

Chapter 13

SRO Notices and Disciplinary Proceedings

13.1.1 CNQ Notice and Request for Comments – Proposed Rule Change to Rules 4-106 and 4-107 Regarding Entry of Orders

PROPOSED RULE CHANGE – 4-106 AND 4-107 ENTRY OF ORDERS

NOTICE AND REQUEST FOR COMMENTS

February 16, 2007

The Board of Directors of Canadian Trading and Quotation System Inc. (“CNQ”) has passed a resolution to amend the order entry rules upon Ontario Securities Commission approval following public notice and comment. The text of the proposed rules is attached as Appendix “A”.

The Board has determined that the proposed amendments are in the public interest and have authorized them to be published for public notice and comments. Comments should be made no later than 30 days from the date of publication of this notice and should be addressed to:

Canadian Trading and Quotation System Inc.
BCE Place, 161 Bay Street
Suite 3850, P.O. Box 207
Toronto, ON
M5J 2S1

Attention: Mark Faulkner, Director, Listings and Regulation
Fax: 416.572.4160
Email: Mark.Faulkner@cnq.ca

A copy should be provided to the Ontario Securities Commission at the following address:

Capital Markets Branch
Ontario Securities commission
Suite 1903, Box 55
20 Queen Street West
Toronto, ON
M5H 3S8

Attention: Cindy Petlock, Manager, Market Regulation
Fax: 416.595.8940
Email: cpetlock@osc.gov.on.ca

Proposed Change

CNQ is proposing amendments to the order entry rules which would eliminate the restriction on CNQ Dealers entering orders that improve the market.

Rationale

On February 1, 2005 CNQ amended order entry rules to allow Non-Market Maker CNQ Dealers to enter additional order types on Market Maker securities. The purpose of the rule change was to improve the efficiency of the trading model by reducing the obligation of the Market Makers and increasing the ability of CNQ Dealers to manage their own order flow.

Compliance with the current rule requires manual order handling, as a decision must be made prior to entry as to whether the order must be directed to a Market Maker or entered into the CNQ system. The removal of the remaining restrictions on CNQ Dealers will result in more direct access to the trading system, and allow CNQ Dealers to develop more automated procedures. Automated, expeditious order handling is essential, given the trade-through obligations when trading interlisted securities.

Direct order entry will also ensure that orders entered by a CNQ Dealer will be identified as orders from that Dealer, rather than a Market Maker. The current lack of visibility “in the book” detracts from transparency and may lead to the erroneous conclusion that Market Makers have an inordinate control or influence over the market.

Description of Rule Change

The changes to the order entry rules, which currently restrict the entry of “market improving” orders to Market Makers, would allow approved traders at all CNQ Dealers to enter orders and crosses on all securities, including orders for client and non-client accounts.

The changes would also impose a restriction that only a Designated Market Maker, i.e. a CNQ Dealer acting as a Market Maker on a specific security, may enter orders on behalf of another participant on that security, regardless of whether the originating dealer is a CNQ Dealer or not.

The definition of “Client Matching Order” and all references will be deleted.

The proposed Rules are attached as Appendix “A”, and a blacklined version of the existing Rules is attached as Appendix “B”.

Impact

The proposed changes will not require any technological changes or development by CNQ Dealers. The rules will not require CNQ Dealers to enter orders directly, but will provide that option. The order flow through Market Makers will be reduced, and orders for CNQ Dealers will be more easily identified in the CNQ system, allowing CNQ Dealers

to more effectively manage their orders. There will be no direct costs associated with compliance.

The removal of the restriction on entering orders that improve the market will for many dealers reduce or eliminate the need to handle all orders manually.

In market data displays orders will be clearly identified by the clearing number of the originating CNQ Dealer, improving transparency and providing more accurate information to market participants and investors.

Consultation

The proposed rule change has been requested by listed companies, individual investors and CNQ Dealers. Market Maker firms representing a significant percentage of market making activity have also been consulted. CNQ is currently considering incentives for Market Makers to encourage continued participation, such as the elimination of trading fees for passive trades.

Alternatives

The purpose of the proposed changes is to provide unencumbered access to the market by CNQ Dealers. As such, no significant alternatives were considered.

Comparable Rules

All Canadian Stock Exchanges allow direct order entry by participants.

Conclusion

The proposed change is recommended on the basis that:

- (i) it is not contrary to the provisions of the Securities Act or UMIR;
- (ii) it is not contrary to the public interest and in fact may contribute to the maintenance of a fair and orderly market by allowing direct access to all CNQ Dealers;
- (iii) it is warranted in the opinion of CNQ Staff after consideration of the circumstances of the CNQ Dealers and Market Makers.

Appendix "A"

Proposed Rules

Rule 4-106 Entry of Orders for CNQ-Listed Securities

- (1) Subject to Rule 4-107, any CNQ Dealer may enter
 - (a) orders and
 - (b) crosses at any price between the bid and offer

into the CNQ System for a CNQ-listed security.

- (2) Orders (other than special terms orders, Client Matching Orders and crosses) may be entered on a fully-disclosed or partially disclosed basis.
- (3) Orders entered on a partially-disclosed basis must disclose at least 50% of the total volume on entry and must be at least 5 Board Lots in size.

Rule 4-107 Entry of Orders for Market Maker Securities

- (1) Only a Designated Market Maker may enter
 - (a) orders and
 - (b) crosses at any price between the bid and offer

into the CNQ System on behalf of another participant for a Market Maker security.

4-111 Trading After the Opening

- (1) A tradeable order for a CNQ-listed security shall be allocated among offsetting orders on the bid or offer (as the case may be) individually by time priority.

Appendix "B"

Existing Rules - Blacklined

Rule 4-106 Entry of Orders for CNQ-Listed Securities with no Market Maker

- (1) Subject to Rule 4-107, any CNQ Dealer may enter
- (a) orders and
 - (b) crosses at any price between the bid and offer
- into the CNQ System for a CNQ-listed security, ~~for which no CNQ Dealer is acting as Market Maker.~~
- (2) Orders (other than special terms orders, Client Matching Orders and crosses) may be entered on a fully-disclosed or partially disclosed basis.
- (3) Orders entered on a partially-disclosed basis must disclose at least 50% of the total volume on entry and must be at least 5 Board Lots in size.

Rule 4-107 Entry of Orders for Market Maker Securities

- (1) ~~Subject to Rule 4-107(2)~~, Only a Designated Market Maker may enter
- (a) orders and
 - (b) crosses at any price between the bid and offer
- into the CNQ System on behalf of another participant for a Market Maker security.
- ~~(2) A CNQ Dealer other than a Designated Market Maker may enter into the CNQ System~~
- ~~a) a Client Matching Order;~~
 - ~~b) a cross at any price between the bid and ask;~~
 - ~~e) a client or non-client buy order with a limit price equal to or lower than the bid price at the time of order entry; and~~
 - ~~d) a client or non-client sell order with a limit price equal to or higher than the ask at the time of order entry~~
- ~~for such securities.~~
- ~~(3) Orders (other than special terms orders, Client Matching Orders and crosses) may be entered on a fully disclosed or partially disclosed basis.~~
- ~~(4) Orders entered on a partially disclosed basis must disclose at least 50% of the total volume on entry and must be at least 5 Board Lots in size.~~

~~(5) CNQ Dealers other than a Designated Market Maker shall, subject to Rules 4-107(2) and (6), direct orders to one or more Designated Market Makers.~~

~~(6) A CNQ Dealer may direct part or all of a Client Matching Order to a Market Maker for execution or entry into the CNQ System, including any unfilled portion of the order previously directly entered into the CNQ System by the CNQ Dealer pursuant to Rule 4-107(2).~~

1-101 Definitions

(2) In these Rules, unless the subject matter or context otherwise requires;

~~"Client Matching Order" means a client hit or take order.~~

4-111 Trading After the Opening

(1) A tradeable order, ~~including a Client Matching Order~~, for a CNQ-listed security shall be allocated among offsetting orders on the bid or offer (as the case may be) individually by time priority.