

# IIROC NOTICE

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

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Institutional  
Legal and Compliance  
Retail  
Operations  
Senior Management  
Trading Desk

### **Comments due by: December 12, 2016**

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**16-0234**  
**October 13, 2016**

## **Re-Publication of Proposed Guidance Respecting Best Execution**

### **Executive Summary**

IIROC is re-publishing proposed guidance respecting best execution (“Proposed Guidance”) for comment concurrently with the re-publication of proposed provisions respecting best execution<sup>1</sup> (“Proposed Amendments”).

The Proposed Amendments set out a Dealer Member’s obligations respecting best execution in the Dealer Member Rules. The Proposed Guidance updates IIROC’s prior guidance on best execution<sup>2</sup> to help Dealer Members strengthen their compliance with their best execution obligation in a multi-marketplace environment.

<sup>1</sup> IIROC Notice [16-0233](#) – UMIR and Dealer Member Rules – *Re-Publication of Proposed Provisions Respecting Best Execution* (October 13, 2016).

<sup>2</sup> 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



The Proposed Guidance addresses questions related to requirements in the Proposed Amendments and would specifically clarify:

- that Dealer Members must establish and maintain best execution policies and procedures
- the factors that need to be included in best execution policies and procedures when executing orders for listed securities, foreign exchange-traded securities and over-the-counter (“OTC”) securities
- the features of a best execution governance structure and the supervision processes that must be adopted
- the aspects of order handling and routing practices that should be disclosed to clients.

We originally published guidance on best execution for comment on December 10, 2015 (“2015 Proposed Guidance”) and received 10 comment letters. We have made changes in response to public comments and discussions with stakeholders and the Canadian Securities Administrators.

The primary differences from the 2015 Proposed Guidance include added guidance on:

- the policies and procedures a non-Executing Dealer Member would need to establish pursuant to 3300.3. of the Proposed Amendments and how they may rely on the policies and procedures of an Executing Dealer in certain instances
- the factors a Dealer Member may consider when executing an order for a listed security on an unprotected marketplace
- the factors a Dealer Member may consider before determining to send an order for a listed security to an intermediary to execute on a foreign market
- information that should be included in the Dealer Member’s policies and procedures describing order handling and routing practices
- the specific information a Dealer Member should provide in its policies and procedures regarding accessing unprotected marketplaces.

We have also simplified certain language used in the 2015 Proposed Guidance to make the Proposed Guidance easier to read and more understandable.

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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).



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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 community<sup>3</sup>.

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 **December 12, 2016** to:

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***Commentators should be aware that a copy of their comment letter will be made publicly available on the IIROC website ([www.iiroc.ca](http://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**

The Proposed Amendments 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 the Proposed Amendments 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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<sup>3</sup> 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.



## Appendix A

### Rules Notice Guidance Note

UMIR and Dealer Member Rules

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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?**

No. Compliance with Rule 3300 is based on the requirement for a Dealer Member to 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, particularly when executing orders on an automated basis, may not be able to achieve best execution for every single order it executes on behalf of a client.

When determining 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. When handling an order manually, IIROC particularly looks at 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.

IIROC expects that these policies and procedures would cover the introduction of new liquidity sources, whether done on a temporary or more permanent basis.

#### **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. The launch of a new marketplace or a significant change to trading functionality offered by an existing marketplace would constitute a material change to the trading environment.



The minimum requirement for an annual review 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 the following for five years:

- reviews of its best execution policies and procedures, including its justification for the considerations and factors used in its best execution analysis
- any decisions and changes made to its best execution policies and procedures.

**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 with policies and procedures reasonably designed to achieve best execution respecting client orders for **all** securities, including listed securities, foreign-exchange traded securities and transactions in OTC securities.

**4. *May a Dealer Member only include the broad factors listed in Rule 3300 with respect to the execution of client orders for listed securities in its best execution policies and procedures?***

Not necessarily. The broad factors of (1) price, (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 include 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 specific activity is precluded by the prohibition in Rule 3300 with respect to the practice of sending client orders in listed securities in bulk to a foreign intermediary?***

The prohibition in section 3300.6 essentially reiterates the earlier requirement in subsection 3300.3(b)(iv) 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 a single source of liquidity without consideration or review of order and trade information from other liquidity sources may mean that the Dealer Member is not obtaining the most advantageous execution terms reasonably available. The prohibition of this practice prevents a pattern whereby client orders are directed to a foreign intermediary and executed, after taking into account any foreign exchange considerations, outside of the Canadian best bid or offer.

**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 comply with section 6.7 of the Trading Rules and 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 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 client orders (including orders for listed securities, foreign exchange-traded securities and transactions in OTC securities) on its behalf (Executing Dealer Member)?***

Yes. Although a Dealer Member may not directly execute its clients' 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.

A Dealer Member is responsible for ensuring that all regulatory 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, an Executing Dealer Member is responsible 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.<sup>4</sup>

Section 3300.5 allows a non-Executing Dealer Member to include in its policies and procedures a link to the Executing Dealer Member's best execution disclosure. This may be done only if the non-Executing Dealer Member's best execution policies and procedures include an initial review of the public best execution disclosure of the Executing Dealer Member and subsequent reviews when changes are made. When completing its initial review, a non-Executing Dealer Member must determine whether an Executing Dealer Member's best execution policies and procedures will effectively achieve best execution for the non-Executing Dealer Member's clients. A non-Executing Dealer may ask for further detailed information than what is publicly included in the Executing Dealer's best execution disclosure if the non-Executing Dealer deems it important in determining whether the policies and procedures are appropriate for its clients' orders.

The review by the non-Executing Dealer of any subsequent changes is meant to ensure that the policies and procedures remain appropriate for executing its clients' orders.

A non-Executing Dealer Member must be satisfied that the manner in which its clients' orders are managed by the Executing Dealer Member is consistent with the public best execution disclosure of the Executing Dealer. Therefore, receipt of an annual attestation from an Executing Dealer Member that it has followed and tested its best execution policies and procedures in compliance with Rule 3300 is required to provide the non-Executing Dealer Member with this assurance.

A non-Executing Dealer is not expected to actively review the execution results of its Executing Dealer when complying with section 3300.5. However, should the non-Executing Dealer Member come across execution results that are inconsistent with the Executing Dealer Member's best execution disclosure (for example, from client inquiries) Rule 3300 requires the non-Executing Dealer to follow up with the Executing Dealer and document the results of the inquiry. The purpose of this communication is to understand the reasons for the execution results and to determine if any changes to the best execution policies and procedures are necessary.

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



## **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 for principal transactions that include a mark-up or mark-down<sup>5</sup>, and for the pricing of agency transactions with added commission.

Both the compensation component and the market value or price component of the OTC transaction are relevant in arriving at an aggregate transaction price for OTC securities that is fair and reasonable. Therefore, a Dealer Member's policies and procedures must address both the market value of the security as well as the reasonableness of compensation. While excessive commissions, mark-ups or mark-downs may cause a violation of the fair pricing standard, 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 the market value or price is “fair and reasonable” as well. IIROC Notice 11-0257 *Guidance on fair pricing of over-the-counter securities* provides further guidance on complying with section 3300.6.

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 IIROC 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 a non-Executing Dealer Member consider implementing respecting agency transactions in OTC securities for its clients that are executed by an Executing Dealer Member?**

With respect to OTC securities, IIROC considers a Dealer Member to have achieved best execution when it obtains a price that is fair and reasonable in relation to prevailing market conditions. It is possible that the amount of an Executing Dealer Member's

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<sup>5</sup> 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.



mark-up together with the security offered at a reasonable price to a non-Executing Dealer Member, results in a final price that is not fair and reasonable when the commission of the non-Executing Dealer Member is also added. Therefore, a non-Executing Dealer Member 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.

**10. *What best execution policies and procedures may an Executing Dealer Member consider implementing relating to agency transactions it executes in OTC securities on behalf of a non-Executing Dealer Member?***

An Executing Dealer Member that executes agency OTC security transactions on behalf of a non-Executing Dealer Member 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 an Executing Dealer Member 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 it were executing the transaction for its own account or its client.

When implementing best execution policies and procedures in respect of agency OTC transactions executed on behalf of a non-Executing Dealer Member, the Executing Dealer Member 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 Executing Dealer Member to canvass various parties to source the availability and the price of the specific security. Passive acceptance of the first price quoted to an Executing Dealer Member executing an agency OTC security transaction is not sufficient to meet the test of ascertaining a fair price.

***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 order is entered on the marketplace as a directed-action order in accordance with UMIR 6.2. Also, 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 or re-price functionalities 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, which may include unprotected marketplaces and foreign organized regulated markets, in accordance with Rule 3300.

**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. However, Rule 3300 requires 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 unprotected marketplaces
- 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
- documenting the rationale for accessing or not accessing 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 or otherwise have access.

If the evaluation reveals that a particular unprotected marketplace has demonstrated on a historical basis that there is a reasonable likelihood of liquidity for securities for which the Dealer Member accepts orders<sup>6</sup>, a Dealer Member would be expected to consider making arrangements with another Dealer Member that does have access to that marketplace to route client orders on the Dealer Member's behalf.

In particular with respect to marketplaces that do not provide pre-trade transparency of orders, Dealer Members should also consider the potential opportunity to trade at a "better price"<sup>7</sup>.

### **13. *What factors may a Dealer Member consider when executing an order for a listed security on an unprotected marketplace?***

Subsection 3300.3.(b)(v) requires a Dealer Member's best execution policies and procedures to consider factors related to executing orders for listed securities on unprotected marketplaces. These factors may include whether:

- client orders could reasonably be expected to execute on the unprotected marketplace at a better price
- the displayed volume on protected marketplaces has historically not been adequate to fully execute client orders on advantageous terms
- the unprotected marketplace has historically demonstrated a reasonable likelihood of liquidity for securities for which the Dealer member accepts orders.

### **14. *What factors may a Dealer Member consider before determining to send an order for a listed security to an intermediary to execute on a foreign market?***

Subsection 3300.3.(b)(vi) requires a Dealer Member's best execution policies and procedures to consider factors related to the sending of orders of listed securities to a foreign intermediary for execution. These factors include:

- whether the foreign market has historically demonstrated a reasonable likelihood of liquidity for listed securities for which the Dealer Member accepts orders

<sup>6</sup> The evaluation is not necessarily dependent on the marketplace meeting a threshold level of trading in securities generally.

<sup>7</sup> See IIROC Notice 12-0130 *Provisions Respecting Dark Liquidity* (April 13, 2012).



- the extent of trading in the particular security on the foreign market relative to the volume of trading on marketplaces
- the extent of exposure to settlement risk in a foreign jurisdiction
- the extent of exposure to fluctuations in foreign currency exchange.

**15. *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 that should be reflected in a Dealer Member’s best execution policies and procedures, 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
  - who will receive reports of the results.

IIROC expects that each Dealer Member that executes orders 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.

A Dealer Member’s head trader, other senior management or best execution committee, as appropriate, may design the process to achieve best execution. This process may include maintaining a written order routing methodology or table.

As part of a process for review of compliance with the best execution obligation, a Dealer Member that executes client orders is expected to monitor its execution quality by conducting internal testing and retaining records of the internal testing to ensure that the policies and procedures are being followed 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 may be conducted to assist in the selection of marketplaces and assessment of the likelihood of execution.

Under Rule 3300, Dealer Members must keep 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 addition to confirming compliance with appropriate internal processes for achieving best execution, the Dealer Member must also determine any deficiencies and promptly amend their policies and procedures to address such deficiencies.

Dealer Members may not simply rely on their clients to monitor the quality of execution. Compliance monitoring provides effective support in demonstrating that the practices used are achieving best execution. This monitoring must cover all 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.

A Dealer Member using sampling as part of its monitoring process must ensure its practices support the consistent delivery of best execution, and that the adequacy of its sampling is reviewed and assessed as part of the annual review of best execution policies and procedures.

In addition, when complying with section 3300.5, a non-Executing Dealer Member may rely on the Executing Dealer Member’s annual attestation that the best execution policies and procedures have been complied with and tested. However, to the extent that a non-Executing Dealer Member identifies that its Executing Dealer Member lacks appropriate policies and procedures to achieve best execution, the non-Executing Dealer Member is expected to ensure that necessary changes are implemented or cease relying on that Executing Dealer Member for best execution.





**16. Section 3300.9 requires a Dealer Member to ensure certain employees are trained to know and understand the application of the Dealer Member's best execution policies and procedures. Which employees should be trained and what training should they receive?**

The Dealer Member should ensure that all employees who need to use best execution policies and procedures can properly apply them. This is especially true when manually handling a client order and when exercising any discretion to execute a client order. While various training methods can be used, the Dealer Member must be satisfied that all requisite employees understand how to apply its best execution policies and procedures, especially in a multiple-market environment.

Depending on its role, an advisor may not need to have a detailed understanding of the application of the best execution policies and procedures of its employer. However, it is expected that an advisor would have an overall understanding of best execution policies and procedures and be able to answer basic questions from clients regarding these policies and procedures.

**17. Section 3300.4 requires a Dealer Member to outline a process designed to achieve best execution which includes identifying the Dealer Member's order handling and routing practices. Is describing the order handling and routing practices used during core trading hours sufficient?**

No. A Dealer Member should include a description of how it handles and routes orders, including how it determines changes to routing tables, during both core trading hours and before and after core trading hours.

**18. What specific information should a Dealer Member include in its best execution process regarding accessing unprotected marketplaces?**

Subsection 3300.4.(b) requires the Dealer Member take order and trade information from all appropriate marketplaces into account and set out its rationale for accessing or not accessing particular marketplaces. Where a Dealer Member does not subscribe to a marketplace that has historically demonstrated a reasonable likelihood of liquidity for securities for which the Dealer Member accepts orders, we expect that the Dealer Member provide information as to what arrangements it has put in place to access that marketplace.



**19. How should a Dealer Member manage order handling and routing practices to address different marketplace features and satisfy its best execution obligation?**

In addition to liquidity, differences in the features offered by marketplaces<sup>8</sup> can impact a Dealer Member’s ability to achieve best execution depending on how the Dealer Member handles and routes client orders. Such marketplace features include:

- 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
- whether a “speed bump” is imposed on orders
- the treatment of marketplace trading fees and/or rebates.

A Dealer Member’s policies and procedures should consider the implications of the different marketplace features. 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 to which orders may be routed for execution or handling (including any trading facilities of a marketplace)<sup>9</sup>
- the identity of each type of intermediary to which the Dealer Member might route orders for handling or execution
- the treatment of marketplace trading fees and rebates and the impact on the client including whether marketplace trading fees and/or rebates are passed on to clients.

IIROC 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:

- the handling of “market” or other “immediately tradable” orders received outside of the core trading hours of 9:30 a.m. to 4:00 p.m., or when certain

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<sup>8</sup> Certain marketplace features are summarized on the IIROC website, see *Summary Comparison of Current Equity Marketplaces* at: [http://www.iroc.ca/industry/marketmonitoringanalysis/Documents/SumCompEquityMarkets\\_en.pdf](http://www.iroc.ca/industry/marketmonitoringanalysis/Documents/SumCompEquityMarkets_en.pdf).

<sup>9</sup> 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.



marketplaces may be unavailable for trading due to technical reasons. The policy may provide that a Dealer Member considers trading opportunities on any visible marketplace that is then open for trading or that a Dealer Member may withhold the order<sup>10</sup> until all marketplaces or the primary listing market opens for trading

- the 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 if multiple marketplaces offer market-on close or call market facilities to execute closing trades at the end of the trading day
- the marketplaces and trading facilities that are accessed by the Dealer Member, taking into consideration whether a marketplace, including any unprotected marketplace, has demonstrated a reasonable likelihood of liquidity for a specific security relative to the size of the client order
- the treatment of marketplace trading fees and rebates and impact on the client including whether marketplace trading fees and/or rebates are passed on to clients
- the management of 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 a limit price to 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.

**20. *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?***

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. The

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<sup>10</sup> 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.



policies and procedures adopted by the Dealer Member will dictate the circumstances under which the Dealer Member may move an order entered on one marketplace to another 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 client instructions with respect to the entry of the order.

A Dealer Member is not required to adopt a policy to migrate a resting order to another marketplace to trade with an order entered after the entry of the “booked” order, including when such an order results in a locked market<sup>11</sup>. If a client instructs a Dealer Member to enter the order on a specific marketplace, a Dealer Member’s policy may provide that it will not monitor trading opportunities for the client order on other marketplaces that continue to trade the security. However, 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. In this instance, we expect the Dealer Member to consider 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, IIROC expects that the Dealer Member has implemented appropriate procedures to monitor trading opportunities on marketplaces that operate outside the core trading hours of 9:30 a.m. to 4:00 p.m., and will migrate appropriate client orders when they can execute with orders displayed on marketplaces that are still open for trading.

A Dealer Member’s policy should also include particulars of when a client “Day” order is considered to expire<sup>12</sup> and when a “Good-Till-Cancelled” order is considered inactive<sup>13</sup> as 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. Upon disclosing these policies to its clients, a Dealer Member is not 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.

## **21. Does the best execution obligation require a Dealer Member to always follow client instructions for handling an order?**

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<sup>11</sup> See generally IIROC Notice 11-0043 – Rules Notice – Guidance Note – UMIR – *Guidance on “Locked” and “Crossed” Markets* (February 1, 2011).

<sup>12</sup> 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
- any other marketplace or marketplaces on which the security trades.

<sup>13</sup> A Dealer Member may consider such an order “active” only when certain marketplaces are open for trading.



Not necessarily. Rule 3300 requires 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 order<sup>14</sup>. Therefore, a Dealer Member must not follow client instructions that would cause the Dealer Member to contravene any Requirements<sup>15</sup>. However, a client may consent to the order being withheld from entry on a marketplace until prevailing market prices would permit the entry of an order without locking or crossing a protected order or contravening other Requirements.

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

Yes. An Executing Dealer Member may route orders directly using a proprietary SOR, or indirectly using a third-party vendor for order routing or arranging this service with another Executing Dealer Member that employs an SOR. An Executing Dealer Member is 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
- ensuring that appropriate SOR strategies are established for retail and institutional clients
- ensuring that the SOR used makes its decisions including data on displayed orders on an unprotected marketplace where its best execution policies and procedures requires the Executing Dealer Member to do so
- 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

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<sup>14</sup> See CSA Notice of Approval – Amendments to National Instrument 23-101 Trading Rules and Companion Policy 23-101CP to National Instrument 23-101 Trading Rules at (2016) 39 OSCB 3237 (April 7, 2016).

<sup>15</sup> “Requirements” is defined in UMIR to mean, collectively:

- (a) UMIR;
- (b) the Policies;
- (c) the Trading Rules;
- (d) the Marketplace Rules;
- (e) any direction, order or decision of the Market Regulator or a Market Integrity Official, and
- (f) securities legislation,

as amended, supplemented and in effect from time to time.



structure occurs, as required under Rule 3300, to determine whether any adjustment to the SOR settings are required<sup>16</sup>.

Executing Dealer Members must also document decisions and changes with respect to their best execution policies and procedures as required under Rule 3300.

### **23. Does payment for order flow (PFOF) contravene a Dealer Member's best execution obligation?**

UMIR 7.5<sup>17</sup> 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 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**

### **24. 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. IIROC expects a Dealer Member to take reasonable steps to provide such clients 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.

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<sup>16</sup> 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.

<sup>17</sup> 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
  - (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.



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. IIROC encourages Participants to require limit prices for all stop-loss orders from Execution-Only Account clients.

As well, 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***

#### **25. What level of detail do Dealer Members need to include in the disclosure of their policies and procedures as required under section 3300.10?**

The disclosure required under section 3300.10 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. The information disclosed should allow clients to understand how, when and why the handling of their orders might differ. We expect each Dealer Member to clearly identify the required information on its website by ensuring this disclosure is easily accessible.

Section 3300.10 requires a description of the factors the Dealer Member considers to achieve best execution. In addition to listing the specific factors considered, we would expect a Dealer Member to explain to clients when and how these factors are taken into account, including:

- how client orders will be handled outside of core trading hours
- when client orders may be directed to a foreign intermediary or executed on a foreign organized regulated market
- how a client's instructions regarding the handling, routing or execution of its order(s) will be taken into account and how this may affect execution of the client's order(s).

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.

3300.10(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 a registered dealer in Canada. A description of each type of intermediary to whom the Dealer Member routes orders may 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 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 non-Executing Dealer Member's best execution policies and procedures may include providing a link to the Executing Dealer Member's best execution policies and procedures in compliance with section 3300.5.

## **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);