

### 5.3 Client Priority

- (1) A Participant shall not enter on a marketplace or an organized regulated market a principal order or a non-client order of the Participant that, based on the information known or reasonably available to the person or persons originating or entering the principal order or non-client order, the Participant knows or should have known will execute or have a reasonable likelihood of executing in priority to a client order received by the Participant prior to the entry of the principal order or non-client order for the same security that is:
  - (a) at the same price or a lower price than the client order in the case of a purchase or the same or a higher price than the client order in the case of a sale; and
  - (b) on the same side of the market.
  
- (2) Despite subsection (1) but subject to Rule 4.1, a Participant is not required to give priority to a client order if:
  - (a) the client specifically has consented to the Participant entering principal orders and non-client orders for the same security at the same price on the same side of the market on the same settlement terms;
  - (b) the principal order or non-client order is:
    - (i) automatically generated by the trading system of an Exchange or QTRS in accordance with the Marketplace Rules in respect of the applicable Market Maker Obligations,
    - (ii) automatically generated by a system operated by the Participant or on behalf of the Participant based on pre-determined order and trading parameters established, programmed and enabled for trading prior to the receipt of the client order,
    - (iii) for a managed account and the client order is for a managed account under the direction of the same person and in respect of which executions are allocated between the various managed accounts on an equitable basis in accordance with the established practices of the Participant, or
    - (iv) a Basis Order;
  - (c) the client order has been entered directly by the client of the Participant on a marketplace;
  - (d) the principal order or non-client order is executed pursuant to an allocation by the trading system of a marketplace and:
    - (i) either:
      - (A) the security which is the subject of the order trades on no marketplace other than that marketplace,

- (B) the principal order or non-client order is a Call Market Order, an Opening Order, a Market-on-Close Order or a Volume-Weighted Average Price Order,
  - (C) each of the client order and the principal order or non-client order was entered on the same marketplace,
  - (D) the client has instructed the Participant to enter the client order on a particular marketplace, or
  - (E) the client has instructed the Participant to enter the client order in a manner that does not disclose the identifier of the Participant in a consolidated market display,
- (ii) the client order was entered by the Participant on that marketplace immediately upon receipt by the Participant, and
  - (iii) if the client order was varied or changed by the Participant at any time after entry, the variation or change was on the specific instructions of the client;
- (e) either the client order or the principal order or non-client order is a Special Terms Order and the client order would not have executed in the transaction or transactions involving the principal order or non-client order due to the terms and conditions of at least one Special Terms Order; or
  - (f) a Market Integrity Official requires or permits the principal order or non-client order to be executed in priority to a client order.
- (3) For the purposes of clause (2)(a), a client shall be deemed to have consented to the Participant entering principal orders and non-client orders for the same security at the same price on the same side of the market on the same conditions and settlement terms if the client order, in accordance with the specific instructions of the client, is to be executed in part at various times during the trading day or at various prices during the trading day.

## **POLICY 5.3 – CLIENT PRIORITY**

### **Part 1 – Background**

*Rule 5.3 restricts a Participant and its employees from trading in the same securities as a client of the Participant. The restriction is designed to minimize the conflict of interest that occurs when a Participant or its employee compete with the firm's clients for execution of orders. The Rule governs:*

- *trading ahead of a client order, which is taking out a bid or offering that the client could have obtained had the client order been entered first. By trading ahead, the pro order obtains a better price at the expense of the client order.*
- *trading along with a client, or competing for fills at the same price.*

*The application of the rule can be quite complex given the diversity of professional trading operations in many firms, which can include such activities as block facilitation, market making, derivative and arbitrage trading. In addition, firms may withhold particular client orders in order*

to obtain for the client a better execution than the client would have received if the order had been entered directly on a marketplace. Each firm must analyze its own operations, identify risk areas and adopt compliance procedures tailored to its particular situation.

**A Participant has overriding agency responsibilities to its clients and cannot use technical compliance with the rule to establish fulfillment of its obligations if the Participant has not otherwise acted reasonably and diligently to obtain best execution of its client orders.**

## **Part 2 – Prohibition on Intentional Trading Ahead**

A Participant can never intentionally trade ahead of a client order that is either a market order or tradeable limit order received prior to the entry of the principal order or non-client order except in accordance with an exemption from the requirements of Rule 5.3(1), which exemptions include obtaining the specific consent of the client. Examples of "intentional trades" include, but are not limited to:

- withholding a client order from entry on a marketplace (or removing an order already entered on a marketplace) to permit the entry of a competing principal or non-client order ahead of the client order;
- entering a client order on a relatively illiquid market (other than on the instructions of the client) and entering a principal or non-client order on a more liquid marketplace where the principal or non-client order is likely to obtain faster execution;
- adding terms or conditions to a client order (other than on the instructions of the client) so that the client order ranks behind principal or non-client orders at that price;
- putting terms or conditions on a principal or non-client order for the purpose of differentiating the principal or non-client order from a client order that would otherwise have priority at that price; and
- entering a principal order or non-client order as an "anonymous order" (without the identifier of the Participant) which results in an execution in priority to a previously entered client order that discloses the identifier of the Participant.

## **Part 3 – No Knowledge of Client Order**

The Participant must have reasonable procedures in place to ensure that information concerning client orders is not used improperly within the firm. These procedures will vary from firm to firm and no one procedure will work for all firms. If a firm does not have reasonable procedures in place, it cannot rely on the exceptions. Reference should be made to Policy 7.1 – Policy on Trading Supervision Obligations, and in particular Part 4 – Specific Procedures Respecting Client Priority and Best Execution.

If a client has instructed a Participant to withhold an order or has granted a Participant discretion with respect to the entry of an order, details of the instruction or grant of discretion must be retained for a period of seven years from the date of the instruction or grant of discretion and, for the first two years, the consent must be kept in a readily accessible location.

## Part 4 – Client Consent

A Participant does not have to provide priority to a client order if the client specifically consents to the Participant trading alongside or ahead of the client. The consent of the client must be specific to a particular order and details of the agreement with the client must be noted on the order ticket. A client cannot give a blanket form of consent to permit the Participant to trade alongside or ahead of any future orders the client may give the Participant.

If the client order is part of a pre-arranged trade that is to be completed at a price below the best bid price or above the best ask price as indicated on a consolidated market display, the Participant will be under an obligation to ensure that “better-priced” orders on a marketplace are filled prior to the execution of the client order. Prior to executing the client order, the Participant must ensure that the client is aware of the better-priced orders and has consented to the Participant executing as against them in priority to the client order. The consent of the client must be noted on the order ticket.

If the client has given the Participant an order that is to be executed at various times during a trading day (e.g. an “over-the-day” order) or at various prices (e.g. at various prices in order to approximate a volume-weighted average price), the client is deemed to have consented to the entry of principal and non-client orders that may trade ahead of the balance of the client order. Unless the client has provided standing written instructions that all orders are to be executed at various times during the trading day or at various prices during the trading day, the client instructions should be treated as specific to a particular order and the details of the instructions by the client must be noted on the order ticket. However, if the un-entered portion of the client order would reasonably be expected to affect the market price of the security, the Participant may be precluded from entering principal or non-client orders as a result of the application of the frontrunning rule.

In certain circumstances, a client may provide a conditional consent for the Participant to trade alongside or ahead of the client order. For example, a client may consent to a principal order of Participant sharing fills with the client order provided the client order is fully executed by the end of the trading day. If the client's order is not fully executed, the client may expect that the Participant “give up” its fills to the extent necessary to complete the client order. In this situation, the Participant should mark its orders as “principal” throughout the day. Any part of the execution which is given up to the client should not be re-crossed on a marketplace but should simply be journalled to the client (since the condition of the consent has not been met, the fills in question could be viewed as properly belonging to the client rather than the principal order). To the extent that a Participant “gives up” part of a fill of a principal order to a client based on the conditional consent, the Participant shall report the particulars of the “give up” to the Market Regulator not later than the opening of trading on marketplaces on the next trading day. The conditional consent of the client must be specific to a particular order. The details of the agreement with the client must be noted on the order ticket.

**Defined Terms:** NI 21-101 section 1.1 – “order”

UMIR section 1.1 – “Basis Order”, “Call Market Order”, “client order”, “consolidated market display”, “employee”, “Exchange”, “Market Integrity Official”, “Market Maker Obligations”, “Market-on-Close Order”, “marketplace”, “Marketplace Rules”, “non-client order”, “Opening Order”, “Participant”, “principal order”, “QTRS”, “Special Terms Order”, “trading day” and “Volume-Weighted Average Price Order”

UMIR section 1.2(2) – “trade”

**Related Provisions:** UMIR section 4.1

**Regulatory History:** Effective May 26, 2006, the applicable securities commissions approved amendments to repeal and replace Rule 5.3 and Policy 5.3. Prior to that date, Rule 5.3 and Policy provided:

### **5.3 Client Priority**

- (1) A Participant shall give priority to its client orders over all of its non-client or principal orders in the same security and on the same side of the market, unless the non-client or principal order is executed at a price above the client's limit price (for a buy order) or below the client's limit price (for a sell order).
- (2) A Participant shall give priority to its client market orders over its non-client or principal orders in the same security and on the same side of the market.
- (3) Subsections (1) and (2) shall not apply to allocations made by a trading system of a marketplace, provided that any client orders of the Participant were entered immediately upon receipt by the Participant and were not subsequently changed or removed from the system (other than changes or removals made on the instruction of the client).
- (4) Subsections (1) and (2) shall not apply to client orders where the client has specifically given the Participant discretion with respect to execution of an order or where the Participant is making a bona fide attempt to obtain best execution for a client order, provided that no director, officer, partner, employee or agent of the Participant with knowledge of open client orders for a security that have not been fully executed enters a non-client or principal order on the same side of the market in such security.
- (5) Subsections (1) and (2) shall not apply with respect to a particular client order where the client has specifically consented to the Participant trading ahead or alongside that order.
- (6) The Participant shall record the specific consent referred to in subsection (5) on the order ticket.
- (7) The exemptions in subsections (3), (4) and (5) shall not apply unless the Participant has implemented a reasonable system of internal policies and procedures to ensure compliance with this Rule and to prevent misuse of information about client orders.
- (8) Subsections (1) and (2) shall not apply to a client order that has been entered directly by the client of the Participant on a marketplace that does not require the disclosure of the identifier of the Participant in a consolidated market display and the director, officer, partner, employee or agent of the Participant who enters a principal order or a non-client order does not have knowledge that the client order is from a client of the Participant until the execution of the client order.

### **POLICY 5.3 – CLIENT PRIORITY**

#### **Part 1 – Background**

Rule 5.3 restricts Participants and their employees from trading in the same securities as their clients in order to minimize the conflict of interest that occurs when a firm or a pro trader competes with the firm's clients for executions.

The Rule governs two types of activities. The first is trading ahead of a client order, which is taking out a bid or offering that the client could have obtained had the client order been entered first. By trading ahead, the pro order obtains a better price at the expense of the client order.

The second activity governed by the rule is trading along with a client, or competing for fills at the same price.

The application of the rule can be quite complex given the diversity of professional trading operations in many firms, which can include such activities as block facilitation, market making, derivative and arbitrage trading. In addition, firms may withhold particular client orders in order to obtain for the client a better execution than the client would have received if the order had been entered directly on a marketplace. Each firm must analyze its own operations, identify risk areas and adopt compliance procedures tailored to its particular situation.

#### **Part 2 – Broker's Legal Obligations**

Agency law imposes certain obligations on those who act on behalf of others. Among those obligations is a prohibition on an agent appropriating for itself an opportunity that could go to the principal (client) unless the principal specifically consents.

At common law, the client can consent to the Participant trading ahead or alongside. Such consent must be specific to an order, and not contained in a general consent in a client account agreement. For example, an institutional client may consent to splitting fills with the Participant or may consent to the Participant trading ahead in order to move the market to the agreed-upon price for a block trade (e.g. permitting the Participant as pro to move the market down to the price at which it will buy a block from the client).

Participants have overriding agency responsibilities to their clients and cannot use technical compliance with the rule to establish fulfillment of their obligations if they have not otherwise acted reasonably and diligently to obtain best execution of their client orders. Firms should obtain legal advice that their own order handling procedures comply with their obligations to their clients.

### **Part 3 – Prohibition on Intentional Trading Ahead**

Rule 5.3 provides that a Participant must give priority of the execution to client orders, subject to certain exceptions necessary to ensure overall efficiency of order handling. The Rule contains an exception for allocations in a trading system provided that the firm enters client orders immediately and does not interfere with the system allocation in any way. The rationale is that a pro who has committed to the marketplace ahead of a client is not taking a trading opportunity from the client as the client's trading opportunity does not arise until he or she gives an order.

The Rule also contains an exception where a client order has been withheld in a bona fide attempt to get better execution for the client, provided that any pro who is trading ahead of the client order does not have knowledge of that order and that the firm has reasonable procedures in place to ensure that information concerning client orders is not used improperly within the firm. These procedures will vary from firm to firm and no one procedure will work for all firms.

A Participant cannot intentionally obtain execution of a pro order ahead of a client order without the specific consent of the client, unless the trade is at a better price than the client's limit. A Participant can never intentionally trade ahead of a client market or tradeable limit order without the specific consent of the client. Such consent must be specific to a particular order, and details of the agreement with the client must be noted on the order ticket.

Examples of "intentional trades" include, but are not limited to:

- withholding a client order from entry on a marketplace (or removing an order already entered on a marketplace) to permit the entry of a competing pro order ahead of the client order;
- entering a client order in a relatively illiquid market and entering a pro order in a more liquid marketplace where the pro order is likely to obtain faster execution; and
- adding terms to an order (other than on the instructions of the client) so that the order ranks behind pro orders in the regular market at that price.

### **Part 4 – No Knowledge of Client Order**

Rule 5.3 also contains two exceptions that requires that the director, officer, partner, employee or agent of the Participant who enters the principal order or the non-client order be unaware that the client order has not been entered. The two exceptions are:

- if the client specifically grants discretion to the Participant with respect to the entry of the order; and
- if the Participant withholds the client order from entry in a bona fide attempt to get better execution for the client.

In these circumstances, the Participant must have reasonable procedures in place to ensure that information concerning client orders is not used improperly within the firm. These procedures will vary from firm to firm and no one procedure will work for all firms. If a firm does not have reasonable procedures in place, it cannot rely on the exceptions in subsections (3), (4) and (5) of Rule 5.3. Reference should be made to Policy 7.1 – Policy on Trading Supervision Obligations.

The procedures must address the handling of client orders and must be followed up by after-the-fact monitoring. At a minimum, these procedures, which must be documented, must include:

- Education of all traders in their responsibilities in handling client orders. In particular, traders must be informed that intentionally trading ahead of a client order is prohibited and will result in disciplinary action against the trader.
- Identification of particular areas within the firm where there is a risk of non-compliance. For many firms this would include:
  - the point at which the order is taken (e.g. a branch or institutional desk);
  - the points at which orders are managed (e.g. an OMS trader or retail special handling desk); and
  - areas of the firm that are in proximity to areas where orders are handled.
- After-the-fact reviews of trading must also be conducted. Client complaints must be documented and followed-up. On a monthly basis (at a minimum) the firm must compare execution of a reasonable sample of non-client orders with contemporaneous client orders in the same security on the same side of the market. A Participant will be expected to investigate instances where it appears that a pro may have traded with knowledge of a client order prior to its entry on a marketplace.

Periodically the firm must review its procedures to ensure that they are appropriate to ensure that the firm is meeting both the requirements of Rule 5.3 and its agency obligation to clients.

#### **Part 5 –Client Consent**

A Participant does not have to provide priority to a client order if the client specifically consents to the Participant trading along side or ahead of the client. Any request must be specific to that order. A client cannot give a blanket consent to permit the Participant to trade along side or ahead of any future orders the client may give the Participant.

A Participant must keep a record of the client's consent to withhold orders for seven years from the date of the instruction and, for the first two years, the consent must be kept in a readily accessible location.

If the client has given the Participant that is to be executed at various times during a trading day (e.g. an "over-the-day" order) or at various prices (e.g. at various prices in order to approximate a volume-weighted average price), the client is deemed to have consented to the entry of entry of principal and non-client orders that may trade ahead of the balance of the client order. However, if the unentered portion of the client order would reasonably be expected to affect the market price of the security, the Participant may be precluded from entering principal or non-client orders as a result of the application of the frontrunning rule.

Effective October 31, 2003, the applicable securities commissions approved the amendment to add subsection (8) of Rule 5.3 as it read prior to May 26, 2006.

Effective March 9, 2007, the applicable securities commissions approved an amendment to repeal and replace Rule 5.3 and to repeal and replace Parts 2 and 3 of Policy 5.3. Prior to that date, Rule 5.3 and Parts 2 and 3 of Policy 5.3 provided:

#### **5.3 Client Priority**

- (1) A Participant shall give priority to a client order of the Participant over all principal orders and non-client orders of the Participant that are entered on a marketplace or an organized regulated market after the receipt of the client order for the same security that is:
  - (a) the same price or a higher price in the case of a purchase or the same or a lower price in the case of a sale; and
  - (b) the same side of the market.
- (2) Despite subsection (1) but subject to Rule 4.1, a Participant is not required to give priority to a client order if:
  - (a) the client specifically has consented to the Participant entering principal orders and non-client orders for the same security at the same price on the same side of the market on the same settlement terms;
  - (b) the client order has not been entered on a marketplace as a result of:
    - (i) the client specifically instructing the Participant to deal otherwise with the particular order,
    - (ii) the client specifically granting discretion to the Participant with respect to entry of the order, or
    - (iii) the Participant determining in accordance with Rule 6.3(1)(e) that, based on market conditions, entering the order would not be in the best interests of the client,and no director, officer, partner, employee or agent of the Participant with knowledge that the client order has not been entered on a marketplace enters a principal order or a non-client order for the same security on the same side of the market on the same conditions and settlement terms;
  - (c) the principal order or non-client order is:
    - (i) automatically generated by the trading system of an Exchange or QTRS in accordance with the Marketplace Rules in respect of the applicable Market Maker Obligations, or
    - (ii) a Basis Order;
  - (d) the client order has been entered directly by the client of the Participant on a marketplace that does not require the disclosure of the identifier of the Participant in a consolidated market display and the director, officer, partner, employee or agent of the Participant who enters a principal order or a non-client order does not have knowledge that the client order is from a client of the Participant until the execution of the client order;

- (e) *the principal order or non-client order is executed pursuant to an allocation by the trading system of a marketplace and:*
- (i) *either:*
    - (A) *the security which is the subject of the order trades on no marketplace other than that marketplace,*
    - (B) *the principal order or non-client order is a Call Market Order, an Opening Order, a Market-on-Close Order or a Volume-Weighted Average Price Order, or*
    - (C) *each of the client order and the principal order or non-client order was entered on the same marketplace,*
  - (ii) *the client order was entered by the Participant on that marketplace immediately upon receipt by the Participant, and*
  - (iii) *if the client order was varied or changed by the Participant at any time after entry, the variation or change was on the specific instructions of the client;*
- (f) *either the client order or the principal order or non-client order is a Special Terms Order and the client order would not have executed in the transaction or transactions involving the principal order or non-client order due to the terms and conditions of at least one Special Terms Order; or*
- (g) *a Market Integrity Official requires or permits the principal order or non-client order to be executed in priority to a client order.*
- (3) *For the purposes of clause (2)(a), a client shall be deemed to have consented to the Participant entering principal orders and non-client orders for the same security at the same price on the same side of the market on the same conditions and settlement terms if the client order, in accordance with the specific instructions of the client, is to be executed in part at various times during the trading day or at various prices during the trading day.*

#### **Part 2 – Prohibition on Intentional Trading Ahead**

*Rule 5.3 provides that a Participant must give priority of the execution to client orders over all principal orders and non-client orders of the Participant that are entered on a marketplace or an organized regulated market after the receipt of the client order for the same security at the same price on the same side of the market on the same conditions and settlement terms. The requirement is subject to certain exceptions necessary to ensure overall efficiency of order handling.*

*In particular, exceptions to the client priority rule are provided if the principal order or non-client order that is entered after the receipt of the client order is:*

- *automatically generated by the trading system of an Exchange or QTRS in accordance with the Market Maker Obligations of that marketplace;*
- *a Basis Order; or*
- *required or permitted to be executed by a Market Integrity Official in priority to the client order.*

*A principal order which is automatically generated by the trading system of an Exchange or QTRS in accordance with that marketplace's rules on market-making activities is not an intentional attempt by a Participant to trade ahead of or along with a client order. An exemption from the client priority rule is therefore provided in order to ensure overall market liquidity in accordance with established Market Making Obligations.*

*A Basis Order is undertaken at a price that is determined by prices achieved in related trades made in the derivatives markets. As such, the execution of a Basis Order is not an intentional attempt by a Participant to trade ahead of or along with a client order.*

*An exception to the client priority rule is also provided where the trading system of a marketplace allocates the fill to a principal order or non-client order. In order to be able to rely on this exception the following three conditions must be met:*

- *either:*
  - *the security does not trade on any marketplace other than the one on which the client order and the principal order or non-client order is entered,*

- *the principal order or non-client order is a Call Market Order, an Opening Order, a Market-on-Close Order or a Volume-Weighted Average Price Order, or*
- *each of the client order and the principal order or non-client order was entered on the same marketplace;*
- *the client order was entered immediately upon receipt by the Participant; and*
- *after entry, the client is not varied or changed except on the specific instructions of the client.*

*The exception that is provided for a principal or non-client order which is a Call Market Order, Opening Order, Market-on Close Order or a Volume-Weighted Average Price Order recognizes that the price at which such an order may execute will not generally be known at the time the principal or non-client order is entered on a marketplace. Provided the client order has been entered on receipt and not varied without the consent of the client, any allocation by the trading system of the marketplace for these particular types of orders is not an attempt to bypass client orders.*

*A Participant can never intentionally trade ahead of a client market or tradeable limit order received prior to the entry of the principal order or non-client order without the specific consent of the client. Examples of "intentional trades" include, but are not limited to:*

- *withholding a client order from entry on a marketplace (or removing an order already entered on a marketplace) to permit the entry of a competing principal or non-client order ahead of the client order;*
- *entering a client order in a relatively illiquid market and entering a principal or non-client order in a more liquid marketplace where the principal or non-client order is likely to obtain faster execution;*
- *adding terms or conditions to a client order (other than on the instructions of the client) so that the client order ranks behind principal or non-client orders at that price;*
- *adding terms or conditions to a client order (other than on the instructions of the client) so that the client order ranks behind principal or non-client orders at that price;*
- *putting terms or conditions on a principal or non-client order for the purpose of differentiating the principal or non-client order from a client order that would otherwise have priority at that price; and*
- *entering a principal order or non-client order as an "anonymous order" (without the identifier of the Participant) which results in an execution in priority to a previously entered client order where the identifier of the Participant has been disclosed on the entry of the client order.*

### **Part 3 – No Knowledge of Client Order**

*Rule 5.3 also contains four exceptions to client priority that require the director, officer, partner, employee or agent of the Participant who enters the principal order or the non-client order to be unaware that the client order has not been entered. The exceptions are:*

- *the client specifically instructs the Participant to withhold entry of the order;*
- *the client specifically grants discretion to the Participant with respect to the entry of the order;*
- *the Participant withholds the client order from entry in accordance with Rule 6.3 in a bona fide attempt to get better execution for the client; and*
- *the client enters the order directly on a marketplace that does not require the disclosure of the identifier of the Participant in a consolidated market display.*

*In these circumstances, the Participant must have reasonable procedures in place to ensure that information concerning client orders is not used improperly within the firm. These procedures will vary from firm to firm and no one procedure will work for all firms. If a firm does not have reasonable procedures in place, it cannot rely on the exceptions. Reference should be made to Policy 7.1 – Policy on Trading Supervision Obligations, and in particular Part 4 – Specific Procedures Respecting Client Priority and Best Execution.*

*If a client has instructed a Participant to withhold an order or has granted a Participant discretion with respect to the entry of an order, details of the instruction or grant of discretion must be retained for a period of seven years from the date of the instruction or*

grant of discretion and, for the first two years, the consent must be kept in a readily accessible location.

**Guidance:** 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 background information from Market Integrity Notice 2005-023 is set out under Rule 3.1 and additional text is set out under Rules 5.2, 7.7 and 8.1.

A Participant that enters client orders and principal or non-client orders for the same security on more than one marketplace must be aware of the requirements regarding client priority set out in Rule 5.3. A Participant can never intentionally trade ahead of a client market or tradeable limit order received prior to the entry of the principal order or non-client order without the specific consent of the client. One example of an intentional trade includes simultaneously entering a client order in a relatively illiquid market and entering a principal or non-client order in a more liquid marketplace where the principal or non-client order is likely to obtain faster execution.

In Market Integrity Notice 2005-017 (June 10, 2005), RS has proposed amendments to the rules related to client priority. One of the proposed changes would remove the ability to rely on the allocation made by the trading system of a marketplace as an exemption from the requirements of the client priority rule in circumstances where trades occur on more than one marketplace.

**Guidance:** 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, 5.1, 5.3, 7.7 and 8.1.

#### **Rule 5.3 – Client Priority**

A Participant that enters client orders and principal or non-client orders for the same security on more than one marketplace must be aware of the requirements regarding client priority set out in Rule 5.3. As a general requirement, a Participant is required to provide priority for a client order over a principal order or non-client order only if the client order is received prior to the entry of the principal order or non-client order and the client order is at the same or “better” price and is subject to the same conditions and settlement terms as the principal order or non-client order. In particular, a Participant can never intentionally trade ahead of a client order that is either a market order or a tradeable limit order that was received prior to the entry of the principal order or non-client order unless the Participant receives the specific consent of the client. One example of an intentional trade includes simultaneously entering a client order in a relatively illiquid market and entering a principal or non-client order in a more liquid marketplace where the principal or non-client order is likely to obtain faster execution at the same or better price than the client order. In this circumstance, the Participant is not able to rely on the exemption from client priority provided for allocations made by the trading system of a marketplace since the client order and the principal or non-client order were entered on different marketplaces. Reference should be made to Market Integrity Notice 2006-012 – Amendment Approval – Provisions Respecting Client Priority (May 26, 2006) for further guidance on the application of Rule 5.3 as amended effective May 26, 2006.

Shorcan limits access to its marketplace to dealers trading as principal. If a Participant receives a client order for a particular security which is entered on another marketplace and the Participant subsequently enters a principal order on Shorcan, the Participant may be under an obligation to reallocate any fill received on the execution of the principal order on Shorcan to the client. The reallocation would be required if the client’s order has not executed but would have executed on Shorcan ahead of the Participant’s order if the client’s order had been eligible for entry on Shorcan and had been entered on Shorcan on receipt of the client’s order by the Participant.

**Guidance:** 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 5.1, 5.2, and 6.3.

#### **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:

#### **4. What are the “client priority” obligations if a marketplace or facility permits orders to be assigned different priorities for execution?**

For Participants who participate in the ATX facility of the TSX, each particular account which is eligible to enter an “intent” will be assigned to a PAG that will be “hard-coded” into ATX and which will not be subject to trade-by-trade allocations or changes by traders. Under Rule 5.3, a Participant may have to provide priority to a client order received prior to the entry of a principal order or non-client orders at the same or an inferior price to that of the client order. “Client priority” would be required if the Participant, based on the information known or reasonably available to the person or persons originating or entering the principal order or non-client order, knows or should have known that the principal order or non-client order will execute or have a reasonable likelihood of executing in priority to a client order received by the Participant prior to the entry of the principal order or non-client order:

- for the same security;
- at the same or an inferior price; and
- on the same side of the market.

If a client order is to be entered into ATX as an “intent”, the client would have to specifically consent to receiving a PAG rating which is lower than those used for principal or non-client orders. In the view of IIROC, such consent would have to be “informed”, in other words, the client would have to understand the implications for the execution of their order.

It is the intention of IIROC, as part of its trade desk review, to review the assignment of PAGs or priority for execution to ensure that client priority has been provided or that informed consent has been obtained from clients in the event a client has been assigned a lower PAG or priority for execution than that used by principal or non-client accounts.

**5. If a marketplace or facility permits orders to be assigned different priorities for execution, do all client orders have to be assigned the same level of priority?**

The client priority rules under UMIR do not preclude the possibility that different PAGs or priority for execution may be assigned to different groups of clients. However, as noted above, a client assigned a lower PAG or lower priority for execution would be expected to have provided an informed consent with respect to such assignment. As part of its trade desk review, IIROC would intend to review the evidence of the informed consent in the event a client is assigned a PAG or priority for execution lower than that assigned to other clients. In all cases, the Participant would remain subject to Rule 5.1 with respect to its “best execution” obligation for each client order.

**Disciplinary Proceedings: In the Matter of Desjardins Securities Inc. (“Desjardins”), Jean-Pierre De Montigny (De Montigny) and Jean-Luc Brunet (“Brunet”) (March 16, 2005) SA 2005-002**

*Facts* – RS Trade Desk Reviews (“TDRs”) in November 2002 and October 2003 highlighted insufficient supervision of trading practices and procedures and other UMIR deficiencies related to audit trail violations. In a subsequent TDR in 2004, it was found that the deficiencies noted in 2002 and 2003 were not corrected, and in many instances were more extensive. In addition to these failings, RS’s investigation also noted 17 instances of the Desjardins trading along side a client, without recording the requisite client consent for each order.

*Disposition* – By failing to address the various deficiencies noted by the TRD team, and failing to implement an effective trading supervision system, the Participant, De Montigny and Brunet failed to establish an effective compliance and trading supervision system for the firm’s trading operation, contrary to their respective obligations under UMIR.

*Requirements Considered* – Rules 5.3(6), 10.11, 7.1 and Policy 7.1

*Sanction* –

Desjardins Securities Inc. – \$1,500,000 fine and costs of \$125,000; Board of Directors certification that trading compliance and supervision systems are compliant with UMIR;

Jean-Pierre De Montigny – \$300,000 fine

Jean-Luc Brunet – \$35,000 fine

**Disciplinary Proceedings: Rule 5.3 was considered In the Matter of Kai Tolpinrud (“Tolpinrud”) (January 16, 2006) OOS 2004-001. See Disciplinary Proceedings under Rule 2.1.**

**Disciplinary Proceedings: Rule 5.3(6) was considered In the Matter of Salman Partners Inc. (“Salman”), Sameh Magid (“Magid”), William Burk (“Burk”) and Ian Todd (“Todd”) (February 18, 2005) SA 2005-001. See Disciplinary Proceedings under Rule 3.1.**

**Disciplinary Proceedings: In the Matter of Raymond James Ltd. (“Raymond James”) and Marc Deslongchamps (“Deslongchamps”) (June 30, 2006) DN 2006-006**

*Facts* – In the period February 2003 to February 2005 Deslongchamps, the “Head Trader” for Raymond James, was responsible for supervising Raymond James’ institutional sales, proprietary and facilitation traders across Canada. In addition to acting as Head Trader, Deslongchamps conducted proprietary trading for one of Raymond James’ inventory accounts. During the relevant period, trading by certain traders under the direction of Deslongchamps and trading by Deslongchamps himself resulted in numerous client priority, audit trail and order marking violations. RS identified instances in which Deslongchamps and traders under his supervision traded ahead of or alongside clients without client consent, failed to properly record client consent in cases where client consent was obtained, failed to complete trade tickets with appropriate information and improperly marked client trades “non-client”, all of which resulted in an incomplete audit trail.

In the period July 2003 to February 2005 Raymond James’ institutional trading supervision and compliance systems were not reasonably designed to prevent the UMIR violations referenced above. Also, the Manager of Compliance at Raymond James used a flawed methodology to test for possible client priority issues. The flawed nature of the testing resulted in ongoing trade and audit trail problems not being escalated.

*Disposition* – In failing to implement an institutional trading supervision and compliance system

*which was reasonably designed to prevent and detect client priority, consent, order marking requirements set out in UMIR and failing to take effective steps to ensure the Head Trader carried out his trading supervision obligations, Raymond James failed to comply with its trading supervision obligations under UMIR.*

*In failing to take effective steps to supervise the traders he oversaw to ensure compliance with client priority and audit trail requirements Deslongchamps failed to comply with his trading supervision obligations under UMIR.*

*Requirements Considered – Rules 5.3(1), 5.3(2), 5.3(6), 6.2(1)(b), 10.11(1), 7.1(1), 7.1(4) and Policy 7.1*

*Sanction –*

*Raymond James – \$400,000 fine and costs of \$125,000*

*Deslongchamps – \$50,000 fine; prohibition against acting in a supervisory capacity for 1 year*