

## **PART 7 – TRADING IN A MARKETPLACE**

### **7.1 Trading Supervision Obligations**

- (1) Each Participant shall adopt written policies and procedures to be followed by directors, officers, partners and employees of the Participant that are adequate, taking into account the business and affairs of the Participant, to ensure compliance with UMIR and each Policy.
- (2) Prior to the entry of an order on a marketplace by a Participant, the Participant shall comply with:
  - (a) applicable regulatory standards with respect to the review, acceptance and approval of orders;
  - (b) the policies and procedures adopted in accordance with subsection (1); and
  - (c) all requirements of UMIR and each Policy.
- (3) Each Participant shall appoint a head of trading who shall be responsible to supervise the trading activities of the Participant in a marketplace.
- (4) The head of trading together with each person who has authority or supervision over or responsibility to the Participant for an employee of the Participant shall fully and properly supervise such employee as necessary to ensure the compliance of the employee with UMIR and each Policy.

### **POLICY 7.1 – TRADING SUPERVISION OBLIGATIONS**

#### **Part 1 – Responsibility for Supervision and Compliance**

*For the purposes of Rule 7.1, a Participant shall supervise its employees, directors and officers and, if applicable, partners to ensure that trading in securities on a marketplace (an Exchange, QTRS or ATS) is carried out in compliance with the applicable Requirements (which includes provisions of securities legislation, UMIR, the Trading Rules and the Marketplace Rules of any applicable Exchange or QTRS). An effective supervision system requires a strong overall commitment on the part of the Participant, through its board of directors, to develop and implement a clearly defined set of policies and procedures that are reasonably designed to prevent and detect violations of Requirements. The board of directors of a Participant is responsible for the overall stewardship of the firm with a specific responsibility to supervise the management of the firm. On an ongoing basis, the board of directors must ensure that the principal risks for non-compliance with Requirements have been identified and that appropriate supervision and compliance procedures to manage those risks have been implemented.*

*Management of the Participant is responsible for ensuring that the supervision system adopted by the Participant is effectively carried out. The head of trading and any other person to whom supervisory responsibility has been delegated must fully and properly supervise all employees under their supervision to ensure their compliance with Requirements. If a supervisor has not followed the supervision procedures adopted by the Participant, the supervisor will have failed to comply with their supervisory obligations under Rule 7.1(4).*

*When the Market Regulator reviews the supervision system of a Participant (for example, when a violation occurs of Requirements), the Market Regulator will consider whether the supervisory system is reasonably well designed to prevent and detect violations of Requirements and whether the system was followed.*

*The compliance department is responsible for monitoring and reporting adherence to rules, regulations, requirements, policies and procedures. In doing so, the compliance department must have a compliance monitoring system in place that is reasonably designed to prevent and detect violations. The compliance department must report the results from its monitoring to the Participant's management and, where appropriate, the board of directors, or its equivalent. Management and the board of directors must ensure that the compliance department is adequately funded, staffed and empowered to fulfil these responsibilities.*

*The obligation to supervise applies whether the order is entered on a marketplace:*

- *by a trader employed by the Participant,*
- *by an employee of the Participant through an order routing system,*
- *directly by a client and routed to a marketplace through the trading system of the Participant, or*
- *by any other means.*

*In performing the trading supervision obligations, the Participant will act as a "gatekeeper" to help prevent and detect violations of applicable Requirements.*

*Where an order is entered on a marketplace without the involvement of a trader (for example by a client with a systems interconnect arrangement in accordance with Policy 2-501 of the Toronto Stock Exchange), the Participant retains responsibility for that order and the supervision policies and procedures should adequately address the additional risk exposure which the Participant may have for orders that are not directly handled by staff of the Participant. For example, it may be appropriate for the Participant to sample for compliance testing a higher percentage of orders that have been entered directly by clients than the percentage of orders sampled in other circumstances.*

*In addition, the "post order entry" compliance testing should recognize that the limited involvement of staff of the Participant in the entry of orders by a direct access client may restrict the ability of the Participant to detect orders that are not in compliance with specific rules. For example, "post order entry" compliance testing may be focused on whether an order entered by a direct access client:*

- *has created an artificial price contrary to Rule 2.2;*
- *is part of a "wash trade" (in circumstances where the client has more than one account with the Participant);*

- is an unmarked short sale (if the trading system of the Participant does not automatically code as “short” any sale of a security not then held in the account of the client); and
- has complied with order marking requirements and in particular the requirement to mark an order as from an insider or significant shareholder (unless the trading system of the Participant restricts trading activities in affected securities).

## **Part 2 – Minimum Element of a Supervision System**

For the purposes of Rule 7.1, a supervision system consists of both policies and procedures aimed at preventing violations from occurring and compliance procedures aimed at detecting whether violations have occurred.

The Market Regulator recognizes that there is no one supervision system that will be appropriate for all Participants. Given the differences among firms in terms of their size, the nature of their business, whether they are engaged in business in more than one location or jurisdiction, the experience and training of its employees and the fact that effective jurisdiction can be achieved in a variety of ways, this Policy does not mandate any particular type or method of supervision of trading activity. Furthermore, compliance with this Policy does not relieve Participants from complying with specific Requirements that may apply in certain circumstances. In particular, Participants are reminded that, in accordance with subsection (2) of Rule 10.1, the entry of orders must comply with the Marketplace Rules on which the order is entered and the Marketplace Rules on which the order is executed. (For example, for Participants that are Participating Organizations of the TSE, reference should be made to the Policy on “Connection of Eligible Clients of Participating Organizations”).

Participants must develop and implement supervision and compliance procedures that exceed the elements identified in this Policy where the circumstances warrant. For example, previous disciplinary proceedings, warning and caution letters from the Market Regulator or the identification of problems with the supervision system or procedures by the Participant or the Market Regulator may warrant the implementation of more detailed or more frequent supervision and compliance procedures.

Regardless of the circumstances of the Participant, however, every Participant must:

1. Identify the relevant Requirements, securities laws and other regulatory requirements that apply to the lines of business in which the Participant is engaged (the “Trading Requirements”).
2. Document the supervision system by preparing a written policies and procedures manual. The manual must be accessible to all relevant employees. The manual must be kept current and Participants are advised to maintain a historical copy.
3. Ensure that employees responsible for trading in securities are appropriately registered and trained and that they are knowledgeable about the Trading Requirements that apply to their responsibilities. Persons with supervisory responsibility must ensure that employees under their supervision are appropriately registered and trained. The Participant should provide a continuing training and education program to ensure that its employees remain informed of and knowledgeable about changes to the rules and regulations that apply to their responsibilities.

4. *Designate individuals responsible for supervision and compliance. The compliance function must be conducted by persons other than those who supervised the trading activity.*
5. *Develop and implement supervision and compliance procedures that are appropriate for the Participant's size, lines of business in which it is engaged and whether the Participant carries on business in more than one location or jurisdiction.*
6. *Identify the steps the Participant will take when a violation or possible violation of a Requirement or any regulatory requirement has been identified. These steps shall include the procedure for the reporting of the violation or possible violation to the Market Regulator if required by Rule 10.16. If there has been a violation or possible violation of a Requirement identify the steps that would be taken by the Participant to determine if:*
  - *additional supervision should be instituted for the employee, the account or the business line that may have been involved with the violation or possible violation of a Requirement; and*
  - *the written policies and procedures that have been adopted by the Participant should be amended to reduce the possibility of a future violation of the Requirement.*
7. *Review the supervision system at least once per year to ensure it continues to be reasonably designed to prevent and detect violations of Requirements. More frequent reviews may be required if past reviews have detected problems with supervision and compliance. Results of these reviews must be maintained for at least five years.*
8. *Maintain the results of all compliance reviews for at least five years.*
9. *Report to the board of directors of the Participant or, if applicable, the partners, a summary of the compliance reviews and the results of the supervision system review. These reports must be made at least annually. If the Market Regulator or the Participant has identified significant issues concerning the supervision system or compliance procedures, the board of directors or, if applicable, the partners, must be advised immediately.*

### **Part 3 - Minimum Compliance Procedures for Trading on a Marketplace**

*A Participant must develop and implement compliance procedures for trading in securities on a marketplace that are appropriate for its size, the nature of its business and whether it carries on business in more than one location or jurisdiction. Such procedures should be developed having regard to the training and experience of its employees and whether the firm or its employees have been previously disciplined or warned by the Market Regulator concerning the violations of the Requirements.*

*In developing compliance procedures, Participants must identify any exception reports, trading data and/or other documents to be reviewed. In appropriate cases, relevant information that cannot be obtained or generated by the Participant should be sought from sources outside the firm including from the Market Regulator.*

The following table identifies minimum compliance procedures for monitoring trading in securities on a marketplace that must be implemented by a Participant. The compliance procedures and the Rules identified below are not intended to be an exhaustive list of the provisions of UMIR and procedures that must be complied with in every case. Participants are encouraged to develop compliance procedures in relation to all the Rules that apply to their business activities.

The Market Regulator recognizes that the requirements identified in the following table may be capable of being performed in different ways. For example, one Participant may develop an automated exception report and another may rely on a physical review of the relevant documents. The Market Regulator recognizes that either approach may comply with this Policy provided the procedure used is reasonably designed to detect violations of the relevant provision of UMIR. The information sources identified in the following table are therefore merely indicative of the types of information sources that may be used.

### Minimum Compliance Procedures for Trading Supervision

<b>UMIR and Policies</b>	<b>Compliance Review Procedures</b>	<b>Potential Information Sources</b>	<b>Frequency and Sample Size</b>
<i>Synchronization of Clocks</i>  <i>Rule 10.14</i>	<ul style="list-style-type: none"> <li>• confirm accuracy of clocks and computer network times</li> <li>• remove unused or non-functional machines</li> </ul>	<ul style="list-style-type: none"> <li>• time clocks</li> <li>• Trading Terminal system time</li> <li>• OMS system time</li> </ul>	<ul style="list-style-type: none"> <li>• Daily</li> </ul>
<i>Audit Trail Requirements</i>  <i>Rule 10.11</i>	<ul style="list-style-type: none"> <li>• ensure the presence of:               <ul style="list-style-type: none"> <li>-time stamp</li> <li>-quantity</li> <li>-price (if limit order)</li> <li>-security name or symbol</li> <li>-identity of trader (initial or sales code)</li> <li>-client name or account number-</li> <li>special instructions from any client</li> <li>-information required by audit trail requirements</li> </ul> </li> <li>• for CFOd orders, ensure the presence of second time stamp and clear quantity or price changes</li> </ul>	<ul style="list-style-type: none"> <li>• order tickets</li> <li>• the Diary List</li> </ul>	<ul style="list-style-type: none"> <li>• quarterly</li> <li>• check 25 original client tickets selected randomly over the quarter</li> </ul>
<i>Electronic Records</i>  <i>Rule 10.11</i>	<ul style="list-style-type: none"> <li>• verify that electronic order information is:               <ul style="list-style-type: none"> <li>-being stored</li> <li>-retrievable</li> <li>-accurate</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>• firm and service bureau systems</li> </ul>	<ul style="list-style-type: none"> <li>• annually</li> </ul>
<i>Manipulative and Deceptive Trading</i>  <i>Rule 2.2(1), (2)</i> <i>Policy 2.2</i>	<ul style="list-style-type: none"> <li>• review trading activity for:               <ul style="list-style-type: none"> <li>-wash trading</li> <li>-unrelated accounts that may display a pattern of crossing securities</li> <li>-off-market transactions which</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>• order tickets</li> <li>• the diary list</li> <li>• new client application forms</li> <li>• monthly statements</li> </ul>	<ul style="list-style-type: none"> <li>• quarterly</li> <li>• review sampling period should extend over several days</li> </ul>

<b>UMIR and Policies</b>	<b>Compliance Review Procedures</b>	<b>Potential Information Sources</b>	<b>Frequency and Sample Size</b>
	require execution on a Marketplace		
Establishing Artificial Prices  Rule 2.2(1), (3) Policy 2.2	<ul style="list-style-type: none"> <li>review tick setting trades entered at or near close</li> <li>look for specific account trading patterns in tick setting trades</li> <li>review accounts for motivation to influence the price</li> <li>review separately, tick setting trades by Market on Close (MOC) or index related orders</li> </ul>	<ul style="list-style-type: none"> <li>order tickets</li> <li>the diary list</li> <li>Equity History Report (available on TSE market data website for TSE-listed securities)</li> <li>closing report from Market Regulator (delivered to Participants)</li> <li>new client application forms</li> </ul>	<ul style="list-style-type: none"> <li>monthly</li> <li>emphasis on trades at the end of month, quarter or year (for trades not on MOC or index related)</li> <li>for MOC or index related orders, check for reasonable price movement</li> </ul>
Grey or Watch List  Rule 2.2	<ul style="list-style-type: none"> <li>review for any trading of Grey or Watch List issues done by proprietary or employee accounts</li> </ul>	<ul style="list-style-type: none"> <li>order tickets</li> <li>the diary list</li> <li>trading blotters</li> <li>firm Grey List or Watch List</li> <li>monthly statements</li> </ul>	<ul style="list-style-type: none"> <li>daily</li> </ul>
Restricted List  Rule 2.2 Rule 7.8 Rule 7.9	<ul style="list-style-type: none"> <li>review for any trading of restricted list issues done by proprietary or employee accounts</li> </ul>	<ul style="list-style-type: none"> <li>order tickets</li> <li>the diary list</li> <li>trading blotters</li> <li>firm Restricted List</li> <li>monthly statements</li> </ul>	<ul style="list-style-type: none"> <li>daily</li> </ul>
Frontrunning  Rule 4.1	<ul style="list-style-type: none"> <li>review trading activity of proprietary and employee accounts prior to: <ul style="list-style-type: none"> <li>-large client orders</li> <li>-transactions that would impact the market</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>order tickets</li> <li>the diary list</li> <li>equity history report</li> </ul>	<ul style="list-style-type: none"> <li>quarterly</li> <li>sample period should extend over several days</li> </ul>
Sales from Control Blocks  Securities legislation incorporated by Rule 10.1	<ul style="list-style-type: none"> <li>review all known sales from control blocks to ensure regulatory requirements have been met</li> <li>review large trades to determine if they are undisclosed sales from control block</li> </ul>	<ul style="list-style-type: none"> <li>order tickets</li> <li>trading blotter</li> <li>new client application form</li> <li>OSC bulletin</li> <li>Exchange company bulletins</li> </ul>	<ul style="list-style-type: none"> <li>as required</li> <li>sample trades over 250,000 shares</li> </ul>
Order Handling Rules  Rule 5.1 Rule 5.3 Rule 6.3 Rule 8.1	<ul style="list-style-type: none"> <li>review client-principal trades of 50 standard trading units or less for compliance with order exposure and client principal transactions rules</li> <li>verify that orders of 50 standard trading units or less are not arbitrarily withheld from the market</li> </ul>	<ul style="list-style-type: none"> <li>order tickets</li> <li>equity history report</li> <li>trading blotters</li> <li>the diary list</li> </ul>	<ul style="list-style-type: none"> <li>quarterly</li> <li>sample, specifically: <ul style="list-style-type: none"> <li>-trader managed orders of 50 standard trading units</li> </ul> </li> </ul>
Order Markers  Rule 6.2	<ul style="list-style-type: none"> <li>verify that appropriate client, employee, and proprietary trade markers are being employed</li> </ul>	<ul style="list-style-type: none"> <li>order tickets</li> <li>trading blotters</li> <li>the diary list</li> </ul>	<ul style="list-style-type: none"> <li>quarterly</li> <li>samples should include one full</li> </ul>

<b>UMIR and Policies</b>	<b>Compliance Review Procedures</b>	<b>Potential Information Sources</b>	<b>Frequency and Sample Size</b>
<i>Marketplace Rules incorporated by Rule 10.1 (for marketplaces on which the order is entered or executed)</i>	<ul style="list-style-type: none"> <li>• ensure that client orders are not being improperly entered with pro markers</li> <li>• verify that appropriate order designations are included on orders</li> </ul>		<i>day of trading for orders not entered through the OMS system</i>
<i>Trade Disclosures  Securities legislation incorporated by Rule 10.1</i>	<ul style="list-style-type: none"> <li>• verify appropriate trade disclosures are made on client confirmations <ul style="list-style-type: none"> <li>-principal</li> <li>-average price</li> <li>-related Issuer</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>• trading blotters</li> <li>• client confirmations</li> <li>• the diary list</li> <li>• order tickets</li> </ul>	<ul style="list-style-type: none"> <li>• quarterly</li> <li>• sample should include non-OMS trades</li> </ul>
<i>Normal Course Issuer Bids  Marketplace Rules (e.g. Rule 6-501 and Policy 6-501 of TSE and Policy 5.6 of CDNX)</i>	<ul style="list-style-type: none"> <li>• review NCIBs for: <ul style="list-style-type: none"> <li>-maximum stock purchase limits of 5% in 1 year or 2% in 30 days are observed</li> <li>-purchases for NCIBs are not occurring while a sale from control is being made</li> <li>-purchases are not made on upticks</li> <li>-trade reporting to Exchange (if the firm reports on behalf of issuer)</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>• order tickets</li> <li>• the diary list</li> <li>• trading blotters</li> <li>• new client application form</li> </ul>	<ul style="list-style-type: none"> <li>• quarterly</li> </ul>

#### **Part 4 – Specific Procedures Respecting Client Priority and Best Execution**

Participants must have written compliance procedures reasonably designed to ensure that their trading does not violate Rule 5.3 or 5.1. A Participant must have policies and procedures in place to “diligently pursue the execution of each client order on the most advantageous execution terms reasonably available under the circumstances”. The policies and procedures must:

- outline a process designed to achieve best execution;
- require the Participant, subject to compliance by the Participant with any Requirement, to follow the instructions of the client and to consider the investment objectives of the client;
- include the process for taking into account order and trade information from all appropriate marketplaces and foreign organized regulated markets; and
- describe how the Participant evaluates whether “best execution” was obtained.

In order to demonstrate that a Participant has “diligently pursued” the best execution of a particular client order, the Participant must be able to demonstrate that it has abided by the policies and procedures. At a minimum, the written compliance procedures must address employee education and post-trade monitoring.

*The purpose of the Participant's compliance procedures is to ensure that pro traders do not knowingly trade ahead of client orders. This would occur if a client order is withheld from entry into the market and a person with knowledge of that client order enters another order that will trade ahead of it. Doing so could take a trading opportunity away from the first client. Withholding an order for normal review and order handling is allowed under Rules 5.3 and 5.1, as this is done to ensure that the client gets a good execution. To ensure that the Participants' written compliance procedures are effective they must address the potential problem situations where trading opportunities may be taken away from clients.*

### **Potential Problem Situations**

*Listed below are some of the potential problem situations where trading opportunities may be taken away from clients.*

- 1. Retail brokers or their assistants withholding a client order to take a trading opportunity away from that client.*
- 2. Others in a brokerage office, such as wire operators, inadvertently withholding a client order, taking a trading opportunity away from that client.*
- 3. Agency traders withholding a client order to allow others to take a trading opportunity away from that client.*
- 4. Proprietary traders using knowledge of a client order to take a trading opportunity away from that client.*
- 5. Traders using their personal accounts to take a trading opportunity away from a client.*

### **Written Compliance Procedures**

*It is necessary to address in the written compliance procedures the potential problem situations that are applicable to the Participant. Should there be a change in the Participant's operations where new potential problem situations arise then these would have to be addressed in the procedures. At a minimum, the written compliance procedures for employee education and post-trade monitoring must include the following points.*

#### **Education**

- Employees must know the Rules and understand their obligation for client priority and best execution, particularly in a multiple market environment.*
- Participants must ensure that all employees involved with the order handling process know that client orders must be entered into the market before non-client and proprietary orders, when they are received at the same time.*
- Participants must train employees to handle particular trading situations that arise, such as, client orders spread over the day, and trading along with client orders.*

#### **Post-Trade Monitoring Procedures**

- All brokers' trading must be monitored as required by Rule 7.1.*
- Complaints from clients and Registered Representatives concerning potential violations of the rule must be documented and followed-up.*
- All traders' personal accounts and those related to them, must be monitored daily to ensure no apparent violations of client priority occurred.*

- *At least once a month, a sample of proprietary inventory trades must be compared with contemporaneous client orders.*
- *In reviewing proprietary inventory trades, Participants must address both client orders entered into order management systems and manually handled orders, such as those from institutional clients.*
- *The review of proprietary inventory trades must be of a sample size that sufficiently reflects the trading activity of the Participant.*
- *Potential problems found during these reviews must be examined to determine if an actual violation of Rule 5.3 or 5.1 occurred. The Participant must retain documentation of these potential problems and examinations.*
- *When a violation is found, the Participant must take the necessary steps to correct the problem.*

### **Documentation**

- *The procedures must specify who will conduct the monitoring.*
- *The procedures must specify what information sources will be used.*
- *The procedures must specify who will receive reports of the results.*
- *Records of these reviews must be maintained for five years.*
- *The Participant must annually review its procedures.*

### **Part 5 – Specific Procedures Respecting Manipulative and Deceptive Activities and Reporting and Gatekeeper Obligations**

*Each Participant must develop and implement compliance procedures that are reasonably well designed to ensure that orders entered on a marketplace by or through a Participant are not part of a manipulative or deceptive method, act or practice nor an attempt to create an artificial price or a false or misleading appearance of trading activity or interest in the purchase or sale of a security. The minimum compliance procedures for trading supervision in connection with Rule 2.2 and Policy 2.2 are set out in the table to Part 3 of this Policy.*

*In particular, the procedures must address:*

- *the steps to be undertaken to determine whether or not a person entering an order is:
 
  - *an insider,*
  - *an associate of an insider, and*
  - *part of or an associate of a promotional group or other group with an interest in effecting an artificial price, either for banking and margin purposes, for purposes of effecting a distribution of the securities of the issuer or for any other improper purpose;**
- *the steps to be taken to monitor the trading activity of any person who has multiple accounts with the Participant including other accounts in which the person has an interest or over which the person has direction or control;*

- those circumstances when the Participant is unable to verify certain information (such as the beneficial ownership of the account on behalf of which the order is entered, unless that information is required by applicable regulatory requirements);
- the fact that orders which are intended to or which effect an artificial price are more likely to appear at the end of a month, quarter or year or on the date of the expiry of options where the underlying interest is a listed security; and
- the fact that orders which are intended to or which effect an artificial price or a false or misleading appearance of trading activity or investor interest are more likely to involve securities with limited liquidity.

A Participant will be able to rely on information contained on a “New Client Application Form” or similar know-your-client record maintained in accordance with requirements of securities legislation or a self-regulatory entity provided such information has been reviewed periodically in accordance with such requirements and any additional practices of the Participant.

While a Participant cannot be expected to know the details of trading activity conducted by a client through another dealer, nonetheless, a Participant that provides advice to a client on the suitability of investments should have an understanding of the financial position and assets of the client and this understanding would include general knowledge of the holdings by the client at other dealers or directly in the name of the client. The compliance procedures of the Participant should allow the Participant to take into consideration, as part of its compliance monitoring, information which the Participant has collected respecting accounts at other dealers as part of the completion and periodic updating of the “New Client Application Form”.

## **Part 6 – Specific Provisions Respecting the Best Price Obligation**

Each Participant must adopt written policies and procedures that are adequate, taking into account the business and affairs of the Participant, to ensure compliance with the “best price obligation”. The policies and procedures must set out the steps or process to be followed by the Participant that constitute the “reasonable efforts” that the Participant will take to ensure that orders receive the “best price” when executed on a marketplace. These policies and procedures must address the factors which the Participant will take into account:

- initially in determining whether order on a protected marketplace need to be considered; and
- on an on-going basis once the Participant has determined that orders on a particular protected marketplace should be considered.

The policies and procedures adopted by the Participant:

- must take into account the factors and other requirements enumerated in Policy 5.2; and
- may take into account other additional factors which are reasonable and of particular importance to the type of business conducted by the Participant provided any additional factors identified by a Participant must not be inconsistent with the requirements set out in Policy 5.2 or the provisions of the Marketplace Operation Instrument.

<p><b>Defined Terms:</b></p> <p>NI 14-101 section 1.1(3) – “securities legislation”</p> <p>NI 21-101 section 1.1 – “ATS”, “order” and “self-regulatory entity”</p> <p>UMIR section 1.1 – “client order”, “employee”, “Exchange”, “foreign organized regulated market”, “insider”, “limit order”, “Market-on-Close Order”, “Market Regulator”, “marketplace”, “Marketplace Operation Instrument”, “Marketplace Rules”, “non-client order”, “Participant”, “Policy”, “principal account”, “protected marketplace”, “QTRS”, “short sale”, “standard trading unit”, “Requirements”, “significant shareholder”, “Trading Rules” and “UMIR”</p> <p>UMIR section 1.2(2) – “person” and “trade”</p> <p><b>Related Provisions:</b> UMIR Policy 1.2 Part 4 – interpretation of “applicable regulatory standards”, UMIR section 5.2</p> <p><b>Regulatory History:</b> Effective April 1, 2005, the applicable securities commissions approved amendments to:</p> <ol style="list-style-type: none"> <li>1. Clause (2)(a) of Rule 7.1 to insert the phrase “, acceptance”.</li> <li>2. Part 1 of Policy 7.1 to add the last three paragraphs.</li> <li>3. Part 2 of Policy 7.1 to replace numbered paragraph 6. Prior to that date, that paragraph provided:</li> <li>6. Identify the steps a firm will take when violations of Requirements, securities laws or other regulatory requirements have been identified. This may include cancellation of the trade, increased supervision of the employee or the business activity, internal disciplinary measures and/or reporting the violation to the Market Regulator or other regulatory organization.</li> <li>4. Policy 7.1 to add Part 5.</li> </ol> <p>Effective May 16, 2008, an amendment was made to Policy 7.1. This amendment was approved by the applicable securities commissions on April 17, 2009 with retroactive application to May 16, 2008. Reference should be made to Rules Notice 09-0107 – Notice of Approval – Provisions Respecting the “Best Price” Obligation (April 17, 2009) which approved an amendment to add Part 6 to Policy 7.1.</p> <p>In connection with the recognition of IIROC and its adoption of UMIR, the applicable securities commissions approved amendments to Rule 7.1 and Part 3 of Policy 7.1 that came into force on June 1, 2008 to replace the phrase “these Rules” with “UMIR”, “the Rules” with “the provisions of UMIR”, “relevant Rule” with “relevant provision of UMIR” and “Rules and Policies” with “UMIR and Policies”.</p> <p>Effective September 12, 2008, the applicable securities commissions approved an amendment to replace the first paragraph of Part 4 of Policy 7.1. Prior to that date, the first paragraph of Part 4 of Policy 7.1 read as follows:</p> <p style="padding-left: 40px;"><i>Participants must have written compliance procedures reasonably designed to ensure that their trading does not violate Rule 5.3 or 5.1. At a minimum, the written compliance procedures must address employee education and post-trade monitoring.</i></p> <p><b>Guidance:</b></p> <p>The following is the text of Market Integrity Notice 2003-025 issued on November 28, 2003 under the heading “<b>Guidelines on Trading Supervision Obligations</b>”.</p> <p><i>This Notice provides guidance to Participants on the application of Policy 7.1 under Universal Market Integrity Rules (“UMIR”) related to Trading Supervision Obligations. Policy 7.1 has been in effect since April 1, 2002. Prior to that time, the Toronto Stock Exchange had a similar policy respecting trading supervision and compliance that required that a supervisory system be in place not later than September 28, 2001.</i></p> <p><b>Participants are reminded that failure to develop and implement appropriate policies and procedures in accordance with the requirements of Policy 7.1 may result in disciplinary action against the firm, its management and its directors.</b></p> <p><i>As part of each trade desk review undertaken by staff of the Investment Industry Regulatory Organization of Canada (“IIROC”), IIROC will review the policies and procedures that have been adopted by a Participant. As a result of this review, IIROC will comment on whether, in the opinion of IIROC, such policies and procedures appear to be adequate to prevent and detect violations of Requirements in light of the type and volume of business undertaken by the Participant. The review of the policies and procedures does not constitute an approval of the policies and procedures by IIROC as IIROC will not have undertaken a comprehensive analysis of the business of the Participant.</i></p> <p><i>On an ongoing basis, the directors of the Participant must ensure that the principal risks for non-compliance with Requirements have been identified and that appropriate supervision and compliance procedures to manage those risks have been implemented. Management of the Participant is responsible for ensuring that the supervision system is effectively carried out.</i></p> <p><i>Participants are also reminded that management and the board of directors must ensure that the compliance department is adequately funded, staffed and empowered to fulfil its responsibilities. To date, trade desk reviews have not commented on this requirement but may do so in the future. Similarly, inadequate funding of the compliance function may be taken into account in the context of any disciplinary action.</i></p>	
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## Background and Terminology

UMIR Policy 7.1 requires a Participant “to develop and implement a clearly defined set of policies and procedures that are reasonably designed to prevent and detect violations of Requirements”. Participants are reminded that the “Requirements” include more than UMIR and its policies and that supervision systems must encompass these “Requirements. For the purposes of Policy 7.1, the term “Requirements” is presently defined as including:

- UMIR and its Policies;
- National Instrument 23-101 (the “Trading Rules”)
- Rules, policies and other similar instrument adopted by a recognized exchange or recognized quotation and trade reporting system (“Marketplace Rules”); and
- any direction, order or decision of IIROC or any other regulation services provider (“Decisions”).

Policy 7.1 sets out requirements for both supervisors and compliance departments and requires that a supervision system include both supervision policies and procedures and compliance policies and procedures. Policy 7.1 uses a number of terms regarding supervision systems that are not specifically defined in UMIR or the Policy. An appreciation of these terms may assist Participants in developing their supervision systems and the following are IIROC’ administrative interpretations for various terms:

- “**supervision system**” and “**supervisory system**” encompasses the activities of both the supervision procedures and the compliance procedures
- “**supervise**”, “**supervision**”, “**supervisor**”, and “**supervisory**” refer to the responsibilities of the head of trading “and each person who has authority or supervision over or responsibility to the Participant for an employee of the Participant” with respect to the trading activities of the Participant as described in Rule 7.1(4). A Participant may have more than one head of trading and any number of persons who have authority over the trading activity of employees.
- “**supervision procedures**” are the policies and procedures to be followed by supervisors that are aimed at preventing violations from occurring.
- “**compliance department**”, “**compliance**” and “**monitoring**” refer to the responsibilities of the persons responsible for the compliance activities of the Participant.
- “**compliance procedures**” are the policies and procedures to be followed by the compliance department that are aimed at detecting whether violations have occurred.
- “**management**” means those persons who are in either supervisory or monitoring roles.

### Minimum Elements of a Supervision System

Trade desk reviews conducted by IIROC have found that Participants have a number of common misconceptions about the requirements of Policy 7.1 and that there are a number of common deficiencies in the supervision system adopted by Participants. A supervision system must have both compliance procedures and supervision procedures. The nine elements of a supervision system that are listed in Part 2 of Policy 7.1 are primarily conceptual in nature and must be reflected in the overall structure of a Participant’s policies and procedures. A Participant cannot simply list each of these elements in its policies and procedures or affirm that each is being done. When evaluating policies and procedures, IIROC determines whether these elements have been included. Specific guidance is offered on each of the required nine elements of a supervision system.

#### • **Element 1 - Identification of Relevant Requirements**

A Participant’s policies and procedures must address all of the “Requirements” that apply to its business and trading. Participants are reminded that “Requirements” include not only the rules under UMIR but also the Trading Rules, Marketplace Rules and Decisions.

At a **minimum**, IIROC will review supervisory and compliance policies and procedures for inclusion of:

- the rules set out in Part 3 of Policy 7.1 (Minimum Compliance Procedures for Trading on a Marketplace); and
- any practice or procedure to be followed by a Participant as described in a Market Integrity Notice issued by IIROC.

IIROC issues a Market Integrity Notice upon a new or amended provision coming into effect. The following table identifies the changes to UMIR and its Policies that have become effective since April 1, 2002.

Market Integrity Notice	Date	Title	Related UMIR Provision
2002-012	July 9, 2002	Regulation ID Order Markers	6.2
2003-012	June 11, 2003	Definition of “Employee”	1.1
2003-024	October 31, 2003	Accommodation of Anonymous Orders	5.3, 8.1

From time to time, IIROC will publish a Market Integrity Notice to provide guidance on the interpretation of a particular provision of UMIR. The following table identifies Market Integrity Notices published since April 1, 2002 which have provided guidance on the interpretation of UMIR provisions.

<b>Market Integrity Notice</b>	<b>Date</b>	<b>Title</b>	<b>Related UMIR Provision</b>
2002-005	April 10, 2002	Evidence of Beneficial Ownership of Accounts	10.12
2002-007	May 6, 2002	Time Synchronization	10.14
2002-010	June 26, 2002	Changes in Beneficial and Economic Ownership	2.2, 6.4
2002-021	December 16, 2002	Prohibition Against Establishing Artificial Prices	2.2
2003-002	January 13, 2003	Prohibition on Double Printing	2.2
<b>Market Integrity Notice</b>	<b>Date</b>	<b>Title</b>	<b>Related UMIR Provision</b>
2003-007	March 27, 2003	Order Marking	6.2
2003-009	April 29, 2003	Trades on an "Organized Regulated Market"	6.4
2003-010	May 5, 2003	Trades in Debt Securities	6.4
2003-011	May 27, 2003	Short Position Reports	10.10
2003-016	August 13, 2003	Short Position Reports	10.10
2003-017	August 19, 2003	Trades in Listed Securities or Quoted Securities	6.4
2003-023	October 28, 2003	Obligations Related to TSX Specialty Crosses	5.3, 10.1

- **Element 2 - Documentation of the Supervision System**

A Participant must have written policies and procedures for both supervision and compliance. The written policies and procedures must be sufficiently detailed such that a reasonably knowledgeable person can understand when a policy or procedure would apply and how to comply with the policy or procedure. For compliance procedures, a testing method must be described in a manner that a reasonably knowledgeable person would be able to duplicate the testing method.

Preferably, the policies and procedures would be in narrative form. Compliance procedures would contain a step-by-step description of the testing methodologies together with any definitions that would be necessary to explain the logic of the procedures.

Participants should be aware that a copy, photocopy or slightly augmented version of Policy 7.1 does not satisfy the requirement for either compliance procedures or supervisory procedures. The procedures adopted by a Participant must be appropriate for the size and type of business and trading conducted by the Participant and must specifically address the "Requirements" that apply to that type of business or trading.

- **Element 3 - Training and Proficiency**

Supervisors must have policies and procedures that ensure employees are educated and trained on all of:

- the applicable Requirements;
- the procedures adopted by the Participant; and
- the electronic systems used by the Participant, such as trade stations.

Supervisors must also ensure that there is adequate education and training with respect to:

- changes in Requirements, procedures or systems;
- rectifying any problems found by compliance monitoring.

A Participant should not assume that a new employee has been adequately trained by another firm or by taking an industry course. The existence of multiple or inconsistent procedures may indicate that a firm has not adequately trained its employees. Each Participant must document the education and training that is provided to employees.

To date, trade desk reviews generally have not commented on the education and training provided by supervisors. In the future, the trade desk reviews may comment on the adequacy of the education and training programme adopted by a Participant.

- **Element 4 - Designation of Supervisory and Compliance Personnel**

IIROC recognizes that duties can be delegated. However, compliance duties must not be delegated to any person who would be in a conflict of interest. For example, it is not appropriate to delegate the compliance function to an employee that reports to a trading supervisor.

Participants should also be aware that any employee or officer that has supervisory or compliance responsibility and who delegates the duties to another person retains the responsibility for the performance of those functions.

- **Element 5 - Tailor Procedures to Fit the Participant's Business**

Policy 7.1 applies to all the trading done by a Participant. The Policy is not limited in its application to the head office or to institutional trading. Supervision procedures must encompass all employees involved in the trading process and ensure that they are appropriately educated and trained. These employees may include investment advisors and operations staff. Compliance monitoring must encompass all business units and locations to evaluate the complete trading process.

- **Element 6 – Procedures for Dealing with Violations**

The compliance department must report problems to the trading supervisors or their delegates. It does not satisfy the Policy to simply monitor trading but not take appropriate steps to correct any problems that are detected. Supervisors are responsible for ensuring that adequate steps are taken to address problems. If the supervisors do not adequately address problems, the person responsible for compliance must ensure that the problem is escalated within the Participant to a higher management level or even the board of directors. These steps and corrective actions must be documented and maintained in an easily retrievable format.

In the view of IIROC, compliance testing showing that the same or similar problems continue to occur over a period of time may indicate that supervisors have not taken adequate steps to supervise activities or to provide training and education. The continuation of a problem over a period of time may also indicate that the compliance department has not adequately reported the deficiencies in the supervision system to the appropriate management level.

- **Element 7 - Reviewing the Supervision System**

The Participant must ensure that its supervision and compliance policies and procedures are effective and relevant by reviewing them at least annually. Policy 7.1 has been in effect since April 1, 2002. Prior to that time, the Toronto Stock Exchange had a similar policy respecting trading supervision and compliance that required that a supervisory system be in place not later than September 28, 2001. As such, each Participant that has been in business since September of 2001 should have completed at least two annual reviews of their policies and procedures.

Management must ensure that the compliance procedures and supervisory procedures are updated to reflect new rules, procedures, systems, business lines, offices and employees. Compliance procedures must be reviewed to ensure the testing is effective and address any changes in the Participant.

- **Element 8 - Retaining Results of Compliance Reviews**

Compliance reviews are to be used to determine a Participant's level of compliance generally and to identify particular areas or rules that in respect of which problems have occurred. The compliance reviews will show if there is a compliance problem and, over time, whether the problem is increasing or decreasing. The compliance reviews will also show if the steps taken by supervisors to address previously identified problems have been effective. For these reasons, tracking trends and patterns over several compliance reviews can be very useful.

IIROC requires that the results of the compliance reviews be summarized, quantified and retained in an easily retrievable format. Test results must be verifiable. In undertaking a trade desk review, IIROC will evaluate all summary documents of the required testing and may request the underlying sources for review.

- **Element 9 - Reports to the Board of Directors**

A summary of the compliance reviews and the results of the supervision system review must be provided at least annually to the board of directors of the Participant. As of this date, each Participant should have reported at least once to its board of directors on these matters. As part of the trade desk review, IIROC will request a copy of that section of the minutes of the meeting of the board of directors dealing with these reviews together with a copy of the material provided to the board of directors for their consideration.

### **Minimum Compliance Procedures for Trading on a Marketplace**

Part 3 of Policy 7.1 sets out a framework for the **minimum** compliance procedures to be used to monitor trading on a marketplace. Participants are reminded that their compliance procedures should be modified to take account of:

- new or amended Rules or Policies as made from time to time;
- interpretations of UMIR as published by IIROC as a Market Integrity Notice.

Each Participant must monitor the publication of Market Integrity Notices and the compliance department should determine if the compliance procedures need to be modified to reflect any development described in a Market Integrity Notice. Lists of the relevant Market Integrity Notices which have been issued in the period April 1, 2002 to October 31, 2003 are set out on page 3 of this Notice under the heading "Identification of Relevant Requirements".

Each Participant must determine the level of testing which is appropriate for their firm based on size and type of business conducted by that firm. Each Participant must determine and document its testing methodologies, including the reports and systems that are used by their firm. The table in Part 3 of Policy 7.1 contains columns headed "Compliance Review Procedures" and "Potential Information Sources". The information in the table under these headings is intended to only be suggestions and should not be interpreted as an exhaustive list of requirements.

Similarly, each Participant must determine the appropriate standards for their firm. In many cases, larger sample sizes and more frequent testing may be required. Each Participant must develop reasonable sample sizes and review frequencies and must document the rationale supporting these decisions. The information in the table under the heading "Frequency and Sample Size" only sets out minimum standards for sample size and frequency of tests.

As part of a trade desk review, IIROC will evaluate the appropriateness of the testing methodologies adopted by a Participant.

**Guidance:** The following is the relevant text of Market Integrity Notice 2005-006 issued on March 4, 2005 under the heading "**Obligations of an "Access Person" and Supervision of Persons with "Direct Access"**".

#### **Responsibility of a Participant that Provides "Direct Access"**

The Toronto Stock Exchange ("TSX") may establish categories of persons other than dealers that are permitted to trade on the TSX. TSX Policy 2-501 allows a Participant to grant access to the order routing system of the Participant to various domestic and foreign institutional clients and to retail clients through Order-Execution Accounts (essentially accounts in respect of which the Participant is not required to review orders for suitability). Effective May 31, 2004, the TSX Venture Exchange ("TSXV") adopted "Direct Access Rules" which are substantially similar to the requirements of TSX Policy 2-501.

If a client of a Participant enters orders to the trading system of the TSX, TSXV or any other Exchange or QTRS by means of an electronic connection to the order routing system of the Participant (a "Direct Access Client"), that client is subject to applicable securities legislation. The Direct Access Client is not subject to disciplinary or enforcement action under UMIR.

In providing Direct Access to the TSX, TSXV or any other Exchange or QTRS, the Participant is not relieved from any obligations under UMIR with respect to the supervision of trading activities by a Direct Access Client. The Participant retains full responsibility for any order entered by a Direct Access Client, even though that order is electronically routed to the marketplace. The policies and procedures of a Participant should specifically address the additional risk exposure which the Participant has for orders that are not directly handled by employees of the Participant prior to the entry of such orders on a marketplace.

Depending on the business practices adopted by a Participant, Direct Access trading may restrict the ability of the Participant to detect on a "real time" basis orders that are not in compliance with UMIR. If this is the case, the "post order entry" compliance testing by the Participant should specifically address the risks associated with trading by Direct Access Clients. For example, it may be appropriate for the Participant to sample for "post order entry" compliance testing a higher percentage of orders from Direct Access Clients than the percentage of orders sampled in other circumstances.

Examples of "post order entry" compliance reviews may include testing whether an order entered by a Direct Access Client:

- has created an artificial price;
- is part of a "wash trade" (in circumstances where the client has more than one account with the Participant);
- is an unmarked short sale (if the trading system of the Participant does not automatically code as "short" any sale of a security not then held in the account of the client); and
- has complied with order marking requirements and in particular the requirement to mark an order as from an insider or significant shareholder (unless the trading system of the Participant restricts trading activities in affected securities).

**Guidance:** The following is the relevant text of Market Integrity Notice 2006-023 issued on November 30, 2006 under the heading "**Guidance – Joint Regulatory Notice – The Role of Compliance and Supervision**":

#### **Introduction**

Industry compliance professionals play an important role in the system of securities regulation. Self regulatory organizations ("SRO") and industry compliance professionals have a common objective to promote compliance at firms and set industry standards. In order to achieve this objective, SROs need to be absolutely clear in their expectations of the chief compliance officer ("Chief Compliance Officer"), the compliance department ("Compliance Department") and the member firm, including its management.

The purpose of this Notice is to provide Members and Participants (collectively, "Member" or "Members") with SRO expectations of the compliance function at Members and the role, responsibility and accountability of the Member, the board of directors, management, Compliance Departments and compliance officers ("Compliance Officer").

The SROs have issued notices and bulletins in the past that address many of the matters outlined below.<sup>1</sup> In addition, there are specific SRO rules that deal with supervisory and compliance responsibilities. This Notice should be read in conjunction with those regulatory instruments.

<sup>1</sup> IDA Compliance Interpretation Bulletin C-130, July 12, 1999 Accountability of Compliance Officers in Disciplinary Actions  
Bourse's Circular No. 017-2003, February 18, 2003 Surveillance and Compliance  
MFDA Member Regulation Notice MR –0037, March 16, 2005 Compliance Responsibilities  
RS Market Integrity Notice No. 2003-025, November 28, 2003 Guidelines on Trading Supervision Obligations  
RS Market Integrity Notice No. 2005-011, April 1, 2005 Provisions Respecting Manipulative and Deceptive Activities

### **Responsibility for Compliance**

The responsibility for compliance belongs to the Member generally: the board of directors, management, supervisors and those fulfilling the compliance function. Compliance should not be viewed as an isolated activity of the Compliance Department but as an integral part of a Member's general business activities. Within that general framework, it is the responsibility of the board of directors, management and supervisors to consider and implement the advice from those performing a compliance function.

The role of the Compliance Department is to identify, assess, advise on, communicate, monitor and report on the Member's compliance with regulatory requirements.

### **Distinction between Supervisory and Compliance Roles**

Compliance Departments and Compliance Officers, while they carry out similar functions across firms, have responsibilities tailored to the size, resources and business needs of the particular Member. In some cases their sole responsibility will be fulfilling the compliance function; in others they may also have supervisory roles.

In contrast to the compliance role described above, a person in the role of "supervisor" has authority for the day-to-day management of a business function or area which includes the supervision of individuals and the authority to implement changes to how the business function or area is run. The difference between supervisory and compliance roles is defined by who has the authority to resolve issues once they are identified.

For example, if an issue is identified by a Compliance Officer and referred to a branch manager for resolution, the Compliance Officer is executing a compliance function only. In doing so, the Compliance Officer may also, while still conducting a compliance function, be checking on the efficacy of the branch manager's reviews. As long as the authority to effect change resides with the branch manager, he or she is in the supervisory role. In those circumstances where Compliance Officers have the express authority to effect change they are also exercising a supervisory role.

In determining whether an individual is acting in a supervisory role, the SROs will look at the individual's responsibilities, authority and the functions he or she performs for the Member, not simply at his or her title. While the SROs will consider documentation setting out an individual's responsibilities and authority, they will also look to confirm whether these are reflected in the day-to-day operations of the firm. In other words, it is a two-fold test: documentation and practice.

The activities of those exercising compliance functions should not be viewed by supervisors as a substitute for their responsibility to supervise the business of the firm. Supervisors still retain ultimate authority over, and are ultimately accountable for, business activities and the people they supervise when issues arise, and supervisors must remain vigilant in carrying out their responsibilities.

In some instances, the Compliance Officer may also have supervisory responsibility, for example, as a branch manager. The risks of such consolidation should be carefully considered when outlining the responsibilities of each position.

### **Role of the Member, Board of Directors, Management and the Compliance Officer**

#### **The Member**

The Member is responsible for establishing, implementing, communicating and maintaining effective compliance programs to ensure compliance with applicable laws and regulations. This responsibility extends to all directors of the Member with respect to their corporate governance responsibilities and all officers of the Member with regard to areas of their management responsibility.

#### **The Board of Directors**

The board of directors must ensure that the Member maintains a compliance program that identifies and addresses material risks of non-compliance and that appropriate supervision and compliance procedures to manage those risks have been implemented. The board has responsibility to act on reports from the Compliance Department as outlined below.

#### **Management**

Senior management has responsibility to establish and maintain a Member's overall compliance system. All management has the responsibility to supervise and to direct the activities of the Member and the individuals within the Member firm to achieve compliance with applicable laws and regulation with respect to areas of their management responsibility.

#### **The Chief Compliance Officer<sup>2</sup>**

The Chief Compliance Officer must report the results from its monitoring to management and the board of directors at least annually, but should have direct access to senior management as needed to report significant issues as they arise. The mandate of the Chief Compliance Officer is to provide the board of directors with reasonable assurance that all standards and requirements of applicable laws and regulations are met.

#### **The Compliance Officer**

A Compliance Officer's responsibility is to monitor compliance and take appropriate steps to assist in ensuring that corrective measures are being taken by supervisors or managers to remedy any issues that are identified. It is not enough to simply identify issues. Compliance Officers in their advisory capacity should communicate their findings to the appropriate manager and recommend appropriate corrective measures. If performing solely a compliance function, the steps will involve advising supervisors or managers who have the authority to direct what must be done.

<sup>2</sup> The term "Chief Compliance Officer" is not used by the MFDA or RS. Unless otherwise indicated, references to "compliance officer" in this Notice include individuals designated as the Chief Compliance Officer.

Compliance Officers must also monitor the corrective measures taken. If supervisors do not adequately address problems, the Compliance Officer must escalate the problem as appropriate. Escalation procedures should be detailed in the firm's procedures. In some cases the Compliance Officer may raise the issue with a higher level supervisor, in others, to the Chief Compliance Officer, who must ensure that the problem is escalated within the Member to a higher management level or, where appropriate, the board of directors.

The steps taken by Compliance Officers and corrective actions taken by supervisors must be documented, maintained and auditable.

#### **Other Individuals**

Other individuals in the Member firm must also comply with the Member's compliance program.

#### **When Individuals will be Subject to Enforcement Action by SROs**

The standard against which the conduct of board members, management, Compliance Officers and other individuals will be measured in a discipline hearing is that of a reasonably proficient and diligent individual in that position. The standard is an objective one; it is not what the respondent actually knew or did but rather what he or she ought to have known or done. It is always open to the individual to demonstrate that they exercised due diligence to prevent the harm that occurred.

A Compliance Officer may be subject to enforcement action if she or he violates securities laws or aids and abets another in such violations. A Compliance Officer may be subject to enforcement action for failing to supervise if she or he has been specifically delegated, or has assumed, supervisory authority for particular business activities or situations, and therefore has the requisite degree of responsibility, ability or authority to affect the conduct of the individual in the Member firm whose behaviour is at issue. A Compliance Officer may be subject to enforcement action if she or he fails to identify rule violations according to the standard of a reasonably proficient and diligent Compliance Officer, or, if after identifying the violation, he or she fails to sufficiently escalate and follow up the issue with management, in accordance to the standard of a reasonably proficient and diligent Compliance Officer. What is sufficient escalation and follow-up will often be fact specific. If the SRO is satisfied that the Compliance Officer has met these regulatory expectations he or she will not be subject to an enforcement action.

#### **Creating an Effective Compliance Program**

In order to be effective, compliance programs must be reasonably designed to identify and control the risk of compliance failure that could result in investor and/or market harm and financial losses and reputational damage to the Member.

Members have an obligation to develop and implement effective compliance programs, which includes: allocating sufficient resources; creating measures and systems that encourage and reward compliant behaviour and discourage non-compliant behaviour; and ensuring that Compliance Officers have appropriate access to senior management. There are many steps that a Member can take to promote the importance of compliance, including the following:

- (i) Promote a culture of compliance by clearly identifying, prioritizing and communicating compliance goals.
- (ii) Insist on compliance and high ethical standards throughout the Member with senior management leading by example.
- (iii) Ensure that effective execution of compliance and supervisory roles is an explicit element of compensation and promotion decisions.
- (iv) Ensure that others in the firm have a clear understanding of the role of Compliance Officers and the Compliance Department.
- (v) Communicate compliance and regulatory information to individuals within the Member. Emphasize compliance and regulatory subjects in training. Training should include educating individuals about their compliance responsibilities on an ongoing basis.
- (vi) Make available to all individuals an effective means of communicating (confidential or anonymous, if appropriate) compliance, regulatory or ethical concerns to Compliance Officers, senior management or the board of directors if necessary without fear of retaliation.
- (vii) Encourage the development, training, professionalism and retention of the Member's Compliance Officers with compensation, benefits and recognition in keeping with their contributions; and implement sanctions or other corrective actions for non-compliant behaviour. Further, staff the Compliance Department with sufficient, qualified, experienced and knowledgeable professionals.
- (viii) Ensure sufficient access to information for Compliance Officers to enable them to carry out their responsibilities.
- (ix) Develop a cooperative relationship between regulators and Members.

#### **Tips for Compliance Officers**

There are many steps that Compliance Officers can take to ensure that they have discharged their responsibilities in connection with the expectations of SROs including the following:

- (i) Ensure that they have a clear understanding of the nature of their responsibilities. This includes having a detailed job description with clearly established reporting lines and a clear understanding of whether they are expected to act in a supervisory capacity.
- (ii) Maintain written records that detail all steps that were taken to either correct, report or escalate issues that were identified along with any supporting documentation which demonstrates actions taken.

- (iii) *Lawyers who perform compliance functions in addition to legal functions should make it clear to other individuals when they are acting as legal counsel and providing legal advice.*
- (iv) *Compliance Officers should be active in promoting compliance related initiatives both inside and outside the Member and be available to individuals within the Member for consultation on compliance issues.*
- (v) *Ensure steps in the compliance process are appropriately tailored to the size and nature of the Member's business and that they are tested to ensure that they adequately address any compliance gaps.*
- (vi) *Ensure that SRO rule changes, bulletins and notices are reviewed and incorporated into the Member's compliance policies and procedures in a timely and effective manner which addresses the nature and size of the Member's business.*
- (vii) *Compliance policies and procedures should be constantly reviewed, tested and updated to ensure that existing procedures continue to effectively reflect the business practices of the Member and are in compliance with new rules and regulations.*
- (viii) *Periodically review the websites of provincial regulators and the SROs and where possible attend SRO meetings or seminars devoted to regulatory issues. Doing so will give Compliance Officers advance notice of proposed and imminent rule changes that may affect the Compliance Officer and the Member firm.*
- (ix) *Develop a cooperative relationship between regulators and Members.*

**Guidance:** *The following is the relevant text of Market Integrity Notice 2007-010 issued on April 20, 2007 under the heading "Guidance – Compliance Requirements for Dealer-Sponsored Access Trading".*

#### **Summary**

*This Market Integrity Notice provides guidance on the compliance requirements under the Universal Market Integrity Rules ("UMIR") for a Participant who provides "Dealer-Sponsored Access", commonly known as "direct market access", to a client.*

#### **Background**

*The Investment Industry Regulatory Organization of Canada ("IIROC") published Market Integrity Notice 2005-011 – Notice of Amendment Approval - Provisions Respecting Manipulative and Deceptive Activities (April 1, 2005), which made effective a number of amendments to UMIR, including an amendment to Policy 7.1 to clarify that Participants have supervisory and compliance responsibility for all client orders irrespective of the source of the order or the means by which the order is transmitted to a marketplace. The amendment to Policy 7.1 made specific reference to the entry of an order on a marketplace without the involvement of a trader (for example by a client with a systems interconnect arrangement in accordance with Policy 2-501 of the Toronto Stock Exchange), and highlighted the need for a Participant to adopt supervisory policies and compliance procedures that take into account the additional difficulties experienced by the Participant for orders that are not directly handled by staff of the Participant.*

*Concurrent with the issuance of this Market Integrity Notice, IIROC issued Market Integrity Notice 2007-009 – Request for Comments – Provisions Respecting Access to Marketplaces (April 20, 2007), which requests comments on proposed amendments to UMIR respecting "Dealer-Sponsored Access" and other aspects of access to marketplaces ("Proposed Amendments"). Under the Proposed Amendments:*

- *the term "Dealer-Sponsored Access" would be defined as the right to access to the trading system of a marketplace either directly or by means of an electronic connection to the order routing system of a Participant that has been granted by the Participant to a client that is an "institutional customer" for the purposes of Policy 4 – Minimum Standards for Institutional Account Opening, Operation and Supervision of the Investment Dealers Association ("IDA")<sup>3</sup> [referred to as of June 1, 2008 as IIROC Rule 2700 – Minimum Standards for Institutional Account Opening, Operation and Supervision];*
- *the definition of "Access Person" would be expanded to include a client of a Participant to whom the Participant has granted Dealer-Sponsored Access (a "DSA Client");*
- *the definition of "Participant" would also be expanded to include a dealer with Dealer-Sponsored Access that that is able to act as an intermediary on behalf of clients with respect to securities traded on a marketplace and who is not otherwise a member of an exchange, a user of a quotation and trade reporting system or a subscriber to an alternative trading system; and*

<sup>3</sup> IDA Policy 4 – Minimum Standards for Institutional Account Opening, Operation and Supervision [as of June 1, 2008, IIROC Rule 2700] provides five broad categories of persons that would be considered "institutional customers" including:

- *acceptable counterparties as defined in the Joint Regulatory Financial Questionnaire and Report ("JRFQ");*
- *acceptable institutions as defined in the JRFQ;*
- *regulated entities as defined in the JRFQ;*
- *registrants (other than individual registrants) under securities legislation; and*
- *a non-individual with total securities under administration or management exceeding \$10 million.*

- a DSA Client would be required to comply with certain provisions of UMIR and would be subject to disciplinary proceedings for any breach of the applicable UMIR provisions in the same manner as currently required of a subscriber to an alternative trading system (“ATS”).

In the view of IIROC, definition of “Dealer-Sponsored Access” excludes the handling of an order by a Participant in respect of which the Participant provides to non-institutional clients only an order-execution service in accordance with the requirements of a securities regulatory authority or self-regulatory entity. As such, a Participant that offers “discount brokerage” services to clients (other than “institutional customers” for the purposes of IDA Policy 4) will not be considered to be providing “Dealer-Sponsored Access”. A Participant who provides order-execution services to a client that is not an institutional customer should refer to Market Integrity Notice 2007-011 - Guidance – Compliance Requirements for Order-Execution Services (April 20, 2007), which sets out IIROC’s expectations with respect to trading supervision and compliance procedures of a Participant providing order-execution services to clients that are not institutional customers for the purposes of IDA Policy 4.

**The guidance contained in this Market Integrity Notice sets out IIROC’s expectations regarding compliance procedures to be adopted by a Participant that provides “direct market access” or Dealer-Sponsored Access and is applicable whether or not the Proposed Amendments are approved. Additional guidance may be provided if the Proposed Amendments are significantly revised prior to approval.** It is IIROC’s view that notwithstanding that the Proposed Amendments would extend the definition of “Access Person” to include a DSA Client, a Participant is not relieved from any of its supervisory or compliance obligations with respect to any order entered on a marketplace by means of an electronic connection to the order routing system of the Participant.

#### **Supervisory Obligations of Participants**

Part 1 of Policy 7.1 provides that a Participant has an obligation to supervise orders which are entered on a marketplace:

- by traders employed by the Participant;
- by an employee of the Participant through an order routing system;
- directly by a client and routed to a marketplace through the trading system of a Participant; or
- by any other means.

In the view of IIROC, the means by which an order is entered on a marketplace does not relieve a Participant of responsibility for the supervision of such orders. IIROC is also of the view that orders entered directly on a marketplace without the involvement of staff of the Participant present heightened risks to both the integrity of the markets and the Participant through whom the order is routed. IIROC expects a Participant to have supervision policies and procedures and compliance testing which addresses the additional risk exposure posed by orders entered by a DSA Client.

#### **Questions and Answers**

The following is a list of frequently asked questions regarding the compliance requirements of a Participant who has granted Dealer-Sponsored Access to clients and the response of IIROC to each question:

**1. Is there an obligation to monitor on a “real-time basis” the orders entered by a DSA Client?**

A number of Participants have commented that while they have the ability to report order flow from a DSA Client on a real-time basis, it is not practical to expect staff of the Participant to supervise all orders entered on a “real time” basis. IIROC is cognizant of the practical limitations surrounding “real time” reviews of orders from DSA Clients, and as such, expects that a Participant will have sufficient “post-trade” compliance testing to address the risks associated with orders entered by DSA Clients. However, it is important that the compliance department of the Participant have the capacity to monitor orders entered by DSA Clients on a real-time basis should such monitoring become necessary as a result of a request by IIROC, an applicable securities regulatory authority or the marketplace on which the orders are entered. Similarly, if compliance has determined that trading by a particular DSA Client needs additional “monitoring” the Participant should have the capacity to do so on a real-time basis.

**2. Why does IIROC believe that there is greater “risk” to market integrity associated with an order entered by a DSA Client?**

Orders entered by DSA Clients are conducted, for the most part, in the absence of any meaningful pre-order or pre-trade oversight by the Participant. It is IIROC’s view that this lack of involvement by staff of a Participant eliminates a significant opportunity for a Participant to perform its “gatekeeper” function and to act on “red flags”. If an investment adviser or trader “handles” an order, the experience and knowledge of the employee increases the possibility that unusual trading patterns or anomalies can be detected prior to the entry of an order to a marketplace. The performance of the “gatekeeper” function would require the employee to inquire about unusual trading patterns or anomalies or to involve a supervisor. These actions may prevent offending orders from being entered on a marketplace. This same safeguard is not available for orders entered by a DSA Client that are routed directly to a marketplace.

**3. Can the additional risks associated with trading by a DSA Client be satisfied by “screening” a client prior to granting Dealer-Sponsored Access?**

IIROC is aware that a number of Participants attempt to “front-load” their gatekeeper and compliance obligations by focusing on the screening process for clients to which Dealer-Sponsored Access is granted. However, once a client has been approved for Dealer-Sponsored Access, the Participant undertakes only limited post-trade testing of orders entered by a DSA Client or trades resulting from such orders.

A review of disciplinary decisions by self-regulatory organizations and securities regulatory authorities indicates that established and well-respected institutions are not immune from undertaking breaches of regulatory requirements. Frequently, these violations may arise as a result of the actions of a single or small number of employees or officers of the DSA Client. While extensive due diligence on the proficiency of a client who is seeking Dealer-Sponsored Access is to be encouraged, that screening is not a substitute for an effective compliance programme.

**4. Can a Participant use the same compliance sampling and testing standards to monitor trading activity by DSA Clients as other clients?**

Market Integrity Notice 2005-006 - Obligations of an "Access Person" and Supervision of Persons with "Direct Access" (March 4, 2005) provided guidance on the types of "post-order entry" compliance testing that Participants should consider in developing effective compliance procedures. That Notice provided examples of "post-order entry" compliance testing that may be appropriate in light of the risks associated with trading by clients with direct order entry access to a marketplace that can not be supervised at the time of order entry. The Notice also suggested that, if a Participant does not conduct separate compliance testing of trading by such clients, the Participant should sample for "post-order entry" compliance testing a higher percentage of orders from DSA Clients than the percentage sampled of orders that were subject to supervision by staff of the Participant at the time of order receipt or at entry on a marketplace. In essence, if an order can not be supervised prior to entry on a marketplace, the Participant must compensate for this lack of supervision by enhanced compliance testing.

**5. Are there any particular "risks" that need to be addressed in compliance procedures for trading by DSA Clients?**

Part 3 of Policy 7.1 under UMIR sets out the minimum compliance procedures for trading on a marketplace. However, Policy 7.1 also stipulates that the compliance procedures must be appropriate for the lines of business conducted by a Participant. Given that orders entered by a DSA Client will be subject to limited supervision prior to entry on a marketplace, the compliance procedures for DSA Clients should, at a minimum, address the procedures for testing:

- orders that have been entered for order markers as required by Rule 6.2 of UMIR, and in particular:
  - the "short sale" marker unless the trading system of the Participant automatically code as "short" any sale of a security not then held in the account of the DSA Client, and
  - the insider or significant shareholder order markers unless the trading system of the Participant restricts trading activities in affected securities; (As set out in Market Integrity Notice - 2002-012 - Regulation ID Order Markers and Order Inhibition During Regulatory Halts & Suspensions (July 9, 2002), a Participant may rely on the "know your client" information collected from the account holder provided that such information is "current" and the Participant does not have actual knowledge that a client is an insider or significant shareholder.)
- orders that have been entered for "spoofing" contrary to Rule 2.2 of UMIR (the entry of an order or orders which are not intended to be executed for the purpose of determining the depth of the market, checking for the presence of an "iceberg" order, affecting a calculated opening price or other similar improper purpose);
- orders that have been entered on a marketplace and trades that have executed for the creation of an "artificial price" contrary to Rule 2.2 of UMIR (particularly since institutional investors are among the investors which may have an interest in "high closing" particular securities in their portfolios often at the end of a reporting period);
- trades for "wash trading" (particularly if the DSA Client has more than one account with the Participant); and
- trades for failure in settlement.

As required by Rule 7.1, any special compliance procedures employed for trading by DSA Clients must be in writing and must contain detailed guidance on how testing of DSA Client orders and trades is to be conducted.

A Participant should also be aware that Part 5 of Policy 7.1 requires that the procedures adopted by a Participant address the steps to be taken to monitor the trading activity of any person who has multiple accounts with the Participant including other accounts in which the person has an interest or over which the person has direction or control. Similarly, the procedures should address trading activity by a particular client through a DSA account and through other accounts at the Participant.

**6. Does IDA Policy 4 [as of June 1, 2008 IIROC Rule 2700] affect supervisory or compliance obligations under UMIR?**

The supervisory and compliance obligations of a Participant in respect of trading that is subject to UMIR is set out in Policy 7.1. Those obligations under Policy 7.1 are more expansive and specific than the requirements of IDA Policy 4 - Minimum Standards for Institutional Account Opening, Operation and Supervision which became effective June 1, 2006 [referred to as of June 1, 2008 as IIROC Rule 2700 - Minimum Standards for Institutional Account Opening, Operation and Supervision]. Under IDA Policy 4, a Participant is required to have supervisory procedures and compliance monitoring procedures that are reasonably designed to detect account activity that is or may be a violation of applicable securities legislation, requirements of any self-regulatory organization applicable to the account activity and the rules and policies of any marketplace on which the account activity takes place. As such, IDA Policy 4 does not relieve a Participant from any obligation under Policy 7.1 of UMIR.

**Guidance:** The following is the relevant text of Market Integrity Notice 2007-011 issued on April 20, 2007 under the heading “**Guidance – Compliance Requirements for Order-Execution Services**”.

### Summary

This Market Integrity Notice provides guidance on the compliance requirements under the Universal Market Integrity Rules (“UMIR”) for a Participant providing order-execution services for orders of qualified clients.

### Background

The Investment Industry Regulatory Organization of Canada (“IIROC”) published Market Integrity Notice 2005-011 – Notice of Amendment Approval - Provisions Respecting Manipulative and Deceptive Activities (April 1, 2005), which made effective a number of amendments to UMIR, including an amendment to Policy 7.1 to clarify that Participants have supervisory and compliance responsibility for all client orders irrespective of the source of the order or the means by which the order is transmitted to a marketplace. The amendment to Policy 7.1 highlighted the need for a Participant to adopt supervisory policies and compliance procedures that take into account the additional risk exposure experienced by the Participant for orders that may not be directly handled by staff of the Participant.

Concurrent with the issuance of this Market Integrity Notice, IIROC has issued Market Integrity Notice 2007-009 – Request for Comments – Provisions Respecting Access to Marketplaces, (April 20, 2007) which requests comments on proposed amendments to UMIR respecting “Dealer-Sponsored Access” and various other aspects of access to marketplaces (“Proposed Amendments”). Under the Proposed Amendments, the term “Dealer-Sponsored Access” would be defined as the right to access to the trading system of a marketplace either directly or by means of an electronic connection to the order routing system of a Participant that has been granted by the Participant to a client that is an “institutional customer” for the purposes of Policy 4 – Minimum Standards for Institutional Account Opening, Operation and Supervision of the Investment Dealers Association (“IDA”)<sup>4</sup> [as of June 1, 2008 referred to as IIROC Rule 2700 – Minimum Standards for Institutional Account Opening, Operation and Supervision.].

In the view of IIROC, the definition of “Dealer-Sponsored Access” excludes the handling of an order by a Participant in respect of which:

- the client is not an “institutional customer” for the purposes of IDA Policy 4 [as of June 1, 2008, IIROC Rule 2700]; and
- the Participant provides only an “order-execution service”<sup>5</sup>, which for this purpose is considered as the handling, in accordance with the requirements of a securities regulatory authority or a self-regulatory entity, of a client order which:
  - the Participant has not recommended, and
  - the Participant has no responsibility as to the appropriateness or suitability of the order to the financial situation, investment knowledge, investment objectives and risk tolerance of the client.

**The guidance contained in this Market Integrity Notice sets out IIROC’s expectations regarding compliance procedures to be adopted by a Participant providing an order-execution service to a client that is not an “institutional customer” (“Execution Client”) and is applicable whether or not the Proposed Amendments are approved.** A Participant who provides “Dealer-Sponsored Access” to clients that are “institutional customers” should refer to Market Integrity Notice 2007-010 - Guidance – Compliance Requirements for Dealer-Sponsored Access Trading (April 20, 2007), which sets out IIROC’s expectations with respect to trading supervision and compliance procedures of a Participant that provides Dealer-Sponsored Access.

### Supervisory Obligations of Participants

Part 1 of Policy 7.1 provides that a Participant has an obligation to supervise orders which are entered on a marketplace:

- by traders employed by the Participant;
- by an employee of the Participant through an order routing system;
- directly by a client and routed to a marketplace through the trading system of a Participant; or
- by any other means.

<sup>4</sup> IDA Policy 4 – Minimum Standards for Institutional Account Opening, Operation and Supervision [as of June 1, 2008, IIROC Rule 2700] provides five broad categories of persons that would be considered “institutional customers” including:

- acceptable counterparties as defined in the Joint Regulatory Financial Questionnaire and Report (“JRFQ”);
- acceptable institutions as defined in the JRFQ;
- regulated entities as defined in the JRFQ;
- registrants (other than individual registrants) under securities legislation; and
- a non-individual with total securities under administration or management exceeding \$10 million.

<sup>5</sup> The term “order-execution service” is defined in IDA Policy 9 – Minimum Requirements for Members Seeking Approval Under Regulation 1300.1(E) for Suitability Relief for Trades not Recommended by the Member as “the acceptance and execution of orders from customers for trades that the Member has not recommended and for which the Member takes no responsibility as to the appropriateness or suitability of the trades to the customers’ financial situation, investment knowledge, investment objectives and risk tolerance.”

In the view of IIROC, the means by which an order is entered on a marketplace does not relieve a Participant of responsibility for the supervision of such orders. IIROC is also of the view that orders entered by an Execution Client which are routed to the order management system of a Participant without the involvement of staff of the Participant present heightened risks to both the integrity of the markets and the Participant through whom the order is routed. The lack of involvement by staff of the Participant (i.e. an investment advisor or trader "handling" an order) eliminates a significant opportunity for a Participant's personnel to identify and detect unusual trading patterns or anomalies prior to the offending order being entered on a marketplace. To the extent that orders entered by an Execution Client are not directly handled by staff of the Participant, IIROC expects that a Participant will have supervision policies and procedures and compliance testing which addresses the additional risk exposure posed by Execution Client trading.

#### **Questions and Answers**

The following is a list of frequently asked questions regarding the compliance requirements of a Participant that provides order-execution services to its clients and the response of IIROC to each question:

**1. Is there an obligation to monitor on a "real-time basis" the orders entered by an Execution Client?**

IIROC expects a Participant to have supervision policies and procedures and compliance testing which are appropriate for its size and business and which are reasonably designed to prevent and detect violations of requirements. To this end, Participants are expected to employ appropriate supervisory policies and procedures that have the ability to detect an offending order prior to such order being entered on a marketplace. To the extent that it is not feasible to employ on-going monitoring of specific elements of an order on a "real-time basis", IIROC expects that a Participant will have sufficient "pre-" and "post-trade" compliance testing to address the risks associated with orders entered by Execution Clients. However, it is important that the compliance department of the Participant have the capacity to monitor orders entered by Execution Clients on a real-time basis should such monitoring become necessary as a result of a request by IIROC, an applicable securities regulatory authority or the marketplace on which the orders are entered. Similarly, if compliance has determined that trading by a particular Execution Client needs additional "monitoring" the Participant should have the capacity to do so on a "real-time basis".

**2. Why does IIROC believe that there is greater "risk" to market integrity associated with an order entered by an Execution Client?**

IIROC understands that Participants generally rely on automated "filters" to identify potentially offending orders. It is IIROC's further understanding that the implementation of such "filters" varies broadly in nature and scope amongst Participants, and that the majority of such filters, are primarily "credit-based", that is, they are designed to "flag" orders that exceed a client's credit or cash position or other pre-established "credit based" parameters set by a Participant. As such, to the extent that a potentially offending order is not otherwise "off-side" any credit-based parameters, such order would not be "flagged" for review by staff of the Participant and would be routed directly to the marketplace without involvement of staff of the Participant. It is IIROC's view that this lack of involvement eliminates a significant opportunity for a Participant to perform its "gatekeeper" function and to act on "red flags".

This lack of involvement by staff of a Participant is particularly significant given the varied knowledge and experience of Execution Clients. Unlike Dealer-Sponsored Access trading that is available specifically to "eligible clients", namely institutional clients that employ experienced traders and conduct trading in accordance with internal policies and procedures and in certain cases bound by fiduciary obligations, there are no eligibility requirements for a client accessing the order-execution services of a Participant. In IIROC's view, the lack of eligibility requirements may give rise to a higher proportion of unintentional offending orders being entered by Execution Clients with limited knowledge of the trading rules. Similarly, the anonymous nature of trading conducted by means of an order-execution account may equally lend itself to unscrupulous trading by sophisticated Execution Clients that is meant to circumvent trading rules and may also result in a higher proportion of offending orders being entered by Execution Clients.

**3. Can a Participant use the same compliance sampling and testing standards to monitor trading conducted by Execution Clients as it does for other trading activity?**

Under Policy 7.1 of UMIR, if an order is entered on a marketplace without the involvement of a trader a Participant's supervision policies and procedures should adequately address the additional risk exposure which the Participant may have for orders that are not directly handled by staff of the Participant. To the extent that a Participant does not conduct separate testing of trading by Execution Clients, it may be appropriate for a Participant to sample for compliance testing a higher percentage of orders entered by Execution Clients that have not been handled by staff of the Participant (i.e. orders that were not "flagged" or otherwise handled by staff of the Participant) than the percentage of orders sampled in other circumstances.

**4. Are there any particular "risks" that need to be addressed in compliance procedures for trading by Execution Clients?**

Part 3 of Policy 7.1 under UMIR sets out the minimum compliance procedures for trading on a marketplace. However, Policy 7.1 also stipulates that the compliance procedures must be appropriate for the lines of business conducted by a Participant. Given that orders entered by an Execution Client will in most circumstances be subject to limited supervision prior to being sent to the order routing system of the Participant, the compliance procedures for Execution Clients should, at a minimum, address the procedures for testing:

- orders that have been entered for order markers as required by Rule 6.2 of UMIR, and in particular:
  - the “short sale” marker unless the trading system of the Participant automatically codes as “short” any sale of a security not then held in the account of the Execution Client, and
  - the insider or significant shareholder order markers unless the trading system of the Participant automatically codes the order appropriately or restricts trading activities in affected securities; (As set out in Market Integrity Notice - 2002-012 - Regulation ID Order Markers and Order Inhibition During Regulatory Halts & Suspensions (July 9, 2002), a Participant may rely on the “know your client” information collected from the account holder provided that such information is “current” and the Participant does not have actual knowledge that a client is an insider or significant shareholder.)
- orders that have been entered for “spoofing” contrary to Rule 2.2 of UMIR (the entry of an order or orders which are not intended to be executed and are entered for the purpose of determining the depth of the market, checking for the presence of an “iceberg” order, affecting a calculated opening price or other similar improper purpose);
- orders that have been entered on a marketplace and trades that have executed for the creation of an “artificial price” contrary to Rule 2.2 of UMIR;
- orders that have been entered which seek to abuse the minimum guaranteed fill facility of a Market Maker;
- orders that have entered at unreasonable prices;
- trades for “wash trading” (particularly if the Execution Client has more than one account with the Participant); and
- trades for failure in settlement.

As required by Rule 7.1, any special compliance procedures employed for trading by Execution Clients must be in writing and must contain detailed guidance on how testing of Execution Client orders and trades is to be conducted.

A Participant should also be aware that Part 5 of Policy 7.1 requires that the procedures adopted by a Participant address the steps to be taken to monitor the trading activity of any person who has multiple accounts with the Participant including other accounts in which the person has an interest or over which the person has direction or control. Similarly, the procedures should address trading activity by a particular client through an Order-Execution Service account and through other accounts at the Participant.

**5. Does IDA Policy 9 [as of June 1, 2008 referred to as IIROC Rule 3200] affect supervisory or compliance obligations under UMIR?**

IDA Policy 9 - Minimum Requirements for Members Seeking Approval Under Regulation 1300.1(E) for Suitability Relief for Trades not Recommended by the Member [as of June 1, 2008 referred to a IIROC Rule 3200 – Minimum Requirements for Dealer Members Seeking Approval under Rule 1300.1(T) for Suitability Relief for Trades Not Recommended by the Member] details the minimum supervisory and compliance requirements of a Participant in circumstances where the Participant is offering Order-Execution Services exclusively (generally considered to be discount brokerage services) and circumstances in which the Participant offers both advisory and Order-Execution Services to clients. In both instances, IDA Policy 9 requires a Participant to have supervisory and compliance procedures and systems in place that are at least equal to and address the concerns listed in IDA Policy 2 - Minimum Standards for Retail Account Supervision.

IDA Policy 2 establishes minimum industry standards for retail account supervision. That policy does not preclude a Participant from establishing a higher standard of supervision and in certain situations deems a higher standard to be necessary to ensure proper supervision. In particular, IDA Policy 2 provides that a Participant is required to know and comply with the by-laws, rules, regulations and policies of other self-regulatory organizations and applicable securities legislation. As such, IDA Policy 9 does not alter or relieve a Participant from any obligation under Policy 7.1 of UMIR.

**Guidance:** 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, 5.1 and 5.2.

**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.

**6. If a Participant has agreed to trade at a “guaranteed” Volume-Weighted Average Price, may a Participant rely for the purposes of calculating the price on trades on a marketplace other than the marketplace on which the trade will be executed?**

A Participant may rely on any combination of marketplaces in calculating a “guaranteed” Volume-Weighted Average Price (“VWAP”), including marketplaces that do not have a facility to handle VWAP trades or that do not disseminate trade information in a readily useable format. A “guaranteed” VWAP may be executed on any marketplace that allows

for such trades irrespective of whether or not data from that marketplace has been used in the calculation of the VWAP. When handling an order to “approximate VWAP” on behalf of a client, a Participant must ensure that the client is aware of any limitations (e.g. data from more than one marketplace will be included in the calculation) in arriving at the approximated VWAP.

Immediately upon a Participant agreeing to guarantee the price of a trade to a client, the Participant must provide written notice to IIROC. The written notice must indicate, among other things:

- the security;
- whether the trade will be a purchase or sale by the Participant;
- the volume of the trade;
- the method of determining the price which the Participant will be guaranteeing, including identification of the marketplace or combination of marketplaces used to determine the price and the time period over which the price will be determined;
- the details of any profit sharing arrangement to be entered into between the Participant and the client with respect to the trade; and
- the time and the marketplace on which the trade will be executed.

Participants should refer to Market Integrity Notice 2006-005 – Guidance – Guarantee By a Participant of a Trade Price (February 10, 2006) for additional guidance on the procedures to be followed by a Participant when executing a “guaranteed” VWAP trade.

**13. What information must be disclosed on the trade confirmation if a Participant executes a client order for a particular security at an average price on more than one marketplace?**

Under section 36 of the Securities Act (Ontario) and comparable provisions of the securities legislation of other jurisdictions, a Participant is required to send a trade confirmation to the client. In accordance with Part 3 of the policy adopted under Rule 7.1 of UMIR, a Participant is required to have appropriate policies and procedures to ensure compliance with these requirements.

If a client order for the purchase or sale of a particular security is executed at an average price on more than one marketplace, the trade confirmation may disclose that the order has been executed at an average price on multiple marketplaces. However, the confirmation must also disclose that details of each trade are available upon request. A Participant must provide the details of each trade at no charge. If a client order has been filled at multiple prices on a single marketplace, the trade confirmation must continue to identify the marketplace on which the client order was executed.

**Guidance:** The following is the relevant text of Market Integrity Notice 2008-003 issued on January 18, 2008 under the heading “**Guidance – Supervision of Algorithmic Trading**”.

**Summary**

This Market Integrity Notice provides guidance on the supervisory requirements under the Universal Market Integrity Rules (“UMIR”) of a Participant with respect to the use of an algorithmic trading system and certain limitations on the ability of the Investment Industry Regulatory Organization of Canada (“IIROC”) to intervene to vary or cancel trades arising from a malfunctioning algorithmic trading system.

**Supervisory Obligations of Participants**

Part 1 of Policy 7.1 provides that a Participant has an obligation to supervise orders which are entered on a marketplace:

- by traders employed by the Participant;
- by an employee of the Participant through an order routing system;
- directly by a client and routed to a marketplace through the trading system of a Participant; or
- by any other means.

In the view of IIROC, the source of the order or the means by which an order is entered on a marketplace does not relieve a Participant of responsibility for the supervision of such orders. IIROC is also of the view that orders entered on a marketplace without the involvement of staff of the Participant, such as in the case of orders transmitted to a marketplace by means of an algorithmic trading system, present heightened risks to both the integrity of the markets and to the financial position of the Participant. Algorithmic trading systems provide the ability to enter a high volume of orders on one or more marketplaces in a short period of time. As such, algorithmic trading systems can disrupt a fair and orderly market if such systems “malfunction”. IIROC expects a Participant that employs the use of an algorithmic trading system will have supervisory policies and procedures that are adequate to prevent and detect violations of UMIR and applicable securities requirements, as well as appropriate safeguards that are reasonably designed to prevent the entry and execution of “unreasonable” orders and trades on a marketplace.

The minimum elements of a supervisory system are set out in Part 2 of Policy 7.1 of UMIR. Policy 7.1 also stipulates that the supervision policies and procedures must be appropriate given the nature of the business conducted by a Participant. Given the potential impact that a malfunctioning algorithmic trading system may have on the maintenance of a fair and orderly market, IIROC

expects that a Participant will ensure that each algorithmic trading system has been adequately tested assuming various market conditions prior to the algorithmic trading system being “engaged”. In the view of IIROC, the Participant retains this testing obligation even in circumstances when the algorithmic trading system is provided by a third party service provider or by a client of the Participant.

If a Participant has provided Dealer-Sponsored Access, commonly known as direct market access, to a client (“DSA Client”), the Participant, as part of its on-going supervision of client orders, must be aware of the origin of the orders entered by the DSA Client, including whether the DSA Client employs the use of algorithmic trading systems. The Participant must ensure the proper testing of any algorithmic trading system used by a DSA Client to enter orders on a marketplace by means of the Dealer-Sponsored Access provided by the Participant.

In the view of IIROC, a Participant should develop and implement “fail-safe” mechanisms for the supervision of proprietary algorithmic trading systems that are adequate to prevent the entry of orders and execution of trades that, based on market conditions, are “unreasonable”. For example, a Participant should consider developing internal parameters that would prevent or “flag” (on a real-time basis) the entry of orders and execution of trades by an algorithmic trading system that exceed certain volume, order, price or other parameters set by the Participant. In considering the scope of appropriate order and trade parameters, a Participant should tailor policies and procedures that are appropriate for the strategy or strategies being executed by a algorithmic trading system with due consideration of the potential market impact of defining such parameters too broadly. In any event, each algorithmic trading system should contain an “override” function which permits the Participant to immediately disengage the operation of the algorithmic trading system as soon as the Participant becomes aware of any potential malfunction by the algorithmic trading system. The Participant must be able to immediately prevent the flow of orders from a malfunctioning algorithmic trading system from being entered on a marketplace even if the orders are being generated by an algorithmic trading system operated by a DSA Client.

#### **Limitations on Variation of Unreasonable Orders or Trades**

In the view of IIROC, the best course of action is for market forces to drive trading activity without interference by IIROC. Ordinarily, IIROC will only intervene to cancel or vary an order or trade in limited circumstances when, in the opinion of an IIROC Market Integrity Official, the order or trade has had an impact on a fair and orderly market or otherwise represented a risk to market integrity. In particular, IIROC will not ordinarily vary or cancel orders or trades resulting from errors, including orders generated by a “runaway” algorithmic trading system. Orders or trades that impact market volatility or quality (such as when there is a high volume of orders with no change in the market price of a security or successive changes in the market price of the security within acceptable parameters) will not be cancelled or varied by IIROC. If a Participant has allowed a high volume of orders to be entered on a marketplace by a “runaway” algorithmic trading system, the Participant will be fully exposed to the risks associated with the execution of the orders unless IIROC determines that the orders have affected market integrity.

Under Rule 10.9(1) of UMIR, an IIROC Market Integrity Official may, among other things:

- refuse to allow an order to be recorded at any time if, in the opinion of the IIROC Market Integrity Official, such quotation is unreasonable;
- vary or cancel a trade which, in the opinion of the IIROC Market Integrity Official, is unreasonable; and
- delay, halt or suspend trading in a security if unreasonable orders and trades affect the fairness and/or orderliness of the market.

If, in the opinion of an IIROC Market Integrity Official, a trade or series of trades in a security occurred at unreasonable prices, IIROC may in its sole discretion, among other things, vary the price of all trades in a security that are deemed to have occurred at an unreasonable price. If the security only trades on marketplaces monitored by IIROC, the decision whether to vary the trade price may be made solely by IIROC based on the facts of the situation. However, if the security also trades on a foreign organized regulated market, IIROC ordinarily seeks to co-ordinate any adjustment in the price of unreasonable trades with the foreign organized regulated market, particularly when a significant volume of trading of the security has occurred on the foreign organized regulated market during the period of the unreasonable prices. In these circumstances, if IIROC is unable to obtain the agreement of the foreign organized regulated market to adjust the prices of “unreasonable” trades, IIROC may be unable to provide relief to the Participant that entered the unreasonable orders.

**Guidance:** The following is the relevant text of IIROC Notice 09-0081 issued on March 20, 2009 under the heading “Rules Notice – Guidance Note – Specific Questions Related To Supervision of Algorithmic Trading”.

#### **Summary**

This Rules Notice provides guidance on specific questions relating to the supervisory requirements under the Universal Market Integrity Rules (“UMIR”) of a Participant with respect to the use of an algorithmic trading system.

## **Background**

The Investment Industry Regulatory Organization of Canada (“IIROC”) has previously set out guidance on the supervisory requirements under UMIR for a Participant that uses or allows its clients to use an algorithmic trading system to enter orders on a marketplace through the trading system of the Participant.<sup>6</sup> Among other things, guidance was provided on:

- supervisory policies and procedures that a Participant is expected to have in place when using an algorithmic trading system, including provision for appropriate safeguards that are reasonably designed to prevent the entry of orders and execution of trades that are “unreasonable”;
- a Participant’s obligation to ensure that an algorithmic trading system has been tested prior to being “engaged”, including the ability of the Participant to immediately disengage the operation of the algorithmic trading system should the need arise; and
- a Participant’s supervisory requirements with respect to trading by a Dealer-Sponsored Access client (“DSA Client”) that uses an algorithmic trading system.

This Rules Notice addresses specific questions related to the supervision of algorithmic trading systems and supplements the guidance provided in the above referenced Market Integrity Notice.

## **Questions and Answers**

The following is a list of the most frequently asked questions regarding the supervisory requirements of a Participant with respect to the use of an algorithmic trading system and IIROC’s response to each:

### **1. Is the obligation to supervise orders entered on a marketplace by means of an algorithmic trading system a new requirement?**

No. Under Part 1 of Policy 7.1 of UMIR a participant has an obligation to supervise orders which are entered on a marketplace:

- by traders employed by the Participant;
- by an employee of the Participant through an order routing system;
- directly by a client and routed to a marketplace through a trading system of a Participant; or
- by any other means.

In the view of IIROC, the source of the order or the means by which an order is entered on a marketplace does not relieve a Participant of responsibility for the supervision of such orders. Given the heightened risks to both market integrity and the financial position of the Participant posed by the use of an algorithmic trading system (namely, the ability to enter a high volume of orders on one or more marketplaces in a short period of time), IIROC expects that a Participant that uses or allows its clients to use an algorithmic trading system will have supervisory policies and procedures that are adequate to prevent and detect violations of UMIR and applicable securities requirements.

### **2. What testing is a Participant expected to conduct of an algorithmic trading system prior to its use by the Participant?**

IIROC expects that a Participant will ensure that each algorithmic trading system that will be used by the Participant to route orders to a marketplace has been adequately tested prior to the algorithmic trading system being “engaged”.

IIROC expects that a Participant will, at a minimum, ensure that each algorithmic trading system has:

- been tested under various market conditions to identify problematic outcomes related to the operation of the algorithmic trading system;
- built-in features or functionality that prevent (or provide a real-time alerts when) certain pre-programmed order or trade parameters from being exceeded (i.e. certain volume, order or price limits); and
- an “override” functionality which either automatically “disengages” the operation of the algorithmic trading system or permits the Participant to do so remotely.

In the view of IIROC, the Participant retains this testing obligation even in circumstances when the algorithmic trading system is provided by a third party service provider. While IIROC expects that a Participant, consistent with prudent business practices, will conduct appropriate due diligence with respect to the testing of all aspects of the operation algorithmic trading system prior to its use by the Participant, IIROC recognizes that, testing of certain aspects an algorithmic trading system by a Participant may not be feasible or practical, particularly in the case of a algorithmic trading system provided by a third party service provider.

IIROC is of the view that, if a Participant chooses to use an algorithmic trading system provided by a third party service provider, the Participant may rely on representations from the service provider as part of its due diligence into the operation of the algorithmic trading system. For greater certainty, IIROC is of the view that a Participant’s reliance on representations from the service provider is limited to those aspects of the algorithmic trading system that the Participant cannot reasonably test independently. For example, if a Participant’s testing regime would impinge on proprietary

<sup>6</sup> Reference should be made to Market Integrity Notice 2008-003 – Guidance – Supervision of Algorithmic Trading (January 18, 2008).

aspects of the algorithmic trading system, the Participant may rely on representations from the system provider for those aspects of the trading system that the Participant is unable to test independently.

IIROC expects that a Participant, as part of its supervisory policies and procedures, will maintain a written record with sufficient details to demonstrate the testing of the algorithmic trading system undertaken by the Participant, including details of the testing conducted by the provider algorithmic trading system provider. **Notwithstanding that a Participant may rely on representations from the provider of the algorithmic trading system for certain aspects of the testing of the trading system, the Participant continues to be responsible for any offending order entered on or trade executed on a marketplace resulting from the improper operation of the algorithmic trading system.**

**3. What testing is a Participant expected to conduct with respect to the use of an algorithmic trading system by a DSA client of the Participant?**

Under Part 1 of Policy 7.1 of UMIR, a Participant has an obligation to supervise orders which are entered on a marketplace directly by a client and routed to a marketplace through a trading system of a Participant. As part of its supervisory obligation, a Participant must be aware of the origin of orders entered by a DSA client, including whether orders may be generated by an algorithmic trading system.

In the view of IIROC, a Participant, as part of its initial “screening” of a DSA client, must ensure that any algorithmic trading system that will be used by the DSA client is adequately tested and includes appropriate safeguards in place to prevent the entry of offending orders on a marketplace. IIROC is also of the view that, as part of the Participant’s ongoing supervisory obligations, the Participant is required to make regular inquiries to ensure that any modifications to a previously “approved” algorithmic trading system in use by a DSA client continues to maintain appropriate safeguards.

While IIROC expects that a Participant, consistent with prudent business practices, will undertake appropriate due diligence with respect to all aspects of an algorithmic trading system used by its DSA clients, IIROC recognizes that testing certain aspects of a DSA client’s algorithmic trading system, particularly those related to proprietary trading models used by the DSA client, may not be feasible or practical. IIROC expects that at a minimum, a Participant’s testing of any algorithmic trading system used by a DSA client will include verification that the algorithmic trading system has:

- been tested under various market conditions to identify problematic outcomes related to the operation of the algorithmic trading system;
- built-in features or functionality that prevent (or provide a real-time alerts when) certain pre-programmed order or trade parameters from being exceeded (i.e. certain volume, order or price limits); and
- an “override” functionality which either automatically “disengages” the operation of the algorithmic trading system or permits the Participant to do so remotely.

**Notwithstanding that a Participant may rely on representations from the DSA client or the provider of the algorithmic trading system used by the DSA client, the Participant continues to be responsible for any offending order entered on or trade executed on a marketplace resulting from the improper operation of the algorithmic trading system.**

**4. Under what circumstances will IIROC vary or cancel orders or trades entered on a marketplace by a “runaway” algorithmic trading system?**

In the ordinary course, IIROC will only intervene to cancel or vary an order or trade resulting from a “runaway” algorithmic trading system if, in the opinion of an IIROC Market Integrity Official, the order or trade has impacted the fair and orderly operation of the market or otherwise represents a risk to market integrity. The determination of what constitutes an “impact on a fair and orderly market” or “risk to market integrity” is a fact-specific analysis driven by numerous competing factors. IIROC retains absolute discretion as to the determination of when, and under what circumstances, IIROC will intervene to cancel or vary an order or trade (or series of orders and/or trades).

If a Participant has allowed a high volume of orders to be entered on a marketplace by a “runaway” algorithmic trading system (by the Participant’s or DSA client’s algorithmic trading system), the Participant will be fully exposed to the risks associated with the execution of the orders unless the trades are varied or cancelled by IIROC. A Participant who uses or allows its clients to use an algorithmic trading system to enter orders on a marketplace should not rely on IIROC to intervene in the case of a “runaway” algorithmic trading system. The Participant should have adequate guidelines for, and means of, disengaging an algorithmic trading system.

**5. Once a Participant has disengaged a “runaway” algorithmic trading system, is there a minimum period of time during which the algorithmic trading system must remain disengaged?**

No. Once a Participant has disengaged the operation of an algorithmic trading system, including algorithmic trading system used by a DSA client, there is no required minimum period of time during which the algorithmic trading system must remain “off-line”. IIROC expects that a Participant, consistent with its supervisory obligations, will take appropriate steps to ensure that the issues that gave rise to decision to “disengage” the algorithmic trading system have been resolved to the satisfaction of the Participant and that appropriate safeguards are in place to prevent the entry of “unreasonable” orders on a marketplace.

**6. Is a Participant expected to access the “code” or other proprietary aspects of an algorithmic trading system supplied by a third party provider or used by a DSA client?**

The obligation that a Participant test an algorithmic trading used by the Participant or its DSA clients does not require that the Participant access the “code” or other proprietary aspects of the algorithmic trading system and the Participant may rely on representations by the DSA client or the provider of the algorithmic trading system.

Notwithstanding a Participant’s reliance on representations by a DSA client or the provider of an algorithmic trading system, a Participant continues to be responsible for all orders entered on a marketplace by a “runaway” algorithmic trading system. This includes instances in which the cause of the malfunction which gave rise to the “runaway” algorithmic trading system was attributed to an aspect of the algorithmic trading system’s operation that was not “accessible” to the Participant for testing.

**Disciplinary Proceedings: In the Matter of Dominick & Dominick Securities Inc. (“Dominick”) (December 19, 2002) OOS 2002-009**

*Facts – During the period of July 1, 1998 to February 1, 1999, an investment advisor at Dominick, in the course of acting for a company engaged in a normal course issuer bid, failed to exercise due diligence in relation to the entry of orders by the company for the purchase of its shares, including from accounts related to or affiliated with the company and its insiders.*

*Disposition – Dominick failed to ensure that its employee carried out the issuer bid in compliance with exchange requirements, and failed to exercise due diligence in relation to the entry of orders by the company for the purchase of its shares.*

*Requirements Considered – VSE Policy 21.10, VSE Rules F.1.01(1)(b) and B.4.16, VSE By-law 5.01(2). Comparable UMIR Provision - Rule 7.1 and Policy 7.1, reference made to “gatekeeper function” (Rule 10.16 effective April 1, 2005).*

*Sanction - \$25,000 fine and costs of \$5,000; disgorgement of \$2,392 in gains*

**Disciplinary Proceedings: In the Matter of Georgia Pacific Securities Corporation (“Georgia”) (August 18, 2003) OOS 2003-004**

*Facts – Between February 1999 and November 1999, an investment advisor employed by Georgia engaged in a pattern of non-economic trading in client accounts which had a pre-existing debit positions in their accounts. The investment advisor engaged in the practice of buying, and immediately thereafter selling the same share positions in clients’ accounts for the sole purpose of causing the clients’ account debit position to be re-aged, thereby postponing payment for the debits in the clients’ accounts.*

*Disposition – The Georgia board of directors was responsible for overall stewardship of supervision and compliance at the firm with specific responsibility to ensure that its employees and officers comply with regulatory requirements. The board failed to establish and apply prudent supervisory and compliance procedures to ensure that its employees adhered to regulatory and exchange requirements.*

*Requirements Considered – VSE By-laws 5.07(1) and 5.01(2), VSE Rules F.2.28, F.2.08 and F.1.01. Comparable UMIR Provision - Rule 7.1 and Policy 7.1*

*Sanction - \$35,000 fine and costs of \$5,000; disgorgement of \$21,105 in gains*

**Disciplinary Proceedings: In the Matter of Edward Dean Duggan (“Duggan”) (August 18, 2003) OOS 2003-005**

*Facts – Between February 1999 and November 1999, Darren Hunter Bell (“Bell”) an investment adviser at Georgia Pacific Securities Corporation (“Georgia”) engaged in a pattern of non-economic trading on behalf of four client accounts whereby he bought and immediately thereafter sold shares of highly liquid securities for clients’ accounts with the sole purpose of causing clients’ debit positions to be re-aged, thereby postponing payment for the debits in the clients accounts’.*

*Disposition – As the senior officer of Georgia, Duggan bore responsibility for the conduct of Georgia’s business and its management, including ensuring that Georgia’s compliance procedures were effective. Duggan failed to diligently supervise or ensure supervision of accounts handled by Bell and failed to establish prudent business and compliance procedures to ensure that Georgia and its employees carried out business in compliance with regulatory requirements.*

*Requirements Considered – VSE By-laws 5.07(2) and (3) and 5.01(2), VSE Rules F.2.08 and F.1.01. Comparable UMIR Provision - Rule 7.1 and Policy 7.1*

*Sanction - \$20,000 fine and costs of \$5,000; suspension from acting in a supervisory capacity for 1 year*

**Disciplinary Proceedings: In the Matter of Roger Brian Ashton (“Ashton”) (August 18, 2003) OOS 2003-006**

*Facts – Between February 1999 and November 1999, Darren Hunter Bell (“Bell”) an investment adviser at Georgia Pacific Securities Corporation (“Georgia”) engaged in a pattern of non-economic trading on behalf of four client accounts whereby he bought and immediately thereafter sold shares of highly liquid securities for clients accounts with the sole purpose of causing clients’ debit positions to be re-aged, thereby postponing payment for the debits in the clients accounts’.*

*Disposition – As the senior officer of Georgia, Ashton bore responsibility for the conduct of Georgia’s business and its management, including ensuring that Georgia’s compliance procedures were effective. Ashton failed to diligently supervise or ensure supervision of accounts handled by Bell and failed to establish prudent business and compliance procedures to ensure that Georgia and its employees carried out business in compliance with regulatory requirements.*

*Requirements Considered – VSE By-laws 5.07(2) and (3) and 5.01(2), VSE Rules F.2.08 and F.1.01. Comparable UMIR Provision - Rule 7.1 and Policy 7.1*

*Sanction - \$30,000 fine and costs of \$5,000; suspension from acting in a supervisory capacity for 1 year*

**Disciplinary Proceedings: In the Matter of Canaccord Capital Corporation (“Canaccord”) (October 28, 2003) OOS 2003-007**

*Facts – Client X, a director of Tree Brewing Co. Ltd. (“Tree Brewing”), a Vancouver Stock Exchange listed issuer, controlled a number of accounts at Canaccord. Between August 1, 1998 and March 31, 1999, client X engaged in a pattern of uneconomic and repetitive trading in Tree Brewing which involved the sale and subsequent re-purchase of a comparable number of shares for the purpose of deferring payment for the securities traded.*

*Disposition – Canaccord failed to closely monitor trading by the insider, to use due diligence to learn the essential facts concerning each order accepted by its trader and to diligently supervise its traders.*

*Requirements Considered – VSE Rules F.2.08 and F.1.01(1). Comparable UMIR Provision - Rule 7.1 and Policy 7.1*

*Sanction - \$12,500 fine and costs of \$3,000; disgorgement of \$7,090.02 in gains*

**Disciplinary Proceedings: In the Matter of Matthew Philip Linden (“Linden”) (November 26, 2003) OOS 2003-012**

*Facts – Between February 1 and July 5, 2000, Linden, the branch manager was responsible for the supervision of 26 employees, including John Scott (“Scott”), an investment advisor at the branch. During this period, the Retail Compliance Department of the dealer identified what appeared to be suspicious trading in the client accounts managed by Scott and also revealed an unusually high portfolio concentration of one specific private placement in each of these clients’ accounts. The Retail Compliance Department sent five inquiries to Linden alerting him of trading anomalies and other “red flags” associated with these clients’ accounts. In all instances Linden questioned Scott about the compliance inquiries, and in all instances accepted Scott’s explanations, concluding that no further investigation or follow-up was required.*

*Disposition – As branch manager, Linden was responsible for supervision of all retail trading at the branch. The inquiries received from the Retail Compliance Department should have heightened Linden’s review of the clients’ accounts and caused him to investigate further rather than just relying on the answers provided by Scott to the Retail Compliance inquiries. In this regard, Linden failed in his supervisory responsibilities as branch manager.*

*Requirements Considered – Section 8.34 of the General By-law of the TSX and TSX Rule 2-401(4). Comparable UMIR Provision - Rule 7.1 and Policy 7.1*

*Sanction – \$50,000 fine and costs of \$12,500; successful completion of the Branch Manger examination*

**Disciplinary Proceedings: In the Matter of Canaccord Capital Corporation (“Canaccord”) (December 5, 2003) OOS 2003-013**

*Facts – Canaccord employed Kai Tolpinrud (“Tolpinrud”) to trade for institutions and quasi-institutional clients, and corporate clients and at the same time permitted him to trade his personal account and inventory accounts. In reliance on this arrangement, between March 1, 2001 and March 11, 2002 Tolpinrud took advantage of client orders and information when acting as agent for the purchase and sale of securities to commit numerous infractions and contraventions including frontrunning, trading opposite his clients, improper client-principal trading and failing to give client orders priority when he entered client and non-client orders. Also, notwithstanding that Tolpinrud was not registered to trade on the CDNX, Canaccord allowed him to enter orders from another trader’s terminal.*

*Disposition – By allowing an arrangement which was prone to a heightened conflict of interest, Canaccord should have known that a high degree of diligence and greater level of supervision was required. Canaccord failed to establish and maintain an appropriate supervisory system to ensure that the handling of client business, inventory trading and pro trading by Tolpinrud was within the bounds of ethical conduct and consistent with just and equitable principals of trade.*

*Requirements Considered – CDNX Rules F.2.22, F.2.03 and G.3.01(6); TSX Rules 2-401, 2-404(2) and 4-405(1). Comparable UMIR Provision – Rule 7.1 and Policy 7.1*

*Sanction – \$50,000 fine and costs of \$43,000; undertaking to review and implement changes to existing compliance and supervisory systems; other undertakings*

**Disciplinary Proceedings: In the Matter of HSBC Securities (Canada) Inc. (“HSBC”) (August 23, 2004) SA 2004-005**

*Facts – A 2001 trade desk review conducted by RS of HSBC’s trade desk uncovered numerous deficiencies. HSBC was required to remedy the deficiencies and undertake to complete monthly and quarterly reviews – the results of which were to be submitted to RS for review. During a follow-up audit by the RS trade desk review team in 2003, a number of the items identified in the 2001 audit continued to remain unresolved and new issues were identified. HSBC represented to RS that it would redraft its trade review procedures to address the issues identified, and that such procedures would include daily, monthly and quarterly reviews. During a 2004 review, it was discovered that HSBC failed to adhere to its commitment concerning quarterly reports and that quarterly reviews were not conducted by HSBC between January and December 2003. The 2004 trade desk review also found unresolved deficiencies that were identified in the 2001 and 2003 trade desk reviews.*

*Disposition – The Board of Directors, Senior Management and the Compliance Department did not meet their respective supervisory obligations. The continued failure of HSBC to identify and address the issues identified by RS during its various trade desk reviews evidenced a Board of Directors and senior management team that were ineffective in their supervisory responsibilities.*

*Requirements Considered – Rule 7.1(1) and Policy 7.1*

*Sanction – \$625,000 fine and costs of \$87,500; implementation of changes recommended by an independent consultant and RS*

**Disciplinary Proceedings: Rule 7.1(1) and Policy 7.1 were considered In the Matter of UBS Securities Canada Inc. (“UBS Canada”) (October 8, 2004) SA 2004-006. See Disciplinary Proceedings under Rule 2.2.**

**Disciplinary Proceedings: Rule 7.1 and Policy 7.1 were considered In the Matter of CIBC World Markets Inc., (“CIBC”) Scott Mortimer and Carl Irizawa (December 21, 2004) SA 2004-008. See Disciplinary Proceedings under Rule 2.1.**

**Disciplinary Proceedings: Rule 7.1 and Policy 7.1 were 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: Rule 7.1 and Policy 7.1 were considered 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. See Disciplinary Proceedings under 5.3.**

**Disciplinary Proceedings: In the Matter of Zoltan Horcsok (“Horcsok”) (July 18, 2005) SA 2005-003**

*Facts – During the relevant period, Horcsok was the Executive Director, Head of Sales Trading at UBS Securities Canada Inc. (“UBS Canada”) and was responsible for the supervision of 12 sales traders in the Toronto and Montreal offices. In February of 2005, with Horcsok’s knowledge, an employee, over whom Horcsok had supervisory authority altered a trade ticket (which Horcsok subsequently destroyed), entered false information on an electronic trade ticket and created false and misleading “chat” communication in an effort to conceal trading improprieties conducted by a trader at a U.S. affiliate of UBS Canada.*

*Disposition – By involving an employee over whom he had supervisory responsibility in the attempted concealment of trading improprieties conducted by a trader at UBS’s U.S. affiliate and for his role in destroying a trade ticket, deliberately conducting telephone conversations with the U.S. broker on untaped telephone lines and misleading UBS Canada’s compliance department in its investigation of the matter, Horcsok contravened his supervisory obligations and engaged in conduct that resulted in UBS Canada violating certain audit trail requirements under UMIR.*

*Requirements Considered – Rules 7.1(4), 10.3(4), 10.11(1) and 10.12(1)*

*Sanction – \$100,000 fine and costs of \$25,000; suspension from RS regulated marketplaces for 3 months; 6 months strict supervision; prohibited from acting as supervisor for 1 year.*

**Disciplinary Proceedings: In the Matter of Mark Ellis (“Ellis”) (October 19, 2005) DN 2005-008**

*Facts – On September 17, 2003, RS contacted a trader trainee at Dundee Securities Corporation (“Dundee”) concerning non-client orders that he had entered on both sides of the market in a particular security in the pre-opening session of the TSX prior to 9:28 a.m. RS advised the trader to “cease and desist” from this type of activity. Ellis, who along with another Dundee employee, was responsible for overseeing and supervising traders at Dundee, was made aware of the substance of RS’s concerns. Ellis cautioned the trader to discontinue such conduct, but did not take steps to enquire whether any other traders at the firm engaged in similar conduct, nor did he escalate the matter to the firm’s Compliance Department or senior management as required by Dundee’s policies and procedures. It was subsequently discovered that another trader trainee and trader at Dundee engaged in similar conduct between July and December 2003 and October 2003 and February 2005, respectively.*

*Disposition – It is incumbent upon employees in supervisory roles at a Participant to fulfill their own supervisory duties and to follow their firm’s policies and procedures relating to reporting trading issues to the Compliance Department. Ellis did not fully comply with his trading supervision obligations. Requirements Considered – Rule 7.1(4)*

*Sanction – \$15,000 fine and costs of \$6,000*

**Disciplinary Proceedings: In the Matter of Keith Leslie Leonard (“Leonard”) (October 19, 2005) DN 2005-008**

*Facts – On September 17, 2003, RS contacted a trader trainee at Dundee Securities Corporation (“Dundee”) concerning non-client orders that he had entered on both sides of the market in a particular security in the pre-opening session of the TSX prior to 9:28 a.m. RS advised the trader to “cease and desist” from this type of activity. Leonard, who along with another Dundee employee, was responsible for overseeing and supervising traders at Dundee, was made aware of the substance of RS’s concerns. Leonard cautioned the trader to discontinue such conduct, but did not take steps to enquire whether any other traders at the firm engaged in similar conduct, nor did he escalate the matter to the firm’s Compliance Department or senior management as required by Dundee’s policies and procedures. It was subsequently discovered that another trader trainee and trader at Dundee engaged in similar conduct between July and December 2003 and October 2003 and February 2005, respectively.*

*Disposition – It is incumbent upon employees in supervisory roles at a Participant to fulfill their own supervisory duties and to follow their firm’s policies and procedures relating to reporting trading issues to the Compliance Department. Leonard did not fully comply with his trading supervision obligations.*

*Requirements Considered – Rule 7.1(4)*

*Sanction – \$15,000 fine and costs of \$6,000*

**Disciplinary Proceedings:** Rule 7.1 was considered **In the Matter of Union Securities Ltd. (“Union”) (April 18, 2006) DN 2006-004.** See Disciplinary Proceedings under Rule 6.2.

**Disciplinary Proceedings: In the Matter of Research Capital Corporation (“Research”) (April 25, 2006) DN 2006-005**

*Facts – Between September 1, 2002 and May 31, 2003, and between November 1, 2003 and January 12, 2004 an investment advisor at Research participated in his clients’ use of manipulative methods of trading in connection with the purchase and sale of a TSXV listed security which involved a pattern of trading which was not consistent with a bona fide effort to accumulate shares of the security over time and represented an overall pattern of trading at prices higher than would otherwise been dictated by market forces.*

*Disposition – In failing to supervise the investment advisor and failing to adopt systems and procedures which were adequate to assist its supervisory and compliance personnel in detecting patterns of improper or unusual trading in client accounts, Union failed to comply with its trading supervision obligations under UMIR.*

*Requirements Considered – Rule 7.1 and Policy 7.1*

*Sanction - \$16,260 fine and costs of \$135,000; certification by Research that it has extended the implementation of the recommendations made in a March 20, 2005 consultant’s report and that it has implemented effective supervision and compliance procedures to identify and address manipulative and deceptive trading and monitor of trading through its order management system for compliance with UMIR.*

**Disciplinary Proceedings:** Rule 7.1(1), 7.1(4) and Policy 7.1 were considered **In the Matter of Raymond James Ltd. (“Raymond James”) and Marc Deslongchamps (“Deslongchamps”) (June 30, 2006) DN 2006-006.** See Disciplinary Proceedings under Rule 5.3.

**Disciplinary Proceedings:** **In the Matter of Standard Securities Capital Corporation (“Standard”) (July 6, 2006) DN 2006-008**

*Facts – Between April 2002 and April 2004 RS conducted 3 separate trade desk reviews (“TDRs”) of Standard’s trade desk policies, procedures and practices, and in each case identified and reported to Standard that its trading policies and procedures failed to adequately address Standard’s requirements respecting its supervisory and compliance obligations under UMIR. In particular, the TDRs revealed that the policies and procedures failed to adequately ensure compliance with the client priority rule, describe how Standard would conduct compliance testing and how issues identified during the testing would be reported to management. Standard also failed to maintain adequate evidence that it conducted compliance testing and failed to review its trading policies and procedures annually as required by UMIR.*

*Disposition – Despite the deficiencies noted by the TDR group, Standard failed to adopt written policies and procedures to be followed by its directors, officers, partners and employees that were adequate, taking into account Standard’s business and affairs, to ensure compliance with UMIR Rules and Policies.*

*Requirements Considered – Rule 7.1 and Policy 7.1*

*Sanction – \$80,000 fine and costs of \$20,000*

**Disciplinary Proceedings:** Rule 7.1(1) and Policy 7.1 were considered **In the Matter of TD Securities Inc. (“TDSI”) (July 5, 2006) DN 2006-007.** See Disciplinary Proceedings under Rule 5.1

**Disciplinary Proceedings:** Rule 7.1 and Policy 7.1 were considered **In the Matter of Michael Bond (“Bond”) and Sesto DeLuca (“DeLuca”) (June 4, 2007) DN 2007-003.** See Disciplinary Proceeding under Rule 2.2.

**Disciplinary Proceedings:** Rule 7.1 and Policy 7.1 were considered **In the Matter of Golden Capital Securities Ltd. (“Golden”), Jack Finkelstein (“Finkelstein”) and Jeff Rutledge (“Rutledge”) (November 23, 2007) DN 2007-004.** See Disciplinary Proceeding under Rule 6.2.

**Disciplinary Proceedings:** **In the Matter of Northern Securities Inc. (“Northern”) (May 30, 2008) DN 2008-002**

*Facts - Trade desk reviews conducted by RS in the fall of 2003 and 2004 at Northern found insufficient supervision of certain trading practices and compliance testing policies and procedures. The trade desk reviews also found several UMIR deficiencies, most notably related to audit trail and order entry designation. During a follow-up audit by the RS trade desk review team in 2005, RS noted some improvements in Northern’s testing procedures and other compliance and supervision issues, however, several deficiencies, namely related to the failure to document compliance and internal testing at Northern remained unresolved.*

*Disposition – In failing to implement and update its written trading supervision and compliance policies and procedures and failing to ensure proper internal compliance testing, including maintaining evidence of such testing, Northern contravened Rule 7.1 and Policy 7.1 of UMIR.*

*Requirements Considered – Rule 7.1 and Policy 7.1*

*Sanction – \$125,000 fine and costs of \$50,000.*

**Proposed Amendments:** For information on the current proposed amendments to Rule 7.1 and Policy 7.1 of UMIR – Trading Supervision, refer to :

(i) *Market Integrity Notice 2007-009 - Request for Comments - Provisions Respecting Access to Marketplaces (April 20, 2007) which includes the following proposed amendments:*

1. *Policy 7.1 is amended by adding the following as Part 6:*

**Part 6 – Compliance Procedures Applicable to Alternative Trading Systems**

*The policies and procedures adopted by an ATS in accordance with Rule 7.1 must be adequate, taking into account the business and affairs of the ATS, to ensure compliance with those provisions of the Rules that are applicable to an Access Person. In accordance with the provisions of the Marketplace Operation Instrument, each ATS may establish criteria and classes of subscribers and provide different access to different groups or classes of subscribers. The policies and procedures adopted by the ATS must be appropriate for the type and extent of trading undertaken through the ATS by its subscribers. An ATS does not have to monitor trading undertaken by a subscriber that is a Participant as such trading activity is already subject to supervision and compliance requirements in accordance with the Rules.*

*The policies and procedures to monitor orders entered by a subscriber (other than a Participant) should address compliance with those requirements which are applicable to an Access Person, including:*

- prohibition on manipulative and deceptive activities;
- requirement to conduct trading openly and fairly;
- prohibition on entering an order which the Access Person knows or ought reasonably to know does not comply with securities legislation, requirements of the marketplace or the Rules;
- restrictions on short selling; and
- order marking requirements.

The policies and procedures should take into account the information which is available to the ATS in its capacity as a dealer that is subject to “know-your-client” requirements under applicable securities legislation and rules of self-regulatory entities. In this regard, the ATS should consider whether similar policies and procedures adopted by a Participant to review trading activity of a client to which the Participant has provided Dealer-Sponsored Access are appropriate for the ATS in the circumstances.

4. Rule 7.1 is amended by adding the following as subsection (5):

- (5) Each ATS shall adopt written policies and procedures to monitor orders entered by a subscriber who is an Access Person that are adequate, taking into account the business and affairs of the ATS, to ensure compliance with those provisions of the Rules that are applicable to an Access Person.

(ii) IIROC Notice 09-0328 – Rules Notice – Request for Comments – UMIR – Provisions Respecting the Implementation of the Order Protection Rule (November 13, 2009) which includes the following proposed amendments:

5. Rule 7.1 is amended by adding the following as subsection (5):

- (5) Notwithstanding any other provision of this Rule, a Participant or Access Person shall not mark an order on entry to a marketplace as a directed action order unless the Participant or Access Person has established, maintained and ensured compliance with written policies and procedures that are reasonably designed to prevent trade-throughs other than those trade-throughs permitted in Part 6 of the Trading Rules.

3. Part 6 of Policy 7.1 is deleted and the following substituted:

**Part 6 – Specific Provisions Respecting Trade-throughs**

Each Participant must adopt written policies and procedures that are adequate, taking into account the business and affairs of the Participant, to ensure that an order:

- marked as “directed action order” in accordance with Rule 6.2 does not result in a trade-through other than a trade-through permitted under Part 6 of the Trading Rules; or
- entered on a foreign organized regulated market complies with the conditions in subsection (3) of Rule 6.4.

Each Access Person must adopt written policies and procedures that are adequate, taking into account the business and affairs of the Access Person, to ensure that an order marked as a “directed action order” in accordance with Rule 6.2 does not result in a trade-through other than a trade-through permitted under Part 6 of the Trading Rules.

The policies and procedures must set out the steps or process to be followed by the Participant or Access Person to ensure that the execution of an order does not result in a trade-through. The policies and procedures must specifically address the circumstances when the bypass order marker will be used in conjunction with a “directed action order”. These policies and procedures must address the steps which the Participant or Access Person will undertake on a regular basis, which shall not be less than monthly, to test that the policies and procedures are adequate.