

## **PART 3 – SHORT SELLING**

### **3.1 Restrictions on Short Selling**

- (1) Except as otherwise provided, a Participant or Access Person shall not make a short sale of a security on a marketplace unless the price is at or above the last sale price.
  
- (2) A short sale of a security may be made on a marketplace at a price below the last sale price if the sale is:
  - (a) a Program Trade in accordance with Marketplace Rules;
  - (b) made in furtherance of the applicable Market Maker Obligations in accordance with the Marketplace Rules;
  - (c) for an arbitrage account and the seller knows or has reasonable grounds to believe that an offer enabling the seller to cover the sale is then available and the seller intends to accept such offer immediately;
  - (d) for the account of a derivatives market maker and is made:
    - (i) in accordance with the market making obligations of the seller in connection with the security or a related security, and
    - (ii) to hedge a pre-existing position in the security or a related security;
  - (e) the first sale of the security on any marketplace made on an ex-dividend, ex-rights or ex-distribution basis and the price of the sale is not less than the last sale price reduced by the cash value of the dividend, right or other distribution;
  - (f) the result of:
    - (i) a Call Market Order,
    - (ii) a Market-on-Close Order,
    - (iii) a Volume-Weighted Average Price Order,
    - (iv) a Basis Order, or
    - (v) a Closing Price Order;
  - (g) a trade in an Exchange-traded Fund; or
  - (h) made to satisfy an obligation to fill an order imposed on a Participant or Access Person by any provision of UMIR or a Policy.

## **POLICY 3.1 – RESTRICTIONS ON SHORT SELLING**

### **Part 1 – Entry of Short Sales Prior to the Opening**

*Prior to the opening of a marketplace on a trading day, a short sale may not be entered on that marketplace as a market order and must be entered as a limit order and have a limit price at or above the last sale price of that security as indicated in a consolidated market display (or at or above the previous day's close reduced by the amount of a dividend or distribution if the security will commence ex-trading on the opening).*

### **Part 2 – Short Sale Price When Trading Ex-Distribution**

*When reducing the price of a previous trade by the amount of a distribution, it is possible that the price of the security will be between the trading increments. (For example, a stock at \$10 with a dividend of \$0.125 would have an ex-dividend price of \$9.875. A short sale order could only be entered at \$9.87 or \$9.88.) Where such a situation occurs, the price of the short sale order should be set no lower than the next highest price. (In the example, the minimum price for the short sale would be \$9.88, being the next highest price at which an order may be entered to the ex-dividend price of \$9.875).*

*In the case of a distribution of securities (other than a stock split) the value of the distribution is not determined until the security that is distributed has traded. (For example, if shareholders of ABC Co. receive shares of XYZ Co. in a distribution, an initial short sale of ABC on an ex-distribution basis may not be made at a price below the previous trade until XYZ Co. has traded and a value determined).*

*Once a security has traded on an ex-distribution basis, the regular short sale rule applies and the relevant price is the previous trade.*

**Defined Terms:** UMIR section 1.1 – “Access Person”, “arbitrage account”, “Basis Order”, “Call Market Order”, “Closing Price Order”, “consolidated market display”, “derivatives market maker”, “Exchange-traded Fund”, “last sale price”, “limit order”, “Market Maker Obligations”, “Market-on-Close Order”, “market order”, “marketplace”, “Marketplace Rules”, “Participant”, “Policy”, “Program Trade”, “related security”, “short sale”, “trading day”, “UMIR” and “Volume-Weighted Average Price Order”

UMIR section 1.2(2) – “trade”

**Regulatory History:** Effective August 27, 2004, the applicable securities commissions approved the amendment to add clause (g) to subsection (2).

Effective April 8, 2005, the applicable securities commissions approved an amendment to clause (f) of subsection (2) of Rule 3.1 to add subclause (iv).

Effective March 9, 2007, the applicable securities commissions approved an amendment to clause (f) of subsection (2) of Rule 3.1 to add subclause (v).

Effective May 16, 2008, the applicable securities commissions approved an amendment to add clause (h) to subsection (2).

In connection with the recognition of IROC and its adoption of UMIR, the applicable securities commissions approved an amendment to clause (h) at subsection (2) of Rule 3.1 that came into force on June 1, 2008 to replace the phrase “Rule or” with “provision of UMIR or a”.

**Market Integrity Notice:** The following is the relevant portion of Market Integrity Notice 2004-020 issued on August 13, 2004 under the heading “Sales of Restricted Securities”:

Investment Industry Regulatory Organization of Canada (“IIROC”) has recently received a number of inquiries as to whether a sale involving a “restricted” security should be marked as a “short sale”. For the purposes of the definition of a “short sale” under the Universal Market Integrity Rules, a person will be considered not to own a particular security if the securities they hold are subject to a restriction on sale imposed by:

- applicable securities legislation; or
- a requirement of a marketplace as a condition of listing or quoting the security.

If the holder of a security which is subject to a restriction on sale, whether imposed by securities legislation or the rules of a marketplace, enters an order on a marketplace for the sale of such security **before the expiration of the restrictions on sale imposed by securities legislation or the rules of a marketplace**, the order must be marked as a “short sale”. In order to comply with applicable securities legislation and regulatory requirements, an order for the sale of “restricted” securities should be marked as a “short sale” even where the sale restrictions will expire prior to the settlement date of the trade resulting from the execution of the order.

**Market Integrity Notice:** The following is the relevant text of Market Integrity Notice 2005-023 issued on July 29, 2005 under the heading “**Guidance – Securities Trading on Multiple Marketplaces**”. Market Integrity Notice 2005-023 was repealed and replaced by Market Integrity Notice 2006-017 issued on September 1, 2006 under the heading “**Guidance – Securities Trading on Multiple Marketplaces**”. Additional text is set out from Market Integrity Notice 2005-023 under Rules 5.2, 5.3, 7.7 and 8.1:

#### **Summary**

This Market Integrity Notice provides guidance on the obligations of a Participant or Access Person under the rules and policies of the Universal Market Integrity Rules (“UMIR”) with respect to trading activity in a security that trades on more than one marketplace. UMIR defines a marketplace as a recognized exchange (“Exchange”), a recognized quotation and trade reporting system (“QTRS”) or an alternative trading system (“ATS”) that carries on business in Canada.

#### **Background**

National Instrument 21-101 (“Marketplace Operation Instrument”) and National Instrument 23-101 (“Trading Rules”) (together, the “ATS Rules”) envisage different marketplaces trading the same securities. Market Regulation Services Inc. (“RS”) is recognized as a self-regulatory organization by the Alberta Securities Commission, British Columbia Securities Commission, Manitoba Securities Commission, Ontario Securities Commission and, in Quebec, by the Autorité des marchés financiers (the “Recognizing Regulators”) and authorized to be a regulation services provider for the purposes of the ATS Rules. RS adopted, and the Recognizing Regulators approved, UMIR as the integrity trading rules that would apply in any marketplace that retains RS as its regulation services provider.

Currently, RS has been retained to be the regulation services provider for: the Toronto Stock Exchange (“TSX”), TSX Venture Exchange (“TSX V”) and Canadian Trading and Quotation System (“CNQ”), each as an Exchange; and for Bloomberg Tradebook Canada Company, Liquidnet Canada Inc. and Markets Securities Inc. (“MSI”), each as an ATS. Until very recently, none of these marketplaces executed trades in a security which was also traded on another marketplace. Certain securities are now inter-listed between CNQ and TSX V. It is the intention of MSI that upon commencement of operations it will allow trading in all securities which are listed on the TSX. In the future, MSI may expand its trading of securities to include securities which are listed on CNQ or TSX V.

#### **Requirements Under UMIR**

UMIR contains a number of rules which require that trading be conducted at the “last sale price”, or at a price that is the same as or better than the “best ask price” or “best bid price”. In each case, this price will be determined by reference to order or trade information contained in “a consolidated market display”, which is made up of order and trade information from those marketplaces to which a Participant or Access Person has access. Specifically, a Participant is required to refer to order and trade information from each:

- Exchange of which they are a member;
- QTRS of which they are a user; and
- ATS of which they are a subscriber.

In addition, a Participant would be required to refer to order and trade information from a particular marketplace if the Participant has entered into a contractual arrangement as an “introducing broker” with another dealer as “carrying broker” and that other dealer is a subscriber, user or member of the marketplace.

An Access Person is required to refer to order and trade information from each:

- Exchange or QTRS to which they have been granted access rights either directly or by means of an electronic connection to the order routing system of a member or user;
- QTRS of which they are a user; and
- ATS of which they are a subscriber.

Presently, an Access Person who is a subscriber to an ATS would take into consideration order and trade information from that ATS, as well as:

- the TSX if they have been granted access to the order routing system of a Participant pursuant to TSX Policy 2-501; and
- the TSX V if they have been granted access to the order routing system of a Participant pursuant to the "Direct Access Rules" of the TSX V.

While the ATS Rules as originally adopted in 2001 contemplated the existence of a "market integrator" and, in the alternative, required each marketplace to maintain an electronic connection to every other marketplace that traded the same securities, both concepts were removed from the ATS Rules with amendments that were effective in 2004. As such, marketplaces are not required to have the capacity to route orders to other marketplaces which have better prices.

As a result, the obligation to monitor information on orders entered on and trades executed on the marketplaces to which a Participant or Access Person has access falls to the Participant or Access Person. However, neither UMIR nor the ATS Rules requires a Participant or an Access Person to maintain trading access to every Canadian marketplace on which a security may trade.

Each Participant and Access Person should also note that, while Rule 10.15 of UMIR provides that each security shall be assigned a unique symbol for trading purposes, securities which are presently inter-listed between CNQ and TSX V have different trading symbols on each marketplace. Notwithstanding the difference in trading symbols, a Participant must have adequate procedures in place to ensure that order and trade information from each marketplace to which the Participant has access is taken into account for the purposes of complying with the applicable requirements of UMIR.

There are five rules under UMIR for which the requirement to monitor order and trade information from multiple marketplaces is most important. Rule 3.1 applies to both a Participant and an Access Person while Rules 5.2, 5.3, 7.7 and 8.1 apply only to a Participant. As additional marketplaces develop and as the means for distributing market data on orders and trades evolves, RS will review the rules and guidance provided with respect to dealing with securities trading on multiple marketplaces.

#### **Rule 3.1 – Restrictions on Short Selling**

Rule 3.1 of UMIR provides that, subject to certain exemptions, neither a Participant nor an Access Person may make a short sale below the "last sale price". In turn, the term "last sale price" is defined as the price of the last sale of at least one standard trading unit displayed in "a consolidated market display". As set out in Market Integrity Notice 2005-018 (June 10, 2005), RS is proposing to replace the definition of a "consolidated market display" with the concept of an "applicable market display" which contains information on orders and trades on those marketplaces to which a Participant or Access Person has access. As such, a Participant or Access Person may not make a short sale below the "last sale price" of that security as such price is reported for the marketplaces to which the Participant or Access Person has trading access. Specifically, the lowest price at which a Participant or Access Person may make a short sale will be the lesser of:

- the last sale price of the security on the marketplace on which the Participant or Access Person enters the short sale order; or
- the last sale price of the security on any other marketplace to which the Participant or Access Person has access provided such trade occurred subsequent to the last sale on the marketplace on which the Participant or Access Person enters the short sale order.

If the order for the short sale would be immediately executed on entry on a marketplace at a price which complies with Rule 3.1 due to the last sale price on another marketplace to which the Participant or Access Person has access, the bundled order may be marked as "short exempt" if that marker is available on the marketplace on which the order is entered (such as the TSX). If the order is entered on a marketplace which does not provide for the inclusion of a "short exempt" marker (such as the TSX V or CNQ), the trade should be identified as a "short sale".

*Example #1:* Canadian security ABC is traded on both Marketplace D and Marketplace E. Participant X has trading access to Marketplace D only. Participant X executes a short sale of ABC on Marketplace D, based upon the last sale price on Marketplace D, even though the last sale price of ABC on Marketplace E was higher at the time of the sale. Participant X is in compliance with the short sale rule.

*Example #2:* Canadian security ABC trades on both Marketplace D and Marketplace E. Participant X has trading access to both Marketplace D and Marketplace E. Participant X executes a short sale of ABC on Marketplace D, based upon the last sale price on Marketplace E that is more recent than the last sale on Marketplace D, even though the last sale price of ABC on Marketplace D was higher than that on Marketplace E at the time of the short sale. Participant X is in compliance with the short sale rule.

**Market Integrity Notice:** The following is the relevant text of Market Integrity Notice 2005-024 issued on July 27, 2005 under the heading "**Guidance – Short Sales Made in Furtherance of Market Maker Obligations**":

#### **Summary**

This Market Integrity Notice provides guidance relating to the exemption from the price restrictions on short sales under the Universal Market Integrity Rules ("UMIR") if the sale is made by a person pursuant to their Market Maker Obligations.

### **Definition of “Market Maker Obligations”**

UMIR defines “Market Maker Obligations” as the obligations imposed by rules of an exchange (“Exchange”) or quotation and trade reporting system (“QTRS”) on a member or user (a “Market Maker”), to guarantee:

- a two-sided market for a particular security on a continuous or reasonably continuous basis; and
- the execution of orders for the purchase or sale of a particular security which are less than a minimum number of units of the security as designated by the marketplace (a “Minimum Guaranteed Fill”).

Presently, Registered Traders and Specialists under the market making system of the Toronto Stock Exchange and Market Makers under the market making system of the Canadian Quotation and Trade Reporting System are considered to have Market Maker Obligations. Since Odd Lot Dealers on the TSX Venture Exchange do not have an obligation to maintain a continuous or reasonably continuous two-sided market, their activities do not qualify as Market Maker Obligations.

### **Exemption from the Price Restriction on Short Sales**

Under Rule 3.1 of UMIR, a short sale may not be made at a price which is less than the last sale price of the security. If a sale is being executed in accordance with Market Maker Obligations, the sale will be exempt from this price restriction and should be marked as a “short exempt” trade. If a marketplace does not have such a marker available the trade should be marked in the same manner as a sale from a “long” position.

Given the requirement under Market Maker Obligations to maintain a two-sided market and to provide automatic execution of orders which are less than the Minimum Guaranteed Fill, Investment Industry Regulatory Organization of Canada is of the view that a Market Maker may execute a trade with an order at the “best bid price” that is for the Minimum Guaranteed Fill or less by making a short sale that is exempt from the general price restriction under Rule 3.1. A Market Maker may make such an exempt short sale even if the Market Maker is already in a short position with respect to the particular security. In addition, trades which are automatically generated by the trading system of the Exchange or QTRS to fulfill Market Maker Obligations may be made at a price which is less than the last sale price of the security.

A trade executed by a Market Maker which is not pursuant to Market Maker Obligations is subject to the price restrictions on short sales and should be properly marked as a “short sale”.

**Market Integrity Notice:** The following is the relevant text of Market Integrity Notice 2005-025 issued on July 27, 2005 under the heading “**Guidance – Bundling Orders from a Long and Short Position**”:

### **Summary**

This Market Integrity Notice provides guidance on the obligations of a Participant or Access Person under the Universal Market Integrity Rules (“UMIR”) with respect to the entry of orders and the execution of trades involving the bundling together of sale orders from a long position and a short position.

### **General Requirement**

Generally, a sale order from a long position may not be bundled together with a sale order from a short position and entered on a marketplace as a single order. The orders should be entered separately, one being entered as a sale order from a long position and the other entered as a sale order from a short position and marked with the appropriate designation as required by Rule 6.2 of UMIR.

### **Exceptions**

A sale order from a long position may be bundled with a sale order from a short position if:

- the bundled order is entered on a marketplace for the account or accounts of a single beneficial owner; or
- the bundled order is part of an intentional cross.

These exceptions are **not** available in certain circumstances and a bundled order involving sales from both a long and a short position must **not be entered** on a marketplace:

- prior to the opening of trading on that marketplace as the “short” element of the order might adversely impact the price at which the security opens for trading on that marketplace; or
- during a trading session when all trades in a particular security are executed at a single price.

### **Marking a Bundled Order**

On entry, the bundled order should be marked as “short exempt” if that marker is available on the marketplace on which the order is entered (such as the Toronto Stock Exchange). If the order is entered on a marketplace which does not provide for the inclusion of a “short exempt” marker (such as the TSX Venture Exchange and Canadian Trading and Quotation System Inc.), the trade should not be identified as a “short sale”.

### **Compliance with Short Sale Restrictions**

The short sale component of the trade will be considered to comply with the requirement under Rule 3.1 that a short sale not be undertaken at a price less than the last sale price. In executing a bundled order, the long portion of the order will be deemed to have traded first. If the bundled order does not fully execute in a single transaction, the Participant or Access Person must ensure that the short portion of a bundled order does not execute at a price lower than the last sale price.

A sale from a long position, at a price that is below the previous sale price, can be used as the last sale price for a subsequent short sale by the same beneficial holder of the security. However, a person will be considered to have undertaken a manipulative or deceptive activity contrary to Rule 2.2. of UMIR if that person purchases a security at a price for the purpose of establishing a last sale price to facilitate a short sale at that price. For example Client X, who wishes to sell short a total of 1,000 shares can not purchase 100 shares at a price lower than the immediately preceding last sale and then execute a short sale of 1,100 shares at the first purchase price.

**Market Integrity Notice:** The following is the relevant text of Market Integrity Notice 2005-028 issued on July 29, 2005 under the heading "**Guidance – Sale of Securities Subject to Transfer Restrictions Only in the United Securities**":

#### **Summary**

This Market Integrity Notice provides guidance on the requirements under the Universal Market Integrity Rules ("UMIR") with respect to the sale of securities which are subject to transfer restrictions only in the United States or to residents of the United States and are otherwise "freely-tradable" on a Canadian marketplace (a "U.S. Restricted Security").

#### **Background**

A Participant may be asked by a client to facilitate the sale or transfer of a listed security or a quoted security that qualifies as a U.S. Restricted Security due to transfer restrictions imposed pursuant to securities legislation in the United States, particularly Rule 144A under the Securities Act of 1933. Such restrictions do not preclude a person who is not a resident of the United States from purchasing the securities on a marketplace in Canada.

However, if the securities to be sold or transferred are subject to restrictions on transfer imposed by Canadian securities legislation or the marketplace on which the securities are listed or quoted, any transaction must comply with those requirements. For guidance on the sale on a marketplace of securities in these circumstances, reference should be made to Market Integrity Notice 2004-020 – Sales of Restricted Securities issued on August 13, 2004.

#### **Entry of Orders for the Sale of a U.S. Restricted Security**

As a general rule, an order for the sale of a U.S. Restricted Security may be entered on a marketplace as:

- part of an intentional cross at a price between the best ask price and the best bid price when the Participant knows that the purchaser is not a resident of the United States or otherwise subject to the transfer restriction; or
- a Special Terms Order (that is subject to the condition that the purchaser not be a resident of the United States).

Orders entered as an intentional cross at a price between the best ask price and the best bid price may be executed on a marketplace without concern about potential interference by a party who may not be qualified to acquire the securities.

If a Participant enters an order on a marketplace to sell a U.S. Restricted Security as a Special Terms Order at a price below the best bid price, the Participant must contact each Participant and Access Person who has entered orders disclosed in a consolidated market display at a better price than the price of the Special Terms Order and offer to satisfy their orders up to the volume of the Special Terms Order provided the Participant or Access Person is eligible to purchase the U.S. Restricted Security. If each Participant or Access Person with a better-priced order is either unwilling or unable to acquire the U.S. Restricted Security, the Special Terms Order may be executed at an inferior price with a party that is able to acquire the U.S. Restricted Security.

#### **Marking Orders for the Sale of a U.S. Restricted Security**

An order to sell a U.S. Restricted Security entered on a marketplace will be considered to be a "short sale" for the purposes of the definition under Rule 1.1 of UMIR unless the seller has a reasonable belief that they will be able to deliver the security without restriction on the settlement date of the trade. Since the restriction under Rule 144A ceases to have effect when the security is acquired on a marketplace by a person who is not resident in the United States, the sell order may be marked in accordance with Rule 6.2(1)(b)(ix) as "short exempt", being a short sale that is exempt from the restriction under Rule 3.1 that the sale be completed at a price not less than the last sale price of the security.

**Market Integrity Notice:** The following is the relevant text of Market Integrity Notice 2006-006 issued on February 17, 2006 under the heading "**Guidance – Sale of Securities Subject to Certain United States Securities Laws**":

#### **Summary**

This Market Integrity Notice provides guidance relating to a transfer of securities into Canada from the United States in reliance on Rule 904 under Regulation S - Rules Governing Offers and Sales Made Outside the United States Without Registration Under the Securities Act of 1933 ("Regulation S").

#### **Background**

A Participant may be asked by a client to facilitate the sale into Canada of a security that was privately placed in the United States and is listed, quoted or traded on a marketplace in Canada. Such a security is subject in the United States to the jurisdiction of the United States Securities and Exchange Commission ("SEC"). A Participant may transfer such a security into Canada where the Participant complies with all relevant United States and Canadian securities laws.

In Regulation S, the SEC has set out a regime whereby certain securities offered and sold outside the United States need not be registered with the SEC. A Participant may rely on Regulation S when facilitating the sale of a security on a marketplace in Canada from the United States. In conducting such a sale, the Participant must ensure compliance with Regulation S and all other relevant United States securities laws.

#### **Sale into Canada as an “Offshore Transaction” under Rule 904 of Regulation S**

One of the general conditions of Rule 904 under Regulation S is that an offer, sale or resale of the securities must be made in an “offshore transaction”. An “offshore transaction” can be, among other things:

- a transaction where no offer is made to a person in the United States and the transaction is executed through the facilities of a “designated offshore securities market” where neither the seller nor any person acting on its behalf knows that the transaction has been prearranged with a buyer in the United States; or
- a transaction where no offer is made to a person in the United States and where the buyer must be outside the United States or the seller and any person acting on its behalf must reasonably believe the buyer is outside the United States.

As of February 17, 2006, the Toronto Stock Exchange (“TSX”) and the TSX Venture Exchange (“TSXV”) are the marketplaces in Canada that qualify as a “designated offshore securities market” for the purposes of Regulation S. A Participant may satisfy the requirements for an “offshore transaction” by facilitating the sale into Canada of a security through the facilities of the TSX or TSXV if:

- neither the Participant nor the selling client “knows that the transaction has been prearranged with a buyer in the United States”; or
- the Participant follows the procedure set out in Market Integrity Notice 2005-028 - Sale of Securities Subject to Transfer Restrictions Only in the United States.

However, if the sale is completed through the facilities of a marketplace in Canada that **does not qualify as a “designated offshore securities market”**, IIROC is of the view that the Participant **must** comply with the procedure set out in Market Integrity Notice 2005-028 and ensure that the order is entered on the marketplace as:

- part of an intentional cross at a price between the best ask price and the best bid price when the Participant knows that the purchaser is outside the United States and complies with any other restrictions on ownership; or
- a Special Terms Order that is subject to the condition that the purchaser be outside the United States and complies with any other restrictions on ownership.

If the Participant enters the order on the Canadian marketplace as a Special Terms Order at a price below the best bid price, the Participant must contact each Participant and Access Person who has entered orders disclosed in a consolidated market display at a better price than the price of the Special Terms Order and offer to satisfy their orders up to the volume of the Special Terms Order provided the Participant or Access Person is a purchaser outside the United States and complies with any other restrictions on ownership. If each Participant or Access Person with a better-priced order is either unwilling or unable to acquire the security, the Special Terms Order may be executed at an inferior price with a party that is able to acquire the security.

It is the responsibility of the Participant to ensure compliance with all relevant aspects of Regulation S including, but not limited to, the offshore transaction requirement. In particular, a Participant must ensure that the sale into Canada is bona fide and not, for example, for the purpose of “washing off” a legend with resale restrictions imposed on “restricted securities” under Rule 144A under the Securities Act of 1933 (United States) to facilitate the immediate re-sale of the securities into the United States. **If a Participant is unsure of any of its obligations under United States securities laws, including sales pursuant to rules under Regulation S other than Rule 904, IIROC recommends that the Participant consult with United States legal counsel.**

#### **Order Marking on a Canadian Marketplace**

As set out in Market Integrity Notice 2005-028, if a Participant is asked to facilitate the sale into Canada of a security that is subject to resale restrictions in the United States, for example, by virtue of having been acquired under Rule 144A or Regulation D under the Securities Act of 1933, then an order to sell that security entered on a Canadian marketplace will generally be considered to be a “short sale” for the purposes of the definition under Rule 1.1 of UMIR. However, as the restriction will “disappear” upon the execution of a trade in Canada that complies with requirements of securities legislation in the United States, the sell order may be marked in accordance with Rule 6.2(1)(b)(ix) as “short exempt” on those marketplaces and facilities that permit that marker (and otherwise marked “short” if the “short exempt” marker is not supported) if the Participant effects the trade for “regular delivery” and the Participant would need to borrow free-trading securities to complete settlement while arranging for the removal of any restrictive legend. If the trade is completed as a Special Terms Order with “delayed delivery” to allow time before settlement for the removal of any restrictive legend, the sale will be considered to have been made from a “long” position and will not be marked as “short”.

**Market Integrity Notice:** The following is the relevant text of Market Integrity Notice 2006-010 issued on April 7, 2006 under the heading “**Guidance – Short Sale Designations and Restrictions**”:

#### **Summary**

This Market Integrity Notice provides guidance relating to the conduct of short sales and the need to designate such orders on entry on a Canadian marketplace as “short” or “short exempt” for the purposes of the Universal Market Integrity Rules (“UMIR”).

## Questions and Answers

The following is a list of frequently asked questions regarding the conduct of “short sales” (including the appropriate order designation and the application of price restrictions in particular circumstances) and the response of Investment Industry Regulatory Organization of Canada (“IIROC”) to each:

**1. Must a sell order be marked “short” if the security is trading on a marketplace on a “when issued” basis?**

If a person has entered into a contract to purchase a security by subscription to an offering or purchase on a “when issued” basis over-the-counter or on a marketplace or would become the holder of such security as a result of an arrangement, amalgamation or take-over bid, that person may sell such “when issued” securities on a marketplace which has posted a “when issued” market for that security and the order for the sale will be considered to be from a long position and should not be marked “short”.

However, if a marketplace has a “regular” market in units of that security which are issued and outstanding any sell order entered in the “regular” market by that person for the sale of their “when-issued” security, the sale will be considered a “short sale” and must be marked as such in accordance with Rule 6.2 of UMIR.

If a person does not have an entitlement to receive a security when that security is issued, any sale of that security in either the “when issued” or the “regular” market will be considered to be a “short sale”.

For a more detailed discussion of issues related to securities trading on a “when issued” basis, reference should be made to Market Integrity Notice 2006-002 – Guidance - “When Issued” Trading (January 30, 2006).

**2. What price restrictions apply to the short sale of a security that has not previously traded on a Canadian marketplace?**

Under Rule 3.1 of UMIR, a short sale may not be made at a price which is less than the “last sale price”. The term “last sale price” is defined in Rule 1.1 of UMIR as the “price of the last sale of at least one standard trading unit of a particular security displayed in a consolidated market display but does not include the price of a sale resulting from an order that is a Basis Order, Call Market Order or Volume-Weighted Average Price Order.” The consolidated market display includes information on order or trades on an Exchange, QTRS or ATS operating in Canada. Information on trades which have occurred outside of Canada does **not** establish a last sale price for a security.

In accordance with Rule 1.2(4) of UMIR, if a security has not previously traded on a Canadian marketplace the “last sale price” shall be deemed to be the price at which the security has been issued or distributed to the public.

**3. What restrictions apply to the entry of a short sale on a marketplace prior to the marketplace opening for trading?**

In accordance with Part 1 of Policy 3.1 of UMIR, a short sale may not be entered on a marketplace prior to the opening of that marketplace for trading as a market order. In these circumstances, the short sale must be entered as a limit order and have a limit price at or above the last sale price of that security as indicated in a consolidated market display (or at or above the previous day’s close reduced by the amount of a dividend or distribution if the security will commence ex-trading on the opening).

**4. Must an order to sell a security subject to a U.S. resale restriction be marked “short” when the order is entered on a Canadian marketplace?**

If a Participant is asked to facilitate the sale into Canada of a security that is subject to resale restrictions in the United States, for example, by virtue of having been acquired under Rule 144A or Regulation D under the Securities Act of 1933, then an order to sell that security entered on a Canadian marketplace will generally be considered to be a “short sale” for the purposes of the definition under Rule 1.1 of UMIR. However, as the restriction will “disappear” upon the execution of a trade in Canada that complies with requirements of securities legislation in the United States, the sell order may be marked as “short exempt” in accordance with Rule 6.2 of UMIR on those marketplaces and facilities that permit that marker (and otherwise marked “short” if the “short exempt” marker is not supported) if the Participant effects the trade for “regular delivery” and the Participant would need to borrow free-trading securities to complete settlement while arranging for the removal of any restrictive legend. If the trade is completed as a Special Terms Order with “delayed delivery” to allow time before settlement for the removal of any restrictive legend, the sale will be considered to have been made from a “long” position and will not be marked as “short”.

For a more detailed discussion of issues related to sales of securities subject to a U.S. resale restriction, reference should be made to Market Integrity Notice 2006-006 – Guidance - Sale of Securities Subject To Certain United States Securities Laws (February 17, 2006).

**5. Must an order to sell a security that is subject to a resale restriction under applicable Canadian securities legislation (for example a four-month “private placement” hold period) be marked “short”?**

For the purposes of the UMIR definition of a “short sale”, a person will be considered not to own a security if the security is subject to a restriction on sale imposed by applicable Canadian securities legislation or a Canadian marketplace as a condition of listing or quoting the security.

A holder of a security which is subject to such a sale restriction who enters an order on a Canadian marketplace for the sale of the security before the expiration of the sale restriction must mark the sale order as “short”. This obligation to mark the order as “short” applies even if the sale restriction will expire prior to the settlement date of the trade.

For a more detailed discussion of the trading of restricted securities, reference should be made to Market Integrity Notice 2004-020 – Sales of Restricted Securities (August 13, 2004).

**6. A person holds an option and intends to pay the exercise price of the option from the proceeds of the sale of the securities that will be issued on the exercise of the option. Must the sell order be designated as “short”?**

The definition of “short sale” in Rule 1.1 of UMIR states that a seller shall be considered to own a security if the seller “has an option to purchase the security and has exercised the option”. Since the holder of the option has not done everything required to exercise the option (including the payment of the exercise price) at the time of the proposed sale, any sell order for the underlying securities must be designated as “short” and will be subject to the price restrictions under Rule 3.1 of UMIR.

**7. Must an order be marked “short” where it is a bundled order of a “long” and “short” position?**

Generally, sell orders from both a long position and a short position may not be bundled together. However, a sale order from a long position may be bundled with a sale order from a short position if:

- the bundled order is entered on a marketplace for the account or accounts of a single beneficial owner; or
- the bundled order is part of an intentional cross.

These exceptions are **not** available in certain circumstances and a bundled order involving sales from both a long and a short position must **not be entered** on a marketplace:

- prior to the opening of trading on that marketplace as the “short” element of the order might adversely impact the price at which the security opens for trading on that marketplace; or
- during a trading session when all trades in a particular security are executed at a single price.

On entry, an order bundling a “long” and a “short” order together should be marked as “short exempt” if that marker is available on the marketplace on which the order is entered. If the order is entered on a marketplace which does not provide for the inclusion of a “short exempt” marker, the sell order should not be designated as a “short sale”. In executing a bundled order, the long portion of the order will be deemed to have traded first. The short portion of the order will be deemed to comply with the price restriction requirement under Rule 3.1 of UMIR. If the bundled order does not fully execute in a single transaction, the Participant or Access Person must ensure that the short portion of the order does in fact comply with the price restriction requirement under Rule 3.1.

Reference should be made to Market Integrity Notice 2005-025 – Bundling Orders from a Long and Short Position (July 27, 2005).

**Market Integrity Notice:** The following is the relevant text of Market Integrity Notice 2006-017 issued on September 1, 2006 under the heading “**Guidance – Securities Trading on Multiple Marketplaces**”. Additional text is set out under Rules 5.1, 5.2, 5.3, 7.7 and 8.1:

**Background**

National Instrument 21-101 (“Marketplace Operation Instrument”) and National Instrument 23-101 (“Trading Rules”) (together, the “ATS Rules”) envisage different marketplaces trading the same securities. Investment Industry Regulatory Organization of Canada (“IIROC”) is recognized as a self-regulatory organization by the Alberta Securities Commission, British Columbia Securities Commission, Manitoba Securities Commission, Ontario Securities Commission (“OSC”) and, in Quebec, by the Autorité des marchés financiers (the “Recognizing Regulators”) and authorized to be a regulation services provider for the purposes of the ATS Rules. IIROC adopted, and the Recognizing Regulators approved, UMIR as the integrity trading rules that would apply in any marketplace that retains IIROC as its regulation services provider.

Currently, IIROC has been retained to be the regulation services provider for: the Toronto Stock Exchange (“TSX”), TSX Venture Exchange (“TSXV”) and Canadian Trading and Quotation System (“CNQ”), each as an Exchange; and for Bloomberg Tradebook Canada Company (“Bloomberg”), Liquidnet Canada Inc. (“Liquidnet”), Perimeter Markets Inc. (“BlockBook”) and Shorcan ATS Limited (“Shorcan”), each as an ATS.

CNQ has received approval of the OSC to vary its recognition order to offer trading in securities listed on other Exchange through a facility to be known as “Pure Trading” and IIROC will act as the regulation services provider for trading through that facility. Pure Trading is expected to launch the first phase of operations on October 12, 2006 with a cross printing facility. The second phase consisting of a full continuous auction market will be launched four to six weeks later. Liquidnet has notified the applicable securities regulatory authorities that Liquidnet expects to vary its operations by the end of 2006 to allow the matching of orders for Canadian listed securities rather than acting solely as an order router. TriAct Canada Marketplace LP (“MATCH Now”) has notified the OSC that it intends to launch operations as an ATS that would trade Canadian listed securities. IIROC has received an application to act as the regulation services provider for MATCH Now, which expects to launch operations by the end of 2006.

**Conforming UMIR to the Requirements of the Canadian Securities Administrators**

On July 14, 2006, the Canadian Securities Administrators (“CSA”) published a Notice of Proposed Amendments to National Instrument 21-101 – Marketplace Operation and Companion Policy 21-101CP and National Instrument 23-101 – Trading Rules and Companion Policy 23-101CP (the “CSA Notice”). In the CSA Notice, the CSA clarified their requirements with regard to information on orders and trades that each Participant is to take into account when fulfilling best execution obligations. In particular, the CSA confirmed their view “that availability of pre-trade and post-trade information is essential to facilitate best

execution and market integrity, especially with multiple marketplaces trading the same securities". Although the CSA review of "trade-through" and "best execution" obligations generally is ongoing, the CSA proposed to clarify their requirements by amending Companion Policy 23-101CP to add the following section:

*In order to meet best execution obligations, we [the CSA] expect that a dealer will take into account order information from all marketplaces where a particular security is traded (not just marketplaces where a dealer is a participant) and take steps to access orders, as appropriate. This may include making arrangements with another dealer who is a participant of a particular marketplace or routing an order to a particular marketplace, where appropriate.*

*In the CSA Notice, the CSA indicated that further amendments to the ATS Rules may be proposed on the completion of the study following Concept Paper 23-403 – Developments in Market Structure and Trade-Through Obligations published by the CSA on July 22, 2005. The provisions of UMIR and their interpretation and application would be modified to conform to the positions adopted by the CSA. Upon the publication of the proposed amendments to the ATS Rules respecting trade-through obligations, IIROC will issue additional Market Integrity Notices to request comments on proposed amendments to UMIR and to provide further guidance on trading practices that may be required as a direct consequence of the final position adopted by the CSA with respect to trade-through obligations.*

*Until such time as there is an information processor to provide pre-trade and post trade information consolidated for all marketplaces, the current "market-driven solution" to data consolidation that relies on information vendors may be subject to certain limitations on the ability to integrate data from certain marketplaces based on the basic operating features of those marketplaces. In these circumstances, IIROC recognizes that the constraints on the availability of trade information may impact the ability of a Participant or Access Person to fully comply with the requirements of UMIR.*

*UMIR contains a number of rules which require that trading be conducted at the "last sale price", or at a price that is the same as or better than the "best ask price" or "best bid price". Each of these prices has been determined by reference to order or trade information contained in "a consolidated market display", which contained orders and trade information from each marketplace to which the Participant or Access Person has trading access. Specifically, a Participant has been required to refer to order and trade information from each:*

- Exchange of which they are a member;
- QTRS of which they are a user;
- ATS of which they are a subscriber; and
- a particular marketplace if the Participant has entered into a contractual arrangement as an "introducing broker" with another dealer as "carrying broker" and that other dealer was a subscriber, user or member of that marketplace.

*With the publication of the CSA Notice, the CSA clarified that each Participant should make reference to order or trade information from each marketplace trading the particular security that has been provided by the marketplace to an information vendor. In order to ensure that the provisions and application of UMIR conform to the requirements of the CSA, IIROC:*

- **is issuing this Market Integrity Notice which repeals and replaces Market Integrity Notice 2005-023 – Guidance – Securities Trading on Multiple Marketplaces (July 29, 2005) and Market Integrity Notice 2005-015 – Guidance – Complying with "Best Price" Obligations (May 12, 2005); and**
- **will be proposing the amendment of Part 1 of Policy 5.2 to remove as qualifications on the "best price" obligation factors related to access to information, access to marketplaces and consideration of foreign markets.**

#### **Summary of Basic Operating Features of Current Marketplaces**

*Appendix "A" includes a summary of the basic features, as of August 22, 2006, of each of the marketplaces for which IIROC acts as a regulation services provider. Information is also provided on:*

- the Pure Trading facility of CNQ as approved by the OSC;
- the proposed changes in the operations of Liquidnet which remain subject to the approval of the applicable regulatory authorities; and
- the proposed operations of MATCH Now which remain subject to the approval of the OSC.

*The summary of features includes:*

- a description of the marketplace operation model;
- the type of securities traded;
- access requirements;
- provisions for pre-trade transparency;
- provisions for post-trade transparency; and
- the hours of operation.

*The summary is provided in the context of assisting Participants and Access Persons to ascertain their obligations in accordance with the requirements of the CSA as set out in the CSA Notice when trading a security that is eligible to be traded on multiple marketplaces. This summary is not meant to be comprehensive of all facilities and features offered, or to be offered, by a*

particular marketplace. Reference should be made to the rules and policies of the marketplace or to material provided by each marketplace for a more detailed description of their operations. The information on the proposed changes in operation by Liquidnet and the proposed operation by MATCH Now is based on their current intentions and may change prior to implementation.

#### **Order Transparency**

None of BlockBook, Bloomberg and Liquidnet provides pre-trade transparency as contemplated by Part 7 of the Marketplace Operation Instrument of any orders entered on their marketplace. Upon launch of operations, MATCH Now will not provide pre-trade transparency of any orders<sup>1</sup>. While Shorcan provides pre-trade transparency by means of a web-page available through a connection to Reuters, data disseminated in this manner may not be readily incorporated into data feeds provided by other information vendors. Each of CNQ, TSX and TSXV provides pre-trade transparency of all orders with the data disseminated through a number of information vendors. Upon launch of operations, Pure Trading intends to provide pre-trade transparency of all orders with the data disseminated through a number of information vendors.

BlockBook uses proprietary signalling to indicate to all subscribers the presence of liquidity and pricing of liquidity based on certain parameters. In the case of Liquidnet, subscribers are informed if another subscriber has a matching "indication of liquidity", following which a one-on-one negotiation of orders may take place. Reference should be made to Appendix "A" for a summary description of these features.

#### **Trade Transparency**

In accordance with the requirements of the Marketplace Operation Instrument, each marketplace must provide details of each trade to an information vendor in a timely manner. Bloomberg and Liquidnet do not provide post-trade transparency as each marketplace presently operates as an order router with orders entered on their system being executed on other marketplaces or organized regulated markets. While BlockBook and Shorcan provide post-trade transparency by means of a web-page available through Reuters, data disseminated in this manner may not be readily incorporated into data feeds provided by other information vendors. In addition, BlockBook presently disseminates trade information through TSXDatalinx though no data vendors currently offer this data other than through the web-page available through Reuters. Upon the launch by Liquidnet of trading in Canada of TSX-listed securities in Canadian funds, post-trade transparency in such securities will be provided by means of a web-page available through Reuters (in a manner similar to BlockBook and Shorcan). Each of CNQ, TSX and TSXV provides full post-trade transparency of all trades executed on their marketplace with the data disseminated through a number of information vendors. Upon launch of operations, both Pure Trading and MATCH Now intend to provide full post-trade transparency of all trades executed on their marketplace with the data disseminated through a number of information vendors.

#### **Limited Access to a Marketplace**

BlockBook limits access to its marketplace to registered dealers and qualified institutional investors that have become subscribers. In the case of each of the Exchanges, TSX, TSXV and CNQ (including the "Pure Trading" facility), access to the marketplace is limited to dealers that have become "members" of the Exchange. Shorcan limits access to its marketplace to dealers that have become subscribers and who enter orders as principal (and not as agent on behalf of clients). MATCH Now will limit access to its marketplace to registered dealers who become subscribers. Bloomberg and Liquidnet limit subscribers to "institutional investors" (other than dealers). As a result of the differences in access criteria, if a Participant is acting on behalf of a client, the Participant would not be able to access orders on Bloomberg, Liquidnet or Shorcan and, if the Participant is acting as principal, the Participant would not be able to access orders on Bloomberg or Liquidnet. A Participant that is not a subscriber to Shorcan may not jockey an order through a dealer that is a subscriber to Shorcan.

#### **Manual or Fully-Automated Marketplaces**

With the exception of Shorcan, all of the other marketplaces approved to date provide for fully-automated electronic order entry by persons with access. Each of Bloomberg and Liquidnet currently operate as order routers and do not execute or match orders on their marketplaces. Upon the launch by Liquidnet of trading in Canada of TSX-listed securities in Canadian funds, order entry will be fully automated and trading will occur based on anonymous and direct negotiations conducted electronically between subscribers. Each of BlockBook, CNQ, Pure Trading, MATCH Now, TSX and TSXV provide or will provide fully-automated order matching and trade execution (and, as such, an order entered on their trading system is electronically and immediately executable whether or not the order has been visible in a consolidated market display). On the other hand, Shorcan is a "manual" marketplace in which all orders are physically entered on the marketplace by employees of Shorcan and all "indications of interest" provided by subscribers to an employee of Shorcan must be confirmed by an employee of Shorcan before entry into the Shorcan trading system as an order.

#### **Requirements Under UMIR**

There are six rules under UMIR for which the requirement to monitor order and trade information from multiple marketplaces is most important. Rule 3.1 applies to both a Participant and an Access Person while Rules 5.1, 5.2, 5.3, 7.7 and 8.1 apply only to a Participant. As additional marketplaces develop and as the means for distributing market data on orders and trades evolves (including the possible introduction of an information processor in response to the CSA Notice), IIROC will review the rules and

<sup>1</sup> MATCH Now will provide real-time aggregate liquidity information (symbol and side) to the order routing system used by subscribers. This information will not be transparent to subscribers. However, it will provide their routing systems with an indication of those securities for which there is a reasonable likelihood that an order routed to MATCH Now will trade.

guidance provided with respect to dealing with securities trading on multiple marketplaces. **The guidance provided in this Market Integrity Notice may be further varied or altered depending upon amendments to the ATS Rules adopted following the completion of the review initiated by Concept Paper 23-403 – Developments in Market Structure and Trade-Through Obligations.**

As indicated in the “Summary of Basic Features of Current Marketplaces”, not all marketplaces provide transparency for orders entered on that marketplace and the provisions for post-trade transparency vary between marketplaces. In addition, not all marketplaces may be accessed by either Participants or Access Persons and not all marketplaces provide fully-automated order matching and trade execution. These differences in data dissemination, marketplace access and market structure impact on the steps which a Participant or Access Person must take in order to comply with UMIR.

#### **Rule 3.1 – Restrictions on Short Selling**

Rule 3.1 of UMIR provides that, subject to certain exemptions, neither a Participant nor an Access Person may make a short sale below the “last sale price”. In turn, the term “last sale price” is defined as the price of the last sale of at least one standard trading unit displayed in “a consolidated market display” but excludes the price of a trade resulting from a Basis Order, Call Market Order or Volume-Weighted Average Price Order.

In the absence of an information processor, trade information disseminated by certain marketplaces is not readily incorporated into data feeds provided by other information vendors. IIROC is of the view that a Participant or Access Person when determining the “last sale price” of a particular security may rely on trade information from the “principal market” for the trading of that security. In determining “last sale price” for the purpose of Rule 3.1 (and “last independent sale price” for the purpose of Rule 7.7), IIROC would consider a marketplace to be the “principal market” for the trading of the security if:

- trade data from the marketplace is disseminated in real-time and electronically through one or more information vendors;
- in the previous calendar year, the marketplace had the largest trading volume for that security as among the marketplaces that disseminated trade data in real-time and electronically through one or more information vendors; and
- the security continues to be traded on that marketplace.

If a security has not traded on any marketplace for at least one calendar year, IIROC would consider the “principal market” to be:

- in the case of a listed or quoted security, the marketplace on which the security was first listed or quoted and on which the security continues to trade; or
- in the case of security other than a listed security or quoted security, the marketplace on which the security was first traded and continues to trade.

As at the date of this Market Integrity Notice, the “principal market” for any listed security is the Exchange on which the security is listed subject to the following exceptions:

- XPEL Technologies Corp. which trades on the TSXV under the symbol “DAP.U” while also listed on CNQ under the symbol “XPEL” and for which the “principal market” is CNQ; and
- United Reef Limited which trades on CNQ under the symbol “URPL” while also listed on the TSXV under the symbol “URP” and for which the “principal market” is TSXV.

In the view of IIROC, the lowest price at which a Participant or Access Person may make a short sale will be the lesser of:

- the last sale price of the security on the principal market; or
- the last sale price of the security on the marketplace on which the Participant or Access Person enters the short sale order provided such trade occurred subsequent to the last sale on the principal market.

If the order for the short sale would be immediately executed on entry on a marketplace at a price which complies with Rule 3.1 due to the last sale price on the principal market, the order may be marked as “short exempt” if that marker is available on the marketplace on which the order is entered. If the order is entered on a marketplace which does not provide for the inclusion of a “short exempt” marker (such as the TSXV or CNQ), the trade should be identified as a “short sale”.

In the opinion of IIROC, MATCH Now will operate as a “Call Market” in addition to having certain features of a continuous market. As a result of this “hybrid” structure, any trade on MATCH Now will not establish the “last sale price”.

**Market Integrity Notice:** The following is the relevant text of Market Integrity Notice 2007-003 issued on February 28, 2007 under the heading “Guidance – ‘Principal Market’ Determination for 2007”.

<sup>2</sup> An exchange is a market that is registered as an “exchange” under the Exchange Act of 1933 (United States). In particular, it should be noted that an ECN, the Bulletin Board and the Pink Sheets are NOT an “exchange”

<sup>3</sup> The TSX publishes monthly a list of securities that are inter-listed with an exchange in the United States in the TSX Monthly Review.

<sup>4</sup> An exchange is a market that is registered as an “exchange” under the Exchange Act of 1933 (United States). In particular, it should be noted that an ECN, the Bulletin Board and the Pink Sheets are NOT an “exchange”.

RS initially set out its criteria for the determination of the “principal market” in Market Integrity Notice 2006-017 – Guidance – Securities Trading on Multiple Marketplaces (September 1, 2006). In determining “last sale price” for the purpose of Rule 3.1 and “last independent sale price” for the purpose of Rule 7.7, RS considers a marketplace to be the “principal market” for the trading of the security if:

- trade data from the marketplace is disseminated in real-time and electronically through one or more information vendors;
- in the previous calendar year, the marketplace had the largest trading volume for that security as among the marketplaces that disseminated trade data in real-time and electronically through one or more information vendors; and
- the security continues to be traded on that marketplace.

For securities that were listed on an Exchange on January 1, 2007, the “principal market” during 2007 is the Exchange on which the security is listed subject to the following exceptions:

- XPEL Technologies Corp. which trades on CNQ under the symbol “XPEL” while also listed on the TSXV under the symbol “DAP.U” and for which the “principal market” is TSXV; and
- United Reef Limited which trades on CNQ under the symbol “URPL” while also listed on the TSXV under the symbol “URP” and for which the “principal market” is TSXV.

For any security that was not listed or traded on a marketplace as of January 1, 2007, RS would consider the “principal market” during 2007 to be:

- in the case of a listed or quoted security, the marketplace on which the security is first listed or quoted and on which the security continues to trade; or
- in the case of security other than a listed security or quoted security, the marketplace on which the security is first traded and continues to trade.

If a security that was listed on an exchange as of January 1, 2007 “inter-lists” during the 2007 calendar year on another exchange, the exchange on which the security was listed as of January 1, 2007 will remain the “principal market” throughout 2007 provided the security continues to trade on that exchange. If the security “delists” from the original exchange, the second exchange will become the “principal market” for the balance of 2007 after the date the security is delisted from the original exchange.

**Market Integrity Notice:** The following is the relevant text of Market Integrity Notice 2007-014 issued on July 6, 2007 under the heading “Guidance – Exemption of Certain Inter-listed Securities from Price Restrictions on Short Sales”.

#### **Summary**

This Market Integrity Notice provides notice that the Investment Industry Regulatory Organization of Canada (“IIROC”) has granted, effective July 6, 2007, an exemption from the price restrictions on a short sale for the purposes of the Universal Market Integrity Rules (“UMIR”) in the case of a short sale of a listed security that is also listed on an exchange in the United States.

#### **Background**

Section 3.1 of UMIR provides that a Participant or an Access Person may not make a short sale on a marketplace unless the price is at or above the last sale price for that security or certain exceptions apply.

On June 13, 2007, the SEC approved amendments to remove the price restrictions on short sales as set out in Rule 10a-1 as well as any short sale price test of any self-regulatory organization, including the requirements of the New York Stock Exchange and Nasdaq. In addition, the amendments prohibit any self-regulatory organization from having a price test. These amendments were effective July 3, 2007 with a compliance date indicated of July 6, 2007.

Based on trading statistics of Canadian marketplaces for April of 2007, securities which are inter-listed with an exchange in the United States account for approximately 55% of the value of securities traded and approximately 30% of the volume of securities traded. In addition, approximately 25% of trades on a Canadian marketplace involve a short sale (including sales which qualify as “short exempt” from the price restrictions under Rule 3.1 of UMIR). These numbers indicate the significant extent to which trading on Canadian marketplaces may be impacted by the decision of the SEC to repeal price restrictions on short sales. In the view of IIROC, to have a markedly different standard for short sales on a marketplace as compared to trades in the same security on an organized regulated market in the United States would put marketplaces at a competitive disadvantage.

#### **Exemption from Price Restrictions on Short Sales of Certain Inter-listed Securities**

In light of the decision of the SEC to remove price restrictions on short sales, IIROC granted, effective July 6, 2007, an exemption from the price restrictions on a short sale under Rule 3.1 of UMIR in respect of securities which are inter-listed on an exchange in the United States. For the purposes of UMIR, the Toronto Stock Exchange (“TSX”), TSX Venture Exchange (“TSXV”) and CNQ currently qualify as an “Exchange”. If a security is listed on an Exchange and is also listed on an exchange in the United States, a short sale of the security may be entered on any marketplace, including an alternative trading system, that trades the security and permits the use of the “short exempt” marker. Securities which trade on an ECN in the United States but are not otherwise listed on an exchange<sup>2</sup> in the United States do not qualify for the exemption.

If a particular marketplace does not support the “short exempt” marker provided for under Rule 6.2 of UMIR, the order must be marked as “short”. In this circumstance, if the marketplace system enforces compliance with the price restrictions on short sales, the marketplace may suspend the automatic enforcement of the price restrictions on securities covered by the exemption. If a marketplace is unable to suspend the automatic enforcement of the price restrictions on securities covered by the exemption, short sales of exempt securities on that marketplace will continue to be executed at a price not less than the last sale price of the security.

In order to assist marketplaces, Participants, Access Persons and their respective service providers in giving effect to this exemption, a list of the securities which are inter-listed between the TSX and an exchange in the United States as of June 15, 2007 is attached as Appendix “A”.<sup>3</sup> [Appendix “A” is not reproduced.] A number of securities are presently inter-listed between the TSXV and an exchange in the United States. However, the TSXV does not support the “short exempt” marker and the securities are not otherwise traded on a marketplace that does support the “short exempt” marker.

**Market Integrity Notice:** The following is the relevant text of Market Integrity Notice 2007-015 issued on August 10, 2007 under the heading “**Guidance – Specific Questions Related to Trading on Multiple Marketplaces**”. Additional text is set out under Rules 2.2, 5.1, 5.2 and 7.1

#### **Questions and Answers**

The following is a list of questions regarding the obligations of a Participant or an Access Person with respect to trading in a security that trades on more than one marketplace. UMIR defines a marketplace as a recognized exchange (“Exchange”), a recognized quotation and trade reporting system (“QTRS”) or an alternative trading system (“ATS”) that carries on business in Canada.

**1. What are the procedures for the sale of a security that is subject to transfer restrictions in the United States on a marketplace that does not qualify as a “designated offshore securities market” under Regulation S of the United States Securities Act of 1933?**

Rule 904 under Regulation S (“Regulation S”) of the Securities Act of 1933 (United States) provides that, subject to certain conditions, the offer, sale or resale of securities made in an “offshore transaction” are exempt from registration with the SEC. Under Rule 904, an “offshore transaction” includes a transaction in which no offer is made to a person in the United States and the transaction is executed through the facilities of a “designated offshore securities market” provided neither the seller nor any person acting on its behalf knows that the transaction has been prearranged with a buyer in the United States. Currently, the Toronto Stock Exchange (“TSX”) and the TSX Venture Exchange (“TSXV”) are the marketplaces in Canada that qualify as a “designated offshore securities market” for the purposes of Regulation S.

Under Rule 5.2, a Participant has an obligation to make reasonable efforts to fill certain better-priced orders on a marketplace before executing a trade at an inferior price on another marketplace. (Reference should be made to Market Integrity Notice 2006-017 – Guidance – Securities Trading on Multiple Marketplaces (September 1, 2006) and Market Integrity Notice 2007-002 – Amendment Approval – Provisions Respecting Competitive Marketplaces (February 26, 2007) for a discussion of the circumstances when the “best price” obligation arises.) In the context of a Participant facilitating the sale of a US Restricted Security that trades on more than one marketplace, the Participant handling the order has an obligation to execute the trade on a marketplace with the better-priced orders before executing a trade at an inferior price on a marketplace that qualifies as a “designated offshore securities market” under Regulation S.

To the extent that a Participant trades with orders on a marketplace that does not qualify as a “designated offshore securities market”, a Participant must comply with the procedures set out in Market Integrity Notice 2005-028 – Sale of Securities Subject to Transfer Restrictions Only in the United States (July 29, 2005). As set out in that notice, an order for the sale of a US Restricted Security may be entered on a marketplace as:

- part of an intentional cross at a price between the best ask price and the best bid price when the Participant knows that the purchaser is not a resident of the United States or otherwise subject to the transfer restrictions; or
- a Special Terms Order (that is subject to the condition that the purchaser not be a resident of the United States).

Orders entered as an intentional cross at a price between the best ask price and the best bid price as indicated in a consolidated market display may be executed on a marketplace without concern about potential interference by a party who may not be qualified to acquire the securities.

If the order is entered as a Special Terms Order at a price below “better-priced” orders in a consolidated market display in respect of which the Participant owes a “best price” obligation under Rule 5.2, the Participant must contact each Participant and Access Person who has disclosed orders at a better price than the price of the Special Terms Order and offer to satisfy their orders up to the volume of the Special Terms Order provided the Participant or Access Person is eligible to purchase the US Restricted Security. If each Participant or Access Person with a better-priced order is either unwilling or unable to acquire to acquire the U.S. Restricted Security, the Special Terms Order may be executed at an inferior price with a party that is able to acquire the US Restricted Security. Reference should be made to Market Integrity Notice 2006-006 – Guidance - Sale of Securities Subject to Certain United States Securities Laws (February

17, 2006) for additional guidance on “offshore transactions” under Rule 904 of Regulation S and order marking requirements under UMIR for orders involving the sale of a U.S. Restricted Security.

**3. What is the lowest price at which a Participant or Access Person may make a short sale of securities which are inter-listed on an exchange in the United States?**

On June 13, 2007, the SEC approved amendments to Rule 10a-1 and Regulation SHO that will remove price restrictions on short sales as set out in Rule 10a-1 as well as any short sale price test of any self-regulatory organization. In addition, the amendments will prohibit any self-regulatory organization from having a price test. These amendments became effective July 3, 2007 with a compliance date of July 6, 2007.

In light of the decision of the SEC to remove price restrictions on short sales, IIROC published Market Integrity 2007-014 – Guidance – Exemption of Certain Inter-Listed Securities from Price Restrictions on Short Sales (July 6, 2007) which granted, effective July 6, 2007, an exemption from the price restrictions on a short sale under Rule 3.1 of UMIR in respect of securities which are inter-listed on an exchange in the United States. For the purposes of UMIR, the Toronto Stock Exchange (“TSX”), TSX Venture Exchange (“TSXV”) and CNQ currently qualify as an “Exchange”. If a security is listed on an Exchange and is also listed on an exchange in the United States, a short sale of the security may be entered on any marketplace, including an ATS, which trades the security and permits the use of a “short exempt” marker. Securities which trade on an ECN in the United States but are not otherwise listed on an exchange<sup>4</sup> in the United States do not qualify for the exemption.

If a particular marketplace does not support the “short exempt” marker provided for under Rule 6.2 of UMIR, the order must be marked “short”. In this circumstance, if the marketplace system enforces compliance with the price restrictions on short sales, the marketplace may suspend the automatic enforcement of the price restrictions on securities covered by the exemption. If a marketplace is unable to suspend the automatic enforcement of the price restrictions on securities covered by the exemption, short sales of exempt securities on that marketplace will continue to be executed at a price not less than the last sale price of the security (see question 4 below).

**4. What is the lowest price at which a Participant or Access Person may make a short sale of securities which are not inter-listed on an exchange in the United States?**

Rule 3.1 of UMIR provides that, subject to certain exemptions, neither a Participant nor an Access Person may make a short sale below the “last sale” price. In turn, the term “last sale price” is defined as the price of the last sale of at least one standard trading unit displayed in a “consolidated market display”. As set out in Market Integrity Notice 2006-017 – Guidance – Securities Trading on Multiple Marketplaces (September 1, 2006), IIROC is of the view that, in the context of a security that trades on more than one marketplace, the lowest price at which a Participant or Access person may make a short sale will be the lesser of:

- the last sale price of the security on a principal market; or
- the last sale price of the security on the marketplace on which the Participant or Access Person enters the short sale order provided such trade occurred subsequent to the last sale on the principal market.

The following assumption and chart provides the basis for the two examples below:

Assume that a particular security is listed on an Exchange that is the “principal market” and on two ATSs.

Marketplace	Bid Price	Ask Price	Last Sale	Time of Last Sale
Principal Market	\$9.90	\$10.10	\$10.00	11:15 a.m.
ATS 1	\$9.90	\$10.20	\$9.90	11:05 a.m.
ATS 2	\$9.89	\$10.20	\$10.05	10:15 a.m.

**Example 1:** A Participant wishes to enter an order to sell shares “short” at the lowest possible price. The lowest price at which a Participant or Access Person would be able to enter a short sale on any of the above marketplaces would be \$10.00 (being the “last sale price” on the Principal Market). The “last sale prices” on ATS 1 and ATS 2 were established prior to the last sale on the Principal Market, and as such, do not set the short sale price.

**Example 2:** Assume that all factors remain unchanged, however the last sale on ATS 1 (\$9.90) is more recent (11:20 a.m.).

A Participant or Access Person would be able to enter a short sale on:

- the Principal Market at \$10.00 (being the “last sale price” on that marketplace);
- ATS 1 at \$9.90 (as the last sale price on ATS 1 was established subsequent to the last sale on the Principal Market); and
- ATS 2 at \$10.00 (as the \$10.05 last sale on ATS 2 was prior to the \$10.00 last sale on the Principal Market).

**Market Integrity Notice:** The following is the relevant text of Market Integrity Notice 2008-002 issued on January 11, 2008 under the heading "Guidance – 'Principal Market' Determination for 2008".

**Determination of "Principal Market"**

IIROC initially set out its criteria for the determination of the "principal market" in Market Integrity Notice 2006-017 – Guidance – Securities Trading on Multiple Marketplaces (September 1, 2006). In determining "last sale price" for the purpose of Rule 3.1 and "last independent sale price" for the purpose of Rule 7.7, IIROC considers a marketplace to be the "principal market" for the trading of the security if:

- trade data from the marketplace is disseminated in real-time and electronically through one or more information vendors;
- in the previous calendar year, the marketplace had the largest trading volume for that security as among the marketplaces that disseminated trade data in real-time and electronically through one or more information vendors; and
- the security continues to be traded on that marketplace.

For securities that were listed on an Exchange on January 1, 2008, the "principal market" during 2008 is the Exchange on which the security is listed subject to the following exceptions:

- Roxmark Mines Limited, which is listed on CNQ under the symbol "RMKL" while also listed on TSXV under the symbol "RMK and for which the "principal market" is TSXV; and
- United Reef Limited which trades on CNQ under the symbol "URPL" while also listed on the TSXV under the symbol "URP" and for which the "principal market" is TSXV.

For any security that was not listed or traded on a marketplace as of January 1, 2008, IIROC would consider the "principal market" during 2008 to be:

- in the case of a listed or quoted security, the marketplace on which the security is first listed or quoted and on which the security continues to trade; or
- in the case of security other than a listed security or quoted security, the marketplace on which the security is first traded and continues to trade.

If a security that was listed on an exchange as of January 1, 2008 "inter-lists" during the 2008 calendar year on another exchange, the exchange on which the security was listed as of January 1, 2008 will remain the "principal market" throughout 2008 provided the security continues to trade on that exchange. If the security "delists" from the original exchange, the second exchange will become the "principal market" for the balance of 2008 after the date the security is delisted from the original exchange.

**Disciplinary Proceedings:** **In the Matter of Salman Partners Inc. ("Salman"), Sameh Magid ("Magid"), William Burk ("Burk") and Ian Todd ("Todd") (February 18, 2005) SA 2005-001**

*Facts – Between April 1, 2002 and July 30, 2002, Salman engaged in a paired trading strategy with one of its institutional clients which it erroneously believed constituted arbitrage trading. The arrangement did not in fact constitute arbitrage trading for the purposes of UMIR, and as such, the trades entered as part of the strategy did not benefit from the various exemptions provided for under UMIR, and caused Salman to violate numerous UMIR provisions. In April 2002, Salman engaged in trading in a second issuer that resulted in certain transactions being recorded off-market when those transactions ought to have been posted on an exchange. Finally, in another trade, Salman failed to properly supervise a trader's attempt to cover a short position in an issuer when a client submitted a buy order in the same security. Throughout these events, Salman failed to maintain a proper audit trail for their order flow.*

*Disposition – Salman failed to develop and implement appropriate policies and procedures to fulfill its compliance and supervisory obligations in relation to its trading on marketplaces regulated by RS, including failing to ensure that employees with supervisory responsibilities had clearly defined roles and responsibilities and that audit trail requirements were complied with. Several senior officers were found to have failed in their supervisory responsibilities as well.*

*Requirements Considered – Rules 3.1, 5.3(6), 6.2(1)(b)(viii) and (x), 6.4, 7.1 and 10.11(1) and Policy 7.1*

*Sanction -*

<i>Salman Partners Inc. -</i>	<i>\$600,000 fine and costs of \$90,000</i>
<i>Sameh Magid -</i>	<i>\$80,000 fine and costs of \$15,000; personal undertakings</i>
<i>William Burk -</i>	<i>\$30,000 fine</i>
<i>Ian Todd -</i>	<i>\$30,000 fine</i>

**Proposed Amendments:**

*For information on the current proposed amendment to Rule 3.1 and Policy 3.1 of UMIR – Short Selling, refer to Market Integrity Notice 2007-017 – Request for Comments - Provisions Respecting Short Sales and Failed Trades (September 7, 2007) which includes the following proposed amendments:*

2. *Rule 3.1 is deleted and the following substituted:*

*A Participant or Access Person shall not enter an order to sell a security on a marketplace that on execution would be a short sale:*

*(a) unless the order is marked as a short sale in accordance with subclause 6.2(1)(b)(viii); or*

*(b) if the security is a Short Sale Ineligible Security at the time of the entry of the order.*

3. *Policy 3.1 is deleted.*