

PART 8 – PRINCIPAL TRADING

8.1 Client-Principal Trading

- (1) A Participant that receives a client order for 50 standard trading units or less of a security with a value of \$100,000 or less may execute the client order against a principal order or non-client order at a better price provided the Participant has taken reasonable steps to ensure that the price is the best available price for the client under prevailing market conditions.

- (2) Subsection (1) does not apply if the client has directed or consented that the client order be:
 - (a) a Call Market Order;
 - (b) an Opening Order;
 - (c) a Market-on-Close Order;
 - (d) a Volume-Weighted Average Price Order;
 - (e) a Basis Order; or
 - (f) a Closing Price Order.

- (3) Subsection (1) does not apply if the client order has been entered directly by the client of the Participant on a marketplace that does not require the disclosure of the identifier of the Participant in a consolidated market display and the director, officer, partner, employee or agent of the Participant who enters a principal order or a non-client order does not have knowledge that the client order is from a client of the Participant until the execution of the client order.

POLICY 8.1 – CLIENT PRINCIPAL TRADING

Part 1 - General Requirements

Rule 8.1 governs client-principal trades. It provides that, for trades of 50 standard trading units or less, a Participant trading with one of its clients as principal must give the client a better price than the client could obtain on a marketplace. A Participant must take reasonable steps to ensure that the price is the best available price for the client taking into account the condition of the market. If the security is traded on more than one marketplace, the client must receive, when the Participant is buying, a higher price than the best bid price, and, if the Participant is selling, the client must pay a lower price than the best ask price.

For client-principal trades greater than 50 standard trading units, the Participant may do the trade provided the client could not obtain a better price on a marketplace in accordance with its best execution obligation under Dealer Member Rule 3300. The Participant must take reasonable steps to ensure that the best price is obtained and the price to the client is justified by the condition of the market.

Part 2 – Legal Aspects of the Client-Principal Relationship

A Participant owes a fiduciary duty to its clients. This duty and investors' trust in our Participants are fundamental to investor confidence in the integrity of the market. In the Market Regulator's view, this relationship of trust arises where there is reliance by the client on the Participant's expertise in securities matters. From the point of view of both the client and the Participant, the fiduciary responsibility exists regardless of the legal form of the transaction. In other words, an investor who relies on the expertise of a Participant expects the Participant to act in the investor's best interests regardless of whether the Participant is acting as agent or as principal. The legal framework underpinning client-principal trades was stated in the 1965 report of the Royal Commission on the Windfall Co. scandal:

An agent must conduct himself so that the interest of the person in whose behalf he is acting is not brought into conflict with his personal interest. An agent may not make for himself any deal which could have been made for his client within the scope of the client's instructions; if he does, he is assumed to have been acting on his client's behalf and the client is entitled to the benefit of the transaction. An agent must disclose to the client any fact known to the agent which would be likely to operate on the client's judgment. An agent may not, in connection with his client's business, make a secret profit for himself.

These restrictions flow from the recognition of the serious conflicts inseparable from the agency relationship, and from a corresponding recognition that every such conflict must be resolved in favour of the client. A principal trade may be subject to attack if it appears that the Participant did not act to the best advantage of its client even if the Participant complies with the technical requirements of the Rule. For example, if the principal account profited from the trade by unwinding the position again soon after the principal trade was made, or if the Registered Representative receives a higher commission than for agency transactions of a similar size involving similar securities, the Participant will find it more difficult to justify its actions. Participants should obtain their own legal advice as to the propriety of their client-principal trading practices. The following are considerations in any client-principal trade:

Consent — *At common law, the prior informed consent of the client must be obtained before the agent may act as principal. This is impractical in the context of trading securities on a marketplace, where at the time of receipt of the client's order the Participant will likely not know who will be on the other side. If the Participant, through the Registered Representative or other employee knows that the firm or a non-client of the firm will or probably will take the other side, the client's consent should be obtained. In particular, if the Registered Representative wishes to take the other side of the trade with their client, the client must be informed and consent to the trade in advance. Such consent must be specific to that trade and cannot be in a general consent to any future trades with the Registered Representative. As promptly as possible following the execution of a principal trade, the client should be advised that all or part of the securities taken or supplied were from an account in which the Participant or a non-client of the Participant has an interest. This advice would form part of the usual discussion that occurs when a Registered Representative confirms to the client that the client's order has been filled. In addition, the written confirmation must disclose that the order has been filled in a principal transaction.*

Nature of the Client — *Some clients are in greater need of protection from the potential conflict of interest in client-principal trades. The onus on the Participant usually will be reduced if the client is a fully informed institutional client with regard to the state of the market. Sophisticated institutional clients are able to judge whether a specific net price is appropriate*

in the context of the market. If there was no prior discussion with the client concerning executing the client's order in a client-principal trade, or if there are no standing instructions on handling of orders, the Participant must judge whether any steps need be taken, taking into account the size of the order and other circumstances, to ensure that a better price is not available. To a large degree this will depend on the depth of the market and normal liquidity of the security.

Suitability — *Compliance with the client-principal trading rules does not relieve a Participant of its suitability and "know your client" obligations. As with any other trade, Participants must ensure that the trade is suitable for the client, even if the best possible price has been obtained.*

Facilitation Accounts — *The rules do not apply to a client-principal trade where the inventory account was used solely to facilitate the execution or confirmation of a client order (for example, an inventory accumulation account used to give an institutional client a single average-price confirmation). In these cases, the client is the beneficial owner of the position in the inventory account at all times.*

Refusal by Client — *Participants should ensure that procedures are in place to identify orders that should not be effected on a principal basis. This is necessary to deal with situations where clients notify a Participant that they do not consent to principal trading generally or to particular principal trades.*

Part 3 - Factors in Determining "Best Available Price"

The price of the principal transaction must also be justified by prevailing market conditions. Participants should consider such factors as:

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

For example, if the market is \$10 bid and \$10.50 asked and a client wants to sell 1,000 shares, it would be inappropriate for a Participant to do a principal trade at \$10.05 if the security has been trading heavily at \$10.50 and there is strong bidding for the security at \$10 compared to the number of securities being offered at \$10.50. The condition of the market suggests that the client should be able to sell at a better price than \$10.05. Accordingly, the Participant as agent for the client should post an offer at \$10.45 or even \$10.50, depending on the circumstances. The desire of the client to obtain a fill quickly is always a consideration.

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

In determining the "best available price", Participants should consider the price and size of orders displayed on marketplaces other than protected marketplaces if such information is available or known to the Participant. Specifically, we expect an employee of a Participant to use all order price information that is available or known to that employee when determining the "best available price". For example, an employee that has access to price information from both protected and unprotected marketplaces would be in compliance with the requirement to determine the "best available price" only if all price information from both protected and unprotected marketplaces was considered when executing a principal or non-client order with

a client order. However, a Participant will be considered not to have complied with Rule 8.1 if an employee executes a principal or non-client order with a client order at a better price which is inferior to the price that would have been available to the client on a displayed marketplace that is not a protected marketplace and the employee executes, in whole or in part, with the order displayed on the marketplace that is not a protected marketplace.

Defined Terms:	<p>NI 21-101 section 1.1 - "order"</p> <p>NI 21-101 section 1.4 – Interpretation -- "security"</p> <p>UMIR section 1.1 – "Basis Order", "best ask price", "best bid price", "better price", "Call Market Order", "client order", "Closing Price Order", "consolidated market display", "employee", "Market-on-Close Order", "marketplace", "Market Regulator", "non-client order", "Opening Order", "Participant", "principal account", "principal order", "standard trading unit" and "Volume-Weighted Average Price Order"</p> <p>UMIR section 1.2(2) – "trade"</p>
Related Provision:	UMIR section 1.2(3) - Interpretation
Regulatory History:	<p>Effective October 31, 2003, the applicable securities commissions approved an amendment to add subsection (3) of Rule 8.1 that provides an exemption from the requirement in subsection 8.1(1) under certain circumstances. See Market Integrity Notice 2003-024 – "Accommodation of Anonymous Orders" (October 31, 2003).</p> <p>Effective April 8, 2005, the applicable securities commissions approved an amendment to subsection (2) of Rule 8.1 to add clause (e) that exempts basis orders from the requirement in subsection 8.1(1). See Market Integrity Notice 2005-010 – "Provisions Respecting a Basis Order" (April 8, 2005).</p> <p>Effective March 9, 2007, the applicable securities commissions approved an amendment to subsection (2) of Rule 8.1 to add clause (f) that exempts closing price orders from the requirement in subsection 8.1(1). See Market Integrity Notice 2007-002 – "Provisions Respecting Competitive Marketplaces" (February 26, 2007).</p> <p>Effective May 16, 2008, the applicable securities commissions approved an amendment to Part 1 of Policy 8.1 to add the last sentence of the first paragraph that explains if a security is traded on more than one marketplace, the client must receive a higher price than the bid price when the Participant is buying and the client must pay a lower price than the best ask price when the Participant is selling. See Market Integrity Notice 2008-008 – "Provisions Respecting 'Off-Marketplace' Trades" (May 16, 2008).</p> <p>In connection with the recognition of IIROC and its adoption of UMIR, the applicable securities commissions approved an amendment to Part 1 of Policy 8.1 that came into force on June 1, 2008 to replace the phrase "of less" with "or less". See Footnote 1 in Status of Amendments.</p> <p>Effective September 12, 2008, the applicable securities commissions approved an amendment to Rule 8.1 to delete the phrase "taking into account the condition of the market at that time" and substitute the phrase "under prevailing market conditions". See IIROC Notice 08-0039 – "Provisions Respecting Best Execution" (July 18, 2008).</p> <p>Effective September 12, 2008, the applicable securities commissions approved an amendment to add Part 3 to Policy 8.1 that outlines factors to be considered in determining "best available price". See IIROC Notice 08-0039 – "Provisions Respecting Best Execution" (July 18, 2008).</p> <p>Effective December 9, 2013, the applicable securities commissions approved housekeeping amendments to the French version of UMIR. See IIROC Notice 13-0294 – "Amendments to the French version of UMIR" (December 9, 2013).</p> <p>Effective September 18, 2015, the applicable securities commissions approved amendments to Part 3 of Policy 8.1. See IIROC Notice 15-0211 - Notice of Approval – "Provisions Respecting Unprotected Transparent Marketplaces and the Order Protection Rule" (September 18, 2015).</p> <p>Effective January 2, 2018, the applicable securities commissions approved amendments to Part 1 of Policy 8.1. See IIROC Notice 17-0137 – "Amendments Respecting Best Execution" (July 6, 2017).</p>
Repealed Guidance:	See Market Integrity Notice 2005-023 – " Securities Trading on Multiple Marketplaces " (July 29, 2005). This Notice was repealed and replaced by Market Integrity Notice 2006-017 – " Securities Trading on Multiple Marketplaces " (September 1, 2006).
Guidance:	See Market Integrity Notice 2006-017 – " Securities Trading on Multiple Marketplaces " (September 1, 2006).
Guidance:	See IIROC Notice 17-1038 – " Guidance on Best Execution " (July 6, 2017).
Disciplinary Proceedings:	<p><u>In the Matter of Robert Bastianon ("Bastianon")</u> (October 30, 2002) OOS 2002-004</p> <p>Facts – On February 19, 2002, Bastianon, a trader, executed an order to sell shares of a listed security from his firm's inventory account in a cross trade with a client. The trade was entered at</p>

price of \$28.00 at a time when the quotation for the listed security was \$27.80 bid and \$28.00 ask.

Disposition – Bastianon was required to provide the client with price improvement over the ask price to ensure that the client received a price that was better than the quoted market. Bastianon failed to provide the requisite price improvement to the client.

Requirements Considered – TSX Rule 4-502(2). Comparable UMIR Provision – Rule 8.1

Sanction - \$10,000 fine and costs of \$2,500

Disciplinary Proceedings: In the Matter of Russell Marceniuk (“Marceniuk”) (December 12, 2002) OOS 2002-008

Facts – On May 7, 2001, Marceniuk, a liability trader and registered representative, executed an order to sell shares of a company from his liability account (principal account) in a cross with a client. The trade was entered at \$68.68, at a time when the quotation for the stock was \$68.50 bid and \$68.68 ask.

Disposition – When a trader engages in a customer-principal trade, the trader is required to ensure that the client receives a price that is better than the quoted market. Marceniuk was required to provide the client with price improvement over the ask price.

Requirements Considered – TSX Rule 4-502. Comparable UMIR Provision – Rule 8.1

Sanction - \$10,000 fine and costs of \$1,500

Disciplinary Proceedings: Rule 8.1 was 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 Steve Horrocks (“Horrocks”) (August 5, 2009) DN 09-0229

Facts – On each of July 12, September 5, and November 12, 2006, Horrocks, an institutional trader at Canaccord Capital Corporation (“Canaccord”), executed intentional cross trades between a Canaccord proprietary account and a client account for 50 standard trading units or less (with a value of less than \$100,000) in listed securities without providing price improvement to the client order. In all cases the client order traded with orders for Canaccord’s proprietary account at either the “ask” price in the case of a buy, or the “bid” price in the case of a sale.

Disposition – When a trader engages in a client-principal trade for 50 standard trading units or less, the trader is required to ensure that the client receives a price that is better than the quoted market. By failing to provide price improvement to the client orders, Horrocks violated Rule 8.1.

Requirements Considered – Rules 8.1 and 10.3(4)

Sanctions - \$10,000 fine and costs of \$2,000.

Disciplinary Proceedings: In the Matter of Melaney Phillips (“Phillips”) (November 30, 2011) DN 11-0343

Facts – On or about July 13, 2007, Phillips recommended and purchased shares in the account of her client which were acquired directly from part of her own personal sell order without advising the client of her interest in the transaction or taking reasonable steps to ensure the client obtained the shares for the best available price. The client received a worse price than that which was in the market in that there was no activity in the market for the security at any price. The remainder of Phillips’ sell order was filled in subsequent days at lower prices.

Disposition – Phillips sold shares from her own account to a client without ensuring the client obtained the best available price, contrary to UMIR 8.1 which provides that a representative may only sell to a client for the representative’s own account if they sell to a client at a better price than that which is in the market.

Requirements Considered – Rule 8.1.

Sanction – The Hearing Panel imposed penalties on Phillips related to the breach of UMIR 8.1 and other breaches of the Dealer Member Rules with a fine of \$290,000; disgorgement of profits of \$10,350; a 3 year suspension from registration; payment of fine, disgorgement and costs prior to re-registration; successful completion of appropriate courses prior to re-registration; strict supervision for the first 2 years in the event of re-registration and payment of costs in the amount of \$15,000.