



## INDEPENDENT THINKING

November 21, 2006

Via Electronic Mail (rule-comments@sec.gov)

Nancy M. Morris

Secretary

Office of the Secretary

U.S. Securities and Exchange Commission

100 F Street, N.E.

Washington, D.C. 20549

Re: File Number SR-NASD-2004-130

Dear Ms. Morris:

Canaccord Capital Corporation ("Canaccord"), the Canadian Operating Subsidiary of Canaccord Capital, Inc., appreciates the opportunity to comment on the proposed amendments to NASD Rules 2320(g) and 3110(b) to exclude from the "Three Quote Rule's" coverage transactions in foreign securities of a foreign issuer that are part of the FTSE All-World Index. While we support the NASD's efforts to improve the ability of broker-dealers to provide timely and best execution to their customers' orders, we are concerned that the NASD's stated intention to withdraw all existing exemptions it has granted to the "Three Quote Rule" that relate to foreign securities without any explanation, empirical data, analysis or study of the consequences of that action, will have the opposite effect.

Through its principal subsidiaries, Canaccord Capital Inc. (CCI) is a leading independent full service investment dealer in Canada with capital markets operations in the United Kingdom and the United States of America. Canaccord Capital is publicly traded on both the Toronto Stock Exchange and AIM, a market operated by the London Stock Exchange.<sup>1</sup>

### **The Three Quote Rule**

The Three Quote Rule was adopted on May 2, 1988,<sup>2</sup> as an amendment to NASD's best execution interpretation and requires that members that execute transactions in non-exchange-listed securities on behalf of customers contact a minimum of three dealers (or all dealers if three or less) and obtain quotations, if there are fewer than two quotations displayed on an inter-dealer quotation system that permits quotation updates on a real-time basis. The Three

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<sup>1</sup> Canaccord has over 1,500 employees worldwide in 30 offices, including 23 Private Client Services offices located across Canada. Canaccord Adams, the international capital markets division, has significant operations in Toronto, London, Boston, Vancouver, New York, Calgary, Montreal, San Francisco and Houston.

<sup>2</sup> See Securities Exchange Act Release No. 25637 (May 2, 1988), 53 FR 16488 (May 9, 1988).

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Quote Rule is a minimum standard, and compliance with the Rule, in and of itself, does not mean a member has met its best execution obligations.

### **The Three Quote Rule Could Operate to Impede the Obligation of Best Execution**

The NASD through amending the Three Quote Rule and the granting of exemptions thereto has found that under certain circumstances, the Three Quote Rule often can impede, rather than further, best execution by causing significant delays in obtaining executions of customer orders by requiring a broker-dealer to obtain three quotes by telephone contact or otherwise. Although knowing with reasonable certainty where the best market is, the required delay may result in an execution at a time where the market has moved to an inferior price.

As a result of this understanding, the NASD, in 2000, amended the Three Quote Rule to eliminate the requirement to contact three market makers when there are at least two priced quotations displayed in an inter-dealer quotation system that permits quotation updates on a real-time basis.<sup>3</sup> The NASD concluded that, where there were two transparent, firm quotes, the costs associated with delayed executions resulting from compliance with the Three Quote Rule were not outweighed by the benefits of obtaining three telephone quotes.

### **Since at Least 2000, the NASD has Consistently Recognized That the Three Quote Rule Could Impede Best Execution of Transactions in Foreign Securities**

NASD staff has agreed that the protections of the Three Quote Rule may not be necessary with respect to all orders in foreign securities. The Commission, in its approval order granting NASD exemptive authority with respect to the Three Quote Rule, specifically indicated that exemptive relief may be appropriate for transactions executed on a foreign exchange.<sup>4</sup> The Commission stated that exemptive relief may be appropriate in such circumstances because the foreign exchange may constitute the best market for securities that are listed on that market and the time delay involved in contacting three dealers may, therefore, hinder a member from obtaining best execution for the customers.<sup>5</sup> In other words, the costs associated with delayed executions resulting from compliance with the Three Quote Rule were not outweighed by the benefits of obtaining three telephone quotes.

### **The Proposed Amendments**

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<sup>3</sup> See Securities Exchange Act Release No. 43319 (September 21, 2000), 65 FR 58589 (September 29, 2000). This rule change also alleviated the corresponding recordkeeping requirements under Rule 3110(b) where NASD could validate and confirm compliance with applicable requirements directly through its internal historical data.

<sup>4</sup> See Securities Exchange Act Release No. 39266 (October 22, 1997), 62 FR 5617 (October 29, 1997).

<sup>5</sup> Id.



The NASD is proposing amendments that would exclude from the Three Quote Rule's coverage transactions effected in foreign securities of foreign issuers that are part of the FTSE All-World Index.<sup>6</sup> Therefore, under the proposed rule change, a member would not be required to obtain three quotes in connection with transactions in foreign securities that are part of the FTSE All-World Index. The proposed rule change would not require that the transaction be executed on a foreign market so as not to limit the member's ability to determine, in fulfilling its best execution obligations, that a better execution would be obtained off the foreign market. However, to qualify for the exemption, the transaction must be executed during regular business hours of the foreign market for the security and no trading halt or other similar trading or quotation restriction may be in effect in any foreign market on which for such foreign security is listed.

Canaccord supports the proposal, believes that it puts the customers' interests first and that it enhances a broker-dealers efforts to meet its best execution obligations and timely execute its customers' transactions.

**The NASD's Intention to Withdraw All Existing Exemptions it has Granted to the "Three Quote Rule" That Relate to Foreign Securities Will Harm Customers and Impede Best Execution**

In this proposal the NASD indicated that:

contingent upon approval of the proposed rule change, NASD staff plans to withdraw all existing exemptions it has granted to the Three Quote Rule that relate to foreign securities.<sup>7</sup> NASD staff has granted seven exemptions for customer transactions in Canadian securities executed on a Canadian exchange on an agency or riskless principal basis. See, e.g., Letter to Mr. Kenneth W. Perlman, General Counsel, Mayer & Schweitzer, Inc., from Alden S. Adkins, Senior Vice President and General Counsel, NASD Regulation, Inc., on May 29, 1998.<sup>8</sup>

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<sup>6</sup> The proposed rule change also would provide a corresponding exclusion to the recordkeeping requirements set forth in Rule 3110(b) relating to the Three Quote Rule if the member can establish and document its reliance on this exclusion. Rule 3110(b) requires that members indicate on the order ticket for each transaction in a non-exchange-listed security the name of each dealer contacted and the quotations received to determine the best inter-dealer market as required by the Three Quote Rule.

<sup>7</sup> Securities Exchange Act Release No. 54650 (October 25, 2006), 71 FR 63812, 63813, ft. 13 (October 31, 2006)

<sup>8</sup> Although the cited exemptive letter is published on the NASD Website at [http://www.nasd.com/RulesRegulation/PublicationsGuidance/ExemptiveLetters/NASDW\\_002602](http://www.nasd.com/RulesRegulation/PublicationsGuidance/ExemptiveLetters/NASDW_002602), the remaining six exemptive letters are not published. As a result, this letter can not specifically address the details of those letters but the principles espoused in this letter may also apply.

In the Mayer & Schweitzer, Inc. exemption letter the NASD relied on representations that executions on a Canadian exchange at the exchange price ordinarily result in the customer obtaining best execution of his/her order and that a recent analysis of dealer prices compared to exchange prices concluded that, in virtually all cases the exchange had the best price. The NASD agreed and issued an exemption from the requirements of NASD Rules 2320(g)(1) and 3110(b)(2) for customer transactions in Canadian securities executed on a Canadian exchange, where a member periodically monitors and reviews customer executions to assure that the member is achieving best execution under NASD Rule 2320 for customer transactions; and such customer transactions handled either as an agent or riskless principal.

The NASD concluded that contacting and obtaining quotes from three dealers in these circumstances could result in significant delays and would be unproductive and not in the best interest of the customer and thus would pose a hindrance to achieving best execution for the customer. In other words, the costs associated with delayed executions resulting from compliance with the Three Quote Rule were not outweighed by the benefits of obtaining three telephone quotes.

In December 2000, the NASD reiterated this conclusion when it issued a Request for Comment that proposed an exclusion to the Three Quote Rule for transactions in foreign securities by a NASD member as agent or riskless principal on a foreign market that is the primary market for the security. In this proposal, the NASD affirmatively stated that

The proposed rule change, if approved, would not supersede any exemptions that previously have been granted relating to the application of the Three Quote Rule to transactions in foreign securities. Further, the staff will continue to have exemptive authority with respect to the Three Quote Rule under Rule 2320(g)(5)

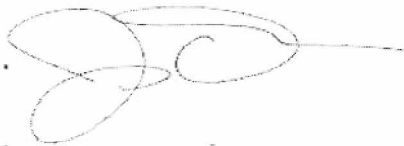
The instant proposal, without any explanation, seeks to do just the opposite. As a result approximately 3000 Canadian Securities that are not part of the FSE All-World Index will have to trade as they did pre-1998 where contacting and obtaining quotes from three dealers resulted in significant delays, was unproductive, not in the best interest of the customer and posed a hindrance to achieving best execution for the customer. The significant amount of effort and money spent on the development of seamless integration FIX link processes will have been wasted and trading these securities will become untimely and more expensive for investors.

**The NASD Should not Withdraw all Existing Exemptions it has Granted to the "Three Quote Rule" That Relate to Foreign Securities Without any Explanation, Empirical Data, Analysis or Study of the Consequences of That Action.**

The NASD does not explain why after determining that these exemptions were necessary for the protection of investors and operating for the last eight years under their auspices, it is now necessary to roll back the clock and hinder the best execution of customer orders in Canadian securities. The NASD has not presented any analysis, study or empirical evidence that would support its intention to withdraw these exemptions or that executions of customer orders in Canadian securities have not been improved by them.

Moreover, the Three Quote Rule still maintains a provision allowing the NASD to grant exemptions to the rule. We applaud and support the NASD for proposing to amend the Rule to codify the concepts and principles contained in the exemptions, however, a rule of this type can not envision and provide for every fact and circumstance and that is why exemptive authority is necessary. And in this case, those existing exemptions should be maintained. The operation of a rule, ease of regulatory enforcement or reporting requirement should not operate to impede best execution, harm customers or stifle business and technological development. Withdrawing these exemptions will do just that.

Please do not hesitate to contact me at (416) 869-3381 if you have any questions or wish to discuss this further.



James Duncan  
Senior Vice President & Director  
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Very truly yours,



Andrew Jappy  
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cc: Erik R. Sirri, Director, Division of Market Regulation, SEC  
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