

### 5.3 Client Priority

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

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

## **POLICY 5.3 – CLIENT PRIORITY**

### **Part 1 – Background**

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

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

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

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

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

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

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

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

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

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

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

## **Part 4 – Client Consent**

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

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

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

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

**Defined Terms:**

NI 21-101 section 1.1 – “order”

NI 21-101 section 1.4 – Interpretation -- “security”

UMIR section 1.1 – “best ask price”, “best bid price”, “Basis Order”, “Call Market Order”, “client order”, “consolidated market display”, “employee”, “Exchange”, “limit order”, “Market Integrity Official”, “Market-on-Close Order”, “market order”, “Market Regulator”, “marketplace”, “Marketplace Rules”, “Marketplace Trading Obligations”, “non-client order”, “Opening Order”, “Participant”, “pre-arranged trade”, “principal

order”, “QTRS”, “Special Terms Order”, “trading day” and “Volume-Weighted Average Price Order”  
UMIR section 1.2(2) – “trade”

**Related Provisions:** UMIR section 4.1 and Policy 7.1

**Regulatory History:**

Effective October 31, 2003, the applicable securities commissions approved an amendment to accommodate anonymous orders. See Market Integrity Notice [2003-024](#) – “**Accommodation of Anonymous Orders**” (October 31, 2003).

Effective May 26, 2006, the applicable securities commissions approved amendments to repeal and replace Rule 5.3 and Policy 5.3. See Market Integrity Notice [2006-012](#) – “**Provisions Respecting Client Priority**” (May 26, 2006).

Effective March 9, 2007, the applicable securities commissions approved an amendment to repeal and replace Rule 5.3 and to repeal and replace Parts 2 and 3 of Policy 5.3. See Market Integrity Notice [2007-002](#) – “**Provisions Respecting Competitive Marketplaces**” (February 26, 2007).

Effective August 26, 2011, the applicable securities commissions approved an amendment to Rule 5.3(2) to replace the reference to “Market Maker Obligations” with “Marketplace Tracking Obligations”. See IIROC Notice [11-0251](#) – “**Provisions Respecting Market Maker, Odd Lot and Other Marketplace Trading Obligations**”(August 26, 2011).

Effective December 9, 2013, the applicable securities commissions approved amendments to the French version of UMIR. See IIROC Notice [13-0294](#) – “**Amendments to the French version of UMIR**” (December 9, 2013).

Effective September 18, 2015, the applicable securities commissions approved an amendment to Part 4 of Policy 5.3. See IIROC Notice [15-0211](#) - Notice of Approval – “**Provisions Respecting Unprotected Transparent Marketplaces and the Order Protection Rule**” (September 18, 2015).

Effective January 2, 2018, the applicable securities commissions approved an amendment to Part 3 of Policy 5.3. See IIROC Notice [17-0137](#) – “Amendments Respecting Best Execution” (July 6, 2017).

**Repealed Guidance:** See Market Integrity Notice [2005-023](#) – “**Securities Trading on Multiple Marketplaces**” (July 29, 2005). This Notice was repealed 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 Market Integrity Notice [2007-019](#) – “**Entering Client Orders on Non-Transparent Marketplaces and Facilities**” (September 21, 2007).

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

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

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

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

Sanction –

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

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

Jean-Luc Brunet – \$35,000 fine.

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

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



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

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

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

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

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

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

*Sanction –*

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

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

**Disciplinary Proceedings: In the Matter of Bert Griffin (“Griffin”) (August 31, 2009) DN 09-0245**

*Facts – On January 27, April 11, and 21, 2006, Griffin failed to give priority to client orders over non-client orders in the same security and on the same side of the market. Griffin’s improper order handling resulted in a financial disadvantage to certain clients and a disadvantage to other clients who did not receive a fill that may have otherwise been obtained in the absence of Griffin’s non-client orders.*

*Disposition – Absent specific client consent to the Participant trading ahead or alongside an order, client priority must be respected in order to minimize the conflict of interest that occurs when a firm or trader competes with the firm’s clients for executions. Under the terms of a Settlement Agreement, Griffin agreed that he did not record that any client had specifically consented to his trading ahead or alongside on any of the order tickets, as required by UMIR 5.3(6), nor did he make any other record of any of the clients providing their consent. Griffin contravened the client priority rule on multiple occasions by filling orders for his own account that his clients could have obtained had the client orders been entered first.*

*Requirements Considered – Rule 5.3 and Policy 5.3.*

*Sanction - Griffin agreed to a \$15,000 fine, \$5,000 in costs and to successfully complete both the Conduct and Practices Handbook and Trader Training Course examinations within six (6) months.*

**Proposed Amendments:** For information on the current proposed amendments to Part 3 of Policy 5.3, refer to IIROC Notice 15-0277 – Rules Notice – Request For Comments – UMIR and DMR – Proposed Provisions Respecting Best Execution (December 10, 2015)