade-through represents only 2.5% of all trades
- concluded that 2.5% is not significant enough volume to warrant regulatory intervention
- noted that when institutional clients trade through, retail investors whose orders are left on the book are usually affected by margins of one penny or less.

[64] See footnote 6.

only be monitored once another marketplace trading the same securities as the existing exchanges begins to operate. During the comment period of this discussion paper and the transition if and when a rule is being considered, the CSA and RS will monitor the rates of trade-throughs, if any, on Canadian marketplaces and their impact on the Canadian market.

VII. CONCLUSIONS

The introduction of new marketplaces in Canada, the proliferation of direct market access to new types of trading participants, new facilities to accommodate block trading and rapidly changing technology all have led to the current trade-through debate. The regulation of the capital markets must strike a balance between encouraging innovation and creating a capital market that is fair and unbiased.

We encourage comment from all participants in the capital markets on this important issue. The outcome of this debate will shape the future of Canada's capital markets, and as a result, we feel the debate should be transparent and that all interested parties should have a chance to voice their opinions. We look forward to working with marketplace participants, marketplaces and other regulators in implementing a solution that provides flexibility and fairness for all market participants.

VIII. COMMENT PROCESS

A. Specific Comment Requested

The CSA specifically asks for comment on the following questions that appear throughout the paper:

1. What factors or criteria should be considered in identifying the appropriate structure and requirements for the Canadian market?

2. What market structure issues should be considered as part of the discussion on the trade-through obligation?

3. Should the discussion about trade-throughs consider trading of non-exchange traded securities on marketplaces other than exchanges (for example, fixed income securities trading on more than one ATS)? If so, please identify market structure issues that need to be reviewed.

4. Please provide comments on the RS proposal regarding trade-through obligations. Which elements do you agree or disagree with and why?

5. If a trade-through obligation is imposed, what differences between Canadian and United States markets should be considered?

6. Should trade-throughs be treated differently on derivatives markets than equity markets? Why or why not?

7. Should trade-through protection be imposed where there are multiple marketplaces trading the same securities? Why? Why not? What are the advantages and disadvantages?

8. Will the trade-through obligation impact innovation and competition in the Canadian market? How?

9. Should the trade-through obligation remain an obligation owed by dealers to their clients or should all marketplace participants owe a general duty to the market?

10. If a trade-through obligation is imposed, should the obligation be imposed on the marketplace participant or the marketplace? Why?

11. What technology solutions exist or need to be developed if a trade-through obligation is imposed on marketplaces? What solutions exist if the obligation is imposed, instead, on marketplace participants?

12. Does the absence of a data consolidator affect whether and how the trade-through obligation should be imposed?

13. Does a regime imposing a trade-through obligation need to address access fees?

14. If a trade-through obligation is placed on the marketplace participants, what other access issues need to be addressed?

15. If a trade-through obligation is imposed, should the obligation use a full depth-of-book approach or only a top-of-book approach?

16. Should the solution developed to deal with trade-throughs include the ability to route sweep orders?

17. Where marketplace participants are trading on a marketplace where they do not know if their orders will match and the order book is not transparent, upon execution of an order outside the bid/ask spread of another marketplace, should the participant have to satisfy better-priced orders available on other marketplaces? If so, how? Should this be restricted to visible orders?

18. If a trade-through obligation is imposed, should it occur at, simultaneously to or immediately after execution of the inferior- priced trade? Should the model accommodate all three solutions?

19. If a trade-through obligation is imposed, should it apply to all better-priced orders existing when the obligation is discharged, all better-priced pre-existing orders (at the time of execution) or should it be limited to amount of the trade at the inferior price?

20. If a trade-through obligation is imposed, should exemptions be provided for special terms orders? Which ones and why?

21. If a trade-through obligation is imposed, should an exemption be provided for orders for which the price or other material terms cannot be determined on order entry?

22. If a trade-through obligation is imposed, should it include an exemption for large block trades?

23. Should the size threshold for a block trade exemption for the same security traded on multiple marketplaces be the same across marketplaces? If not, what would the impact be?

24. If a trade-through obligation is imposed, will sweep orders facilitate the execution of block orders? How?

25. If a trade-through obligation is imposed, should it apply to any non-visible portions of a trading book?

26. Should we provide the ability to opt out of routing orders to marketplaces where the better-priced order is on a manual marketplace or should the rule be drafted to apply to protect only those orders that are immediate and automatically accessible?

27. What is the impact of imposing a trade-through obligation on non-dealers?

28. Does the introduction of multiple marketplaces trading the same security cause a conflict between what is needed to meet best price obligations and what is needed to meet best execution obligations if the latter is defined as something different from best price only? How can this conflict be resolved? Is one obligation, best price or best execution more important than the other? Why? Why not?

29. How should locked or crossed markets be treated? Should procedures be set up to limit the occurrence of locked or crossed markets? If so, upon whom should the obligation be placed?

30. Should the method of trade allocation (price priority or price-time priority or some entirely different method) be the same for all marketplaces or should the marketplace be allowed to determine its own procedures for allocation of trades? Why or why not?

31. Should the last sale price reflect trading on all marketplaces or should each marketplace have a separate last sale price? Why or why not?

B. Comments

Interested parties are invited to make written submissions on the concept paper. Please provide comments in writing on or before **Thursday, October 20**, 2005 to the CSA listed below in care of the OSC, in duplicate, as indicated below:

British Columbia Securities Commission
Alberta Securities Commission
Saskatchewan Financial Services Commission
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
New Brunswick Securities Commission
Registrar of Securities, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
Registrar of Securities, Northwest Territories
Registrar of Securities, Yukon Territory
Registrar of Securities, Nunavut

Please send your comments **only** to the addresses below. Your comments will be forwarded to the remaining CSA member jurisdictions.

c/o John Stevenson, Secretary
Ontario Securities Commission
20 Queen Street West
Suite 1903, Box 55
Toronto, Ontario M5H 3S8
Fax: (416) 593-2318
Email: jstevenson@osc.gov.on.ca

Please also send your submission to the Autorité des marchés financiers as follows:

Anne-Marie Beaudoin, Directrice du secrétariat
Autorité des marchés financiers
Tour de la Bourse
800, square Victoria
C.P. 246, 22e étage
Montréal, Québec H4Z 1G3
Email: consultation-en-cours@lautorite.com

Comment letters submitted in response to requests for comments are placed on the public file in certain jurisdictions and form part of the public record, unless confidentiality is requested. Comment letters will be circulated among the securities regulatory authorities, whether or not confidentiality is requested. Although comment letters requesting confidentiality will not be placed in the public file, freedom of information legislation in certain jurisdictions may require securities regulatory authorities in those jurisdictions to make comment letters available. Persons submitting comment letters should therefore be aware that the press and members of the public may be able to obtain access to any comment letters.

C. Public Forum

Because of the importance of the issues relating to the trade-through obligation and their impact on the Canadian capital markets, the CSA have scheduled a public forum on **Friday, October 14, 2005 at 10:00 am** to permit all interested parties to participate in the discussions relating to trade-through protection. Interested parties who wish to participate at the public forum are invited to indicate in their comment letter to this discussion paper that they wish to appear. These comment letters must be received by **Monday, September 19, 2005.**

It is anticipated that Commissioners will preside over the forum. Staff will not make submissions, but will participate as observers.

The public forum will be informal. Presentations may be made by counsel, experts and employees of all market participants. Only Commissioners will be allowed to question those who give oral presentations. However, other may provide contrary evidence as rebuttal. Presentations will be limited to one-half hour, unless otherwise justified. A transcript of the proceedings will be made. The final decision regarding the details of the process will be announced after CSA staff have reviewed the submissions and discussed the process with interested parties.

The issues should be focused on those raised in the discussion paper and the question asked.

D. Questions

Please refer your questions to any of the following people:

Randee Pavalow
Ontario Securities Commission
(416) 593-8257
rpavalow@osc.gov.on.ca

Cindy Petlock
Ontario Securities Commission
(416) 593-2351
cpetlock@osc.gov.on.ca

Tracey Stern
Ontario Securities Commission
(416) 593-8167
tstern@osc.gov.on.ca

Darren Sumarah
Ontario Securities Commission
(416) 593-2307
dsumarah@osc.gov.on.ca

Susan Toews
British Columbia Securities Commission
(604) 899-6764
stoews@bcsc.bc.ca

Blaine Young
Alberta Securities Commission
(403) 297- 4220
blaine.young@seccom.ab.ca

Serge Boisvert
Autorité des marchés financiers
(514) 395-0558x4358
serge.boisvert@lautorite.qc.ca

Doug Brown
Manitoba Securities Commission
(204) 945-0605
doubrown@gov.mb.ca

July 22, 2005