

PART 5 – BEST EXECUTION OBLIGATION

5.1 Best Execution of Client Orders

A Participant shall diligently pursue the execution of each client order on the most advantageous terms for the client as expeditiously as practicable under prevailing market conditions.

POLICY 5.1 – BEST EXECUTION OF CLIENT ORDERS

"Best execution" refers to a reasonable period of time during which the order is handled, not merely the precise moment in time that it is executed. The price of the principal transaction must also be justified by the condition of the market. Participants should consider such factors as:

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

For example, if the market is \$10 bid and \$10.50 asked and a client wants to sell 1000 shares, it would be inappropriate for a Participant to do a principal trade at \$10.05 if the security has been trading heavily at \$10.50 and there is strong bidding for the security at \$10 compared to the number of securities being offered at \$10.50. The condition of the market suggests that the client should be able to sell at a better price than \$10.05. Accordingly, the Participant as agent for the client should post an offer at \$10.45 or even \$10.50, depending on the circumstances. The desire of the client to obtain a fill quickly is always a consideration.

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

Part 2 – Factors to be Considered

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

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

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

Defined Terms:	NI 21-101 – section 1.1 – “order” UMIR section 1.1 – “client order”, “consolidated market display”, “foreign organized regulated market”, “Market Regulator”, “marketplace” and “Participant”
Regulatory History:	Effective March 9, 2007, the applicable securities commissions approved an amendment to Policy 5.1 to add Part 2. Effective May 16, 2008, the applicable securities commissions approved an amendment to Part 2 of Policy 5.1 to replace the phrase “organized regulated markets outside of Canada” with “foreign organized regulated markets”.
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 3.1, 5.2, 5.3, 7.7 and 8.1:
Rule 5.1 – Best Execution of Client Orders	
<p>The obligation to monitor information on orders entered on and trades executed on marketplaces trading the same security falls to the Participant handling the client order. Neither UMIR nor the ATS Rules requires a Participant to maintain trading access to every Canadian marketplace on which a security may trade. However, with the publication of the CSA Notice, the CSA has clarified their requirement that each Participant will take into account order and trade information from all marketplaces that trade the same securities when discharging their best execution obligations. As set out in the CSA Notice, the CSA expects that a Participant will make arrangements with another dealer who is a participant of a particular marketplace or will directly route an order to a particular marketplace, where appropriate. In the view of IIROC, a Participant would be expected to make such arrangements if the particular marketplace had demonstrated that there is a reasonable likelihood that the marketplace will have liquidity for a specific security relative to the size of the client order.</p> <p>IIROC is also of the view that a Participant in discharging its best execution obligation should consider possible liquidity on marketplaces that do not provide transparency of orders in a consolidated market display, such as BlockBook and MATCH Now, if:</p> <ul style="list-style-type: none"> • <i>the displayed volume in the consolidated market display is not adequate to fully execute the client order on advantageous terms for the client; and</i> • <i>the non-transparent marketplace has demonstrated that there is a reasonable likelihood that the marketplace will have liquidity for the specific security.</i> <p>As originally set out in Market Integrity Notice 2005-015 – Guidance – Complying with “Best Price” Obligations, IIROC is of the opinion that a Participant may have an obligation to consider execution opportunities in special trading facilities of a marketplace if the price at which such trades will execute in such special facilities is a better price than available on another marketplace. For example, both BlockBook and Shorcan offer facilities to “discover” additional volume at the price of the last trade on their market. In the case of BlockBook this facility is known as the “Follow-on Auction” and on Shorcan the facility is known as the “Trade Expansion Protocol”. Reference should be made to Appendix “A” for a summary description of these facilities.</p> <p>If a Participant in handling various “Good Till Cancelled” orders on behalf of clients has entered the orders on a marketplace that has closed for trading on a particular day, IIROC would not expect that the Participant would move the orders “en masse” to a marketplace that continues to trade those securities. In considering best execution of the client orders, the Participant must weigh the possible loss of priority against the likelihood of execution opportunities. Nonetheless, IIROC would expect that the Participant would continue to monitor trading opportunities on those marketplaces that are open for trading and would enter appropriate orders if the client orders would trade with orders displayed on the marketplace that continues to trade.</p>	

A Participant does not have to consider as part of its best execution obligation of a client order any marketplace to which dealers are not eligible to have trading access. If a marketplace limits access to dealers trading as principal, IIROC would permit a Participant to execute a trade on that marketplace as principal and then to unwind the position taken on as principal in a transaction with a client order on another marketplace without such transactions being considered “double printing” contrary to Rule 2.2 of UMIR on manipulative and deceptive activities.

Participants are reminded that they may have other legal obligations (including applicable securities law requirements or common law) to their clients that may require them, in certain circumstances, to consider other marketplaces and organized regulated markets that may not otherwise be required by Rule 5.1 of UMIR.

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, 3.1, 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.

7. Is a Participant required to consider organized regulated markets outside of Canada as part of “best execution” obligation?

IIROC published Market Integrity Notice 2007-002 – Amendment Approval – Provisions Respecting Competitive Marketplaces (February 26, 2007) which contained a series of amendments to UMIR, including additional factors that IIROC would consider when determining whether a Participant has diligently pursued the best execution of a client order. One of the additional factors to be considered is whether a Participant has considered organized regulated markets outside of Canada (particularly if the principal market for the security is outside of Canada) in handling of a client order. The addition of the factor to consider organized regulated markets outside of Canada as part of best execution of a client order parallels a provision on best execution contained in the Companion Policy to the CSA Trading Rules.¹

To the extent that a foreign market is considered in order to provide a client with “best execution” in accordance with Rule 5.1, the Participant would nonetheless have an obligation to better-priced orders on Canadian marketplaces under the “best price” obligation under Rule 5.2.

10. What are the specific risks to a Participant in accepting an “All-or-None” client order in a multiple marketplace environment?

Rule 5.1 of UMIR requires a Participant to diligently pursue the execution of each client order on the most advantageous terms for the client as expeditiously as practicable under prevailing market conditions. To the extent that a Participant accepts “All-or-None” orders from clients, IIROC expects a Participant to adopt policies and procedures with respect to the handling of such client orders and inform its clients of such policy, including the implications and risks (i.e. partial fills) associated with the use of an “All-or-None” order. If a Participant has not informed clients of the Participant’s policy on the handling of “All-or-None” orders, IIROC would expect that the Participant will handle an “All-or-None” order in conformity with client instructions.

If a Participant, in handling an “All-or-None” order assumes the risk of a partial fill, that is, any unfilled portion of the client order is filled to the client out of the Participant’s error account, or the partial fill is re-allocated into the Participant’s error account, such orders continue to be considered a client order, and must continue to be properly marked “client”.

If an “All-or-None” order is “triggered” and trades-through a better-priced order on a marketplace, IIROC would consider the trade to be a violation of Rule 5.2. A violation of Rule 5.2 would occur even if the marketplace with the better-priced order does not display sufficient volume at a better price to fully satisfy the “All-or-None” order. In light of the risk of “best price” obligations posed by the use of “All-or-None” orders, IIROC expects a Participant to have a clear understanding of the manner in which the marketplace handles “All-or-None” orders and that the Participant will take appropriate steps to fulfill any “best price” obligations.

Market Integrity Notice: The following is the relevant text of Market Integrity Notice 2007-019 issued on September 21, 2007 under the heading “**Guidance – Entering Client Orders on Non-Transparent Marketplaces and Facilities**”. Additional text is set out under Rules 5.2, 5.3, and 6.3:

¹ Companion Policy 23-101CP, ss 4.1(3). The text of that subsection provides:

For inter-listed securities, the Canadian securities regulatory authorities are of the view that in making reasonable efforts, a dealer should consider whether it would be appropriate in the particular circumstances to look at markets outside of Canada.

Summary

This Market Integrity Notice provides guidance on the application of the best execution, client priority and order exposure requirements of the Universal Market Integrity Rules (“UMIR”) to the entry of client orders on marketplaces and facilities of marketplaces that do not disseminate information on orders to information vendors.

Background

Part 7 of National Instrument 21-101 - Marketplace Operation (the “Marketplace Operation Instrument”) provides that a marketplace that displays orders to any person shall provide accurate and timely information regarding orders to the information processor, if any, or an information vendor. A marketplace need not distribute order information to the information processor or an information vendor if the marketplace does not make details of orders available to persons other than those retained to assist in the operation of the marketplace. As at September 7, 2007, the equity marketplaces that are:

- “transparent” marketplaces which disclose order information are: the Toronto Stock Exchange (“TSX”), the TSX Venture Exchange and CNQ, including Pure Trading; and
- “non-transparent” marketplaces which do not disclose order information are: BlockBook, Liquidnet, and MATCH Now.

In the near future, the TSX intends to enable the “community matching” features of its pre-trade matching facility known as “Alternative Trade eXecution” (“ATX”). Under the “community matching” feature of ATX, a non-transparent “intent” entered by a Participant that participates in ATX may match with intents entered by other Participants or with order flow that is destined for entry in the central limit order book of the TSX. Any “match” in ATX must occur between the best ask price and the best bid price as displayed in a consolidated market display (comprised of all “transparent” marketplaces trading the particular security). The match is reported to the TSX and executed in the central limit order book at a price that is then at or between the best ask price and best bid price. One of the features of ATX allows “intents” from a particular account to be assigned to a “priority allocation group” (“PAG”) that will determine the order in which the intents will match.

None of BlockBook, Liquidnet or MATCH Now provides pre-trade transparency as contemplated by Part 7 of the Marketplace Operation Instrument of any orders entered on their marketplace (through the provision of order information to information vendors for dissemination). BlockBook uses proprietary signalling to indicate to all subscribers the presence 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. None of BlockBook, Liquidnet or MATCH Now provides a mechanism for orders to be assigned different priorities for execution outside of the priorities established by the operating model of the respective marketplace.

For a summary comparison of the basic features of each marketplace, reference should be made to the chart available through the IIROC homepage at www.iirocs.ca under the heading “Markets We Regulate”. For more detailed guidance on the application of UMIR to trading on multiple marketplaces, reference should be made to:

- Market Integrity Notice 2006-017 – Guidance – Securities Trading on Multiple Marketplaces (September 1, 2006);
- Market Integrity Notice 2006-020 – Guidance – Compliance Requirements For Trading On Multiple Marketplaces (October 30, 2006); and
- Market Integrity Notice 2007-015 – Guidance – Specific Questions Related to Trading on Multiple Marketplaces (August 10, 2007).

Questions and Answers

The following are the most frequently asked questions regarding the obligations of a Participant when entering a client order on a non-transparent marketplace or facility and the responses of IIROC to each:

2. Are there circumstances when the “best execution” obligation would require a Participant to consider a “non-transparent” marketplace or facility?

Rule 5.1 of UMIR requires a Participant to diligently pursue the execution of each client order on the most advantageous terms for the client as expeditiously as practicable under prevailing market conditions. IIROC is of the view that a Participant in discharging its best execution obligation should consider possible liquidity on marketplaces that do not provide transparency of orders in a consolidated market display, such as BlockBook and MATCH Now, if:

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

As access to Liquidnet is limited to institutions other than dealers, a Participant would not have an obligation to consider Liquidnet or any other marketplace to which the Participant could not otherwise, directly or indirectly, obtain access to trade as agent.

6. Is an “intent” entered into ATX considered to be an “order” for the purpose of UMIR?

While the rules of the TSX refer to “active intents” and “passive intents” entered into the ATX facility (principally to avoid confusion with respect to orders entered into the central limit order book of the TSX), these “intents” are a firm indication of a willingness to buy or sell a security that may be executed. As such, an “intent” entered into the

ATX facility is considered an “order” for the purposes of Marketplace Operation Instrument and UMIR (and a client order entered on ATX as an “intent” will be monitored by IIROC and subject to review as part of a trade desk review undertaken by IIROC of a Participant).

Nonetheless, ATX is a “matching facility” rather than a marketplace. Any match of an order or active intent with a passive intent in ATX does not constitute a trade. The match only becomes a trade when executed in the trading engine of the TSX. As such, the critical point in time for the purposes of the application of certain UMIR provisions dealing with “trades” will be at the execution of the trade in the central limit order book of the TSX.

Disciplinary Proceedings: **In the Matter of TD Securities Inc. (“TDSI”) (July 5, 2006) DN 2006-007**

Facts – Between December 2003 and January 2005, TDSI on numerous occasions failed to transmit retail client orders to Dealer A, a CNQ Market Maker, for entry onto the CNQ marketplace. TDSI held back client orders that were either not immediately tradeable or which remained outside the posted quote until expiry, including orders for less than 50 standard trading units. Such orders expired unfilled without ever being entered onto CNQ. It was also found that TDSI failed to maintain a complete audit trail relating to these orders.

Disposition – TDSI failed to meet its obligations under several provisions of UMIR in relation to the handling, trading, compliance and supervision of retail client orders for CNQ listed securities. In failing to adequately consider and plan with supervisory, compliance and trading staff an appropriate method of handling and monitoring client orders for CNQ, TDSI failed to fulfill its best execution and order exposure obligations to clients in respect of some CNQ orders. In failing to adopt adequate policies and procedures to be followed by its employees TDSI failed to fulfill its supervisory obligations under UMIR.

Requirements Considered – Rules 5.1, 6.3(1), 10.11(1), 10.12(1), 7.1(1) and Policy 7.1

Sanctions - \$350,000 fine and costs of \$80,000

Proposed Amendments: For information on the current proposed amendments to Rule 5.1 and Policy 5.1 of UMIR – Best Execution of Client Orders, refer to Market Integrity Notice 2007-008 – Requests for Comments - Provisions Respecting Best Execution (April 20, 2007) which includes the following proposed amendments:

1. Rule 5.1 is deleted and the following substituted.

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

1. Policy 5.1 is deleted and the following substituted:

Part 1 – General Factors to be Considered

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

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

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

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

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

- liquidity of the security.

Part 2 – Specific Factors to be Considered

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

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

Part 3 – Consideration of Organized Regulated Markets

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

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

Part 4 – Subject to Best Price Obligation

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