

13.1.8 IIROC Rules Notice – Request for Comments – UMIR – Provisions Respecting Implementation of the Order Protection Rule

RULES NOTICE

REQUEST FOR COMMENTS – UMIR

PROVISIONS RESPECTING IMPLEMENTATION OF THE ORDER PROTECTION RULE

Summary

This IIROC Notice provides notice that, on September 23, 2009, the Board of Directors (“Board”) of the Investment Industry Regulatory Organization of Canada (“IIROC”) approved proposed amendments (“Proposed Amendments”) to the Universal Market Integrity Rules (“UMIR”) that would be consequential to the implementation by the Canadian Securities Administrators (“CSA”) of changes to National Instrument 23-101 – *Trading Rules* (“Trading Rules”) regarding trade-through protection (“Order Protection Rule”).<sup>1</sup>

In particular, the Proposed Amendments would:

- repeal the rule and policies respecting the “best price” obligation of Participants;
- provide that the Order Protection Rule can not be avoided when a Participant is considering a trade on a foreign organized regulated market;
- require a Participant or Access Person to have adequate policies and procedures for the handling of orders that do not rely on a marketplace to ensure compliance with the Order Protection Rule;
- make a number of consequential changes to UMIR including:
  - repealing those portions of the rules and policies on trading supervision and gatekeeper reports dealing with the “best price” obligation from,
  - confirming that the “best execution” obligation is subject to the Order Protection Rule,
  - introducing a marker for a “directed action order” as defined for the Order Protection Rule, and
  - extending the existing provisions of UMIR governing foreign currency translation and the calculation of the value of an order to the determination whether the execution of certain trades on a foreign organized regulated market may give rise to an obligation to fill “better-priced” orders on a marketplace.

***Until the Order Protection Rule comes into force and the Proposed Amendments have been approved and implemented, Participants remain subject to the “best price” obligation under Rule 5.2 of UMIR.<sup>2</sup> The Order Protection Rule is expected to come into force on February 1, 2011.***

Rule-Making Process

IIROC has been recognized as a self-regulatory organization by each of the Canadian provincial securities regulatory authorities (the “Recognizing Regulators”) and, as such, is authorized to be a regulation services provider for the purposes of National Instrument 21-101 (“Marketplace Operation Instrument”) and the Trading Rules.

As a regulation services provider, IIROC administers and enforces trading rules for the marketplaces that retain the services of IIROC.<sup>3</sup> IIROC has adopted, and the Recognizing Regulators have approved, UMIR as the integrity trading rules that will apply in any marketplace that retains IIROC as its regulation services provider.

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<sup>1</sup> Canadian Securities Administrators Notice, Notice of Amendments to National Instrument 21-101 *Marketplace Operation* and National Instrument 23-101 *Trading Rules*, (2009) 32 OSCB 9403. Reference should be made to this notice for particulars on the Order Protection Rule including a discussion of the development of the Order Protection Rule and the policy rationale underlying the rule.

<sup>2</sup> For further guidance on the current application of the “best price” obligation, reference should be made to:

- IIROC Notice 09-0107 – Rules Notice – Notice of Approval – UMIR – *Provisions Respecting the “Best Price” Obligation* (April 17, 2009);
- IIROC Notice 09-0108 – Rules Notice – Guidance Note – UMIR – *Specific Questions Related to the “Best Price” Obligation* (April 17, 2009); and
- Market Integrity Notice 2008-010 - *Guidance – Complying with “Best Price” Obligations* (May 16, 2008).

<sup>3</sup> Presently, IIROC has been retained to be the regulation services provider for: the Toronto Stock Exchange (“TSX”), TSX Venture Exchange (“TSXV”) and Canadian National Stock Exchange (“CNSX”), each as an “exchange” for the purposes of the Marketplace Operation Instrument (“Exchange”); and for Alpha Trading Systems (“Alpha”), Bloomberg Tradebook Canada Company, Chi-X Canada ATS Limited (“Chi-X”), Liquidnet Canada Inc. (“Liquidnet”), Omega ATS Limited (“Omega”) and TriAct Canada Marketplace LP (the operator of “MATCH Now”), each as an alternative trading system (“ATS”). CNSX presently operates an “alternative market” known as “Pure Trading” that is entitled to trade securities that are listed on other Exchanges and that presently trades securities listed on the TSX and TSXV.

The text of the Proposed Amendments is set out in Appendix "A". The Proposed Amendments have been classified as a "Public Comment Rule" and the Board has determined that the Proposed Amendments are in the public interest in that the Proposed Amendments are consequential to changes being proposed by the CSA to the Trading Rules.

Comments are requested on all aspects of the Proposed Amendments, including comments on policy alternatives that may be available to the implementation of the Proposed Amendments. Comments on the Proposed Amendments should be in writing and delivered by **January 12, 2010** to:

James E. Twiss,  
Vice President, Market Regulation Policy,  
Investment Industry Regulatory Organization of Canada,  
Suite 900,  
145 King Street West,  
Toronto, Ontario. M5H 1J8

Fax: 416.646.7265  
e-mail: [jtwiss@iiroc.ca](mailto:jtwiss@iiroc.ca)

A copy should also be provided to Recognizing Regulators by forwarding a copy to:

Susan Greenglass  
Acting Director, Market Regulation  
Ontario Securities Commission  
Suite 1903, Box 55,  
20 Queen Street West  
Toronto, Ontario. M5H 3S8

Fax: (416) 595-8940  
e-mail: [marketregulation@osc.gov.on.ca](mailto:marketregulation@osc.gov.on.ca)

***Commentators should be aware that a copy of their comment letter will be publicly available on the IIROC website ([www.iiroc.ca](http://www.iiroc.ca) under the heading "Policy" and sub-heading "Market Proposals/Comments") after the comment period has ended. A summary of the comments contained in each submission will also included in a future IIROC Notice dealing with the republication or approval of the Proposed Amendments.***

After considering the comments on the Proposed Amendments received in response to this Request for Comments together with any comments of the Recognizing Regulators, staff of IIROC may recommend that revisions be made to the Proposed Amendments. If the revisions are not of a material nature, the Board has authorized the President to approve the revisions on behalf of IIROC and the Proposed Amendments as revised will be subject to approval by the Recognizing Regulators. If the revisions are material, the Proposed Amendments as revised will be submitted to the Board for ratification and, if ratified, will be republished for further public comment.

### **Current "Best Price" Provisions**

The "best price" obligation<sup>4</sup> requires a Participant to make "reasonable efforts" to fill better-priced orders that are displayed on a "protected marketplace"<sup>5</sup> at the time the Participant executes at an inferior price on another marketplace or foreign organized regulated market. A Participant owes a "best price" obligation to only the "visible" portion of a "better-priced" order on a protected marketplace. If a marketplace permits the entry of an "iceberg" order for which only a portion of the volume is disclosed, no "best price obligation" is owed to the portion of the order that is not visible at the time the Participant is determining its obligation under Rule 5.2. At the present time, iceberg orders are permitted on Alpha, Chi-X, CNSX, Omega, Pure, TSX and TSXV.

If a protected marketplace has visible orders but the marketplace is not open for trading at that time, the "best price" obligation does not apply to such orders. A Participant may trade at any time taking into account all visible orders on marketplaces then open for trading. The "best price" obligation is owed to orders displayed in a special trading facility of a marketplace that

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<sup>4</sup> Rule 5.2 of UMIR, *Best Price Obligation*.

<sup>5</sup> UMIR defines a "protected marketplace" as a marketplace that:

- disseminates order data in real-time and electronically through an information processor or one or more information vendors in accordance with the Marketplace Operation Instrument;
- permits dealers to have access to trading in the capacity as agent;
- provides fully-automated electronic order entry; and
- provides fully-automated order matching and trade execution.

conducts trading before or after the “regular” trading hours of that marketplace if other marketplaces are open for trading during the time that the special trading facility is operating.

The policies under Rule 5.2 provide that a Participant will be considered to have made “reasonable efforts” to comply with the “best price” obligation if the Participant has:

- entered the order on a marketplace that will ensure compliance with the “best price” obligation;
- used an acceptable order router; or
- provided the order to another Participant for entry on a marketplace.

If a Participant uses another means to enter an order on a marketplace, a number of factors will be taken into account in determining whether a Participant has made “reasonable efforts” to obtain the best available prices on a protected marketplace. Among the specific factors is whether:

- the protected marketplace recently launched operations;
- order information from the protected marketplace is available through a data vendor used by the Participant;
- the protected marketplace has recently had a material malfunction or interruption of services; and
- the protected marketplace has demonstrated an inordinate proportion of “inferior fills” with respect to tradeable orders routed to it.

A Participant is not permitted to take transaction costs into account as a factor in determining the “best price” obligation. “Reasonable efforts” does not require a Participant to maintain a connection to each protected marketplace.

Each Participant must adopt policies and procedures to ensure compliance with its “best price” obligation and the policies and procedures must include the relevant factors upon which it is relying in making trading decisions. Each Participant must review its policies and procedures on an ongoing basis to reflect changes to the trading environment and market structure.

Effective June 1, 2009, orders sent by a Participant to a marketplace for the purpose of executing against “better-priced” orders should be marked as a “bypass order” to insure that the order does not execute against “hidden” volume or other specialty orders which are not taken into account in the determination of the “disclosed volume”.<sup>6</sup>

## **Summary of the Amendments**

### ***Repeal of the “Best Price” Obligation***

With the adoption of the Order Protection Rule, it is the view of IIROC that the “best price” obligation is essentially redundant to the protection of better-priced orders disclosed in a consolidated market display. For this reason, the Proposed Amendments would repeal Rule 5.2 and Policy 5.2 upon the Order Protection Rule coming into force.

### ***Relationship to the “Best Execution” Obligation***

The obligation not to trade-through, like the “best price” obligation, is an obligation which is owed by market participants to the market generally. UMIR recognizes that the “best execution” obligation is owed by a Participant to its client. The Proposed Amendments would add Part 4 to Policy 5.1 to confirm that the “best execution” obligation is subject to the “trade-through protection” obligation under the Order Protection Rule (in the same manner that the “best execution” obligation is currently subject to the “best price” obligation).

### ***Trading Supervision Requirements***

The Proposed Amendments would repeal the requirement under Policy 7.1 that the policies and procedures adopted by a Participant as part of its trading supervision obligation include specific provisions respecting the “best price” obligation. However, this requirement has been replaced by a requirement that a Participant or Access Person adopt policies and procedures to ensure compliance with trade-through obligations under the Order Protection Rule if the Participant or Access Person intends to use a “directed action order” or if a Participant intends to undertake certain trades on foreign organized regulated markets.

The “directed action order” will act as an instruction to the marketplace on which the order is entered not to check for better-priced orders on other marketplaces and to immediately execute or book the order (in which case the Participant or Access Person entering the order assumes the responsibility for the execution or booking of the order not to result in a trade-through).

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<sup>6</sup> For more information on the use of a “bypass order” see IIROC Notice 09-0128 – Rules Notice – Guidance Note – UMIR – *Specific Questions Related to the Use of the Bypass Order Marker* (May 1, 2009) and IIROC Notice 09-0034 – Rules Notice – Guidance Note – UMIR – *Implementation Date for Marking of Bypass Orders* (February 3, 2009).

In using a “directed action order”, the Participant or Access Person will have assumed the obligation for trade-through protection and the marketplace will be able to execute the order without delay or regard to any other better-priced orders displayed by another marketplace. In order to be able to use a “directed action order”, the Order Protection Rule requires that the person entering the order must “establish, maintain and ensure compliance with written policies and procedures that are reasonably designed to prevent trade-throughs ...”<sup>7</sup>

In the view of IIROC, the policies and procedures which a Participant or Access Person must adopt will be comparable to the existing policies and procedures which a Participant must have for compliance with the “best price” obligation under Rule 5.2 of UMIR. The policies and procedures must specifically address the circumstances when the bypass order marker will be used in conjunction with a “directed action order”.

Each Participant or Access Person must test the adequacy of the policies and procedures in preventing trade-throughs on a regular basis which shall not be less than monthly. IIROC would expect that the results of the compliance testing would be retained by the Participant or Access Person in order that IIROC would be able to review any test and its results as part of trade desk review or other compliance audit by IIROC.

### ***Condition on the Conduct of Certain Trades on a Foreign Organized Regulated Market***

#### ***Policy Rationale for the Condition***

In its comment on CSA Discussion Paper 23-403 and in its submission to the public forum following that paper, Market Regulation Services Inc. (“RS”) supported the introduction of trade-through obligations imposed at the marketplace level that would benefit investors on Canadian marketplaces. However, RS noted that:

... the marketplace-level solution proposed in the Discussion Paper must be supplemented by a parallel obligation on market participants in connection with their trading outside Canada. That is, market participants should not be permitted to trade through better-priced orders on a Canadian marketplace by directing their trading activity to markets outside Canada, but should remain subject to their obligation to displace those better-priced orders on Canadian marketplaces. RS believes that such an obligation is necessary in Canada to protect better-priced orders on Canadian marketplaces given the significance of trading in inter-listed securities on Canadian marketplaces.<sup>8</sup>

One of the principal reasons that RS was of the opinion that a supplemental obligation was required was the inter-play with other UMIR requirements, particularly order exposure requirements. Under Rule 6.3 of UMIR, if a Participant receives a client order for 50 standard trading units or less with a value of \$100,000 or less the Participant must, subject to certain exceptions, enter the client order on a marketplace.<sup>9</sup> Under Rule 6.3, the Participant may execute the client order upon receipt at a better price than orders indicated in a consolidated market display. If the Participant executes the client order against a principal order or non-client order at a better price, Rule 8.1 of UMIR requires that the Participant must have taken reasonable steps to ensure that the price is the best available price for the client, taking into account the condition of the market at the time. The order exposure rule was designed to ensure that clients received the “best price” by:

- requiring their orders to be immediately exposed to a “transparent” marketplace (that discloses order information to information vendors in real-time) rather than being held by a Participant to be matched internally with future order flow; and
- supporting the price discovery mechanism by ensuring that “small” limit orders are included in the displayed volume.

The ability of certain transactions to bypass better-priced orders on a marketplace undercuts the policy rationale for the requirement for the exposure of certain client orders on a transparent marketplace and complicates the ability of a Participant to satisfy its fiduciary obligations with respect to the handling of the client order. IIROC is of the view that it would be unfair to retail investors to require that their limit orders be displayed but once displayed not to require Participants to take all reasonable steps to ensure that those displayed “better-priced” orders are protected.

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<sup>7</sup> Section 6.4 of NI 23-101.

<sup>8</sup> Market Regulation Services Inc., *Response to Request for Comments – CSA Discussion Paper 23-403 – Market Structure Developments and Trade-Through Obligations*, p. 14. At the time of the response to the Discussion Paper, trading in securities inter-listed between the TSX and an exchange in the United States accounted for approximately 55% of the value of trading on TSX and this proportion has increased to approximately 60% in the first 8 months of 2009.

<sup>9</sup> For the purposes of UMIR, 50 standard trading units would be: 5,000 units of a security trading at \$1.00 or more per unit; 25,000 units of a security trading at \$0.10 or more per unit and less than \$1.00 per unit; and 50,000 units of a security trading at less than \$0.10 per unit.

CSA Anti-Avoidance Provisions

IIROC acknowledges that the Order Protection Rule contains an anti-avoidance provision.<sup>10</sup> However, it should be noted that the anti-avoidance provision included in the Order Protection Rule does not impose a requirement that dealers adopt policies and procedures for considering better-priced orders on a marketplace in Canada prior to executing at an inferior price on a foreign organized regulated marketplace.

IIROC was concerned that a Participant that executes orders on a foreign organized regulated market in order to obtain “best execution” for their client that has the effect of trading-through better-priced orders on a marketplace would not be caught by the CSA anti-avoidance rule. In particular, in connection with the execution of pre-arranged trades or intentional crosses, the interest of one or both parties to the trade is to minimize or avoid “interference” from better-priced orders. In the case of the execution of a “block” trade, certainty of execution may have a higher priority with the client than price. Adding conditions to UMIR on the conduct of certain trades on a foreign organized regulated market would supplement the CSA anti-avoidance provision and ensure that the interests of those retail investors whose orders have been compelled to be exposed in a consolidated market display have been compromised if the displayed orders are bypassed. This matter was considered by the Trade-through Implementation Committee, an industry group established early in 2009 by the CSA to provide specific advice and guidance on the implementation of trade-through requirements, which recommended that the anti-avoidance provision in the Order Protection Rule be supplemented by specific provisions in UMIR.

Condition on “Off-Marketplace” Trades

The Proposed Amendments would buttress the anti-avoidance provisions in the Order Protection Rule. Rule 6.4 of UMIR requires a Participant, subject to certain enumerated exceptions, to execute a trade in a listed security on a marketplace. One of the enumerated exceptions, allows a Participant to execute a trade on a foreign organized regulated market. The Proposed Amendments would limit the availability of this exception if the order which is to be entered on a foreign organized regulated market would have executed against better-priced orders on a marketplace had the order been entered on a marketplace. The Proposed Amendments would not impose the obligation to consider better-priced orders on a marketplace when a Participant executes a trade on behalf of:

- a non-Canadian account; or
- a Canadian account that is denominated in a foreign currency.

The Proposed Amendments would also limit the types of orders to which the obligation would apply. The obligation to consider better-priced orders on a marketplace would only apply when a Participant was executing on a foreign organized regulated market an order that meets one of the following four conditions:

- is part of an intentional cross;
- is part of a pre-arranged trade;
- is for more than 50 standard trading units; or
- has a value of \$250,000 or more.

The Proposed Amendments do not impose a similar obligation on Access Persons to consider better-priced orders on a marketplace as UMIR does not require that an Access Person execute trades on a marketplace.

Compliance with the Condition on Executing “Off-Marketplace” Trades

For orders which a Participant intends to execute “off-marketplace” on a foreign organized regulated market, the Proposed Amendments would continue the existing UMIR obligation to consider and honour better-priced orders on a protected marketplace. With the adoption of the Order Protection Rule, a Participant would have several means of complying with this obligation, including:

1. *Continuation of Existing Policies and Procedures of the Participant*

If a Participant has access to each protected marketplace, the Participant will be aware at the time that the Participant is considering the entry of the order on a foreign organized regulated market whether better-priced orders are displayed on a protected marketplace. In these circumstances, a Participant would enter a “directed action order” as contemplated by the Order Protection Rule on each of the marketplaces displaying a better-priced order. In order to enter a “directed action order”, the Participant must have in place policies and

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<sup>10</sup> Section 6.7 of NI 23-101. The text of the proposed provision is:

No person or company shall send an order to an exchange, quotation and trade reporting system or alternative trading system that does not carry on business in Canada in order to avoid executing against better-priced orders on a marketplace.

procedures that, in the opinion of IIROC, are comparable to the existing policies and procedures which a Participant must have for the purposes of complying with the “best price” obligation under Rule 5.2 of UMIR.

2. *Reliance on Marketplace Policies and Procedures*

Under the Order Protection Rule, each marketplace must establish, maintain and ensure compliance with written policies and procedures that are reasonably designed to prevent trade-throughs on that marketplace. If at least one marketplace implements trade-through protection by the establishment of direct linkages to all other marketplace that may have a “protected order”, then a Participant would be able to satisfy any obligation that would be imposed by the Proposed Amendments by entering a “fill and kill” order on such a marketplace at the intended price that the balance of the order would execute on entry on a foreign organized regulated market. The Participant that entered the order on the marketplace need not have access to all of the other marketplaces or even been aware that better-priced orders were present on other marketplaces in order to be able to comply with the condition under the Proposed Amendments. (If no marketplace implements trade-through protection by the establishment of direct linkages to all other marketplaces that may have a “protected order”, a Participant may have to enter orders on one or more marketplaces depending upon the way marketplaces have chosen to provide trade-through protection.)

**Consequential Amendments**

With the proposed repeal of Rule 5.2 dealing with the “best price” obligation, the Proposed Amendments would also make several consequential changes to UMIR including:

- *Gatekeeper Requirements* – The Proposed Amendments would repeal the requirement under Rule 10.16 that a Participant investigate and report on a possible violation of the “best price” obligation that the Participant becomes aware of as part of its gatekeeper obligation.
- *Foreign Currency Translation* - The Proposed Amendments would move the provisions related to foreign currency translation for the purpose of determining when a better-priced order exists on a marketplace from Part 3 of Policy 5.2 (which will be repealed by the Proposed Amendments) to Part 6 of Rule 6.4.
- *Interpretation – Determination of Value of an Order* - The Proposed Amendments would also extend the current methodology used for determining the value of an order for the purposes of Rule 6.3 and Rule 8.1 to the determination of the value of an order in Rule 6.4(3)(d).
- *Order Markers* – The Proposed Amendments would introduce a requirement in Rule 6.2 for “directed action orders” entered on a marketplace to carry an acceptable designation that would be displayed in the order information provided to the information processor or information vendors that would be publicly available.

**Summary of the Impact of the Proposed Amendments**

The most significant impacts of the adoption of the Proposed Amendments would be that Participants would be relieved of the obligation of ensuring that when an order entered on a marketplace is executed, better-priced order in the disclosed volume of orders on a protected marketplace are not ignored or traded-through. This obligation would be placed upon the marketplace receiving the order, in accordance with their policies and procedures adopted in accordance with the provisions of Part 6 of the Trading Rules.

However, if a Participant or Access Person has marked an order as a “directed action order”, they would have an obligation to ensure that better-priced orders on a marketplace displayed in a consolidated market display are honoured when executing that order on a marketplace. A Participant or Access Person would not be entitled to use the “directed action order” marker unless they had established, maintained and ensured compliance with written policies and procedures that are reasonably designed to prevent trade-throughs. Similar policies and procedures would also apply when a Participant intends to execute certain orders at an inferior price on a foreign organized regulated market.

**Changes from the Initial Proposed Amendments and Concept Proposal**

On October 27, 2008, IIROC issued IIROC Notice 08-0163 requesting comments on proposed amendments to UMIR respecting the implementation of the Trade-through Protection Rule proposed by the CSA (“Initial Proposed Amendments”) and a concept proposal designed to prevent avoidance of the Trade-through Protection Rule (“Concept Proposal”).<sup>11</sup> The Concept Proposal has been incorporated into the Proposed Amendments. The following is a summary of the significant changes made to the Initial Proposed Amendments and the Concept Proposal reflected in the Proposed Amendments.<sup>12</sup>

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<sup>11</sup> IIROC Notice 08-0163 – Rules Notice – Request for Comments – UMIR – *Provisions Respecting the Implementation of the Trade-through Protection Rule* (October 27, 2008).

<sup>12</sup> The changes to the Initial Proposed Amendments and the Concept Proposal are highlighted in red in column 1 of Appendix “B”.

- the orders executed on a foreign organized regulated market that must take into account better-priced orders on a marketplace in accordance with amendments to Rule 6.4 have been limited to orders from a Canadian account denominated in Canadian currency that meets one of the following four conditions:
  - is part of an intentional cross,
  - is part of a pre-arranged trade,
  - is for more than 50 standard trading units, or
  - has a value of \$250,000 or more; and
- provision for a marker to designate a “directed action order” has been added to Rule 6.2; and
- provision for policies and procedures in the use of a “directed action order” by a Participant or Access Person and for a Participant executing certain trades on a foreign organized regulated market has been added to Rule 7.1 and Policy 7.1.

## **Technological Implications and Implementation Plan**

### ***Co-ordination with the Coming into Force of the Order Protection Rule***

Any amendments to UMIR respecting the repeal of the “best price” obligations would be expected to become effective on the date the Order Protection Rule comes into force.

### ***“Best Price” Policies and Procedures***

To the extent that a Participant intends to rely on a marketplace for compliance with the Order Protection Rule, a Participant will be able to delete its policies and procedures that have been put in place to ensure compliance with the “best price” obligation under UMIR. If a Participant or Access Person intends to use the “directed action order”, then the Participant or Access Person must have policies and procedures to reasonably ensure that the entry of their order will not result in a trade-through. These policies and procedures would be essentially the same as those required of a Participant to ensure compliance with the “best price” obligation. A Participant may also have to essentially retain the policies and procedures to ensure compliance with the “best price” obligation if the Participant intends to execute certain types of trades on a foreign organized regulated market.

### ***Gatekeeper Reports on Use of “Directed Action Orders”***

Rule 10.16 of UMIR, allows IIROC to designate any requirement for which a Participant or Access Person must undertake a review of any activity that may be a violation of the requirement and to provide a report to IIROC if the review finds that a violation has occurred. If the Proposed Amendments are approved by the Recognizing Regulators, IIROC would propose to designate that a “gatekeeper report”<sup>13</sup> would be required from any Participant or Access Person that determined that:

- an order marked as a “directed action order” did not comply with the policies and procedures of the Participant or Access Person; and
- a periodic test of the policies and procedures adopted by the Participant or Access Person found that the policies and procedures with respect to the use of a “directed action order” were not adequate.

Notice of the designation for the purposes of Rule 10.16 would be included in the IIROC Notice issued in connection with the approval by the Recognizing Regulators of the Proposed Amendments.

## **Appendices**

- Appendix “A” sets out the text of the Proposed Amendments to UMIR that are consequential to changes to the Trading Rules regarding the Order Protection Rule;
- Appendix “B” sets out a summary of the comment letters received in response to the Request for Comments on the proposed amendments as set out in IIROC Notice 08-0163 – Rules Notice – Request for Comments – UMIR – *Provisions Respecting the Implementation of Trade-through Protection* (October 27, 2008). Appendix “B” also sets out the response of IIROC to the comments received and provides additional commentary on the Proposed Amendments. Appendix “B” also contains the text of the relevant provisions of the Rules and Policies as they would read following the adoption of the Proposed Amendments. The changes from the Initial Proposed Amendments and the Concept Proposal are highlighted.

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<sup>13</sup> For additional information on the filing of a “gatekeeper report”, reference should be made to Market Integrity Notice 2008-011 – *Guidance – New Procedures for Gatekeeper Reports* (May 18, 2008).

**Appendix "A"**  
**Provisions Respecting Implementation of the Order Protection Rule**

The Universal Market Integrity Rules are amended as follows:

1. Subsection (3) of Rule 1.2 is amended by deleting the word "and" and inserting the phrase ", Rule 6.4 and Rule" after the phrase "Rule 6.3".
2. Rule 5.2 is deleted.
3. Rule 6.2 is amended by inserting the following as subclause (v.4) in clause (b) of subsection (1):
  - (v.4) a directed action order as defined in the Trading Rules,
4. Rule 6.4 is amended by:
  - (a) inserting a period after the first occurrence of the word "marketplace" and renumbering that sentence as subsection (1);
  - (b) deleting the phrase "unless the trade is" and substituting the phrase "Subsection (1) does not apply to a trade" and renumbering the sentence as subsection (2); and
  - (c) inserting the following as subsection (3):
    - (3) The exemption provided for in clause (d) of subsection (2) is unavailable to an order of a Canadian account denominated in Canadian funds that:
      - (a) is part of an intentional cross;
      - (b) is part of a pre-arranged trade;
      - (c) is for more than 50 standard trading units; or
      - (d) has a value of \$250,000 or more

if the entry of the order on a foreign organized regulated market would avoid execution against a better-priced order entered on a marketplace pursuant to Part 6 of the Trading Rules.
5. Rule 7.1 is amended by adding the following as subsection (5):
  - (5) Notwithstanding any other provision of this Rule, a Participant or Access Person shall not mark an order on entry to a marketplace as a directed action order unless the Participant or Access Person has established, maintained and ensured compliance with written policies and procedures that are reasonably designed to prevent trade-throughs other than those trade-throughs permitted in Part 6 of the Trading Rules.
6. Rule 10.16 is amended by deleting clause (f) of subsection (1) and renumbering the remaining clauses accordingly.

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

1. Part 4 of Policy 5.1 is deleted and the following substituted:

**Part 4 – Subject to Order Protection Rule**

Notwithstanding any instruction or consent of the client, the provision of "best execution" for a client order is subject to compliance with the "order protection rule" under Part 6 of the Trading Rules by the marketplace on which the order is entered or by the Participant if the Participant has marked the order as a directed action order in accordance with Rule 6.2. Similarly, if a Participant considers a foreign organized regulated market in order to provide a client with "best execution", the Participant must ensure that the condition in subsection (3) of Rule 6.4, if applicable, is satisfied prior to the execution on the foreign organized regulated market.

2. Policy 5.2 is deleted.



3. Policy 6.4 is amended by adding the following as Part 6:

**Part 6 – Foreign Currency Translation**

If a trade is to be executed on a foreign organized regulated market in a foreign currency, the foreign trade price shall be converted to Canadian dollars using the exchange rate the Participant would have applied in respect of a trade of similar size on a foreign organized regulated market in that foreign jurisdiction in order to determine whether the condition in subsection (3) of Rule 6.4 restricting avoidance of Part 6 of the Trading Rules has been met. The Market Regulator regards a difference of one trading increment or less as "marginal" because the difference would be attributable to currency conversion. A Participant shall maintain with the record of the order the exchange rate used for the purpose of determining whether a better priced order existed on a marketplace and such information shall be provided to the Market Regulator upon request in such form and manner as may be reasonably required by the Market Regulator in accordance with subsection (3) of Rule 10.11

3. Part 6 of Policy 7.1 is deleted and the following substituted:

**Part 6 – Specific Provisions Respecting Trade-throughs**

Each Participant must adopt written policies and procedures that are adequate, taking into account the business and affairs of the Participant, to ensure that an order:

- marked as "directed action order" in accordance with Rule 6.2 does not result in a trade-through other than a trade-through permitted under Part 6 of the Trading Rules; or
- entered on a foreign organized regulated market complies with the conditions in subsection (3) of Rule 6.4.

Each Access Person must adopt written policies and procedures that are adequate, taking into account the business and affairs of the Access Person, to ensure that an order marked as a "directed action order" in accordance with Rule 6.2 does not result in a trade-through other than a trade-through permitted under Part 6 of the Trading Rules.

The policies and procedures must set out the steps or process to be followed by the Participant or Access Person to ensure that the execution of an order does not result in a trade-through. The policies and procedures must specifically address the circumstances when the bypass order marker will be used in conjunction with a "directed action order". These policies and procedures must address the steps which the Participant or Access Person will undertake on a regular basis, which shall not be less than monthly, to test that the policies and procedures are adequate.

**Appendix "B"**  
**Comments Received in Response to**  
**IIROC Notice 08-0163 – Rules Notice - Request for Comments – UMIR -**  
**Provisions Respecting Implementation of Trade-through Protection**

On October 27, 2008, IIROC issued IIROC Notice 08-0163 requesting comments on proposed amendments to UMIR respecting the implementation of the Trade-through Protection (now referred to as the Order Protection Rule) under the ATS Rules by the CSA ("Initial Proposed Amendments") and a concept proposal designed to prevent avoidance of the Order Protection Rule ("Concept Proposal"). IIROC received comments on the Initial Proposed Amendments and Concept Proposal from:

Alpha Trading Systems ("Alpha")  
 BMO Financial Group ("BMO")  
 CNSX Markets ("CNSX")  
 Canadian Security Traders Association, Inc. ("CSTA")  
 Investment Industry Association of Canada ("IIAC")  
 ITG Canada Corp ("ITG")  
 Liquidnet Canada Inc. ("Liquidnet")  
 RBC Asset Management ("RBCAM")  
 RBC Dominion Securities Inc. ("RBCDS")  
 TD Securities Inc. ("TD")

A copy of each comment letter submitted in response to the Request for Comments is publicly available on the IIROC website ([www.iiroc.ca](http://www.iiroc.ca) under the heading "Policy" and sub-heading "Market Proposals/Comments"). The following table presents a summary of the comments received on the Initial Proposed Amendments and/or Concept Proposal together with the response of IIROC to those comments. Column 1 of the table highlights the revisions to the Initial Proposed Amendments and the Concept Proposal made by IIROC in response to these comments and the comments of the Recognizing Regulators.

Text of Provisions Following Adoption of the Proposed Amendments (Changes from Initial Proposed Amendments and Concept Proposal Highlighted)	Commentator and Summary of Comment	IIROC Response to Comment and Additional IIROC Commentary
<p><b>1.2 Interpretation</b></p> <p>(3) In determining the value of an order for the purposes of Rule 6.3, Rule 6.4 and Rule 8.1, the value shall be calculated as of the time of the receipt or origination of the order and shall be calculated by multiplying the number of units of the security to be bought or sold under the order by:</p> <p>(a) in the case of a limit order for the purchase of a security, the lesser of:</p> <p style="padding-left: 20px;">(i) the specified maximum price in the order, and</p> <p style="padding-left: 20px;">(ii) the best ask price;</p> <p>(b) in the case of a limit order for the sale of a security, the greater of:</p> <p style="padding-left: 20px;">(i) the specified minimum price in the order, and</p> <p style="padding-left: 20px;">(ii) the best bid price;</p> <p>(c) in the case of a market order for the purchase of a security, the best ask price; and</p> <p>(d) in the case of a market order for the sale of a security, the best bid price.</p>		<p>The revision to Rule 1.2(3) to add reference to Rule 6.4 is consequential to the adoption of one of the four enumerated tests for an order to be subject to the anti-avoidance provision added as Rule 6.4(3) that refers to the value of the orders. Orders which are part of an intentional cross, pre-arranged trade, for more than 50 standard trading units or with a value of \$250,000 or more and which will be executed on a foreign organized regulated market will, in effect, be subject to compliance with Order Protection Rule.</p>
<p><b>5.2 Best Price Obligation – repealed</b></p>	<p><b>Alpha</b> - Strongly supports position taken by IIROC.</p>	<p>IIROC acknowledges support for the proposal to repeal the "best price" obligation upon the implementation of the proposed Order Protection Rule by the Canadian Securities Administrators.</p>

Text of Provisions Following Adoption of the Proposed Amendments (Changes from Initial Proposed Amendments and Concept Proposal Highlighted)	Commentator and Summary of Comment	IIROC Response to Comment and Additional IIROC Commentary
	<p><b>Liquidnet</b> - Removal of the UMIR best price rule on dealers is the most advisable way to address the disparate treatment of dealers and other market participants as they relate to the best price rule.</p>	<p>See response to Alpha comment above.</p>
	<p><b>RBCAM and RBCDS</b> - Trade-through protection imposed at marketplace level reflects more practical and effective approach to maintaining fairness in Canadian markets. Proposed elimination of current best price obligation will address a number of inefficiencies under current framework.</p>	<p>See response to Alpha comment above.</p>
<p><b>6.2 Designations and Identifiers</b>            (1) Each order entered on a marketplace shall contain:            ...            (b) a designation acceptable to the Market Regulator for the marketplace on which the order is entered, if the order is:            ...            (v.4) <u>a directed action order as defined in the Trading Rules.</u></p>		<p>The proposed revision to Rule 6.2 is consequential upon the CSA adopting provision for the “directed action order” under the Trading Rules. If an order is marked as a “directed action order”, the marketplace receiving the order may immediately execute the order upon receipt without checking whether a better-priced order is then displayed on another marketplace and the Participant assumes responsibility to ensure that the execution of the order does not result in a trade-through.</p>
<p><b>6.4 Trades to be on a Marketplace</b>            (1) A Participant acting as principal or agent may not trade nor participate in a trade in a security by means other than the entry of an order on a marketplace.            (2) Subsection (1) does not apply to a trade:            (a) <b>Unlisted or Non-Quoted Security</b> – in a security which is not a listed security or a quoted security;            (b) <b>Regulatory Exemption</b> – required or permitted by a Market Regulator to be executed other than on a marketplace in order to maintain a fair or orderly market and provided, in the case of a listed security or quoted security, the Market Regulator requiring or permitting the order to be executed other than on a marketplace shall be the Market Regulator of the Exchange on which the security is listed or of the QTRS on which the security is quoted;            (c) <b>Error Adjustment</b> – to adjust by a journal entry an error in connection with a client order;</p>	<p><b>CNSX</b> - Premature to enforce best price obligation on dealers vis à vis trades on foreign markets in manner proposed.</p>	<p>Under the current Rule 5.2 and Policy 5.2 of UMIR, each Participant must take into account better-priced orders on Canadian marketplaces before executing at an inferior price on a foreign organized regulated market. UMIR provides certain exemptions from this requirement when handling orders from non-Canadian accounts. IIROC is not proposing a “new requirement” but rather the continuation of an existing obligation since compliance with the Order Protection Rule is moved to the marketplace level. Marketplaces are not in a position to replace the “obligations” which each Participant has when the Participant chooses to execute on a foreign organized regulated marketplace.</p>
	<p><b>Liquidnet</b> - It would not be feasible to apply trade through restrictions</p>	<p>See response to CNSX comment above.</p>

Text of Provisions Following Adoption of the Proposed Amendments (Changes from Initial Proposed Amendments and Concept Proposal Highlighted)	Commentator and Summary of Comment	IIROC Response to Comment and Additional IIROC Commentary
<p>(d) <b>On a Foreign Organized Regulated Market</b> – executed on a foreign organized regulated market;</p> <p>(e) <b>Outside of Canada</b> – executed as principal with a non-Canadian account or as agent if both the purchasers and seller are non-Canadian accounts provided the trade is reported to a marketplace or a foreign organized regulated market in accordance with the reporting requirements of the marketplace of foreign organized regulated market;</p> <p>(f) <b>Term of Securities</b> – as a result of a redemption, retraction, exchange or conversion of a security in accordance with the terms attaching to the security;</p> <p>(g) <b>Options</b> – as a result of the exercise of an option, right, warrant or similar pre-existing contractual arrangement;</p> <p>(h) <b>Prospectus and Exempt Distributions</b> – pursuant to a prospectus, take-over bid, issuer bid, amalgamation, arrangement or similar transaction including any distribution of previously unissued securities by an issuer; or</p> <p>(i) <b>Non-Regulatory Halt, Delay or Suspension</b> – in a listed security or quoted security in respect of which trading has been halted, delayed or suspended in circumstances described in clause (3)(a) or subclause (3)(b)(8) of Rule 9.1 that is not listed, quoted or traded on a marketplace other than the Exchange or QTRS on which the security is halted, delayed or suspended provided such trade is reported to a marketplace.</p> <p>(3) The exemption provided for in clause (d) of subsection (2) is unavailable to an order of a Canadian account denominated in Canadian funds that:</p> <p>(a) is part of an intentional cross;</p> <p>(b) is part of a pre-arranged trade;</p> <p>(c) is for more than 50 standard trading units; or</p> <p>(d) has a value of \$250,000 or more if the entry of the order on a <del>trade to be executed on the</del> foreign organized regulated market would avoid execution against a better-priced order on a marketplace pursuant to Part 6 of the Trading Rules <del>had the order been entered on</del></p>	<p>to trades by Canadian customers executed in non-Canadian markets, as proposed in the IIROC paper. Such restrictions would cause frustrations for customers, involve significant costs to industry participants and adversely affect speed and performance or marketplace systems.</p>	<p>As a result of comments made by the Trade-Through Implementation Committee, IIROC proposes that the limitation on the ability to execute on a foreign organized regulated market be limited to circumstances when the Participant is acting for a Canadian account that is denominated in Canadian funds. An order would be required to take into account better-priced orders on a Canadian marketplace if the order meets any one of the following four conditions:</p> <p>(a) is part of an intentional cross;</p> <p>(b) is part of a pre-arranged trade;</p> <p>(c) is for more than 50 standard trading units; or</p> <p>(d) has a value of \$250,000 or more.</p> <p>There would be no obligation to better-priced orders on a Canadian marketplace if the Participant was acting as agent for either a Canadian account denominated in a foreign currency or a non-Canadian account.</p>

Text of Provisions Following Adoption of the Proposed Amendments (Changes from Initial Proposed Amendments and Concept Proposal Highlighted)	Commentator and Summary of Comment	IIROC Response to Comment and Additional IIROC Commentary
<p>a marketplace rather than the foreign organized-regulated market.</p>		
<p><b>7.1 Trading Supervision Obligations</b>  <u>(5) Notwithstanding any other provision of this Rule, a Participant or Access Person shall not mark an order on entry to a marketplace as a directed action order unless the Participant or Access Person has established, maintained and ensured compliance with written policies and procedures that are reasonably designed to prevent trade-throughs other than those trade-throughs permitted in Part 6 of the Trading Rules.</u></p>		<p>The revision to Rule 7.1 of UMIR is consequential to the requirement in section 6.4 of the Trading Rules that a market participant establish, maintain and ensure compliance with written policies and procedures reasonably designed to prevent trade-throughs. Rule 7.1 of UMIR presently imposes obligations for written policies and procedures on Participants and this revision extends the obligation to Access Persons that intend to use “directed action orders”.</p>
<p><b>10.16 Gatekeeper Obligations of Directors, Officers and Employees of Participants and Access Persons</b>            (1) An officer, director, partner or employee of a Participant shall forthwith report to their supervisor or the compliance department of the Participant upon becoming aware of activity in a principal, non-client or client account of the Participant or a related entity that the officer, director, partner or employee believes may be a violation of:            (a) Subsection (1) of Rule 2.1 respecting just and equitable principles of trade;            (b) Rule 2.2 respecting manipulative and deceptive activities;            (c) Rule 2.3 respecting improper orders and trades;            (d) Rule 4.1 respecting frontrunning;            (e) Rule 5.1 respecting best execution of client orders;            (f) Rule 5.3 respecting client priority;            (g) Rule 6.4 respecting trades to be on a marketplace; and            (h) any Requirement that has been designated by the Market Regulator for the purposes of this subsection.</p>		
<p><b>Policy 5.1 – Best Execution of Client Orders Part 4 – Subject to Order Trade-through Protection Rule Obligation</b>            Notwithstanding any instruction or consent of the client, the provision of “best execution” for a client order is subject to compliance with the <u>“order trade-through-protection rule”</u> obligation under Part 6 of the Trading Rules by the marketplace on which the order is entered <u>or by the Participant if the Participant has marked the order as a directed action order in accordance with Rule 6.2.</u></p>		<p>The proposed revisions to Part 4 of Policy 5.2 are consequential to the change in terminology used in the Trading Rules from that proposed in 2008 and the inclusion of provision for a Participant to use a marker designated an order as a “directed action order”.</p>

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<p>Similarly, if a Participant considers a foreign organized regulated market in order to provide a client with “best execution”, the Participant must ensure that the condition in subsection (3) of Rule 6.4, if applicable, is satisfied prior to the execution on the foreign organized regulated market.</p>		
<p><b>Policy 5.2 – Best Price Obligation</b> <b>Part 1 – Qualification of Obligation – repealed</b></p>		
<p><b>Policy 5.2 – Best Price Obligation</b> <b>Part 2 – Orders on Other Marketplaces – repealed</b></p>		
<p><b>Policy 5.2 – Best Price Obligation</b> <b>Part 3 – Foreign Currency Translation – repealed</b></p>		
<p><b>Policy 6.4 – Trades to be on a Marketplace</b></p> <p><b>Part 6 – Foreign Currency Translation</b></p> <p>If a trade is to be executed on a foreign organized regulated market in a foreign currency, the foreign trade price shall be converted to Canadian dollars using the exchange rate the Participant would have applied in respect of a trade of similar size on a foreign organized regulated market in that foreign jurisdiction in order to determine whether the condition in subsection (3) of Rule 6.4 restricting avoidance of Part 6 of the Trading Rules has been met. The Market Regulator regards a difference of one trading increment or less as “marginal” because the difference would be attributable to currency conversion. A Participant shall maintain with the record of the order the exchange rate used for the purpose of determining whether a better priced order existed on a marketplace and such information shall be provided to the Market Regulator upon request in such form and manner as may be reasonably required by the Market Regulator in accordance with subsection (3) of Rule 10.11.</p>		
<p><b>Policy 7.1 – Trading Supervision Obligation</b> <b>Part 6 – Specific Provisions Respecting Trade-throughs the Best Price Obligation –</b> <u>Each Participant must adopt written policies and procedures that are adequate, taking into account the business and affairs of the Participant, to ensure that an order:</u></p> <ul style="list-style-type: none"> <li>• <u>marked as “directed action order” in accordance with Rule 6.2 does not result in a trade-through other than a trade-through permitted under Part 6 of the Trading Rules;</u> <u>or</u></li> </ul>		<p>IIROC has revised the proposed repeal of Part 6 of Policy 7.1 to provide for a Participant or Access Person to adopt appropriate policies and procedures for the marking of an order as a “directed action order” and for testing to ensure that these policies and procedures are adequate to prevent trade-throughs other than those permitted by section 6.4 of the Trading Rules.</p>

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<ul style="list-style-type: none"> <li>entered on a foreign organized regulated market complies with the conditions in subsection (3) of Rule 6.4.</li> </ul> <p>Each Access Person must adopt written policies and procedures that are adequate, taking into account the business and affairs of the Access Person, to ensure that an order marked as a “directed action order” in accordance with Rule 6.2 does not result in a trade-through other than a trade-through permitted under Part 6 of the Trading Rules.</p> <p>The policies and procedures must set out the steps or process to be followed by the Participant or Access Person to ensure that the execution of an order does not result in a trade-through. The policies and procedures must specifically address the circumstances when the bypass order marker will be used in conjunction with a “directed action order”. These policies and procedures must address the steps which the Participant or Access Person will undertake on a regular basis, which shall not be less than monthly, to test that the policies and procedures are adequate.</p> <p><b>Repealed</b></p>		
<p><b>Specific Questions on the Concept Proposal</b></p> <p>1. <i>Should specific provisions be added to UMIR to protect better-priced orders on marketplaces before permitting trading at an inferior price on a foreign organized regulated market (as contemplated by the Concept Proposal set out in Appendix “B”)?</i></p>	<p><b>Alpha</b> - Strongly believes that it is necessary to adopt requirements to protect better-priced orders on Canadian marketplaces.</p> <p><b>BMO, CNSX, IIAC and RBCDS</b> - Complexity involved in monitoring multiple domestic and foreign markets, routing orders to these markets and maintaining detailed audit trail records would pose significant burden on Participants. Even if systems were designed to comply with obligation, benefits of implementation would be marginal, as arbitrage activity is designed to trade against situations that would result in trade-through.</p> <p>Issues surrounding exchange rates raise a number of questions (e.g. rate, where and when is conversion to be done, who bears foreign exchange risk).</p> <p>There is also the issue of the lack of a consolidated feed for foreign markets as well as questions relating to whether fees are taken into account.</p> <p>Need to provide dealers who have</p>	<p>IIROC acknowledges support for the proposal.</p> <p>Under the current Rule 5.2 and Policy 5.2 of UMIR, each Participant must take into account better-priced orders on Canadian marketplaces before executing at an inferior price on a foreign organized regulated market. UMIR provides certain exemptions from this requirement when handling orders from non-Canadian accounts. IIROC is not proposing a “new requirement” but rather the continuation of an existing obligation as compliance with the order protection rule is moved to the marketplace level.</p> <p>The “best price” obligation does not force a Participant to take into account foreign organized regulated markets. If the Participant, further to its best execution obligation, determines to take such a foreign organized regulated market into account in handling a particular client order, the Participant may do so provided better-priced orders on</p>

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	<p>orally negotiated a permitted trade with an appropriate time period in which to execute trade a concern given volatility of markets. Any rule must take into account market considerations.</p> <p>Order sent to a foreign market is handled by a foreign broker not necessarily under control of Canadian Participant. Timing of execution could violate proposed rule due to delays or latency in quotes, routing or volatile exchange rates.</p> <p>Proposal could discourage Participants from considering foreign markets as an option in routing decisions in order to avoid costs of developing monitoring systems.</p>	<p>Canadian marketplaces are “displaced”.</p> <p>As a result of comments made by the Trade-Through Implementation Committee, IIROC proposes that the limitation on the ability to execute on a foreign organized regulated market be limited to circumstances when the Participant is acting for a Canadian account that is denominated in Canadian funds. An order would be required to take into account better-priced orders on a Canadian marketplace if the order meets any one of the following four conditions:</p> <ul style="list-style-type: none"> <li>(a) is part of an intentional cross;</li> <li>(b) is part of a pre-arranged trade;</li> <li>(c) is for more than 50 standard trading units; or</li> <li>(d) has a value of \$250,000 or more.</li> </ul> <p>The existing rules are clear that a “trade” does not occur until such time as the trade is executed on a marketplace or “off-marketplace” in accordance with one of the exemptions. A Participant bears the “displacement” risk that is associated with any delay between the “oral negotiations” and the execution of the trade on a marketplace.</p> <p>Policy 5.2 of UMIR presently provides that in ascertaining whether the “best price” obligation is applicable, the price at which the trade would occur on the foreign organized regulated market is converted to Canadian currency using the exchange rate the Participant would have applied in respect of a trade of a similar size on a marketplace in that foreign jurisdiction.</p>
	<p><b>BMO, CSTA and ITG</b> - Proposed anti-avoidance provision is appropriate to prohibit routing of orders to foreign marketplaces strictly for purpose of avoiding trade-through regime in Canada.</p> <p>No specific provisions should be</p>	<p>IIROC is seeking to supplement the “anti-avoidance” rule proposed by the CSA. The IIROC proposal will ensure that any large order or any intentional cross or pre-arranged trade that is to be executed on a foreign organized regulated market has considered “protected orders”</p>



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	<p>added to UMIR. Addition of a prescriptive rule that only applies to IIROC members will only weaken the efforts by the application of consistent regulation to all market participants.</p> <p>Provisions would create regulatory asymmetry, as foreign regulators do not have such provisions. Domestically it also creates an unlevel playing field in respect of IIROC members and those regulated by the CSA or other SROs.</p>	<p>on Canadian marketplaces.</p> <p>Historically, the United States has imposed the "Three Quote Rule" which governs the execution of orders for securities outside of the United States. While exemptions from the rule are provided for trades executed on the TSX and TSXV, no exemption is provided for trades executed on other marketplaces. IIROC and the CSA do not impose similar restrictions on the execution of orders outside of Canada. Given the differences in the size and liquidity of the markets in Canada and the United States, regulatory symmetry while desirable should not be allowed to undermine the integrity of the Canadian markets.</p>
	<p><b>Liquidnet</b> - Adding provisions would cause significant frustration for customers, involve significant cost to industry participants and adversely affect speed and performance of marketplace systems.</p>	<p>See responses to BMO, CSTA and ITG comments above.</p>
	<p><b>ITG and RBCDS</b> - Provisions not required. In practice, marketplace participants by default materially enforce trade-through obligations when dealers use marketplace routers and comply with their best execution obligations to their clients. Fundamental regulatory obligation is sufficient to ensure that market participants are not trading through better priced orders on any Canadian marketplace unless there are justifiable reasons in the best interests of their clients.</p>	<p>All rules are a designed to strike a "balance" for Participants between the "justifiable reasons in the best interest of their clients" and the interests of the market as a whole. The Canadian marketplace, given its size and relative lack of liquidity, has rules which force the exposure of orders on transparent marketplaces thereby supporting the operation of the price discovery mechanism. In the view of IIROC, orders which have been "forced" into the public domain should be protected. Achieving best execution in the interest of their clients is subject to compliance with requirements designed to ensure fairness and integrity in an efficient market.</p>
	<p><b>RBCAM</b> - Yes, specific provisions should be added to UMIR to protect better-priced orders on marketplaces before permitting trading at an inferior price on a foreign organized regulated market. A very important requirement which should prevent trade-through on trades in inter-listed securities.</p>	

Text of Provisions Following Adoption of the Proposed Amendments (Changes from Initial Proposed Amendments and Concept Proposal Highlighted)	Commentator and Summary of Comment	IIROC Response to Comment and Additional IIROC Commentary
<p>2. <i>If a requirement to consider better-priced orders on marketplaces before permitting trading at an inferior price on a foreign organized regulated market is added to UMIR, should such the requirement be limited to the handling of:</i></p> <ul style="list-style-type: none"> <li>• <i>intentional crosses;</i></li> <li>• <i>pre-arranged trades;</i></li> <li>• <i>block orders with a market value of \$100,000 or more?</i></li> </ul>	<p><b>Alpha</b> - The proposed requirement should not be limited.</p>	
	<p><b>CNSX</b> - Ongoing monitoring of cross-border trading should include gathering of data that would help make this type of decision.</p>	<p>IIROC wishes to ensure that the implementation of the Order Protection Rule does not result in a change to the dynamic for deciding when foreign organized regulated markets are considered in the execution of certain types of trades. Since this movement would be undertaken to avoid inter-action with better-priced orders on Canadian marketplaces, IIROC believes it is in the best interests of the market to take steps to prevent the emergence of this possibility rather than trying to curtail it at a future date.</p>
	<p><b>CSTA</b> - There should be no such requirement. If such a requirement is added to UMIR, it should include only intentional crosses and pre-arranged trades. Block orders with a market value of \$100,000 or more could cause orders on inter-listed securities to go directly to non-Canadian brokers in the US thereby avoiding our markets, and application of our Rules.</p>	<p>Presently, block trades do not go directly to non-Canadian brokers. It is unclear why the continuation of an existing requirement would cause the shift suggested by the CSTA. As a result of comments by the Trade-Through Implementation Committee, IIROC has revised the limitation on “block trades” such that an order must be either for 50 standard trading units or more or have a value of more than \$250,000.</p>
	<p><b>IIAC</b> - If there are concerns with specific types of trades (intentional crosses, pre-arranged trades or block orders with a market value of \$100,000 or more) and IIROC can demonstrate that there have been actual occurrences that materially disadvantage clients or market participants, then regulation may be appropriate, but only if other methods of dealing with the problem are proven ineffective.</p>	<p>See response to CNSX comment above.</p>
	<p><b>ITG</b> - If added to UMIR, obligation should only be applicable to situations in which the intent clearly was to avoid better-priced orders on a Canadian protected marketplace. In most cases, intentional crosses and pre-arranged trades would be situations in which a Participant may want to avoid displacement obligations, however, application of</p>	<p>IIROC acknowledges that arbitrage will generally keep market prices in inter-listed securities between Canadian and US markets within “acceptable bounds”. IIROC therefore suggested limiting the obligation to those types of trades that are most likely to cause a significant (and often temporary) change in the prevailing market price.</p>

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	this duty to markets should not be dependent on how a trade was submitted.	
	<b>Liquidnet</b> - These types of trades are those for which trade-through requirement is least appropriate. Institutional investor should not be impeded from buying stock in privately negotiated transaction where the institution can avoid the market impact costs that result from exposing the institution's order to traditional market intermediaries.	IIROC is of the contrary view. Orders displayed on a Canadian marketplace (often pursuant to the obligations under Rule 6.3 dealing with Order Exposure) are in need of greatest protection when orders are being executed that will move the prevailing market price. For example, orders displayed on marketplaces will be more negatively impacted when a block trade for 10,000,000 shares is crossed on an foreign organized regulated market (at a discount or premium to the prevailing market) then when a retail order for 100 shares is executed on a US market because the client wants US currency exposure. Unlike retail investors, institutional investors are not generally required to avail themselves of the services of a dealer or the facilities of a marketplace. If the institutional investors do chose to use a marketplace, they should be subject to the same requirements as the retail investors.
	<b>RBCAM</b> - There is a legitimate need for some special terms orders to receive exemption from the trade-through obligation and any abuses of these terms are sufficiently covered by UMIR. All other types of orders should be subject to the requirement to consider better-priced orders on marketplaces.	IIROC acknowledges the comment.
	<b>RBCDS</b> - Requirement should be so limited.	IIROC acknowledges the comment.
3. <i>If a requirement to consider better-priced orders on marketplaces before permitting trading at an inferior price on a foreign organized regulated market is added to UMIR, are there any exemptions or other limitations on the requirement that would be appropriate?</i>	<b>Alpha</b> - Additional exemptions would be inconsistent with the intent of the Trade-Through Protection Rule Proposal and would result in the creation of an unfair competitive disadvantage to Canadian marketplaces.	IIROC acknowledges the comment.

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	<p><b>IIAC</b> - Requirement should be limited to trades in accounts that are denominated in Canadian currency. By extension, there should be no requirement to protect a domestic market for a trade in an inter-listed security where it is being traded in a market that trades in the currency of the accounts added to UMIR.</p>	<p>IIROC accepts this suggestion as it would streamline compliance with the Concept Proposal.</p>
	<p><b>ITG</b> - Foreign exchange spreads and costs are unevenly applied to trades by industry. It may be impractical to impose requirement on trades routed to foreign market where account settles in that foreign currency as rate applied to measure trade-through obligations would likely be much smaller or at very least different than rate applied to price for settlement on particular trade.</p>	<p>IIROC acknowledges that there are variations across the industry in the handling of foreign currency depending upon various factors including the size and business lines of the Participant. For that reason, the test which IIROC proposes is a test focused on the practices of that Participant rather than an arbitrary industry-wide standard.</p>
	<p><b>Liquidnet</b> - If such a requirement were implemented, an exception should apply for block trades. Institutions are generally very happy to trade blocks inside the spread without market impact cost. They object when trades executed outside the spread as a result of fast market movement need to be cancelled.</p>	<p>All market participants need to adjust to the increased pace and volatility of markets. The “best price” rule was predicated on “reasonable efforts” and the trade-through protection rule will also incorporate this concept.</p>
	<p><b>RBCAM</b> - Only some special terms orders should receive exemption.</p>	<p>IIROC acknowledges the comment.</p>
	<p><b>RBCDS</b> - There are valid circumstances in which a dealer may execute on a foreign market in order to obtain “best execution” for their client that may have the effect of trading through better-priced orders on a Canadian marketplace.</p>	<p>“Best price” and “best execution” under UMIR have always been distinct concepts with one rule being the obligation to the market and the other the obligation to the client. Under UMIR, “best execution” is subject to compliance with “best price” and it is the position of IIROC that “best execution” should be subject to compliance with “order protection”.</p>
<p>4. <i>Should a Participant that trades as principal with a non-Canadian account in a trade that is not executed on a marketplace or a foreign organized regulated market (in accordance with the exemption for “off-marketplace” trades provided in clause (e) of Rule 6.4 of UMIR) be required to consider better-priced orders on a marketplace that are on the same side of the transaction as the Participant?</i></p>	<p><b>Alpha</b> - Concepts set out by the CSA should be applied in relation to all trading activity, including where Participants execute “off-marketplace” trades.</p> <p><b>BMO, CSTA, IIAC, ITG, RBCAM and RBCDS</b> - Participants should not be required to consider better-</p>	<p>IIROC acknowledges the comment.</p> <p>Historically in the United States, FINRA has imposed the “Three Quote Rule” which sets out various</p>

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	<p>priced orders when executing “off-marketplace” trades. Trade through requirement should not apply to trades that are exempt from the requirement to be printed on a Canadian marketplace. Such trades are reportable and therefore subject to audit.</p> <p>Participant that trades as principal with a non-Canadian account in an off-marketplace trade should not be required to consider better-priced orders on a marketplace that are on the same side of the transaction as the Participant. Non-Canadian clients are not subject to UMIR. No other Securities Regulator requires its members to look to outside markets as part of the regulation.</p> <p>Participants assume risk when executing “off-marketplace” trades therefore they should have option of executing against better-priced orders if they wish to mitigate this risk.</p> <p>The circumstances in 6.4(e) are not comparable to trading on a foreign market for inter-listed securities. Although trades that are negotiated or occur during market hours should be priced within the context of the market, the requirement to conduct business openly and fairly and in accordance with just and equitable principles is sufficient under these circumstances.</p>	<p>handling requirements when an order from a US client is sent outside the United States for execution. IIROC does not believe that such a structure is either appropriate or necessary in connection with trades executed outside of Canada with non-Canadian accounts. Generally, IIROC is content to allow the rules in the foreign jurisdiction governing the activities of that non-Canadian account should apply.</p> <p>Trades involving a Participant and a non-Canadian client are subject to UMIR though UMIR contains a number of specific exemptions in respect of such transactions. IIROC has revised the Proposed Amendments such that the limitation would only apply to particular types of orders when the Participant is trading on behalf of a “Canadian account denominated in Canadian currency.”</p>
	<p><b>CNSX</b> - IIROC should rigorously monitor and enforce dealers’ existing best execution obligations in respect of cross-border transactions and at same time, take the opportunity to gather information about cross-border trading practices as well as availability, costs and efficiencies of technology solutions that will be required for effective compliance.</p>	<p>In the view of IIROC, the best execution obligation should be subject to compliance with “order protection” in the same manner as it currently is subject to the “best price” obligations. IIROC acknowledges that there will be circumstances where pursuit of “best execution” would, in the absence of specific provisions in UMIR or the Trading Rules, justify ignoring better-priced orders on a marketplace.</p>

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	<p><b>ITG</b> - Timing of when such a trade is effective and when it is recorded will create significant challenges to monitor, record and evidence applicable exchange rate that should be applied.</p>	<p>Reference should be made to existing requirements regarding foreign currency translation under Part 3 of Policy 5.2 of UMIR.</p>
<p><b>General Comments</b></p>	<p><b>BMO and CNSX</b> - Single joint notice, as in April 2007 would have streamlined the comment process.</p>	<p>The “joint” notice in April of 2007 also included separate notices from the CSA and IIROC (then Market Regulation Services Inc.). Given the timing of the approval of the IIROC proposal by the Board of IIROC, the publication was not done concurrent with the CSA but the comment period provided corresponded with that under the CSA proposal.</p>
	<p><b>CNSX</b> - Notice does not canvass the alternatives before presenting conclusions. Reliance upon analysis used several years ago, before multiple markets became a practical reality.</p> <p>Significant coordination issues have not been addressed regarding the monitoring and enforcement of marketplace obligations.</p> <p>Why are IIROC (and CSA) satisfied that it is appropriate to prohibit orders that intentionally or unintentionally result in trade-throughs, but have allowed introduction of new order types that free-ride on the pricing provided by other orders to step in front of them, undermining the price discovery process?</p>	<p>Both the CSA and IIROC have issued a number of proposals and discussion papers regarding trade-through/order protection and best price obligations. The proposal by IIROC will conform the requirements of UMIR to amendments by the CSA to the Trading Rules.</p> <p>IIROC will monitor whether trading on marketplaces is being done in conformance with the requirements of the Order Protection Rule. In accordance with Rule 10.1 of UMIR, IIROC will inform the applicable securities regulatory authorities if the results of such monitoring indicate a failure to comply with the Trading Rules.</p> <p>UMIR permits marketplaces to compete for trade executions at the best ask price or best bid price. Marketplaces which provide executions at “better” prices are afforded priority.</p>
	<p><b>Liquidnet</b> - Trade-through requirement is not necessary in light of advances in direct market access technology, smart order routing technology, improved transaction cost analysis products and other technology developments in the market.</p>	<p>If the only objective of the parties to a trade was to maximize proceeds in the case of a sale or minimize cost in the case of a purchase, the technological advances would obviate the need for the Order Protection Rule. However, such technology can create unfairness in the market when factors other than price are considerations in executions.</p>