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marché inc.

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Securities and Exchange Commission,
100F Street, NE.,
WASHINGTON, DC
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Attention: Nancy M. Morris, Secretary

Dear Sirs and Mesdames:

**Re: File Number SR-NASD-2004-130
National Association of Securities Dealers, Inc.
Amendments to Rule 2320(g) and related amendments**

Market Regulation Services Inc. ("RS") has reviewed Securities Exchange Act Release No. 34-54650 regarding the proposed amendments by the National Association of Securities Dealers, Inc. ("NASD") to Rule 2320(g) (the "Three Quote Rule"). The purpose of this letter is to comment on the impact of the disclosure in footnote 13 indicating that existing exemptions for foreign securities, and in particular various exemptions for customer transactions in Canadian securities executed on a Canadian exchange on an agency or riskless principal basis, would be withdrawn upon approval of the proposed amendments.¹ While the objective of NASD is to amend the Three Quote Rule to ensure best execution of client orders, the removal of the existing exemptions for certain Canadian securities may have the opposite effect particularly if the order from the U.S. client is ultimately executed over-the-counter in the inter-dealer market rather than on a Canadian marketplace.

¹ Securities Exchange Act Release No. 34-54650 (October 25, 2006), 71 FR 63812, 63813 (October 31, 2006).

Background

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

As a regulation services provider, RS administers and enforces trading rules for the marketplaces that retain the services of RS. RS has adopted, and the Recognizing Regulators have approved the Universal Market Integrity Rules (“UMIR”)² as the integrity trading rules that apply in any marketplace that retains RS as its regulation services provider. Presently, RS has been retained to be the regulation services provider for: the Toronto Stock Exchange (“TSX”), TSX Venture Exchange and Canadian Trading and Quotation System (“CNQ”), each as a recognized exchange (“Exchange”); and for Bloomberg Tradebook Canada Company, Liquidnet Canada Inc, Perimeter Markets Inc. (the operator of “BlockBook”), Shorcan ATS Limited and TriAct Canada Marketplace LP, each as an alternative trading system. In the near future, CNQ is expected to launch an “alternative market” known as “Pure Trading” that will be entitled to trade securities that are listed on other Exchanges and will, at the time of launch, trade securities that are listed on the TSX.

RS acts as the regulation services provider for each Exchange, quotation and trade reporting system (“QTRS”) and ATS in Canada (defined in UMIR as a “marketplace”) that presently is entitled to trade either “exchange-traded securities” or “foreign exchange-traded securities” in accordance with the Marketplace Operation Instrument. As such, UMIR is the common set of integrity rules that applies to all such and to all trading in Canadian securities (other than derivatives) that are listed on a Canadian Exchange. The Bourse de Montréal is the only Canadian marketplace that trades derivatives and the integrity rules which apply to the trading of derivatives are those established by the Bourse.

Handling of Orders from U.S. Dealers

UMIR defines a “Participant” as a dealer that is a member of an Exchange, user of a quotation and trade reporting system (“QTRS”) or subscriber to an ATS. UMIR imposes a number of obligations on a Participant when trading a security listed on an Exchange or quoted on a QTRS (“Canadian listed or quoted security”) as principal or as agent on behalf of a client.

² The text of the Universal Market Integrity Rules is available on the website of Market Regulation Services Inc. at www.rs.ca under the heading “Market Policy”.

An order for the purchase or sale of a Canadian listed or quoted security received by a Participant from a U.S. dealer acting as principal or as agent on behalf of a client will be considered to be a “client order” for the purposes of UMIR. As a client order, the following provisions of UMIR would be applicable:

Trades to be on a Marketplace

Rule 6.4 requires a dealer that is a Participant to execute trades on a marketplace when purchasing or selling a Canadian listed or quoted security. The trade may occur on the Exchange which has listed the security or any other marketplace which is entitled to trade that security. (For example, the “Pure Trading” facility of CNQ and each of the ATs are able to trade securities that are listed on the TSX.) If a Participant enters into an “arrangement” with respect to the purchase or sale of a security outside of the hours of operation of a marketplace, the “arrangement” does not become a binding trade until such time as it is executed on a marketplace.

In accordance with an exception to this rule, a Participant may execute a trade over-the-counter “as principal with a non-Canadian account or as agent if both the purchaser and seller are non-Canadian accounts provided such trade is reported to a marketplace or to a stock exchange or organized regulated market that publicly disseminates details of trades in that market.”³ This exception permits the Participant to be involved in a trade in a foreign jurisdiction in accordance with the requirements applicable in that foreign jurisdiction rather than the requirements under UMIR.

Best Execution Obligation

Rule 5.1 of UMIR presently requires that a Participant “diligently pursue the execution of each client order on the most advantageous terms for the client as expeditiously as practicable under prevailing market conditions”. This obligation applies equally to an order received from a U.S. dealer as it does to an order from a Canadian-resident client.

In discharging this obligation, the Participant must take into account order and trade information from all marketplaces that trade the same security. In accordance with the provisions of the Marketplace Operation Instrument, each marketplace has a choice of whether to make order information transparent.⁴ Each marketplace must provide transparency with respect to trades by immediately providing after execution information on a trade to an information vendor.⁵

RS has issued guidance on its expectations for compliance with the best execution obligation.⁶ In particular, RS expects that a Participant that does not have access to a particular marketplace will make arrangements with another dealer who is a participant of a particular marketplace or will route an order to a particular marketplace, where appropriate. In the view of RS, a Participant would be expected to make such

³ UMIR, Rule 6.4(e).

⁴ National Instrument 21-101 – Marketplace Operation, s. 7.1.

⁵ Ibid, s. 7.2

arrangements if the particular marketplace had demonstrated that there is a reasonable likelihood that the marketplace will have liquidity for a specific security relative to the size of the client order.

RS is also of the view that a Participant in discharging its best execution obligation should consider possible liquidity on marketplaces that do not provide transparency of orders in a consolidated market display if:

- the displayed volume in the consolidated market display is not adequate to fully execute the client order on advantageous terms for the client; and
- the non-transparent marketplace has demonstrated that there is a reasonable likelihood that the marketplace will have liquidity for the specific security.

The CSA Trading Rules provides that “a dealer acting as agent for a client shall make reasonable efforts to ensure that the client receives the best execution price on a purchase or sale of securities by the client”.⁷ For the purposes of the CSA Trading Rules the focus of “best execution” has been on providing “best price”. However, under the CSA Trading Rules, a Participant is exempt from the “best execution” provisions under Part 4 of the CSA Trading Rules if the Participant complies with the requirements of UMIR when handling a client order that is subject to UMIR.⁸

Best Price Obligation

In addition to this “best execution” requirement, UMIR requires that a Participant make reasonable efforts prior to the execution of a client order to ensure that the client order is executed at the best available price based on order information displayed by marketplaces trading the particular security.⁹ The obligation extends to all better-priced orders displayed on any marketplace and is not limited to orders “at the top of the book”. As such, UMIR recognizes that “best execution” and “best price” are separate but related obligations imposed on a Participant when handling a client order.¹⁰

Exposure of Client Orders

In accordance with Rule 6.3 of UMIR, a Participant must, subject to certain exceptions, immediately enter on a marketplace a client order to purchase or sell 50 standard trading units or less of a security. Based on the definitions in UMIR, the Participant would have a requirement to expose on a marketplace a client for the purchase or sale of an equity or similar security for:

- 5,000 shares or less of a security trading at \$1.00 or more per share;

⁶ Market Integrity Notice 2006-017 – *Guidance – Securities Trading on Multiple Marketplaces* (September 1, 2006).

⁷ National Instrument 23-101 – *Trading Rules*, s 4.1.

⁸ *Ibid*, s. 21

⁹ UMIR, Rule 5.1.

¹⁰ For a discussion of the “best price” obligation in a multiple marketplace environment see “Rule 5.2 – Best Price Obligation” in Market Integrity Notice 2006-017 – *Guidance – Securities Trading on Multiple Marketplaces* (September 1, 2006).

- 25,000 shares for a security trading at \$0.10 or more but than \$1.00 per share; and
- 50,000 shares for a security trading at less than \$0.10.

One exception to the order exposure rule is the immediate execution of the order at a better price than that displayed for any marketplace trading that security.¹¹

Client-Principal Trading

If the Participant receiving a client order that would be subject to the requirements of the order exposure rule executes against the client order as principal, UMIR requires that the Participant execute at a better price than the best price displayed for the security on any marketplace and the Participant must have taken “reasonable steps to ensure that the price is the best available price for the client taking into account the condition of the market at that time.”¹² The rule prevents a Participant from merely providing minimal price improvement without consideration of market conditions.

Conclusion

In the view of RS, if a trade in a Canadian listed or quoted security is executed other than on a marketplace, it would be appropriate to apply the “Three Quote Rule” to the execution of the trade. This would include the execution over-the-counter of a trade by an investment dealer in Canada that is not a “Participant” for the purposes of UMIR (as such an investment dealer and the trade are not subject to the requirements of UMIR). However, if the trade in the Canadian listed or quoted security has been executed on a marketplace which is subject to the application of the UMIR, RS is of the view that the requirements of UMIR are such that the U.S. dealer will receive the “best available price”. A requirement to obtain three quotes in connection with the execution of such a trade would increase the time and effort required to complete the trade without any reasonable likelihood of improvement in the “price” of the execution.

Given that UMIR is applied across all marketplaces and the same obligations extend to a Participant whether the Participant is executing a trade on an Exchange, QTRS or ATS, it is the view of RS that limiting any exemption from the Three Quote Rule to trades executed on an Exchange (as is currently the case for the exemptions provided by NASD) is in itself too narrow. RS believes that it is unlikely that over-the-counter dealers in the United States will be in a position to offer any price improvement to a U.S. client in respect of a trade in a Canadian listed or quoted security from that price that would be obtained if the trade was executed on a Canadian marketplace.

Thank you for providing us the opportunity to comment on the proposed amendments to the “Three Quote Rule” as such amendments might apply to the trading of a Canadian

¹¹ UMIR, Rule 6.3(1)(b).

¹² UMIR, Rule 8.1(1).

listed or quoted security. If you have any questions regarding any of our comments, please contact me at 416.646.7277.

Yours truly,

“James E. Twiss”

James E. Twiss,
Chief Policy Counsel.

cc. Tom Atkinson, President and CEO
Rosemary Chan, Vice-President Market Policy and General Counsel
Maureen Jensen, Vice-President Market Regulation, Eastern Region