13.1.6 TSX Inc. – Summary of Comments Received and TSX Responses Regarding Deletion of TSX Rule 4-804

DELETION OF TSX RULE 4-804 – MARKET MAKER AND PRINCIPAL ACCOUNTS

SUMMARY OF COMMENTS RECEIVED AND TSX RESPONSES

Comments Received from:

1. CIBC World Markets ("CIBC")
2. National Bank Financial ("NBF")

Capitalized terms that have not been specifically defined have the meaning attributed to them in the TSX Proposal.

	Issue and Comments	Comment Summary	TSX Response
CIBC			
1.	Impact on Market Makers	In a multiple marketplace environment, a competitive Market Maker will need to honour the MGF at the National Best Bid and Offer ("NBBO"). As a result, the Pro Order Handling Rule will be rendered ineffective.	We note that CIBC World Markets does not engage in market making. Thus their comments are derived from their experience in retail and institutional trading. TSX agrees that the MGF liability can be triggered by the presence of other marketplaces, not through a rule-based obligation but through the normal course of a market maker's business. We share CIBC's expectation that TSX Market Makers have a natural business incentive to post the best quote across Canadian marketplaces. We agree that the presence of other marketplaces makes the Pro Order Handling Rule ineffective and its removal is not contrary to the public interest.
NBF			
2a.	Impact on Market Makers	Removal of the Pro Order Handling Rule exacerbates the MGF liability risk to Market Makers by increasing the number of participants that can exploit the Market Maker's MGF obligations.	We note that National Bank Financial is heavily engaged in market making. Thus, their comments are derived from their experience in pro and specialist trading. TSX acknowledges that the presence of quotes from new marketplaces does not necessarily trigger an MGF liability. However, we feel that most of our market-making partners are concerned with posting the best quote across marketplaces, and as a result the additional MGF liability will be triggered as part of their normal course of business whether or not the professional order handling rule is removed. TSX does not agree that removal of the Pro Order Handling Rule exacerbates MGF liability risk. As described in NBF's comments, this risk exists today – client orders that tighten the posted spread can be entered in small quantities and at prices that create a certain amount of MGF liability risk. Market makers can mitigate the risk associated with these orders by filling them, either manually or automatically. TSX requires sufficient commitment of capital as part of a market making firm's commitment to managing

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			their stocks of responsibility, This capital requirement is in place to ensure the market maker is capable of filling, on a recurring basis if required, these orders and mitigating their MGF liability risk while maintaining a liquid TSX market for the symbol. Given that procedures already exist for the reporting of abusive trading, TSX feels that the elimination of the Pro Order Handling Rule does not introduce a new or greater MGF liability risk for the Market Maker. Rather, it may marginally increase the frequency at which the existing risk must be managed. TSX-mandated capital requirements are in place to ensure the Market Maker can continue to mitigate MGF liability risk.
2b.	Impact on Market Makers	Removal of the Pro Order Handling Rule means TSX is abandoning Market Makers in order to keep order flow on TSX	Market Makers are business partners of TSX, and are integral to the functioning of the Canadian equity market. In exchange for the benefits associated with market maker status, Market Maker Firms are expected to manage a certain amount of business risk and assist TSX in evolving as market conditions change. We acknowledge that as an exchange, TSX and its Participating Organizations will benefit from removal of the Prof Order Handling Rule because it will remove a risk of regulatory arbitrage that could negatively impact the quality of TSX's central limit order book. Far from abandoning our Market Makers, we are encouraging a level playing field in a multiple-marketplace environment. Competitive Market Makers that seek to post the best intermarket quote will undertake no additional MGF risk, and will also have increased opportunity to challenge quotes on symbols other than their securities of responsibility. We remain committed to our market making partners and will continue to work with them as market making evolves in the new multi-market trading environment.
2c.	Impact on Market Makers	Market Maker performance that is derived from MGF commitments should have its weighting reduced in the overall Market Maker score if the Pro Order Handling Rule is removed	TSX does not agree that the assessment of a Market Maker's performance that is derived from MGF commitments requires adjustment. Market Makers are not measured on MGF performance. Market Maker performance is formally assessed using the following metrics, equally weighted: • Spread maintenance: Measures the Market Maker's ability to call a two-sided market • Participation: Measures the participation of Market Makers in their security of responsibility. • Liquidity: Measures whether Market Makers are lining the book with reasonable depth. Of the three, only participation is indirectly affected by MGF levels, in that the amount of participation that can be undertaken by a Market Maker is a percentage of the MGF offered. Further, participation is a relative

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			metric, in which Market Makers are ranked relative to their peers. As a result, if MGFs decrease across the board, relative positions will not change and no Market Maker would be negatively impacted due to MGF commitments.
3.	Impact on TSX	Maintaining the Pro Order Handling Rule in a multiple marketplace environment may compromise liquidity on TSX	We agree. TSX believes that maintaining the Pro Order Handling Rule in a multiple-marketplace environment, where other marketplaces have no parallel obligation, creates an opportunity for regulatory arbitrage. Pro orders wishing to improve the NBBO in increments smaller than the MGF quantity could be driven to other marketplaces where Rule 4-804 can be bypassed, compromising liquidity on TSX.
4.	Impact of Direct Market Access (“DMA”) Orders	DMA orders, which are marked as client orders today, are not the same as small retail client orders and should be differentiated as ‘sophisticated’ client order flow. These orders are currently able to tighten spreads in increments less than the MGF because they are not treated as Pro orders, thereby creating significant MGF liability risk for Market Makers.	Although valid statements, the concerns raised by NBF about classification of sophisticated client orders raised by NBF are not relevant to the proposed rule change. The Professional Order Handling Rule does not apply to client orders. Its removal will have no impact on MGF liabilities created by sophisticated client flow, and Market Makers will continue to manage the risk created by these orders. TSX will be gathering comments relating to the DMA client order issue from its Market Making partners in 2007.
5.	Proposed Alternative	Exempt Market Makers from MGF obligation if the quote is established by a pro order.	Exempting Market Makers from their MGF responsibilities when quotes are established by a pro order is a poor alternative that would result in occasional minimum fills that are unpredictable, rather than guaranteed minimum fills that are certain, for client orders. This would defeat the purpose of the facility – under NBF’s proposed solution retail investors would never know if their order has a minimum fill guarantee in a fast moving market. Although the proposed solution would be advantageous to pro traders, allowing them to tighten spreads using small orders and simultaneously reducing the MGF risk that they have to manage, it would create a market where, in circumstances that can arise often, retail orders would face MGFs of zero.
6.	Impact on MGF Facility and True Client Orders	Market Makers will likely reduce their MGF obligations to the lowest possible amount (i.e. 200 shares) in order to limit their risk exposure which in turn will significantly disadvantage true client orders.	While TSX agrees that there is a risk that MGF levels will fall, we disagree with NBF’s view that the removal of the Pro Order Handling Rule will be the cause of such reduced levels. As discussed in item 2(a) above, and supported in the comment letter provided by CIBC, as summarized in item 1 above, TSX believes that MGF liability will be an issue for diligent Market Makers with or without the Pro Order Handling Rule. In a multiple marketplace environment, Market Makers will need to post top-of book quotes across marketplaces, or risk being shut out of their own business. Consequently, a competing Pro that pennies a TSX Market Maker on a best-price protected marketplace will trigger MGF liability risk, because that TSX Market Maker will need to match or

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			better this price in order to participate in the market, but will need to guarantee the posted price for a much larger volume. The presence of this risk may put downward pressure on MGFs market wide. Any risk to the MGF quantities offered by our Market Makers however, is a direct consequence of competing marketplaces, as is the possible loss of service to client orders, and not a consequence of the deletion of Pro Order Handling Rule which will become irrelevant the moment a new marketplace without a parallel obligation begins trading TSX-listed securities. Unless the value provided by TSX Market Makers to end clients is acknowledged across marketplaces, and pro order handling rules are put in place to allow them to continue to provide high MGFs without being abused by competing Pros, natural competitive forces will put downward pressure on MGFs. Consider, for example, a client order for 1,000 shares routed to another marketplace with 100 shares showing at the top of book price[1]. That client order will be filled for 100 shares at the better price, and 900 will be filled across one or more less favourable price levels. This client order did not receive the benefits of an MGF at the top of book price. The best-price obligation, without a matching MGF obligation on other marketplaces, erodes the service provided by the MGF facility irrespective of Pro Order Handling Rule. The result of allowing other marketplaces to operate without an MGF facility is an overall reduction of service to client orders in this regard.

[1] To our knowledge, no new marketplace has offered an MGF facility.