

13.1.4 IIROC Rules Notice – Notice of Approval – Provisions Respecting Best Execution

IIROC RULES NOTICE
NOTICE OF APPROVAL – UMIR
PROVISIONS RESPECTING BEST EXECUTION

08-0039
July 18, 2008

PROVISIONS RESPECTING BEST EXECUTION

Summary

This IIROC Rules Notice provides notice of the approval by the applicable securities regulatory authorities (the “Recognizing Regulators”) of amendments to the Universal Market Integrity Rules (“UMIR”) respecting various aspects of best execution (“Amendments”). These Amendments will become effective on September 12, 2008 concurrent with the effective date in Ontario, the jurisdiction of the principal regulator of the Investment Industry Regulatory Organization of Canada (“IIROC”), of comparable changes to the best execution provisions of National Instrument 23-101 (“Trading Rules”).

In particular, the Amendments:

- conform the requirements under UMIR to be consistent with changes (the “CSA Best Execution Amendments”)¹ by the Canadian Securities Administrators (“CSA”) to the Trading Rules; and
- clarify the circumstances when a Participant should consider order and trade information from a foreign organized regulated market²; and
- clarify that obtaining “best execution” remains subject to “best price” obligations.

The Amendments have been revised from the proposals contained in Market Integrity Notice 2007-008 – *Request for Comments – Provisions Respecting Best Execution* (April 20, 2007) (the “Best Execution Proposal”).

Background to the Amendments

Previous Provisions

Prior to the Amendments, Rule 5.1 of UMIR required that a Participant “diligently pursue the execution of each client order on the most advantageous terms for the client as expeditiously as practicable under prevailing market conditions”. In addition to this “best execution” requirement, Rule 5.2 of UMIR requires that a Participant make reasonable efforts prior to the execution of an order, including a client order, to ensure that the order is executed at the best available price.³ As such, UMIR recognizes that “best execution” and “best price” are separate but related obligations imposed on a Participant when handling a client order.

Prior to the CSA Best Execution Amendments coming into force, the CSA Trading Rules provided that “a dealer acting as agent for a client shall make reasonable efforts to ensure that the client receives the best execution price on a purchase or sale or securities by the client”.⁴ For the purposes of the CSA Trading Rules, the focus of “best execution” had been on providing “best price”. In accordance with the CSA Trading Rules, a Participant is exempt from the “best execution” provisions under Part 4 of the CSA Trading Rules if the Participant complies with the requirements of UMIR when handling a client order that is subject to UMIR.⁵

¹ Canadian Securities Administrators Notice on Best Execution, (2008) 31 OSCB 6303.

² For a discussion of the definition of a “foreign organized regulated market”, see Market Integrity Notice 2008-008 – *Amendment Approval – Provisions Respecting “Off-Marketplace” Trades* (May 16, 2008).

³ The “best price” obligation under Rule 5.2 of UMIR will be repealed or significantly amended dependent upon the provisions governing “trade-through” that are adopted by the CSA. Any consequential amendments proposed by IIROC will be issued in a Rules Notice and be open for comment during the same period as any amendments regarding trade-through proposed by the CSA for the CSA Trading Rules and the Marketplace Operation Instrument. For a discussion of the concepts that may be included in the trade-through proposal reference should be made to “Trade-through” in Market Integrity Notice 2007-007 – *Request for Comments - Joint Canadian Securities Administrators/Market Regulation Services Inc. Notice on Trade-Through Protection, Best Execution and Access to Marketplaces – Proposed Amendments to National Instrument 21-101 Marketplace Operation and National Instrument 23-101 Trading Rules and Related Universal Market Integrity Rules* (April 20, 2007).

⁴ National Instrument 23-101, ss. 4.2(1).

⁵ *Ibid.*, s. 2.1.

Market Integrity Notice 2007-002 – *Notice of Approval – Provisions Respecting Competitive Marketplaces* (February 26, 2007) set out certain amendments to the “best execution” obligation under UMIR (the “Competitive Marketplaces Amendments”). Under the Competitive Marketplaces Amendments a Participant, in discharging its best execution obligation, must consider possible liquidity on marketplaces that do not provide transparency of orders in a consolidated market display if:

- the displayed volume in the consolidated market display is not adequate to fully execute the client order on advantageous terms for the client; and
- the non-transparent marketplace has demonstrated that there is a reasonable likelihood that the marketplace will have liquidity for the specific security.

In addition, the Competitive Marketplaces Amendments expanded the Policy to indicate that IIROC would consider two additional factors when determining whether a Participant has diligently pursued the best execution of a client order, namely:

- any specific client instructions regarding the timeliness of the execution of the order; and
- whether organized regulated markets outside of Canada have been considered (particularly if the principal market for the security is outside of Canada).

CSA Best Execution Amendments

On June 20, 2008, the CSA published the CSA Best Execution Amendments which are expected to become effective on September 12, 2008. The CSA Best Execution Amendments make no substantive or material changes to the proposed amendments to the Trading Rules published on April 20, 2007.⁶

In the proposals published in April of 2007, the CSA had also suggested the introduction of reporting by marketplaces and dealers of order execution and market quality information. The CSA has determined not to proceed with this aspect of the proposal at this time.⁷ IIROC had not proposed to have comparable provisions in UMIR as part of the Best Execution Proposal.

Harmonization of the Amendments and the CSA Best Execution Amendments

The Amendments parallel the provisions adopted in the CSA Best Execution Amendments. There are differences in language and structure that reflect:

- the use of different defined terms and drafting protocols;
- the application of the UMIR provisions to orders for securities eligible to be traded on a marketplace that has retained IIROC as its regulation services provider as compared to the application of CSA Best Execution Amendments to all client orders; and
- the application of the UMIR provisions to Participants as compared to the application of CSA Best Execution Amendments to all dealers and advisers that may owe a best execution to clients when handling a client order or dealing on behalf of a portfolio.

In the view of IIROC, there are no substantive differences between the Amendments and the CSA Best Execution Amendments other than as a result of these three factors. If revisions are made to the “best execution” provisions under the CSA Trading Rules, it is intended that necessary consequential revisions will be made to UMIR such that the UMIR provisions will continue to parallel the provisions of the CSA Trading Rules.

If there are continuing differences between the “best execution” provisions under UMIR and the CSA Trading Rules, a Participant would, in accordance with section 2.1 of the CSA Trading Rules, be exempt from the “best execution” provisions

⁶ Canadian Securities Administrators Notice on Best Execution, op. cit., p. 6304. Specifically, the CSA have clarified that:

- A dealer is required to make reasonable efforts to use facilities providing information regarding orders and trades to satisfy the “reasonable efforts” test for the best execution obligation.
- To achieve best execution, a dealer or adviser should be able to demonstrate that it has abided by its best execution policies and procedures. We [the CSA] have further explained that these policies and procedures should describe how the dealer or adviser evaluates whether best execution was obtained and should be regularly and rigorously reviewed.
- Policies and procedures for seeking best execution should include the requirement to evaluate whether taking steps to access orders on a specific marketplace is appropriate under the circumstances.
- Dealers should include in their best execution policies and procedures a regular assessment of whether it is appropriate to consider ATSS in Canada that trade foreign exchange-traded securities as well as the foreign markets upon which these securities trade.

⁷ Ibid.

under Part 4 of the CSA Trading Rules if the Participant complies with the requirements of UMIR. However, the provisions of the CSA Trading Rules apply to:

- a dealer or adviser who is not a “Participant” for the purposes of UMIR; and
- a Participant when trading a client order for a security that is not eligible to be traded on a marketplace regulated by IIROC.

Summary of the Amendments

Effective September 12, 2008, the Amendments vary Rule 5.1 by replacing certain of the language to more closely parallel the terms used in the CSA Best Execution Amendments. Rule 5.1 is amended to refer to “the most advantageous execution terms reasonably available under the circumstances”. Prior to the Amendments, the Rule required a Participant to diligently pursue the execution of each client order on the “most advantageous terms for the client as expeditiously as practicable under prevailing market conditions”. The phrase “expeditiously as practicable under prevailing market conditions” has been deleted from the Rule as the Policy has been amended to set out the four general factors (price, speed of execution, certainty of execution and the overall transaction cost) that are encompassed by concept of “expeditiously as practicable” and to indicate that in considering the “circumstances” the Participant should take into account “prevailing market conditions”.

The Amendments change various parts of Policy 5.1 to provide clarification of:

- the general factors to be considered in providing best execution with the key factors being: price; speed of execution; certainty of execution; and the overall cost of the transaction;
- the specific factors to be considered in providing best execution, namely: client instructions; consideration of marketplaces that have demonstrated a reasonable likelihood of liquidity relative to the size of the client order; and consideration of non-transparent marketplaces if the displayed volume is inadequate and the non-transparent marketplace has demonstrated a reasonable likelihood of liquidity for the specific security;
- the additional factors that may be considered by a Participant when determining whether to execute on a foreign organized regulated market including: available liquidity displayed on a marketplace; the proportion of trading in the security accounted for by the foreign market; exposure to settlement risk and fluctuations in foreign currency exchange; and
- the requirement to comply with the “best price” obligation under Rule 5.2 notwithstanding any client instruction or consent with respect to the “best execution” obligation.

The Amendments also change Part 4 of Policy 7.1 dealing with trading supervision obligations to clarify the requirement that the written policies and procedures of a Participant should outline the process used by the Participant to obtain best execution and permit an evaluation of whether best execution was obtained on the execution of a particular client order. In particular, the policies and procedures must address how a Participant will ensure best execution in circumstances when the Participant has an “incentive” arrangement with a particular marketplace (including ownership, payments or discounts based on the number, value or volume associated with orders entered on or trades executed on that particular marketplace).

As a result of the changes to Rule 5.1 and Policy 5.1, the Amendments move the factors to be taken into account when determining whether a principal trade with a client is undertaken at the “best available price” from Policy 5.1 and add them to Policy 8.1. In addition, the Amendments make an editorial change to Rule 8.1 by replacing the phrase “taking into account the condition of the market at that time” with the phrase “under prevailing market conditions”. This change would standardize the use of terminology between Policy 5.1 and Rule 8.1 with respect to the factors to be taken into account. In the view of IIROC, this amendment simply standardizes the language used and does not represent a substantive change in requirements.

Summary of Changes from the Best Execution Proposal

The Amendments have been revised from the Best Execution Proposal to:

- conform UMIR to changes made to the CSA Best Execution Amendments, particularly with respect to the provisions dealing with policies and procedures (see “CSA Best Execution Amendments” on pages 4 and 5); and
- make consequential changes arising from recent amendments to UMIR, in particular the adoption of the definition of “foreign organized regulated market” as set out in Market Integrity Notice 2008-008 – *Amendment Approval – Provisions Respecting “Off-Marketplace” Trades* (May 16, 2008).

Summary of Changes from the Competitive Marketplaces Amendments

The Amendments specifically vary two aspects of Part 2 of Policy 5.1 as adopted by the Competitive Marketplaces Amendments:

Client Instructions

The policies under the Competitive Marketplaces Amendments permitted a Participant to take into consideration specific client instructions regarding “the timeliness of” the execution of the client order. The Amendments remove the restriction on the client instructions to the speed of execution. However, the Amendments clarify that a Participant would remain subject to the “best price” obligation under Rule 5.2 notwithstanding any client instruction or consent.

Consideration of Foreign Organized Regulated Markets

One of the factors a Participant can take into account under the Competitive Marketplaces Amendments is “whether organized regulated markets outside of Canada have been considered (particularly if the principal market for the security is outside of Canada).” Certain commentators construed this factor as requiring the consideration of foreign markets when trading any security that was traded on both a marketplace and a foreign market. The Amendments set out the additional factors that may be considered by a Participant when determining whether to execute on a foreign organized regulated market including: available liquidity displayed on a marketplace; the proportion of trading in the security accounted for by the foreign organized regulated market; exposure to settlement risk and fluctuations in foreign currency exchange.

Appendices

- Appendix “A” sets out the text of the Amendments to the Rules and Policies respecting best execution; and
- Appendix “B” sets out a summary of the comment letters received in response to the Request for Comments on the Best Execution Proposal set out in Market Integrity Notice 2007-008 - *Request for Comments – Provisions Respecting Best Execution* (April 20, 2007). Appendix “B” also sets out the response of IIROC to the comments received and provides additional commentary on the revisions the Amendments made to the Best Execution Proposal. Appendix “B” also contains the text of the relevant provisions of the Rules and Policies as they read on the adoption of the Amendments. The text has been marked to indicate changes from the Best Execution Proposal.

Appendix "A"

Provisions Respecting Best Execution

The Universal Market Integrity Rules are amended as follows:

1. Rule 5.1 is deleted and the following substituted.

A Participant shall diligently pursue the execution of each client order on the most advantageous execution terms reasonably available under the circumstances.

2. Rule 8.1 is amended by deleting the phrase "taking into account the condition of the market at that time" and substituting the phrase "under prevailing market conditions".

The Policies to the Universal Market Integrity Rules are amended as follows:

1. Policy 5.1 is deleted and the following substituted:

Part 1 – General Factors to be Considered

In seeking the "most advantageous execution terms reasonably available under prevailing market conditions", the Market Regulator would expect that the Participant would take into account a number of general factors, including:

- the price at which the trade would occur;
- the speed of execution;
- the certainty of execution; and
- the overall cost of the transaction.

These four broad factors encompass more specific considerations, such as order size, reliability of quotes, liquidity, market impact (the price movement that occurs when executing an order) and opportunity cost (the missed opportunity to obtain a better price when an order is not completed at the most advantageous time). The overall cost of the transaction is meant to include, where appropriate, all costs associated with accessing an order and/or executing a trade that are passed onto a client, including fees arising from trading on a particular marketplace, jitney fees (ie. any fees charged between dealers to provide trading access) and settlement costs.

In considering the circumstances, Participants should take into account "prevailing market conditions" and consider such factors as:

- prices and volumes of the last sale and previous trades;
- direction of the market for the security;
- posted size on the bid and offer;
- the size of the spread; and
- liquidity of the security.

Part 2 – Specific Factors to be Considered

In determining whether a Participant has diligently pursued the best execution of a client order, the Market Regulator will consider a number of specific factors including:

- any specific client instructions regarding the execution of the order;
- whether the Participant has considered orders on a marketplace that has demonstrated a reasonable likelihood of liquidity for a specific security relative to the size of the client order; and

- whether the Participant has considered possible liquidity on marketplaces that do not provide transparency of orders in a consolidated market display if:
 - the displayed volume in the consolidated market display is not adequate to fully execute the client order on advantageous terms for the client, and
 - the non-transparent marketplace has demonstrated that there is a reasonable likelihood that the marketplace will have liquidity for the specific security.

Part 3 – Consideration of Foreign Organized Regulated Markets

In determining whether to consider the execution of a client order on a foreign organized regulated market, the Participant may consider, in addition to the factors set out in Parts 1 and 2:

- available liquidity displayed on a marketplace relative to the size of the client order;
- the extent of trading in the particular security on the foreign organized regulated market relative to the volume of trading on marketplaces;
- the extent of exposure to settlement risk in a foreign jurisdiction; and
- the extent of exposure to fluctuations in foreign currency exchange.

Part 4 – Subject to Best Price Obligation

Notwithstanding any instruction or consent of the client, the provision of “best execution” for a client order is subject to compliance with the “best price” obligation under Rule 5.2. Similarly, if a foreign organized regulated market is considered in order to provide a client with “best execution”, the Participant has an obligation to better-priced orders on marketplaces that may be required for compliance with the “best price” obligation under Rule 5.2.

2. Part 4 of Policy 7.1 is amended by adding the following after the first sentence:

A Participant must have policies and procedures in place to “diligently pursue the execution of each client order on the most advantageous execution terms reasonably available under the circumstances”. The policies and procedures must:

- outline a process designed to achieve best execution;
- require the Participant, subject to compliance by the Participant with any Requirement, to follow the instructions of the client and to consider the investment objectives of the client;
- include the process for taking into account order and trade information from all appropriate marketplaces and foreign organized regulated markets; and
- describe how the Participant evaluates whether “best execution” was obtained.

In order to demonstrate that a Participant has “diligently pursued” the best execution of a particular client order, the Participant must be able to demonstrate that it has abided by the policies and procedures.

3. The following is added as Part 3 of Policy 8.1:

Part 3 – Factors in Determining “Best Available Price”

The price of the principal transaction must also be justified by prevailing market conditions. Participants should consider such factors as:

- prices and volumes of the last sale and previous trades;
- direction of the market for the security;
- posted size on the bid and offer;

- the size of the spread; and
- liquidity of the security.

For example, if the market is \$10 bid and \$10.50 asked and a client wants to sell 1,000 shares, it would be inappropriate for a Participant to do a principal trade at \$10.05 if the security has been trading heavily at \$10.50 and there is strong bidding for the security at \$10 compared to the number of securities being offered at \$10.50. The condition of the market suggests that the client should be able to sell at a better price than \$10.05. Accordingly, the Participant as agent for the client should post an offer at \$10.45 or even \$10.50, depending on the circumstances. The desire of the client to obtain a fill quickly is always a consideration.

Of course, if a client expressly consents to a principal trade on a fully-informed basis, following the client's instructions will be reasonable.

Appendix "B"

**Comments Received in Response to
Market Integrity Notice 2007-008 – Request for Comments –
Provisions Respecting Best Execution**

Market Integrity Notice 2007-007 – *Joint Canadian Securities Administrators / Market Regulation Services Inc. Notice on Trade-Through Protection, Best Execution and Access to Marketplaces* ("Joint Notice") issued on April 20, 2007 included proposed amendments to National Instrument 21-101 – *Marketplace Operation* and National Instrument 23-101 – *Trading Rules*. Concurrent with the publication of the Joint Notice, Market Integrity Notice 2007-008 was issued requesting comments on proposed amendments to UMIR respecting best execution ("Best Execution Proposal"). Comments were received specifically on the Best Execution Proposal from:

Canadian Trading and Quotation System Inc. ("CNQ")

egX Canada ("egX")

RBC Dominion Securities ("RBCDS")

A copy of each comment letter submitted in response to the Joint Notice on the Best Execution Proposal is publicly available on the IIROC website (www.iiroc.ca under the heading "Policy" and sub-heading "Market Proposals/Comments"). A summary of the comments received on the Joint Notice (including responses to specific questions related generally to "best execution" and the provisions proposed to be added to the National Instruments) is available at (2008), 31 OSCB 6306.

The following table presents a summary of the comments received on the Best Execution Proposal together with the response of IIROC to those comments. Column 1 of the table highlights the revisions to the Best Execution Proposal made by IIROC in response to these comments, the comments received on the Joint Notice and the comments of the Recognizing Regulators.

Text of Provisions Following Adoption of the Amendments (Changes from the Best Execution Proposal Highlighted)	Commentator and Summary of Comment	IIROC Response to Comment and Additional IIROC Commentary
<p>5.1 Best Execution of Client Orders</p> <p>A Participant shall diligently pursue the execution of each client order on the most advantageous execution terms reasonably available under the circumstances.</p>	<p>egX – Dealers need the flexibility to expand the definition based on other determinants also relevant to their business models and the clients' directions.</p> <p>RBCDS – What is meant by "the most advantageous execution terms reasonably available under the circumstances"?</p>	<p>Best execution must be measured in the context of complying with all other applicable regulatory requirements. In particular, IIROC expects compliance with the "best price" obligations even if the client is prepared to execute at an inferior price. "Best execution" is not given priority over any other obligation which a Participant has in executing a trade.</p> <p>As noted in the Market Integrity Notice, the test is essentially a restatement of the current requirements under Rule 5.1 of UMIR. Parts 1 and 2 of Policy 5.1 set out general and specific factors to be taken into account. Part 3 of Policy 5.1 set out considerations to be taken into account when determining whether to access an organized regulated market outside Canada.</p>
<p>8.1 Client-Principal Trading</p> <p>(1) A Participant that receives a client order for 50 standard trading units or less of a security with a value of \$100,000 or less may execute the client order against a principal order or non-client order at a better price provided the Participant has taken reasonable steps to ensure that the price is the best available price for the client under prevailing market conditions.</p>		

Text of Provisions Following Adoption of the Amendments (Changes from the Best Execution Proposal Highlighted)	Commentator and Summary of Comment	IIROC Response to Comment and Additional IIROC Commentary
<p>Policy 5.1 – Best Execution of Client Orders</p> <p>Part 1 – General Factors to be Considered</p> <p>In seeking the “most advantageous execution terms reasonably available under the circumstances”, the Market Regulator would expect that the Participant would take into account a number of general factors, including:</p> <ul style="list-style-type: none"> • the price at which the trade would occur; • the speed of execution; • the certainty of execution; and • the overall cost of the transaction. <p>These four broad factors encompass more specific considerations, such as order size, reliability of quotes, liquidity, market impact (the price movement that occurs when executing an order) and opportunity cost (the missed opportunity to obtain a better price when an order is not completed at the most advantageous time). The overall cost of the transaction is meant to include, where appropriate, all costs associated with accessing an order and/or executing a trade that are passed on to a client, including fees arising from trading on a particular marketplace, jitney fees (ie. any fees charged between dealers to provide trading access) and settlement costs.</p> <p>In considering the circumstances, Participants should take into account “prevailing market conditions” and consider such factors as:</p> <ul style="list-style-type: none"> • prices and volumes of the last sale and previous trades; • direction of the market for the security; • posted size on the bid and offer; • the size of the spread; and • liquidity of the security. 		
<p>Policy 5.1 – Best Execution of Client Orders</p> <p>Part 2 – Specific Factors to be Considered</p> <p>In determining whether a Participant has diligently pursued the best execution of a client order, the Market Regulator will consider a number of specific factors including:</p> <ul style="list-style-type: none"> • any specific client instructions regarding the execution of the order; • whether the Participant has considered orders on a marketplace that has demonstrated a reasonable likelihood of liquidity for a specific security relative to the 	<p>RBCDS – To what extent will client instructions or consent impact the “best execution” obligation?</p>	<p>Client instructions qualify any measure of “best execution”. However, as noted in Part 4 of Policy 5.1, a client instruction or consent can not override the “best price” obligation under Rule 5.2.</p>

Text of Provisions Following Adoption of the Amendments (Changes from the Best Execution Proposal Highlighted)	Commentator and Summary of Comment	IIROC Response to Comment and Additional IIROC Commentary
<p>size of the client order; and</p> <ul style="list-style-type: none"> • whether the Participant has considered possible liquidity on marketplaces that do not provide transparency of orders in a consolidated market display if: <ul style="list-style-type: none"> ○ the displayed volume in the consolidated market display is not adequate to fully execute the client order on advantageous terms for the client, and ○ the non-transparent marketplace has demonstrated that there is a reasonable likelihood that the marketplace will have liquidity for the specific security. 		
<p>Policy 5.1 – Best Execution of Client Orders</p> <p>Part 3 – Consideration of <u>Foreign Organized Regulated Markets</u></p> <p>In determining whether to consider the execution of a client order on an <u>foreign organized regulated market outside of Canada</u>, the Participant may consider, in addition to the factors set out in Parts 1 and 2:</p> <ul style="list-style-type: none"> • available liquidity displayed on a marketplace relative to the size of the client order; • the extent of trading in the particular security on the <u>foreign organized regulated market</u> relative to the volume of trading on marketplaces; • the extent of exposure to settlement risk in a foreign jurisdiction; and • the extent of exposure to fluctuations in foreign currency exchange. 		<p>With the publication of Market Integrity Notice 2008-008 – Amendment Approval – Provisions Respecting “Off-Marketplace” Trades (May 16, 2008), UMIR was amended to adopt a definition of “foreign organized regulated markets”. The changes in this Part of Policy 5.1 are consequential to the adoption of that definition.</p>
<p>Policy 5.1 – Best Execution of Client Orders</p> <p>Part 4 – Subject to Best Price Obligation</p> <p>Notwithstanding any instruction or consent of the client, the provision of “best execution” for a client order is subject to compliance with the “best price” obligation under Rule 5.2. Similarly, if a <u>foreign organized regulated market outside of Canada</u> is considered in order to provide a client with “best execution”, the Participant has an obligation to better-priced orders on marketplaces that may be required for compliance with the “best price” obligation under Rule 5.2.</p>	<p>RBCDS – Is “best execution” consistent with “trade-through” obligations?</p>	<p>Best execution must be measured in the context of complying with all other applicable regulatory requirements. In particular, IIROC expects compliance with the “best price” obligations even if the client consents to or directs an execution at an inferior price.</p> <p>With the publication of Market Integrity Notice 2008-008 – Amendment Approval – Provisions Respecting “Off-Marketplace” Trades (May 16, 2008), UMIR was amended to adopt a definition of “foreign organized regulated markets”. The changes in this Part of Policy 5.1 are consequential to the adoption of that definition.</p>

Text of Provisions Following Adoption of the Amendments (Changes from the Best Execution Proposal Highlighted)	Commentator and Summary of Comment	IIROC Response to Comment and Additional IIROC Commentary
<p>Policy 7.1 – Trading Supervision Obligations</p> <p>Part 4 – Specific Procedures Respecting Client Priority and Best Execution</p> <p>Participants must have written compliance procedures reasonably designed to ensure that their trading does not violate Rule 5.3 or 5.1. A Participant must <u>should</u> have <u>policies and procedures</u> a process in place to “diligently pursue the execution of each client order on the most advantageous execution terms reasonably available under the circumstances”. The process should allow the Participant to evaluate whether “best execution” was obtained and whether the Participant has “diligently pursued” the best execution of a particular client order, including relying on that process. <u>The policies and procedures must:</u></p> <ul style="list-style-type: none"> • <u>outline a process designed to achieve best execution;</u> • <u>require the Participant, subject to compliance by the Participant with any Requirement, to follow the instructions of the client and to consider the investment objectives of the client;</u> • <u>include the process for taking into account order and trade information from all appropriate marketplaces and foreign organized regulated markets; and</u> • <u>describe how the Participant evaluates whether “best execution” was obtained.</u> <p>In order to demonstrate that a Participant has “diligently pursued” the best execution of a particular client order, the Participant must be able to demonstrate that it has abided by the policies and procedures. At a minimum, the written compliance procedures must address employee education and post-trade monitoring.</p> <p>The purpose of the Participant’s compliance procedures is to ensure that pro traders do not knowingly trade ahead of client orders. This would occur if a client order is withheld from entry into the market and a person with knowledge of that client order enters another order that will trade ahead of it. Doing so could take a trading opportunity away from the first client. Withholding an order for normal review and order handling is allowed under Rules 5.3 and 5.1, as this is done to ensure that the client gets a good execution. To ensure that the Participants’ written compliance procedures are effective they must address the potential problem situations where trading opportunities may be taken away from clients.</p>		<p>The CSA Best Execution Amendments clarified a number of aspects from the proposal contained in the Joint Notice, particularly with respect to the adoption of policies and procedures by a dealer. The Amendments to Part 4 of Policy 7.1 conform the requirements of UMIR to the CSA Best Execution Amendments.</p>

Text of Provisions Following Adoption of the Amendments (Changes from the Best Execution Proposal Highlighted)	Commentator and Summary of Comment	IIROC Response to Comment and Additional IIROC Commentary
<p>Policy 8.1 – Client-Principal Trading</p> <p>Part 3 – Factors in Determining “Best Available Price”</p> <p>The price of the principal transaction must also be justified by prevailing market conditions. Participants should consider such factors as:</p> <ul style="list-style-type: none"> • prices and volumes of the last sale and previous trades; • direction of the market for the security; • posted size on the bid and offer; • the size of the spread; and • liquidity of the security. <p>For example, if the market is \$10 bid and \$10.50 asked and a client wants to sell 1,000 shares, it would be inappropriate for a Participant to do a principal trade at \$10.05 if the security has been trading heavily at \$10.50 and there is strong bidding for the security at \$10 compared to the number of securities being offered at \$10.50. The condition of the market suggests that the client should be able to sell at a better price than \$10.05. Accordingly, the Participant as agent for the client should post an offer at \$10.45 or even \$10.50, depending on the circumstances. The desire of the client to obtain a fill quickly is always a consideration.</p> <p>Of course, if a client expressly consents to a principal trade on a fully-informed basis, following the client’s instructions will be reasonable.</p>		
<p>General Comments</p>	<p>CNQ – Believes that requirement to consider foreign markets should be limited to situations where a dealer is currently accessing the foreign market. A dealer may not know all of the marketplaces on which a security trades, may not have access to the relevant market information, may not be able to execute an order on a foreign market at an acceptable cost and settlement practices may be unreasonably delayed or expensive. A dealer holding a client order should be prohibited from trading as principal in a foreign market and immediately unwinding to the client at an inferior price.</p>	<p>Under the IIROC proposal, Part 3 of Policy of 5.1 would qualify the obligation to consider a foreign organized regulated market.</p> <p>Provisions governing client priority would preclude a Participant executing on a foreign market and unwinding at an “inferior price” to a client order held at the time of the purchase on the foreign market. IIROC has also provided guidance that such a practice may be considered “double printing” unless there is a valid reason why the client order could not be executed in the foreign market.</p>

Text of Provisions Following Adoption of the Amendments (Changes from the Best Execution Proposal Highlighted)	Commentator and Summary of Comment	IIROC Response to Comment and Additional IIROC Commentary
	<p>RBCDS – Who is going to provide the “consolidated market display”?</p> <p>Why does UMIR not include provision for the reporting of order execution and market quality?</p>	<p>The “consolidated market display” is simply the compilation of information from all marketplaces which a Participant must take into account when making trading decisions. If there is an information processor, the consolidated market display is the information provided in accordance with Part 14 of the Marketplace Operation Instrument. If there is no information processor, the source of the information can be through one or more information vendors.</p> <p>The obligations contemplated in the CSA proposal that apply to marketplaces are not appropriate for UMIR which is intended to regulate trading activity. The reporting obligation for “dealers” applies to more than Participants and to additional marketplaces and securities than those monitored pursuant to UMIR. As such, the reports may be different and therefore confusing to the intended users.</p>