

IIROC NOTICE

Rules Notice **Request for Comments** UMIR and Dealer Member Rules

Please distribute internally to:
Institutional
Legal and Compliance
Retail
Operations
Senior Management
Trading Desk

Comments due by: March 24, 2016

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15-0278
December 10 2015

Proposed Guidance Respecting Best Execution

Executive Summary

IIROC is requesting comment on proposed guidance respecting best execution (“Proposed Guidance”), which is published concurrently with proposed provisions respecting best execution¹ (“Proposed Amendments”), a proposed rule framework under the Dealer Member Rules regarding a Dealer Member’s obligations respecting best execution. The Proposed Guidance updates IIROC’s prior guidance on best execution² to provide additional clarity in the multi-marketplace environment and assist Dealer Members to strengthen their

¹ IIROC Notice [15-0277](#) – UMIR and Dealer Member Rules - *Proposed Provisions Respecting Best Execution* (December 10, 2015).

² IIROC has issued several guidance notices concerning best execution which are to be updated: See MIN 2006-020 – Guidance – Compliance Requirements for Trading on Multiple Marketplaces; MIN 2007-015 Guidance – Specific Questions Related to Trading on Multiple Marketplaces (August 10, 2007); MIN 2006-017 Guidance – Securities Trading on Multiple Marketplaces (September 1, 2006); MIN 2007-019 Guidance – Entering Client Orders on Non-Transparent Marketplaces and Facilities (September 21, 2007); IIROC Notice 09-0244 Guidance Note – UMIR – “Best Execution” and “Best Price” Obligations For Securities Listed On TSX Venture Exchange (August 27, 2009); IIROC Notice 11-0043 Guidance Note - UMIR – Guidance on “Locked” and “Crossed” Markets (February 1, 2011); IIROC Notice 11-0113 Guidance Note -- UMIR – Guidance on Best Execution and Management of Orders (March 30, 2011); and IIROC Notice 11-0114 Guidance Note -- UMIR – Guidance Respecting the Use of Certain Order Types (March 30, 2011).



compliance with the best execution obligation. The Proposed Guidance addresses questions related to requirements proposed under Rule 3300.

The Proposed Guidance would clarify, among other things:

- (a) parties that must establish and maintain best execution policies and procedures;
- (b) factors that need to be included in best execution policies and procedures when executing orders for listed securities and over-the-counter (“OTC”) securities;
- (c) aspects of a best execution governance structure and supervision processes that must be adopted; and
- (d) aspects of order handling and routing practices that address different marketplace features to achieve best execution that should be disclosed to clients.

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1. Policy Development Process

The Market Rules Advisory Committee (“MRAC”) of IIROC discussed aspects of the Proposed Guidance. MRAC is an advisory committee comprised of representatives of each of: the marketplaces for which IIROC acts as a regulation services provider, Participants, institutional investors and subscribers, and the legal and compliance community³.

Comments are requested on all aspects of the Proposed Guidance, including any matter not addressed in the Proposed Guidance. Comments should be in writing and delivered by **March 24, 2016** to:

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³ The review by MRAC of the Proposed Guidance should not be construed as approval or endorsement of the Proposed Guidance. Members of MRAC are expected to provide their personal advice on topics and that advice may not represent the views of their respective organizations as expressed during the public comment process.



Commentators should be aware that a copy of their comment letter will be made publicly available on the IIROC website (www.iiroc.ca).

After considering the comments on the Proposed Guidance received in response to this Request for Comments, IIROC may make revisions to the Proposed Guidance prior to the issuance of the final Guidance Note.

2. Background

Proposed Rule 3300 would consolidate best execution and fair pricing requirements into a single Dealer Member Rule and would reiterate that best execution is not measured on a trade-by-trade basis. Rather, compliance with Proposed Rule 3300 would be determined by demonstrating that written policies and procedures reasonably designed to achieve best execution when acting for a client have been established, maintained and followed.

The Proposed Guidance would further explain that what constitutes "best execution" will vary depending on the particular circumstances.

3. Appendices

Appendix "A" sets out the text of the Proposed Guidance.



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16-0***
[date], 2016

Guidance on the Best Execution Obligation

Executive Summary

This Guidance, which is effective on **, clarifies certain requirements under Dealer Member Rule 3300. This Guidance updates IIROC's prior guidance on best execution and repeals and replaces guidance listed in section 2 of this Notice.

In order to meet the requirements in Rule 3300, a Dealer Member must be able to demonstrate that its policies and procedures are reasonably designed to achieve best execution when acting for a client. Due to the dynamic nature of the structure of the Canadian market, Rule 3300 also requires Dealer Members to regularly review the way in which they manage client orders and order flow in order to ensure that their best execution policies and procedures remain effective.



The Guidance clarifies various requirements in Rule 3300 and provides further detail as to how Dealer Members can comply with these requirements through responses to a series of frequently asked questions.

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1. Questions and Answers

The following is a list of the “most frequently asked” questions regarding the best execution obligations of a Dealer Member under Dealer Member Rule 3300 (“Rule 3300”) and IIROC’s response to each question:

General

1. *Is best execution measured on a trade-by-trade basis?*

Rule 3300 requires that a Dealer Member establish, maintain and ensure compliance with written policies and procedures that are reasonably designed to achieve best execution when acting for a client. What constitutes "best execution" will vary depending on the particular circumstances and a Dealer Member may not be able to achieve best execution for every single order it executes on behalf of a client, particularly when executing orders on an automated basis. However, in order to determine whether a Dealer Member is in compliance with Rule 3300, IIROC looks to whether the Dealer Member can demonstrate that it has set and follows policies and procedures that are reasonably designed to achieve best execution and that these policies and procedures are reviewed regularly and amended as required. IIROC expects that these policies and procedures would cover the introduction of new liquidity sources, whether done on a temporary or more permanent basis.

When handling an order manually, IIROC also looks to whether the Dealer Member can demonstrate that it has set and followed policies and procedures that include taking into account prevailing market conditions to achieve best execution for that order.

2. *How often must a Dealer Member review its best execution policies and procedures?*

Rule 3300 requires each Dealer Member to review its written best execution policies and procedures at least annually and whenever there is a material change to the trading environment or market structure that may impact a Dealer Member’s ability to achieve best execution for its clients. A material change would generally occur upon the launch of a new marketplace or when there is a significant change to trading functionality offered by an existing marketplace. This does not preclude a Dealer Member’s more frequent review of its best execution policies and procedures as it determines is necessary. A Dealer Member is required to retain records of its reviews of its best execution policies and procedures along with any decisions and changes made to them for five years.



3. Does the best execution obligation only apply to client orders for listed securities?

No. Under Rule 3300, all Dealer Members must ensure that they establish, maintain and ensure compliance of policies and procedures reasonably designed to achieve best execution respecting client orders for all securities, including listed securities and transactions in OTC securities.

4. Are the factors listed in Rule 3300 that must be considered with respect to the execution of client orders for listed securities the only ones a Dealer Member needs to include in its best execution policies and procedures regarding the execution of client orders for listed securities?

Not necessarily. The broad factors of: (1) prices and volumes of historical trading activity, (2) speed of execution, (3) certainty of execution and (4) overall cost of the transaction may 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). Therefore, a Dealer Member is expected to reflect all material considerations, including those listed in Rule 3300, in its best execution policies and procedures.

We note that 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 (i.e. any fees charged between Dealer Members to provide trading access) and settlement costs.

5. What activity is precluded by the statement in Rule 3300 that the bulk sending of orders to a specific foreign market, without considering other liquidity sources, is not in compliance with meeting best execution?

The statement in Rule 3300.3(b)(iii) essentially reiterates the earlier requirement in Rule 3300.3(b)(ii) to take order and trade information from all appropriate marketplaces into account when determining routing strategies designed to achieve best execution. Adopting a policy of sending client orders to only one source of liquidity without consideration or review of orders and trade information from other liquidity sources can mean that the most



advantageous execution terms reasonably available are not being obtained. A pattern where client orders that are solely directed to a specific foreign market and execute, after taking into account any foreign exchange considerations, outside of the Canadian best bid or offer would indicate that the current policy may not be obtaining best execution and that consideration of other liquidity sources needs to be included in the Dealer Member's best execution policy.

6. *Are there factors, in addition to those listed in Rule 3300, that should be looked at when considering whether to execute a client order on a foreign organized regulated market?*

Yes. In particular, Dealer Members should ensure that they are in compliance with section 6.7 of the Trading Rules and Dealer Members that are Participants must ensure that the condition in subsection (3) of UMIR 6.4 is satisfied prior to executing on a foreign organized regulated market.

We also remind Participants that under Part 6 of UMIR Policy 6.4, 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 same 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 UMIR 6.4 restricting avoidance of Part 6 of the Trading Rules has been met.

7. *Does a Dealer Member have to establish policies and procedures respecting best execution if it relies on another Dealer Member to execute orders in listed securities or transactions in OTC securities on its behalf (Executing Dealer Member)?*

Yes. Whether a Dealer Member is a Participant or non-Participant Dealer Member that acts for clients, it must establish best execution policies and procedures to comply with Rule 3300. Although the Dealer Member may not be directly executing its client orders, the Dealer Member is nonetheless obligated to establish, maintain and ensure compliance with policies and procedures reasonably designed to achieve best execution for its clients. This is the case regardless whether the Dealer Member instructs its Executing Dealer Member on how and where to execute, or if the Dealer Member delegates control over the execution to the Executing Dealer Member.

Consistent with other outsourcing arrangements, the Dealer Member retains the responsibility for ensuring that all activities are performed properly and in compliance with relevant IIROC requirements, including those activities carried out by the Executing Dealer Member on its



behalf. In addition, the Executing Dealer Member assumes the responsibility for ensuring that all activities it has agreed to perform on behalf of the Dealer Member are performed properly and in compliance with relevant IIROC requirements.⁴

A Dealer Member must therefore consider how an arrangement with an Executing Dealer Member will work to achieve best execution for its clients and reflect this in its best execution policies and procedures. Ongoing communication with, and supervision of, the Executing Dealer Member will allow the Dealer Member to understand whether best execution is achieved for its clients and to be apprised of any material changes to the best execution policies and procedures of the Executing Dealer Member.

The best execution policies and procedures of the Dealer Member need not be duplicative of the Executing Dealer Member's but at minimum would be expected to include:

- reference to the Executing Dealer Member's order handling and routing practices reasonably designed to achieve best execution as communicated by the Executing Dealer Member; and
- a process for supervision and regular evaluation of the best execution results of the Executing Dealer Member.

The Dealer Member must be satisfied that the manner in which its orders are managed by the Executing Dealer Member is consistent with the policies and procedures of the Dealer Member regarding best execution.

When relying on an Executing Dealer Member, the disclosure of the Dealer Member's best execution policies and procedures may include providing a link to the Executing Dealer Member's best execution policies and procedures.

OTC Securities

8. What specific best execution policies and procedures is a Dealer Member expected to implement with respect to its clients' transactions in OTC securities?

Transactions in OTC securities are not executed through a marketplace and accordingly a Dealer Member is expected to have policies and procedures to ensure that prices to its clients for OTC securities are "fair and reasonable". This is the case for the pricing of OTC securities

⁴ See IIROC Notice 14-0012 – Rules Notice – Guidance Note – *Outsourcing Arrangements* (January 13, 2014).



for principal transactions that include a mark-up⁵ or mark-down, and for the pricing of agency transactions with added commission.

Both the compensation component and the market value/price component of the OTC transaction are relevant in arriving at an aggregate transaction price for OTC securities that is fair and reasonable. Therefore, the Dealer Member's policies and procedures must address both the market value of the security as well as the reasonableness of compensation. Excessive commissions, mark-ups or mark-downs may cause a violation of the fair pricing standard; however it is also possible for a Dealer Member to restrict its profit on transactions to reasonable levels and still not meet its duty of best execution because of a failure to ensure market value/price are "fair and reasonable" as well.

We also note that the data collected on debt securities transactions through the Market Trade Reporting System 2.0, including spreads over benchmarks, commissions, as well as comparing retail versus wholesale trades, will assist IROC in determining whether a Dealer Member's policies and procedures are reasonably designed to obtain prices that are "fair and reasonable".

9. *What best execution policies and procedures may an Introducing Broker consider implementing respecting agency transactions in OTC securities for its clients that are executed by an Executing Dealer Member?*

With respect to OTC securities, a Dealer Member is considered to have achieved best execution when obtaining a price that is fair and reasonable in relation to prevailing market conditions. An Introducing Broker therefore has the responsibility to ensure the end price it offers to a client for an OTC security transaction is fair and reasonable even when it uses the systems, personnel or inventory of an Executing Dealer Member to execute OTC trades for clients.

There may be instances where, as the result of an Executing Dealer Member including its mark-up⁶ and offering a security to an Introducing Broker at a reasonable price, the final price of the client transaction is not fair and reasonable when the commission of the Introducing Broker is also added. An Introducing Broker must accordingly establish policies and procedures to undertake due diligence in obtaining as competitive a price as possible with

⁵ A "mark-up" refers to the Dealer Member's remuneration on a transaction that has been added to the price in the case of a purchase. A "mark-down" refers to the Dealer Member's remuneration on a transaction that has been deducted from the price in the case of a sale.



respect to OTC securities, consistent with its best execution obligation. Such procedures may require a review of the Executing Dealer Member's prices against other possible sources on a frequent basis (at least semi-annually) as a means to accomplish this and require that such review be documented.

10. *What best execution policies and procedures may a Carrying Broker (Executing Dealer Member) consider implementing respecting agency transactions it executes in OTC securities on behalf of an Introducing Broker?*

A Carrying Broker that executes agency OTC security transactions on behalf of an Introducing Broker must establish, maintain and ensure compliance with written policies and procedures reasonably designed to achieve best execution when acting for a client, pursuant to Rule 3300. This means that a Carrying Broker must follow policies and procedures reasonably designed to obtain a price that is fair and reasonable in light of prevailing market conditions for the security and must employ the same care and diligence in doing so as if the transaction were being done for its own account or its client.

When implementing best execution policies and procedures in respect of agency OTC transactions executed on behalf of an Introducing Broker, the Carrying Broker is expected to determine the current market value of the security and use due diligence as necessary to ascertain a fair price. For example, in the context of an illiquid security, policies and procedures "reasonably designed" to achieve best execution may require the Carrying Broker to canvass various parties to source the availability and the price of the specific security. Passive acceptance of the first price quoted to a Carrying Broker executing an agency OTC security transaction is not sufficient.

Listed Securities

11. *Does compliance with the "Order Protection Rule" under Part 6 of the Trading Rules ("OPR") also satisfy a Dealer Member's best execution obligation?*

Not necessarily. Pursuant to Rule 3300, achieving best execution for a client order is **subject to** compliance with OPR 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 UMIR 6.2 notwithstanding any instruction or consent of the client. 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 UMIR 6.4 against avoiding better-priced orders on a marketplace contrary to OPR, if applicable, is satisfied prior to the execution on the foreign organized regulated market.

However, to the extent that a Participant complies with OPR by relying solely on reject and re-price facilities offered by a marketplace (and does not use a Smart Order Router (“SOR”) or a jitney arrangement to access marketplaces to which it does not subscribe), the Participant must establish best execution policies and procedures to deal with rejected or re-priced client orders that are immediately tradable. These procedures should include a process for considering order and trade information from all appropriate marketplaces and foreign organized regulated markets in accordance with Rule 3300.

Although a Participant may withhold an order that is re-priced or rejected if appropriate in the circumstances, consideration of order and trade information from all appropriate marketplaces (which may include marketplaces that are not protected) is necessary in order to be able to determine the most advantageous execution terms reasonably available under prevailing market conditions for client orders that have been re-priced or rejected to comply with OPR.

12. *Is it necessary for a Dealer Member to access real-time order and trade information from every marketplace in order to be able to comply with best execution?*

No. Dealer Members are not required to access real-time data feeds from each marketplace in order to comply with best execution requirements. Access to trading on a marketplace is a decision to be made by the Dealer Member in the context of obtaining best execution of client orders while complying with other applicable regulatory requirements. Rule 3300 does however require the consideration of order and trade information from all appropriate marketplaces. A Dealer Member should accordingly evaluate, as part of its policies and procedures to achieve best execution, whether it should take steps to access marketplaces to which the Dealer Member does not have access, by:

- reviewing all marketplaces, including marketplaces that do not provide pre-trade transparency of orders (“dark pools”) as well as those marketplaces that display orders that are not protected,
- considering the impact of accessing or not accessing a marketplace on the Dealer Member’s ability to achieve best execution for its clients, given those clients’ needs and objectives, and



- documenting the rationale for accessing or not accessing orders on a particular marketplace, (reviewed at least annually as part of the overall review of best execution policies and procedures or upon a material change to the trading environment or market structure).

This evaluation may rely on historic order and trade data from marketplaces, including those marketplaces for which the Dealer Member does not receive real-time data nor otherwise have access.

If the evaluation reveals that a particular marketplace that displays orders has demonstrated on a historical basis that there is a reasonable likelihood of liquidity for securities for which the Dealer Member accepts orders⁷, a Dealer Member would be expected to make arrangements with another Dealer Member that does subscribe to that marketplace to route orders to that marketplace on the Dealer Member's behalf to comply with best execution requirements.

Similarly, if the Dealer Member's evaluation reveals that there is a reasonable likelihood of liquidity for a specific security in a dark pool, a Dealer Member would be expected to consider trading opportunities and whether accessing the marketplace that does not provide pre-trade transparency of orders is necessary in order to achieve best execution given its client's needs and objectives, and the potential opportunity to trade at a "better price"⁸.

13. *What best execution governance structure and supervision processes must a Dealer Member adopt in order to comply with its best execution obligation?*

Rule 3300 establishes minimum governance requirements for best execution which should be reflected in a Dealer Member's best execution policies and procedures, whether a Participant or not, and include:

- a process designed to achieve best execution, and
- a process for review of compliance with the best execution obligation that specifies:
 - who will conduct the review;
 - the review procedures that will be employed;
 - what information sources will be used;
 - a description of specific events that would trigger a review in addition to annual reviews;
 - how the Dealer Member evaluates whether best execution was obtained; and
 - who will receive reports of the results.

⁷ The evaluation is not necessarily dependent on the marketplace meeting a threshold level of trading in securities generally.

⁸ See IROC Notice 12-0130 *Provisions Respecting Dark Liquidity* (April 13, 2012).



IIROC expects that each Dealer Member that acts for clients will establish policies and procedures respecting a best execution governance structure appropriate to the nature and size of its business provided the applicable minimum requirements are met. The process designed to achieve best execution and for a compliance review may be determined by a Dealer Member's head trader, other senior management or best execution committee as appropriate and may include maintenance of a written order routing methodology or table. In addition, a Dealer Member may rely on the Executing Dealer Member as its information source concerning a best execution review, if the results and rationale are fully disclosed to the Dealer Member. However, to the extent that the Dealer Member's monitoring or review of best execution indicates that the Executing Dealer Member lacks the appropriate policies and procedures to achieve best execution a Dealer Member cannot continue to rely on that Executing Dealer Member to achieve best execution.

As part of a process for review of compliance with the best execution obligation, a Dealer Member would also be expected to monitor execution quality by conducting internal testing and retaining records of the internal testing to ensure that the policies and procedures are being adhered to and are effective in achieving best execution. For example:

- unfilled "Day" and "Good Till Cancelled" orders should be sampled periodically;
- execution rates in dark pools should be monitored;
- Opening Orders may be sampled periodically to determine whether a "fair price" has been achieved on any particular marketplace;
- effectiveness of SOR settings and whether orders are being routed to the appropriate marketplace should be reviewed;
- retail sized (50 standard trading units or less) client-principal trades should be reviewed for compliance with order exposure and client-principal transactions requirements under UMIR 6.3 and UMIR 8.1;
- marketplace liquidity analysis should be conducted to assist in the selection of marketplaces and assessment of the likelihood of execution.

In accordance with Rule 3300, Dealer Members must retain documentation respecting internal testing and decisions made concerning best execution, to evidence that the mind of the firm is focused on the effectiveness of its best execution policies and procedures for order routing and order handling methods in order to achieve best execution. In accordance with Rule 3300, in addition to confirming compliance with appropriate internal processes for achieving best execution, the Dealer Member must determine any deficiencies and promptly amend their policies and procedures to address such deficiencies. Compliance monitoring provides effective support in ensuring that business practices achieve best execution. Firms need to ensure that where they use sampling on the grounds of proportionality, that their



methodologies are appropriate to support the consistent delivery of best execution, and that the adequacy of monitoring is reviewed and assessed as part of the annual review of best execution policies and procedures. Firms cannot simply rely on their clients to monitor the quality of execution. Benchmarks, where used, need to be appropriate for the characteristics of the client order and have thresholds that are properly defined. Monitoring must cover all of the execution factors to reflect the full breadth of the best execution obligation, including (but not limited to) the explicit and implicit costs incurred on behalf of clients.

14. How should order handling and routing practices be managed to address different marketplace features and satisfy a Dealer Member’s best execution obligation?

In addition to liquidity, differences in the features offered by marketplaces⁹ such as opening and closing times, opening mechanisms (i.e. an opening auction or a “shot-gun” open), order types accepted, whether the marketplace is protected or unprotected, and the treatment of marketplace trading fees and/or rebates, can impact a Dealer Member’s ability to achieve best execution depending on how the Dealer Member handles and routes client orders.

Dealer Members should adopt policies to manage client order handling and routing that consider the implications of the different marketplace features and are consistent with the best execution obligation owed to the client under Rule 3300. Disclosure to clients of these policies is also required as part of the appropriate management of order handling and routing to provide transparency of, among other things:

- default order handling and routing practices including in the pre-market open and post-market close,
- the identity of the marketplaces (including any trading facilities of a marketplace)¹⁰ and foreign organized regulated markets on which client orders may be entered; and
- whether fees are paid by the Dealer Member or payments or other compensation is received by the Dealer Member, and the circumstances in which such fees, payments or other compensation will be allocated by the Dealer Member to the client that originated or entered the order.

⁹ Certain marketplace features are summarized on the IIROC website , see *Summary Comparison of Current Equity Marketplace* at: http://www.iroc.ca/industry/marketmonitoringanalysis/Documents/SumCompEquityMarkets_en.pdf .

¹⁰ A Dealer Member may be required to consider execution opportunities in the special terms book of a marketplace in accordance with its best execution obligation.



IROC accordingly expects that, in the absence of specific client instructions, Dealer Members will adopt policies and procedures for order handling and routing as well as disclosure consistent with their best execution obligation that include:

- handling of “market” or other “immediately tradable” orders received outside of the “traditional” exchange continuous auction trading hours of 9:30 a.m. to 4:00 p.m., or when certain marketplaces may be unavailable for trading due to technical reasons. The policy may provide that a Dealer Member may consider trading opportunities on any visible marketplace that is then open for trading or that a Dealer Member may withhold the order¹¹ until all marketplaces or the primary market opens for trading;
- routing of orders in the pre-open, with consideration to the liquidity offered at the opening of trading for particular securities and the impact of the “opening mechanism” of a marketplace (whether continuous auction or “shot-gun”) on the probability and “quality” of execution for an Opening Order such that “fair value” may be obtained for the client. The same considerations apply to the policies and procedures for routing a “Market-on Close Order” when multiple marketplaces offer market-on close or call market facilities to execute the closing trades at the end of the trading day;
- the marketplaces and trading facilities that are accessed by the Dealer Member and on which orders may be entered, taking into consideration whether a marketplace, including any marketplace that is not “protected”, has demonstrated a reasonable likelihood of liquidity for a specific security relative to the size of the client order;
- the nature of the treatment of marketplace trading fees and impact on the client including whether marketplace rebates received by the Dealer Member are passed on to clients and whether marketplace trading fees are passed through to the client by the Dealer Member; and
- how the Dealer Member manages a “stop loss” order once “triggered” (whether through automated or manual means) to prevent entry on a marketplace that would execute at a “clearly erroneous” price. The Dealer Member’s policy should limit the use of stop loss orders without limits to orders for the purchase or sale of a particular security which meets certain conditions of high liquidity and low historic volatility¹² and

¹¹ Notwithstanding any policy adopted by a Dealer Member, UMIR 6.3 dealing with the exposure of client orders provides that a Participant is able to withhold entry of a client order to purchase or sell 50 standard trading units or less if the Participant “determines based on market conditions that entering the order would not be in the best interests of the client”. If the Participant withholds the orders in these circumstances, the Participant guarantees that the client will receive a price at least as good as the price the client would have received if the client order had been executed on receipt by the Participant or a “better price” if the client order executes against a principal or non-client order.

¹² See also IROC Notice 13-0191– Rules Notice – Guidance Note – UMIR – *Guidance Respecting the Management of Stop Loss Orders* (July 11, 2013) for complete details of the conditions. The guidance also reminds that the requirements under the UMIR electronic trading



address the risk that in fast moving markets a stop loss order entered on a marketplace without a reasonable limit price may execute at a price the client would not anticipate.

15. Under what circumstances should a Dealer Member consider moving an order that is not immediately tradable from the marketplace where it is “booked” to another marketplace that trades the security in order to comply with its best execution obligation?

The circumstances under which a Dealer Member may move an order entered on one marketplace to another marketplace will be dictated by the policies and procedures it adopts to achieve best execution and discloses to its clients as required under Rule 3300. A client order is not immediately tradable when entered with a limit price that cannot execute against better-priced orders displayed on a protected marketplace. A Dealer Member may enter or “book” a client order that is not immediately tradable on any marketplace that trades the security subject to any instructions provided by the client with respect to the entry of the order.

A Dealer Member is not required to adopt a policy that it will migrate a resting order to another marketplace to trade with an order entered after the “booked” order was entered, including for the purpose of trading with such an order that results in a “locked market”¹³. Similarly, a Dealer Member’s policy may provide that if a client instructs a Dealer Member to enter the order on a specific marketplace, it will not monitor trading opportunities for the client order on other marketplaces that continue to trade the security. A Dealer Member may nonetheless adopt a policy (in the absence of client instructions) to migrate a client order to another marketplace if appropriate to increase the probability of execution, with due consideration of the possible loss of priority and the risk of a partial fill if the existing order is moved, and disclose the policy and its implications to the client. In addition, such policy would require the Dealer Member to have appropriate procedures in place to monitor trading opportunities on marketplaces that operate outside of the historic trading hours of 9:30 a.m. to 4:00 p.m. as applicable, and migrate appropriate client orders if they would trade with orders displayed on the marketplace that continues to trade.

A Dealer Member’s policy should also include particulars of when a client “Day” order is considered to expire¹⁴ and when a “Good-Till-Cancelled” order is considered “inactive”¹⁵ as

rule amendments (“ETR”) apply to stop loss orders and Dealer Members must accordingly ensure that sufficient controls are in place to manage the impact of the execution of the order so that it is also not disruptive of a fair and orderly market.

¹³ Amendments to the “locked and crossed” See also generally IIROC Notice 11-0043 – Rules Notice – Guidance Note – UMIR – *Guidance on “Locked” and “Crossed” Markets* (February 1, 2011).

¹⁴ For example, a Participant might consider a “Day” order to expire at a number of different times, including at the close of:

- the marketplace on which the order is entered;
- the last of the marketplaces on which the security trades and which provides pre-trade transparency; or



well as whether these types of client orders will be migrated to another marketplace that is open and trading the same security if they have been booked on a marketplace that is closed for trading. With the disclosure of these policies to its clients, a Dealer Member would not be expected to continue to monitor trading opportunities on marketplaces that continue to operate after a “Day” order is considered to have expired or while a “Good Till Cancelled” order is inactive.

16. Does the best execution obligation require that client instructions for handling an order always be followed?

Not necessarily. The Proposed Rule would require the Dealer Member to *consider* its client’s instructions with respect to the handling of an order as compliance with the best execution obligation is **subject to** compliance with applicable regulatory requirements, including OPR and the obligation not to create or continue to lock or cross a protected order¹⁶. Therefore, a client that instructs the Dealer Member to enter an order that will cause a regulatory requirement to be contravened cannot enter that order. A client may however consent to the order being withheld from entry on a marketplace until such time as prevailing market prices would permit the entry of an order without locking or crossing a protected order or contravening other regulatory requirements.

17. Is a Dealer Member expected to provide input into order routing management for client orders to comply with its best execution obligation?

Yes. A Dealer Member may route orders directly using a proprietary SOR, or indirectly using a third-party vendor for order routing or by making an arrangement with an Executing Dealer Member that employs a SOR. Regardless of whether a Dealer Member undertakes order routing directly or indirectly to a marketplace, the Dealer Member would be expected to maintain best execution policies and procedures that provide for input into the management of order routing for its clients by:

- understanding how its SOR, or one operated on its behalf, operates;
- having the ability to adjust SOR settings directly or provide input into the configuration and/or adjustment of SOR settings through a consultation process with the Executing Dealer Member;

• any other marketplace or marketplaces on which the security trades.

¹⁵ A Dealer Member may consider such an order “active” only when certain marketplaces are open for trading.

¹⁶ See proposed amendments to Part 6 of National Instrument 23-101 – *Trading Rules* concerning OPR and “locked and crossed orders” at (2014) 37 OSCB 4873.



- ensuring that appropriate SOR strategies are established for retail and institutional clients (i.e. spray, serial or a combination of the two);
- ensuring that the SOR used makes its decisions including data on displayed orders on an unprotected marketplace or a dark pool where compliance with the Dealer member’s best execution policies and procedures requires the Dealer Member to consider orders on an unprotected marketplace; and
- reviewing the performance of the SOR in the course of an annual best execution review or when a material change to the trading environment or market structure occurs, as required under Rule 3300, to determine whether any adjustment to the SOR settings would be required¹⁷.

Dealer Members are expected to consider whether their best execution practices address the ability to adjust SOR settings and, if applicable, provide input to their Executing Dealer Member with respect to SOR settings in order to respond to changing market conditions. Dealer Members must also document decisions and changes with respect to their best execution process and policies and procedures as required under Rule 3300.

Further, consistent with other outsourcing arrangements, a Dealer Member that employs a third-party vendor for order routing or arranges with an Executing Dealer Member to route orders to a marketplace, is responsible to ensure that order routing activities are performed properly and in compliance with relevant IIROC requirements. In addition, a Dealer Member assumes the responsibility for ensuring that order routing activities it has agreed to perform on behalf of another Dealer Member are performed properly and in compliance with relevant IIROC requirements.

18. Does payment for order flow (PFOF) contravene a Dealer Member’s best execution obligation?

UMIR 7.5¹⁸ has the effect of prohibiting payment for order flow by a Dealer Member that is a Participant under UMIR. Like the payment of rebates by marketplaces, the payment for order

¹⁷ The review should also take account of any “trade-through” protection obligation on the Dealer Member. Order routers used by a Dealer Member will not, however, be required to take into account displayed orders on an unprotected marketplace for the purpose of compliance with OPR.

¹⁸ UMIR 7.5 - Recorded Prices provides that:

- (1) No Participant acting as agent shall execute a transaction through a marketplace in which the price recorded on the marketplace is:
 - (a) in the case of a purchase by a client, higher than the net cost to the client; or
 - (b) in the case of a sale by a client, lower than the net proceeds to the client.
- (2) No Participant acting as principal shall execute a transaction through a marketplace in which the price recorded on the marketplace is:
 - (a) in the case of a sale to a client,
 - (i) higher than the net cost to the client, or
 - (ii) lower than the net cost to the client by more than the usual agency commission that would be charged by that Participant to that client for an order of the same size; and



flow by intermediaries can distort behaviour and trading incentives. Similar conflicts also arise for Dealer Members when receiving payment for order flow directed to an intermediary.

Order Execution Accounts

19. Do Dealer Members providing “Execution-Only Accounts” have a best execution obligation?

Yes. While suitability obligations are generally not applicable to an Execution-Only Account, Dealer Members retain a “best execution” obligation with respect to orders from a client with an Execution-Only Account. A Dealer Member should take reasonable steps to ensure that such clients are provided with adequate information on how certain order types, such as market orders and stop loss market orders, function and the associated execution risks in the current equity market structure.

A Participant supporting electronic order entry from “Execution-Only Accounts” may wish to consider implementing a warning on the order entry screen when a client enters an order with a higher risk of unintended execution outcomes, such as a stop loss order with no limit. Participants are encouraged to require that clients with Execution-Only Accounts provide limit prices on all stop loss orders.

As well, as required under Rule 3300, a Dealer Member that provides market data as a service to its clients, must include a description of any missing market data, including an explanation of the risks of trading with incomplete trading data.

Disclosure of Best Execution Policies

20. What level of detail do Dealer Members need to include in the disclosure of their policies and procedures as required under section 3300.8?

The disclosure required under section 3300.8 is expected to include sufficient information in clear and accessible language to help clients make an informed decision about whether to use the services of the Dealer Member and that sufficient information will be provided to allow clients to understand how, when and why the handling of their orders might differ. We

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- (b) in the case of a purchase from a client,
 - (i) lower than the net proceeds to the client, or
 - (ii) higher than the net proceeds to the client by more than the usual agency commission that would be charged by that Participant to that client for an order of the same size.



expect each Dealer Member to clearly identify to clients where on its website the required information can be found.

Section 3300.8 requires a description of the factors the Dealer Member considers for the purpose of achieving best execution. In addition to listing the specific factors considered, we would expect a Dealer Member to explain when and how these factors are taken into account. For example we would expect an explanation to clients as to how their orders will be handled outside of regular trading hours, when orders for securities may be executed on foreign organized regulated markets and how instructions from a client regarding the handling, routing or execution of its order(s) will be taken into account and how this may affect execution for the client.

With respect to the requirement to disclose the identity of marketplaces to which orders are routed, we would expect information specifying markets or facilities in circumstances where a marketplace offers trading on more than one visible continuous auction order book and that the names of any foreign marketplaces to which orders are routed will also be identified.

3300.8(c)(ii) requires Dealer Members to identify each type of intermediary to which the Dealer Member might route orders for handling or execution. This would include identifying those types of intermediaries performing dealer-type functions with respect to the handling and execution of the routed orders, regardless of whether or not the intermediary is registered as a dealer in Canada. A description of each intermediary to whom the Dealer Member routes orders can be satisfied by providing a link to the location on the website of the intermediary where that information can be found.

Rule 3300 requires Dealer Members to identify in the required disclosure the class or type of client to which the disclosure applies. Where a Dealer Member's best execution policies generally apply to all clients and there is no material difference between types or class of client, then separate disclosure is not likely to be needed. Dealer Members are not precluded from providing client-specific disclosure and would likely need to do so if the best execution policies are unique to a particular client and differ materially from best execution policies applied to other clients.

When relying on an Executing Dealer Member, the disclosure of a Dealer Member's best execution policies and procedures may include providing a link to the Executing Dealer Member's best execution policies and procedures.

2. Impact on Existing Guidance

This Guidance repeals and replaces the following Guidance or sections of Guidance as follows:



- Market Integrity Notice 2006-017 Guidance – *Securities Trading on Multiple Marketplaces* (September 1, 2006) – section respecting Rule 5.1 – *Best Execution of Client Orders*;
- Market Integrity Notice 2006-020 – Guidance – *Compliance Requirements for Trading on Multiple Marketplaces* (October 30, 2006) Q. 4, 6, 10, 11;
- Market Integrity Notice 2007-015 Guidance – *Specific Questions Related to Trading on Multiple Marketplaces* (August 10, 2007); Q. 7, 8, 10;
- Market Integrity Notice 2007-019 Guidance – *Entering Client Orders on Non-Transparent Marketplaces and Facilities* (September 21, 2007) Q. 2, 6;
- Market Integrity Notice 2008-010 – Guidance – *Complying with “Best Price” Obligations* (May 16, 2008) Q. 8 in reference to Market Integrity Notice 2007-015 and Q. 5 in reference to Market Integrity Notice 2006-020;
- IIROC Notice 09-0244 Guidance Note – UMIR – *“Best Execution” and “Best Price” Obligations For Securities Listed On TSX Venture Exchange* (August 27, 2009);
- IIROC Notice 11-0043 Guidance Note - UMIR – *Guidance on “Locked” and “Crossed” Markets* (February 1, 2011) Q. 2, 5, 9;
- IIROC Notice 11-0113 Guidance Note - UMIR – *Guidance on Best Execution and Management of Orders* (March 30, 2011);
- IIROC Notice 11-0114 Guidance Note - UMIR – *Guidance Respecting the Use of Certain Order Types* (March 30, 2011);
- IIROC Notice 11-0257 Guidance Notice – *Dealer Member Rules - Guidance on fair pricing of over-the-counter securities* (September 1, 2011).