

June 8, 2001

No. 2001-019

REQUEST FOR COMMENTS - IMPLEMENTATION OF A CALL MARKET

On May 29th, 2001, the Board of Directors of the Toronto Stock Exchange Inc. approved amendments to the Rules and Policies of the TSE to:

- implement a call market as a facility of the TSE (the “POSIT Call Market”); and
- provide Participating Organizations (“POs”) and eligible institutional clients access to the POSIT Call Market.

The amendments, attached as Appendices “A” and “B”, to the existing Rules and Policies will be effective upon approval of the Ontario Securities Commission following public notice and comment. Comments on the rules and amendments to the Rules and Policies should be in writing and delivered within 30 days of the date of this notice to:

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Regulatory & Market Policy
TSE Regulation Services
The Toronto Stock Exchange
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A copy also should be provided to:

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Manager, Market Regulation,
Capital Markets Branch
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BACKGROUND

POSIT Call Market

In November 2000, the TSE announced that it had entered into discussions to license and operate POSIT, a matching system for equity securities as a facility of the TSE, from POSIT-JV. POSIT-JV is a joint venture between ITG Inc. and BARRA, Inc. for the purposes of providing POSIT in Canada. POSIT has been approved by the U.S. Securities and Exchange Commission (the “SEC”) and currently operates in the U.S., U.K. and Australia.

The POSIT Call Market will offer an electronic equity matching system to POs and institutions and will allow for TSE-listed stocks to trade anonymously during timed calls during the day with no impact on the auction market. Trades will match at the midpoint of the bid/offer spread. The TSE believes that the introduction of the POSIT Call Market will provide participants with the desired ability to anonymously trade stocks with other participants at mutually satisfying prices while eliminating “market impact” costs.

The POSIT Call Market will be available to receive orders each trading day from 7:30 a.m. until the last match of the day has commenced (approximately 2:30 p.m.). Orders entered once a match has started will be rejected. Order entry will be reinstated automatically once the internal processes of a match have been completed (i.e. trade reporting and client notification). It is estimated that the timeframe from the beginning of a match until the completion of all reporting will be less than 3 minutes.

CALLS

There will initially be two call sessions at approximately 10:30 a.m. and 2:30 p.m. The actual match times within each call will be random (within a five-minute window of the time of the call). The random match times will minimize the ability of anyone to enter an artificial bid or offer into the auction market in order to affect the call price.

MATCH SEQUENCE

POSIT executes trades by matching buy and sell orders. The algorithm identifies trades by matching buy and sell orders complying with all of the constraints¹ imposed upon the orders by participants. The primary objective of the algorithm is to maximize the total number of shares traded. The secondary objective is to allocate shares between competing orders on a pro-rata basis.

PRICING

¹ Constraints define the rules that will apply to all trades executed for a symbol or a portfolio (a group of symbols). For example, a client can set a minimum or maximum fill value for a stock or a portfolio.

The POSIT Call Market system will read real time quote information provided by the TSE's Toronto Broadcast Feed (the "TBF"). The system will use the best bid and ask to determine the mid-market price to 3 decimal places. A snapshot of the mid-point price is taken at the time the match is initiated. If there is no bid/ask for a stock an alert will be generated and the stock will not participate in the match.

PARTICIPANTS

Participating Organizations ("POs") may grant access to the POSIT Call Market to institutions that are eligible to enter orders on the TSE without review by a PO pursuant to Policy 2-501. Orders for all other clients will be required to be entered into the POSIT facility by a PO.

Eligible institutions entering orders into the POSIT Call Market will be required to have Policy 2-502 agreements in place with POs and must designate a PO as their clearing and settlement broker for each order they enter.

ELIGIBLE STOCKS

Any of the securities listed on the TSE are eligible to be included in the POSIT Call Market symbol set. A list of valid symbols for the day will be downloaded into the system every morning based upon the stock table in STAMP. Upon entry of an order, participants will receive a reject message if that stock symbol is invalid that day.

Should a stock be halted, delayed, frozen or inhibited in the continuous market at the time a match is run, that stock will not participate in the match. Participants entering orders for that stock will receive a "Nothing Done" report for that stock after the match indicating that the order did not get filled.

MINIMUM ORDER SIZE

The minimum order size is the TSE board lot size for that security.²

ORDER TYPE RESTRICTIONS

The entry of orders is restricted to orders for regular settlement. Jitney orders and short sales may be entered but must be marked appropriately. Orders may be entered for a single match or multiple matches. Orders designated for multiple matches will remain in the POSIT system until the client cancels the order, it is filled, or the end of the day is reached.

²A POSIT Order must be for a board lot or an integral multiple thereof for that security.

LAST SALE PRICE

Trades in the POSIT Call Market are executed at the midpoint of the bid and ask in the continuous market at the time of the call and, therefore, the TSE believes the trades are representative of the market in a security and should be eligible to set the last sale price. However, for the trading engine to accept trades as eligible to set the last sale price, the price of a trade must be at or between the bid and the ask.

The issue with respect to POSIT trades is that there is a delay between the call time and when POSIT trades are reported to the market. While it is anticipated that this period could be as brief as 30 seconds, it is possible that the reported price may be outside the then current bid and ask. Therefore, although the POSIT Trade is representative of the market, it would be ineligible to set the last sale price. As a result, an earlier price would set the last sale price although it may be even further off the market than the price of the POSIT Trade.

Moreover, since the last sale cannot be referenced to the time of other trades in the continuous market, a POSIT Trade that is reported at 2:35 p.m. could set the last sale price even though trades in the continuous market had occurred between the call, held at 2:30 p.m., and the time the POSIT Trade was reported.

The TSE proposes to initially allow POSIT trades to be eligible to set the last sale price if it is within the bid and ask price when reported. However, Market Surveillance will have the right to declare a POSIT Trade as either representative or not representative of the market and manually adjust whether it should be eligible to set the last sale price. The Exchange proposes that a review of POSIT trades and the last sale issue be conducted six months after implementation of the POSIT Call Market to determine whether POSIT trades should continue to be eligible to set the last sale price.

In addition, currently the POSIT system calculates the POSIT price to three decimal points – which may not be a standard trading increment. In order to facilitate the POSIT Price being eligible to set the last sale price, the TSE also recommends that any POSIT prices containing a non-standard trading increment be rounded up or down to the nearest cent or half cent.

REPORTS

The system will generate a STAMP Match Report for all trades at the conclusion of each match. These trades will then be validated by the TSE trading engine. Trade notifications will then be sent through the POSIT system to all order originators. The trade information will also be disseminated to official TSE feeds (TBF, CCDF and HSVF). However, since all POSIT trades are anonymous, the trade reports disseminated during the day will have an anonymous broker number, i.e. 001 and contain only public information (e.g. symbol, volume, price and a POSIT trade marker).

Information for anonymous trades, including private information, is made accessible to designated brokers by approximately 4:15 p.m. through a STAMP query. POs will be responsible for building access to the STAMP trade query in order to access this information.

IMPLEMENTATION

Implementation of the POSIT Call Market is anticipated for third quarter, 2001.

SUMMARY OF AMENDMENTS

INSTITUTIONAL ACCESS TO THE POSIT CALL MARKET

In order to facilitate the ability of institutions to execute trading strategies with reduced market impact, the POSIT Call Market must operate with *absolute anonymity* for these participants. To achieve this, the POSIT Call Market has been designed to guarantee anonymity – no orders can be seen or modified by any party other than the originator of an order.³ Consequently, eligible Canadian clients will use a web-based access to send their orders to the POSIT system.⁴ Designated POs will not be able to see eligible client orders or modify such orders and will only be able to access information regarding an eligible client's match results at the end of the trading day.

Currently, a number of institutional clients access the TSE trading engine, and in the near future will access the eVWAP Facility, through a system interconnect with a PO.⁵ The TSE proposes that the same categories of *institutional*⁶ clients be eligible to enter orders into the POSIT Call Market.

POs are currently able to provide system interconnect access to clients provided that:

- the client is in a class prescribed by the TSE; and
- the PO's system has been approved by the TSE and it, among other requirements:
 - ▶ allows the PO to receive an immediate report of the entry and execution of orders;
 - ▶ employs order parameters that permit the PO to route orders over a certain size or value, as agreed to with the client, to a trader and;

³ If necessary and requested by a client experiencing problems accessing the system, TSE Trading Services staff will be able to change a client's order.

⁴ Foreign clients will have to use a fixed means of access that is routed through a securities dealer registered in that jurisdiction and to a Canadian PO prior to entering the POSIT Call Market. These orders will still be anonymous.

⁵ TSE Rule 2-501 and Policy 2-501 govern access for certain "eligible clients" of Participating Organizations.

⁶ Clients using order-execution accounts will not be eligible for access to the POSIT Call Market through a Policy 2-501 system interconnect for such accounts.

- ▶ the PO and client enter into a standard form of agreement approved by the TSE which must include, among other provisions, the right of the PO to reject, change or remove any order or cancel any trade.

To support the anonymous feature of the POSIT facility, the system does not disclose information regarding orders entered by an eligible client to a designated PO and only allows POs to access information regarding a client's matches at the end of each trading day. Consequently, an exemption is required for POs offering clients access to the POSIT Call Market from requirements relating to a PO's ability to see orders, modify or cancel orders, and receive immediate reports relating to the entry and execution of orders by eligible clients.

As indicated above, unlike the standard Policy 2-501 system interconnects, Canadian access to POSIT is through the Internet. In Phase 1, POs will not be providing any front-end software to facilitate a client's access to the TSE and will not have access to a client's orders. Consequently, the PO also cannot set parameters or filters which would route orders over a certain size or value, as agreed to with a client, to a trader at the designated PO. However, the Policy 2-501 agreement between the client and PO for access to POSIT will still be required to contain limits on the value or size of a client's orders. At the end of each trading day a PO can access a client's trade information and review it against the limits imposed in their agreement.

RISKS AND RISK CONTROL MECHANISMS

To the extent that a designated PO cannot review orders nor set parameters to route orders over a certain size or value to a trading desk, there is a greater risk that an order may not comply with Exchange Requirements. Moreover, to the extent that eligible client trades remain undisclosed until the Regular Trading Session closes, the designated PO's credit exposure is unknown to the PO. The TSE believes these risks can largely be mitigated through:

- a training system available for users of the POSIT system;
- educational materials available for users of the POSIT system;
- limits imposed in the agreement between the client and PO as to the size or value of orders;
- the ability for clients to use the constraints feature of the POSIT system to impose a maximum value of matches allowed per call in order to comply with any limits set out in the agreement between the client and a designated broker; and
- effective post-trade review procedures by POs to enforce clients' credit limits.

ANTI-MANIPULATION

The TSE recognizes that to some extent trades in the regular market may be used in an attempt to influence the POSIT price. For example, an individual could attempt to widen the spread on a stock in order to move the mid-point price of the spread in a favourable direction.

The TSE believes that this type of risk can largely be mitigated through:

- random match times so participants will not know exactly when the match will start and the mid-point price set;
- enhanced Market Surveillance tools to monitor manipulation⁷; and
- continued enforcement of TSE anti-manipulation rules.

INDEMNIFICATION PROVISION

Pursuant to Rule 2-307, the TSE is indemnified against losses or claims by POs or clients and the POs are responsible for the entry and execution of all orders on a TSE trading system. As a result, POs are responsible for the entry and execution of orders entered into a TSE trading system by a client through a Policy 2-501 System Interconnect.

Although the POSIT Call Market will be operated as a facility of the TSE and supported by TSE staff, the electronic trading system will retain the POSIT name. This identification with POSIT has raised concerns that client users will identify the TSE call market facility with POSIT-JV (a joint venture of ITG Inc. and Barra, Inc.) even though POSIT-JV is merely licensing the software to the TSE. As a result, the TSE proposes that Policy 2-501 System Interconnect Agreements dealing with access to POSIT contain an indemnification for third party vendors providing software, hardware or services to the TSE in support of such trading systems. This indemnification is comparable to those currently provided to the TSE or other third party vendors providing systems for use in order entry pursuant to Policy 2-501.

HARMONIZATION WITH EXISTING RULES

A number of TSE rules are intended to prevent manipulation and promote a fair and equitable marketplace. However, such rules may be incompatible within a trading system that operates under a different pricing mechanism and a different priority and allocation algorithm. Attempting to enforce such rules would hinder the TSE's effectiveness in implementing new trading methodologies.

⁷ Monitoring systems will compare activity in the POST Call Market with activity in the continuous market and will generate up to six types of Market Surveillance alerts. In addition, Market Surveillance will have access to the POSIT Trade Report and to a list of orders after the call, enabling staff to compare the order information against trades in POSIT and in the continuous market.

There are a number of rules that are incompatible with the key features of the POSIT call market, namely, anonymity, the matching algorithm and the POSIT pricing mechanism. These features may result in inadvertent violations of certain TSE rules. For example, the down tick restriction in the short sale rule and the uptick restriction in the normal course issuer bid policy are both intended to prevent market manipulation. The POSIT pricing mechanism, however, does not allow an individual to control the price at which an order trades. Due to the price being taken from the midpoint of the bid/ask price in the regular market, a short sale could potentially occur at a price below the last reported price for that security (if the last sale was on the offer).

The TSE believes that short sales or other trades executed in the POSIT system would not involve the types of abuses that Rules 4-301 and 4-501 were designed to address. There is no price discovery mechanism in POSIT. Trades are processed on an anonymous basis at a fixed mid-point of the bid-ask spread on the regular market. Trades are executed according to an algorithm that maximizes the number of trades – priority is not based upon size or time. No participant can be assured of a match nor do they know precisely when the match occurs. As a result, the TSE proposes that trades in the POSIT call market be granted exemptions from

- Rule 4-501 relating to Client Priority,
- Rule 4-301 relating to Short Sales, and
- Policy on Normal Course Issuer Bids – restriction on up-ticks.

A short sale exemption was granted by the SEC in 1994 for POSIT U.S. with two conditions: i) that the persons relying on the exemption shall not be represented in the primary market or otherwise influence the primary market bid or offer at the time of the transaction; and ii) transactions effected on POSIT shall not be made for the purpose of creating actual, or apparent, active trading in or depressing or otherwise manipulating the price of any security. The TSE is of the opinion that the conditions imposed in the U.S. by the SEC conditions are unnecessary. Restricting persons entering short sales in POSIT from being in the Regular Session unduly affects a person's ability to trade. Moreover, restrictions against market manipulation and monitoring tools allowing Market Surveillance to compare activity in the Auction Market with the POSIT Call Market should be sufficient to prevent or identify attempts to influence the price of a stock.

CLIENT PRIORITY

Rule 4-501 requires a PO to give priority to client orders. This concept of client priority within a firm is a fundamental underpinning of market integrity. The allocation system of the POSIT Call Market, however, cannot support the client priority rule. In addition, the anonymity feature of the POSIT Call Market prevents a designated PO from complying with the rule for trades resulting from orders entered by eligible institutional clients since the information regarding these clients' trades will not be available to POs until the end of each trading day. As a result, the TSE recommends that Rule 4-501 not apply to eligible institutional client orders entered into the POSIT Call Market

without review by a PO. This exemption is consistent with the client priority rules for the eVWAP Facility.

HARMONIZATION WITH PROPOSED ATS FRAMEWORK RULES

The TSE is of the opinion that the proposed rules relating to the operation of the POSIT call market are consistent with the proposed ATS Framework Rules. In particular, the POSIT Call Market is consistent with the proposed Best Execution Rule since clients will need to request or consent to their orders being sent to the POSIT call market or will send their orders directly because they want to efficiently trade stocks anonymously and with no market impact.

QUESTIONS

Questions concerning this notice should be directed to Regulatory and Market Policy by contacting either Patrick Ballantyne, Director at (416) 947-4281 or Noelle Wood, Senior Counsel at (416) 947-4562.

BY ORDER OF THE BOARD OF DIRECTORS

LEONARD PETRILLO
VICE PRESIDENT
GENERAL COUNSEL & SECRETARY

**THE RULES
OF
THE TORONTO STOCK EXCHANGE INC.**

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

1. Rule 1-101(2) is amended by adding the following definitions:

"Constraint" means a restriction on the trading of a POSIT Order placed at any time prior to execution by the POSIT Participant entering the POSIT Order provided the restriction is:

- (a) the minimum number of units of a security or securities to be traded;
- (b) the Net Buy Imbalance;
- (c) the Net Sell Imbalance; or
- (d) of a type acceptable to the Exchange.

"Multiple Match Order" means a POSIT Order that has been specified by the POSIT Participant at the time of entry to the POSIT Call Market to be an order eligible to trade until the earlier of:

- (a) cancellation of the POSIT Order by the POSIT Participant;
- (b) the completion of the last POSIT Call on the Trading Day on which the POSIT Order was entered.

"Net Buy Imbalance" means the maximum amount by which the total value of the securities to be purchased may exceed the total value of the securities to be sold on the POSIT Order;

"Net Sell Imbalance" means the maximum amount by which the total value of the securities to be sold may exceed the total value of the securities to be purchased on the POSIT Order;

"POSIT Participant" means:

- (a) a Participating Organization; or
- (b) a client of a Participating Organization pursuant to Rule 2-501 that enters an order into the POSIT Call Market but does not include a client that enters an order for an Order-Execution Account.

“POSIT Call Market” means a facility of the Exchange that is an electronic trading system that executes trades at the POSIT Price.

“POSIT Call” means the times during a Trading Day that POSIT Orders may execute.

“POSIT Order” means an order for regular settlement for the purchase or sale of a listed security entered to trade only on the POSIT Call Market.

“POSIT Match Time” means a time not more than five minutes following the POSIT Call which has been randomly selected by the Exchange in respect of that POSIT Call at which POSIT Orders will execute.

“POSIT Price” means, in respect of each security, the average price of the bid price and the ask price for that security on the Exchange at POSIT Match Time [rounded to the nearest price increment permitted in accordance with Rule 4-404].

2. The Rules are amended by adding the following as Rule 4-106:

4-106 POSIT Call Market

(1) Establishment of Times for POSIT Calls

Unless otherwise prescribed, a POSIT Call shall occur on each Trading Day at:

- (a) 10:30 a.m.; and
- (b) 2:30 p.m.

(2) Order Entry

A POSIT Participant may enter a POSIT Order at any time on a Trading Day as may be determined by the Exchange.

(3) Orders for Board Lots

A POSIT Order for a particular security must be for a board lot or an integral multiple of a board lot of that security.

(4) Restrictions on Execution

A POSIT Order for a particular security shall not execute if, at the POSIT Match Time:

- (a) trades in the security are subject to special settlement rules issued by the Exchange in accordance with Rule 5-103(2);
- (b) trading in the particular security has been halted or delayed by the Exchange or a Market Surveillance Official; or
- (c) there is not both an ask price and a bid price for the security.

(5) Unfilled Orders

Unless an order is a Multiple Match Order, any POSIT Order which is not executed at the POSIT Call which occurs immediately following the entry of the POSIT Order shall be automatically cancelled.

(6) Execution and Allocation of Trades

Subject to compliance with any Constraints, in respect of each POSIT Call, POSIT Orders shall execute at the POSIT Price at the POSIT Match Time and shall be allocated among orders:

- (a) to maximize the total number of securities traded during the particular POSIT Call and
- (b) on a *pro rata* basis [rounded to the nearest board lot in respect of each security].

(7) Compliance with Short Sale Rule

For the purposes of Rule 4-301(1), a short sale in a security may be made in the POSIT Call Market notwithstanding that the POSIT Price in respect of such security is below the price of the last board lot sale of the security on the Exchange.

(8) Exemption from the In-House Client Priority Rule

Notwithstanding Rule 4-501, a Participating Organization need not give priority to a client order if the client has entered the order as a POSIT Order pursuant to access provided to the client under Rule 2-501.

3. Rule 4-901(2) is deleted and the following substituted:
 - (2) All transactions in the Special Trading Session shall be at a price of the last sale of the security during the Regular Session or, if the last trade in the security is in the POSIT Call Market, unless otherwise determined by a Market Surveillance Official, at the POSIT Price.

THIS RULE AMENDMENT MADE this 29th day of May, 2001 to be effective upon approval of the amendment by the Ontario Securities Commission.

“Daniel F. Sullivan”
Daniel F. Sullivan, Chair

“Leonard P. Petrillo”
Leonard P. Petrillo, Secretary

**THE POLICIES
OF
THE TORONTO STOCK EXCHANGE INC.**

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

1. Policy 2-502(2)(a) is deleted and the following substituted:
 - (a) the eligible client is authorized to connect to:
 - (i) the Participating Organization’s order routing system,
 - (ii) the eVWAP Facility, or
 - (iii) the POSIT Call Market;

2. Policy 2-502 is amended by adding the following:

(6) POSIT Call Market Requirements

The agreement required by Rule 2-502(b) between a Participating Organization and a client with respect to the POSIT Call Market, may omit provisions otherwise required by Policy 2-502(1)(d), 2-502(2)(d) and (e), and 2-502(3)3 if:

- (a) the agreement provides that any person, other than the Exchange, who provides software, hardware or services to the Exchange (“Third Party Provider”) to support the operations of, or the services or information accessible through, the trading system which shall include without limitation, the POSIT Call Market, shall not be liable to the Participating Organization or the eligible client or any other person for any loss, damage, cost, expense or other liability or claim (including loss of business, profits, trading losses, loss of anticipated profits, business interruption, loss of business information or for indirect, special, punitive, consequential or incidental loss or damage or other pecuniary loss) of any nature arising from any use or inability to use the trading system, howsoever caused, including by the Third Party Provider’s negligence or reckless or wilful acts or omissions, even if the Third Party Providers are advised of such possibilities; and

- (b) the system through which the order is transmitted:
 - (i) enforces Exchange Requirements relating to the entry of POSIT Orders, and
 - (ii) has the ability to generate a trade report to the client and, for the purposes of disseminating the trade report to eligible clients outside of Canada, to the designated Participating Organization; and
- (c) the Participating Organization has the ability to access an eligible client's trade report through the STAMP trade query.

3. Policy 6-501(9)1 is amended by inserting "or the POSIT Call Market" after the phrase "other than purchases made in the eVWAP Facility".

THIS POLICY AMENDMENT MADE this 29th day of May, 2001 to be effective upon approval of the amendment by the Ontario Securities Commission.

"Daniel F. Sullivan"

Daniel F. Sullivan, Chair

"Leonard P. Petrillo"

Leonard P. Petrillo, Secretary