

Chapter 13

SRO Notices and Disciplinary Proceedings

13.1.1 Notice of Commission Approval - Amendments to TSX Rule 4-802 and to Rule 1-101(2) Regarding Cross Interference Exempt Marker

THE TORONTO STOCK EXCHANGE INC. (TSX) NOTICE OF COMMISSION APPROVAL AMENDMENTS TO TSX RULE 4-802 AND TO RULE 1-101(2) REGARDING CROSS INTERFERENCE EXEMPT MARKER

On August 26, 2003, the Commission approved amendments to TSX Rules 4-802 and 1-101 to allow for the entry and execution of certain types of trades which will be exempt from same firm interference if entered as part of an intentional cross. These trades will be marked with a special marker ("Cross Interference Exempt Marker"). The amendments were initially published for comment on July 5, 2002 at (2002) 25 OSCB 4350. Two comment letters were received. A summary of comments received and the response of the TSX are attached. In order to address the comments received, certain amendments were made subsequent to the publication for comment of the original proposed amendments. Attached to this notice is a black lined version of the amendments, indicating the changes from the previously published version.

THE RULES

OF

TSX INC.

The Rules of The Toronto Stock Exchange are hereby amended as follows:

1. Rule 1-101(2) shall be amended to add the following definitions:

"equivalent volume" with respect to a security that is sold means the amount of that security that must be sold to exactly offset (to the nearest board lot) the purchase of an amount of a related security and with respect to a security that is purchased means the amount of that security that must be purchased in order to exactly offset (to the nearest board lot) the sale of an amount of a related security.

"exempt related security cross" means an intentional cross entered by a Participating Organization in order to fill a client's order to buy or sell, as the case may be, a particular security where the Participating Organization has also entered a second intentional cross to fill that same client's order to buy or sell, as the case may be, an equivalent volume of a related security in respect of the particular security, provided that the execution of the order for the particular security and the execution of the order for the related security are each contingent on the execution of the order to buy or sell, as the case may be, an equivalent volume of the other.

"related security" means in respect of a particular security:

- a. a security which is convertible or exchangeable into the particular security;
- b. a security into which the particular security is convertible or exchangeable;
- c. a derivative instrument for which the particular security is the underlying interest;
- d. a derivative instrument for which the market price varies materially with the market price of the particular security; and

- e. if the particular security is a derivative instrument; (i) a security which is the underlying interest of the derivative instrument or; (ii) a security which is a significant component of an index (representing at least 80 per cent of the component share weighting of the index) which is the underlying interest of the derivative instrument.

“related security spread” means the difference between the bid price for one security and the ask price for the related security.

“Special Trading Session order” means an order to buy or sell a security in the Special Trading Session.

2. Rule 4-802 shall be repealed and the following substituted:

Rule 4-802 – “Allocation of Trades”

- (1) An order that is entered for execution on the Exchange may execute without interference from any order in the Book if the order is:

- a. part of an internal cross;
- b. an unattributed order that is part of an intentional cross;
- c. part of an intentional cross entered by a Participating Organization in order to fill a client’s Special Trading Session order ~~that was placed during the Regular Session; or~~
- d. part of an exempt related security cross, provided that the order is exempt from interference only to the extent that there are no offsetting orders entered in the Book, at least one of which is an order entered by the same Participating Organization, which can fill both the client’s order for the particular security, in whole or in part, and an equivalent volume of the client’s order for the related security. Orders in the Book will only be considered to be offsetting orders if the related security spread on execution of the clients’ orders against orders in the Book is equal to or more beneficial than the related security spread offered by the Participating Organization for

the contingent cross arrangement; or

- e. entered as part of a Specialty Price Cross.

- (2) Subject to subsection (1), an intentional cross ~~is executed without~~ on the Exchange will be subject to interference from orders in the Book, other than orders entered in the Book by from the same Participating Organization according to time priority, provided that the such orders in the Book is not an unare attributed orders.

- (3) A tradeable order that is entered in the Book shall be executed on allocation in the following sequence:

- a. to offsetting orders entered in the Book by the Participating Organization that entered the tradeable order according to the time of entry of the offsetting order in the Book, provided that neither the tradeable order nor the offsetting order is an unattributed order; then
- b. to offsetting orders in the Book according to the time of entry of the offsetting order in the Book; then
- c. to the Responsible Registered Trader if the tradeable order is eligible for a Minimum Guaranteed Fill.

LIST OF COMMENTERS

1. TD Newcrest Inc. ("TD Newcrest")
2. BMO Nesbitt Burns ("BMO")

SUMMARY OF COMMENTS AND TSX RESPONSES

ISSUE AND COMMENTER	PUBLIC COMMENT	TSX RESPONSE
A. GENERAL		
BMO	Strongly supportive of the initiative and believes that it is in the best interests of the Canadian capital markets. The commenter seeks clarification regarding the issues identified below.	TSX believes that the proposal is in the best interests of the Canadian capital markets.
TD Newcrest	Supportive of the initiative and believes that it is in the best interests of the Canadian capital markets. The commenter seeks clarification regarding the issues identified below.	See above response to BMO in this section.
B. SCOPE OF THE EXEMPTION		
TD Newcrest	<p>The commenter refers to the following statement in the Proposal relating to the scope of the proposed exemption from cross interference for contingent orders for related securities: "An order that is part of an intentional cross entered by a PO to fill a client's order to buy or sell, as the case may be, a particular security where the PO has also entered a second intentional cross to fill that same client's order to buy or sell, as the case may be, an equivalent volume of a related security ...".</p> <p>The commenter believes that the proposed exemption from cross interference should not be limited to trades executed on behalf of the same client but should be extended to orders from two separate and distinct clients. The commenter believes that the exemption should be granted for all contingent trades, regardless of the number of counterparties involved.</p>	TSX believes that the proposed exemption from cross interference should initially be limited to trades executed on behalf of the same client. TSX may consider expanding the scope of the exemption for contingent trades to include more than one counterparty in the future.
	The commenter notes that the exemptions will be granted to STS orders placed during the Regular Session. The commenter advises that it is not uncommon to receive market-on-close orders the night before or even two days before in advance of when they are to be executed. The commenter wishes confirmation that such orders also qualify for the cross interference exemption.	<p>TSX confirms that such orders would qualify for the exemption from cross interference. For clarification, it is proposed that the phrase "that was placed during the Regular Session" will be deleted from proposed Rule 4-802(c). Accordingly, revised proposed Rule 4-802(c) reads as follows:</p> <p>c. part of an intentional cross entered by a Participating Organization in order to fill a client's Special Trading Session order; or</p>
C. TIME PRIORITY		
TD Newcrest	The commenter refers to the following statement in the Proposal: "Subject to subsection (1) of the proposed amendment to Rule 4-802, an intentional cross is executed without interference from orders in the Book by the same PO according to time priority, provided that the order in the Book is not an unattributed order."	Pursuant to the cross interference exempt marker proposal, an STS order that is flagged with the dedicated STS marker (including basket trades such as the S&P TSX 60 Composite Index) will not be subject to same firm interference.

ISSUE AND COMMENTER	PUBLIC COMMENT	TSX RESPONSE
	<p>The commenter suggests that the statement implies that an STS order will be subject to interference by other orders entered into the Book by the same PO with time priority. The commenter advised that this would require the PO to identify orders in the Book that were entered before the STS order was taken and give priority fills to these orders. The commenter believes that this is not practical, and would require a prohibitive amount of time (particularly, with respect to a MOC order for a basket of the S&P TSX 60 Composite Index which would involve numerous securities) to review the Book to assess which orders were entered into the Book prior to the MOC order being accepted.</p> <p>The commenter further notes that MOC orders executed in the STS should be exempt from interference from orders placed earlier by the same PO. The STS order is a contingent order subject to the closing price of the market. The commenter advises that dealers hedge their risk with complete indifference to the closing price and have an obligation to buy or sell a pre-determined amount of a security at a closing price. Dealers cannot determine what the closing price will be and whether there will be any orders entered by the same PO with time priority at that price. Accordingly, the dealer has no way to accurately quantify this risk in advance of the close which may result in higher volatility at the close as dealers price this uncertainty into the market impact costs of executing MOC trades.</p>	
BMO	<p>One commenter notes that, as proposed, orders entered into the Book prior to the time the PO agreed to guarantee the STS order continue to have priority over orders that are not client orders. The commenter believes that this allocation seems to violate the intention of the exemption since the exemption was granted on the basis that the PO's order was effectively a "Special Terms" order. The client order, regardless of when it was placed in the Book, does not match the "Special Terms" of the PO's order and therefore should not interfere with it.</p>	<p>See above response to TD Newcrest in this section.</p>
D. DEFINITION OF "EQUIVALENT VOLUME"		
BMO	<p>The commenter believes that the proposed definition of "equivalent volume" is too narrow. The commenter notes that most clients will round their order to the nearest board lot. For this reason, they believe that the requirement for an "exact" match should be changed to "exact to the nearest board lot".</p>	<p>Agreed. TSX agrees to amend the proposed definition of "equivalent volume" as follows to provide that an "exact" match will include a match to the nearest board lot as follows:</p> <p>"equivalent volume" with respect to a security that is sold means the amount of that security that must be sold to exactly offset (to the nearest board lot) the purchase of an amount of a related security and with respect to a security that is purchased means the amount of that security that must be purchased in order to exactly offset (to the nearest board lot) the sale of an amount of a related security.</p>

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	<p>The commenter notes that many contingent orders are based on a complex, rather than a share versus share equivalent dollar value formula. For example, in many corporate mergers, the consideration paid for one security is a combination of another security and cash. Accordingly, the strict definition of “related security” will not be met despite the fact that there is a clear relationship. Moreover, the commenter notes that the securities will trade in large volume strictly based on a “spread” between the two for the duration of the merger period. This spread will result in an equivalent dollar value transaction only if the implicit cash value is included.</p>	<p>TSX believes that, at this time, contingent orders should be limited to the proposed share versus share formula. TSX may consider expanding the scope of the exemption for contingent orders in the future.</p>
E. DEFINITION OF “RELATED SECURITY”		
BMO	<p>Believes that the proposed definition of “related security” is too narrow. The “related security” definition requires that the securities must have an element of direct convertibility or exchangeability to them. The commenter believes that the criteria for “related security” not be based on the concept of convertibility but instead based on the contingency requirements of the client’s transaction.</p>	<p>TSX believes, at this time, not to base the criteria for “related security” on the broad concept of the contingency requirements of a client’s transaction. TSX may propose to expand the scope of the exemption in the future.</p>
TD Newcrest	<p>Notes that subsection (e) of the definition of “related security” in proposed Rule 1-101(2) states “... if the particular security is a derivative instrument, a security which is the underlying interest of the derivative instrument or a <i>significant</i> component of an index which is the underlying interest of the derivative instrument”. The commenter notes that the term “significant” is a vague and a subjective concept. The commenter seeks clarification on the threshold for determining what is a significant component of an index.</p>	<p>Consistent with TSX Policy 4-1001 of the Exchange relating to program trading and index participation units, it is proposed that a “significant” component of an index will refer to a trade of listed securities that comprise at least 80 percent of the component share weighting of the index. Proposed Rule 1-101(2)(e) has been revised accordingly.</p>
F. RS REGULATORY APPROVALS		
BMO	<p>The commenter questions whether approval from RS will be required prior to each trade.</p>	<p>No. Intentional crosses marked with the proposed marker that meet the prescribed requirements will automatically be exempt from interference from same firm orders in the Book.</p> <p>See also response to TD Newcrest in the section entitled “Client Priority”.</p>
G. OTHER TYPES OF TRADES		
TD Newcrest	<p>Recommends that the contingent trade exemption should be extended to accommodate trading strategies that are popular on other global markets, but are currently unavailable in Canada. The commenter believes that contingent markers should be extended to permit crossing of stock outside of the posted bid/ask spread provided that the cross is contingent to the execution of a related trade (similar to the exchange for physicals market). Such an exemption would enable Canadians to source other liquidity pools for execution, namely derivative products (eg. futures, ETFs, options, etc.). The commenter notes that two types of trading strategies where a contingent marker allows for crosses to take place outside the posted bid/ask</p>	<p>TSX has received regulatory approval in connection with the entry and execution of certain specialty price crosses (volume-weighted average price trades and basis trades) during the Regular Session and the Special Trading Session. TSX believes that the execution of specialty price crosses on TSX will enable TSX to offer trade execution alternatives that are consistent with the standards of other major international exchanges.</p>

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	spread are basis trades and blind baskets.	
H. VOLATILITY AT THE CLOSE		
TD Newcrest	The commenter does not believe that the cross-interference exemption will significantly reduce day-end volatility. Late session volatility occurs primarily due to the daily supply/demand imbalances resulting from the re-balancing of assets benchmarked to closing prices.	TSX believes that TSX's proposed Market-on-Close System will significantly reduce volatility and increase participation at the close of the continuous market.