

**Request for Comment**

**NOTICE OF PROPOSED AMENDMENTS TO  
NATIONAL INSTRUMENT 21-101 MARKETPLACE OPERATION  
AND COMPANION POLICY 21-101  
AND  
NATIONAL INSTRUMENT 23-101 TRADING RULES  
AND COMPANION POLICY 23-101**

**July 14, 2006**

**Due October 12, 2006**

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**General comments on the proposed amendments:**

*BMO Financial Group (BMO) appreciates the opportunity to comment on the proposed amendments to NI 21-101 and NI 23-101 dated July 14, 2006.*

*BMO performs a multitude of roles in the securities marketplace including that of broker dealer, investment manager and custodian. As such, it is well positioned to comment on the proposed amendments.*

*Of the four options identified regarding transparency of government fixed income securities, BMO recommends that the current exemption in NI 21-101 be extended for a further five years. Over the past 3 years there has been significant progress in the levels of transparency for government debt securities and corporate debt instruments. Price information is available via a wide variety of media from free websites (e.g. TSX public web site), to business periodicals (e.g. Globe & Mail) to information vendors (e.g. CanPx). Despite the transparency exemption for government debt securities, CanPx Inc. delivers comprehensive transparency with respect to federal and provincial government debt through voluntary agreement between Inter-dealer Bond Brokers and dealers. It has also tripled its coverage of corporate securities over the past 3 years.*

*With regard to increasing trade transparency via real time reporting, such a practice will expose dealers to significantly increased costs with no material increase in transparency or benefit to investors. The CSA policy decision in 2003 to allow market forces to develop transparency in the Canadian market is achieving its goal at a reasonable pace.*

*According to the OSC / IDA commissioned 2002 study on transparency, there were no identified systemic transparency problems in the institutional market.*

*BMO is supportive of the CSA's goal of increased transparency in fixed income securities for all market participants. However, we believe the significant differences in process between debt markets and equity markets in Canada warrant a cautious approach.*

*Unlike institutional investors in equity markets, institutional fixed income investors rarely place/leave orders with investment dealers. Most often,*

*clients request a two-way market on a given security from 3 or 4 investment dealers and then act upon the best bid or offer. The final size of the transaction is often divulged only to the winning bidder/offerer. As such, the value of monitoring “orders” or “pre-trade information” is de minimis.*

*In contrast to equity markets, which rely heavily on electronic trading, debt markets rely more heavily on dealer-provided liquidity. This is due to larger trade sizes and lower trading frequency; the rapidity with which liquid securities are superseded by newer, more liquid issues; and a large population of less liquid bonds.*

*BMO has contributed to, and supports the IIAC submission and offers the following additional comments on the proposed amendments to NI 21-101 and NI 23-101.*

**Specific input on the following questions:**

- 1. Should there be a mandatory requirement to report and disseminate information related to designated government debt securities? What are the benefits and disadvantages of this and the alternative approaches?**

*Currently, several Inter Dealer Bond Brokers (IDB's) such as Prebon, Shorcan, etc. provide live feeds delivering comprehensive transparency with respect to federal and government debt to CanPX on a voluntary basis. CanPX also provides coverage on a number of corporate securities. At this time BMO sees no need to make this a mandatory requirement. Should a significant number of IDB's withdraw their voluntary submissions then the issue should be revisited at that time.*

- 2. Should dealers be subject to order and/or trade transparency requirements for government fixed income securities? If so, should they be required to report order information, trade data or both?**

*As described above, the frequency of order transactions makes transparency requirements burdensome without reasonable expectation of commensurate value.*

*Dealers are currently subject to trade transparency under the current reporting regime that requires provision of trade information within one hour of the time of the trade.*

- 3. What type of pre-trade information should be disseminated? Should it include indications of interest?**

*As described above, the pre-trade activity is rare.*

- 4. Are the reporting timelines appropriate – i.e. order information in real time and trade information within one hour of the time of the trade?**

*As described above, order transactions are rare. Reporting timelines for trade information is appropriate.*

- 5. Are the volume caps applicable to government fixed income securities set out in the Companion Policy to NI 21-101 adequate? Should there be further tiering for the different types of government bond securities?**

*BMO believes the volume caps set out in the Companion Policy are adequate. It is unclear how further tiering of volume caps for the different types of government bond securities would provide any benefit to investors.*

**6. Should we require pre-trade transparency for corporate fixed income securities? If so, should the requirements be applicable to marketplaces only or should they also apply to dealers?**

*As described above, the frequency of pre-trade activity makes transparency requirements burdensome without reasonable expectation of commensurate value.*

**7. Should the time for reporting the trades be reduced (for example, should all trades be reported and disseminated in real time)?**

*BMO does not agree with advancing the timeframe from one hour to real time.*

*Reducing the reporting time from the current one hour deadline would significantly increase costs for a number of dealers without a material increase in transparency.*

**8. Has the process for designating benchmark corporate fixed income securities been effective? Please explain your response.**

*BMO has no issue with the current process for designating benchmark corporate fixed income securities.*

**9. Has there been sufficient progress, both regulatory and industry-driven, regarding fixed income transparency to date? For retail investors? For large and small institutional investors?**

*In the last five years, industry-driven initiatives, as well as specific firm-driven initiatives, have led to increased transparency for investment advisors and retail investors in the fixed income market. Apart from the quotes provided by CBID in the financial press daily, a rudimentary yield curve, provided voluntarily by CanDeal, is available at the TSX public web-site <http://www.tsx.com/HttpController?GetPage=BondsRates&Language=en>*

*BMO's retail bond desk provides extensive historical data and market colour to its sales force.*

*Based on feedback from the buy-side, institutional investors have advised us that they are well served with regard to transparency in light of the exhaustive price information provided daily by any number of investment dealers and electronic sources such as Bloomberg, Reuters and CanPX.*

**BMO offers the following additional comments:****Section D: Audit Trail**

*Although the update on TREATS project was informational, BMO offers the following comments.*

*Section D of the Notice of Proposed Amendments to NI 21-101 relates to a dealer/marketplace model and does not reflect the most recent thinking on how to implement TREATS. Recently, BMO provided comments on an alternate regulator-centric model for implementation over a dealer/marketplace centric model.*

*BMO strongly endorses the proposed regulator-centric model. There are a number of significant benefits to both the regulators and the industry. Since the regulator-centric model would mean the creation of a centralized TREATS Hub for data transmission, processing and retention, the system architecture and functionality would be developed once at the industry level and reused by all interested parties. New regulatory requirements and future changes would be limited to the Hub and transparent to the industry. BMO believes that TREATS requirements and implementation would be simplified through centralization, increasing the likelihood of industry compliance and understanding. In addition, technical expertise and project management would be concentrated in one major initiative rather than spread throughout the industry.*

*The revised NI 21-101 notes that the cost benefit analysis will be performed in the fall of 2006. It is BMO's opinion that this timeframe is premature. The CSA should conduct the cost benefit analysis only after requirements for all security classes have been finalized. It is anticipated that while development of the Hub will be complex and expensive it will be significantly less so than the dealer/marketplace model. As with all large initiatives, cost containment and effective management will be critical success factors for all parties.*

*Given the significance of such an undertaking, continued involvement of an industry advisory group is recommended to ensure that regular dialogue amongst all parties continues in a forum that promotes openness and timeliness of discussion.*

*Part of the approval process for new marketplaces should include the requirement for minimum record/data retention requirements. We are aware of at least one ATS that does not provide time of order receipt to the dealer making compliance with UMIR 7.1 difficult to monitor, e.g. a dealer can't effectively supervise for completeness of audit trail (late timestamps), front-running, client priority, best execution, etc. without relevant data.*

*BMO recognizes the considerable work remaining on this initiative and looks forward to documentation that formalizes the nature of the solution to be implemented as well as the finalized TREATS dealer and marketplace*

*requirements. This will assist the industry in clearly understanding what the TREATS “end goal” looks like and better enable it to provide support and guidance during TREATS implementation. Until all TREATS requirements are finalized and the implementation model defined and documented, it is extremely difficult for dealers to plan for implementation.*

*In regard to amendments to subsection 11.2(6) BMO seeks clarification on point #1. What are the specific expectations regarding the revised date of January 1, 2010? Is it the regulators’ expectation that implementation be completed for all security classes or commencement of a phased-in implementation as referenced in point #4?*

### **Section E: Clarification of Best Execution and Other Obligations in a Multiple Marketplace Environment**

*BMO is supportive of the CSA regulatory changes that were implemented to foster competition in the Canadian industry. It believes that the number of new marketplaces and ATS’s that have been approved or are pending regulatory approval is a clear indication that market forces drive innovation and investor choice and that this new regulatory framework is successful.*

*At the CSA public forum on trade-through obligations held in October 2005, the investment dealers recommended that it would be more efficient and cost-effective to require new marketplaces to connect with each other and the primary marketplace rather than to impose connectivity upon the dealers. BMO believes that this approach will ensure the electronic order book characteristics and the public display of market depth along with associated rules are best served with marketplace connectivity over dealer connectivity. Canada should mirror the integrated marketplace model in place in the U.S. rather than moving in a different direction.*

*The CSA position on best execution and the new RS Inc. rules relating to trading securities in multiple markets put unrealistic compliance expectations on the dealers. It is not practical for each dealer to meet the higher burden of compliance with standards which were designed with a market integrator and data consolidator in mind.*

*By expanding best execution obligations beyond markets the participant has decided to access, the regulators have moved from the role of establishing rules and policies in marketplace operation to one of driving technology investments. Market forces and client demand will, and should, drive dealer investments. Healthy competition not overregulation will generate further improvements.*

*BMO is not supportive of the recent CSA clarification of dealer obligations regarding best execution. Best execution extends beyond best price and involves a number of factors ranging from speed of execution, market depth and quality to ensure a greater certainty of execution, technology and access*

costs, amongst others. Based on client needs, dealers will assess the various marketplaces and make the most appropriate trading decision(s) for that client.

BMO takes its client responsibilities seriously and operates with the highest degree of integrity. It has well established policies and procedures in place to ensure that all personnel meet these standards. In addition, all employees are required to certify that they have read, understood and complied with the Code of Business Conduct and Ethics Corporate Policy.

It is the responsibility of the dealer to inform the clients of the marketplaces of which they are participants. If clients are not satisfied with the services provided then they may address their concerns directly to the dealer or direct their business elsewhere. In the event a client believes they have not been treated fairly, e.g. fill prices on orders, then escalation paths are available and invariably addressed to the satisfaction of the client.

While neither UMIR nor the ATS Rules require a Participant to maintain trading access to every Canadian marketplace on which a security may trade, the recent CSA interpretation expects Participants to “take into account order and trade information from all marketplaces where a security is traded (not just marketplaces where a dealer is a participant).” The CSA interpretation and subsequent RS Inc. Notice 2006-017 regarding Securities Trading on Multiple Marketplaces send conflicting messages to Participants. BMO disagrees with being obligated to access marketplaces of which we are not members. Given the impact of introducing a new marketplace when its securities are already traded on another marketplace(s), it should be a prerequisite that industry wide testing be coordinated to ensure all aspects of the order and trade life-cycle amongst all stakeholders (marketplaces, dealers, vendors, back office service bureaus, etc.) operate as anticipated.

BMO is unaware of any systemic best execution issues in the industry. BMO recommends that the CSA and RS Inc continue with its past “principles based” approach to best execution and apply rules only to those marketplaces that a dealer has made a business decision to access. BMO also recommends implementation of TREATS for the equity markets which will enable the regulators to process and interpret complete order and trade information from all dealers and marketplaces. Only if best execution problems surface should the regulators consider detailed rules based solutions. As is currently the practice, trading irregularities should be addressed with the dealers first and then if necessary through rules.

It has taken decades for the US marketplace, with its significantly greater liquidity, to evolve to its current state. It is unrealistic to expect Canada with its nascent competitive marketplaces and unique market structure, to operate at the same level. A principle-based regulatory framework will allow for innovation and evolution.

*RS Inc.'s interpretation that non-transparent marketplaces would qualify as meeting best execution obligations without mandating access is inconsistent. If availability of pre-trade and post-trade information is considered essential to facilitate best execution and market integrity, then Participants should not be obligated to access marketplaces that do not offer full transparency.*

## **Section F. Requirements for and Status of Information Processors for Debt and Equity**

*BMO agrees that while there is value in having an information processor to consolidate equity data this should be introduced based on market forces. While there are a number of new marketplaces trading the same securities, or expected to do so shortly, the competitive landscape is still in a nascent stage. Once the Canadian equity market adjusts to the introduction of new marketplaces, perhaps after a one year period, the incentive for a commercially viable consolidator may naturally present itself. As noted above, the regulators should not expect dealers to meet higher compliance standards in a regulatory framework that was designed with a market integrator and data consolidator in place. BMO believes that if a market-driven solution has not surfaced after this time and the regulators have determined that best execution and market integrity issues exist due to a lack of a consolidator, then it would be appropriate for the regulators to revisit the issue.*

*While BMO understands that CanPx has been approved as an information processor for the debt markets, BMO is not supportive of mandating its use by the dealers.*

### **Availability of technology specifications and testing facilities - proposed amendments to CP 23-101 section 12.3**

*BMO believes that while the proposed amendment requiring marketplaces to “make available to the public any technology requirements regarding interfacing with or access to the marketplace is appropriate” the time frame of 60 days is inadequate for reasons outlined below.*

*The Canadian marketplace is dependent upon third party vendor technology for trading and trading related services. While dealers may be clients of the wide range of technology vendors and have influence on the products and services provided, they do not control the product evolution itself (features and functions, scope of the product, delivery/upgrade schedules, pricing, etc.). Vendors are profit driven and will fill a need when there is sufficient critical mass to justify the investment. In addition, there is a wide variety of*

*technology vendors that must work together to deliver comprehensive services to the dealers. This includes but is not limited to order gathering, order management, trade execution, middle and back office technologies, back office service providers, risk management systems, amongst a myriad of others. Once changes have been made to each system, and process, where appropriate, internal testing is undertaken and if significant, then testing with exchanges and marketplaces is coordinated.*

*The proposed changes to support the CSA best execution interpretation and associated RS Inc. rules represent a fundamental shift in the way the industry operates. This requires extensive effort, investment and time to prepare by all parties.*

*Regulators should consider introducing two distinct stages for marketplace approval. The first approval stage would deal with regulatory compliance of the marketplace offering, e.g. has the marketplace met existing rules and policies, has it considered the full impact on the entire trading life cycle, are the specifications for all stakeholders developed, etc. The regulators should facilitate this process by developing a checklist to be completed by any new marketplace so the impact on all parties can be effectively assessed. The regulators should subsequently publish a notice advising industry participants of the new marketplace and propose an appropriate timeframe for industry readiness, and seeking comments on its reasonableness.*

*The second stage would ensure that the requisite infrastructure is in place prior to industry wide testing and operation. Marketplaces, as commercial enterprises, should be responsible for investing in industry readiness and coordinating the vendor changes that are necessary and ensure a synchronized industry wide implementation.*

*Operational criteria established by the regulators would ensure vendors and dealers take emerging marketplaces seriously. The current model adopted by regulators and new marketplaces which puts the onus on dealers to invest in changes for emerging marketplaces is both inefficient and expensive, the costs of which will ultimately be borne by all industry participants. The CSA should play an active role in managing the proliferation of new marketplaces to ensure this does not occur.*