| Market Integrity Notice |

R | S Market Regulation Services Inc.
Services de réglementation du marché inc.

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Suggested Routing: Institutional, Retail, Trading, Legal & Compliance

ORDER MARKING

Rule Requirements

To assist Participants in complying with the requirements of the Universal Market Integrity Rules (“UMIR”), Market Integrity Notice 2003-0002 dated January 13, 2003 prohibiting double printing, and National Instrument 23-101, Market Regulation Services Inc. (“RS”) wishes to confirm the requirements for order marking in particular circumstances and the implications of these requirements for Participants.

Part 11 of National Instrument 23-101 requires a Participant to record specific information regarding each order received or originated from a client (including the identifier assigned to the order and whether the order is a client, non-client or principal order) in addition to recording additional information immediately following the execution of that order. Consequently, a Participant must keep records of each individual trade and such records must be retained for a period of seven years (and during the first two years, in a readily accessible location) and be available upon request by RS or other regulatory authorities. Furthermore, after December 31, 2003, National Instrument 23-101 will require the information on each order to be transmitted in electronic form to RS or another regulation services provider at the time required by the other regulation services provider.

General Order Marking Principles

In addition to the audit trail requirements in Part 11 of National Instrument 23-101, Rule 6.2 of UMIR requires orders entered on a marketplace to contain the appropriate designations. In particular, client, non-client and principal orders must be properly designated when entered on a marketplace. Rule 10.11 of UMIR provides that a Participant must supplement the order record required by Part 11 of National Instrument 23-101 by adding certain additional information, including all order designations required by Rule 6.2

In other words, orders entered on a marketplace on behalf of a client must be designated or marked as “client” orders. A client order is an order for the purchase or sale of a security for the account of a client of a Participant or a client of an affiliated entity of a Participant. Should a Participant have a firm order from a client, that order must be entered on a marketplace as “client” and not as inventory or “principal”. As indicated in Market Integrity Notice 2003-0002, a Participant should not interpose itself between two orders, effecting two trades when one would have sufficed.

Where a Participant receives an indication of interest from a client or an order with a contingency that has not occurred, the client is under no obligation to purchase the security. In these instances, the Participant assumes liability for any trades done based upon that expression of interest or prior to the fulfillment of the contingency attached to the contingent order and therefore such trades should be marked "principal". In making such trades, a Participant must be cognizant of its obligation not to "frontrun" a client's order that has not be entered for trading.

Order Marking Examples

The following examples illustrate RS's position on order marking under specific circumstances. **It is possible that RS' position on order marking differs from business practices adopted by certain Participants, so please review the following scenarios carefully.**

Scenario 1 – Marking of Orders from Foreign Dealers

A Participant receives an order from a U.S. Securities Dealer that may or may not be an affiliate. The order itself is on behalf of a client of the U.S. dealer.

If the Participant executes the trade as an agent on a marketplace the order should be designated "client". This holds true even when such trades are processed through an account for the purpose of averaging prices or funds conversion.

If, however, the Participant executes an off-marketplace principal take-on trade under clause (e) of UMIR 6.4 (Trade Outside of Canada), all principal unwinding trades on a marketplace in Canada shall be designated as "principal".

What is important in this scenario is the order in which the events occur. If the U.S. Securities Dealer is given an execution prior to entering orders on a marketplace, then the Participant is executing an off-marketplace principal transaction. The Participant has assumed the risk of the market moving prior to unwinding the position and all unwinding trades must be marked "principal". On the other hand, if the U.S. Securities Dealer is not given an immediate execution and instead the order is traded on a marketplace with fills reported after execution, this is an agency trade and must be marked "client".

Please note that foreign affiliates that are registered as securities dealers in a foreign jurisdiction are excluded from the definition of "principal account" in UMIR unless the Participant or a related entity that is a securities dealer in Canada holds an interest in the account. Unless the order is originating from a principal account, all orders from a foreign securities dealer are to be handled as "client" orders. This treatment is consistent with the treatment of Canadian banks that are affiliated with a Participant. <u>These orders should also not be treated as jitney orders (as the Participant is not acting on behalf of another Participant).</u>

Scenario 2 – Offsetting Client Order

A trader receives an offsetting client order simultaneously as he takes on a block of stock in that security (for all or part of the block).

If the offsetting order is received by the trader after execution of the first client order, the second order must be crossed to the client on a marketplace.

If an offsetting order is received while the Participant has a non-client or principal order on a marketplace and wants to give up any subsequent fill to the client, the Participant should "cfo" the account type of the order to "client" in order to ensure an accurate audit trail. Later, if the client order is completed, any remaining balance on the order should be cfo'd to either non-client or principal. (For example, on the Toronto Stock Exchange and the TSX Venture Exchange cfo'ing the account type will not cause the order to lose priority.)

If a Participant with a non-client or principal order on a marketplace receives a client order **after** execution or partial execution of the non-client or principal order and the Participant wishes to give up that execution to the client, the position must be crossed on a marketplace to the client.

Scenario 3 – Several Transactions Over-the-Day on Behalf of a Client

A trader is purchasing small amounts of a security over-the-day on behalf of a committed, time-stamped client order. The client, however, has instructed the trader that the smaller trades be reprinted on a marketplace in one large block rather than several smaller trades.

It is inappropriate to purchase stock on behalf of a client over time and then reprint the entire block to the client in a single transaction. The client must be informed that this second trade would not represent a change in beneficial ownership since the client was the beneficial owner of the stock from the moment each trade was executed. Consequently, the trade should not be printed on a marketplace.

Scenario 4 – Expressions of Interest

A client has expressed an interest in buying a particular security to a Participant but has not given a firm order. The Participant decides to go into the marketplace and buy the security in anticipation of putting together a trade with the client.

Expressions of interest by a client are not considered "orders". Consequently, should a Participant enter the market as a result of an expression of interest the Participant is acting as principal and trades should be marked as such. If the client later agrees to purchase the stock the Participant must cross the stock to the client within the context of the market at that time.

In addition, if the client is receiving a fill on a net basis, pursuant to provision 7.5 of UMIR, the price recorded on the marketplace may not be lower than the net cost or higher than the net proceeds by more than the usual agency commission that would be charged by the Participant to that client for an order of the same size.

Scenario 5 – Contingent Orders

A trader is purchasing a security as a result of a client order that is contingent upon an event happening (e.g. if you sell all of 100,000 ABC stock, purchase 100,000 shares of XYZ stock on a $2 spread).

Where the Participant assumes liability for a trade (should the contingency not occur, the Participant would end up owning the security), the order should be marked "principal". In the event of an "all or none" order where the Participant has decided to strip the terms of the order and enter it into the regular book, the Participant assumes the liability for the order and it should be marked as principal. Unwinding this position to the client must then be done on a marketplace as it constitutes a change in beneficial ownership.

Scenario 6 – Jitney Trades

If a Participant with a client order sends a jitney order to another Participant for execution , can the originating Participant that gave the order then cross the stock again to its client in a principal-client cross?

Jitney trades executed by the executing Participant are to be marked as client if the trade is on behalf of the originating Participant's client. If the trade is a principal or non-client trade for the originating Participant, it should then be marked as such. The originating Participant, upon receipt of the security to fill the client order, would journal the fill to the client.

As a general rule, a jitney order must contain all order markings that would have been attached to the order as if the order had been entered on a marketplace directly by the originating Participant. For example, a jitney order must indicate contain the "insider" or "significant shareholder" marker if the order was originally given by an insider or significant shareholder of the issuer of the security which is being bought or sold.

Scenario 7 – Flattening a Liability Position

A Participant takes on a position from a client in a client-principal trade and unwinds the position in the marketplace at the quote.

What is important in this scenario is the sequence of events. If the client-principal cross occurs first and the Participant then unwinds the position, the unwinding transaction should be marked principal. However, if the Participant takes out the quote in the book first, the order should be marked client and the balance, if there is one, should be marked as a client-principal trade.

Scenario 8 – Re-crossing Trades Executed in the U.S.

A Participant executes trade on behalf of a client through a U.S. securities dealer on a U.S. marketplace. Can this trade be re-crossed on a Canadian marketplace?

If a Participant executes a client order on a particular marketplace in accordance with client instructions, such trades should not be reprinted on a Canadian marketplace. However, if a Participant executes a trade on a U.S. marketplace in order to fill a client order but the client has specifically requested the trade be done on a Canadian marketplace, the Participant should purchase as principal in the foreign market and re-cross the trade in Canada as a principal-client trade. In these circumstances, the Participant must retain the client's instructions with the record of both trades.

Further Information

For additional information regarding this Market Integrity Notice please contact Bruce Sinclair, Manager, Trade Desk Compliance at 416.646.7207; Noelle Wood, Senior Counsel, Market Surveillance at 416.646.7275; James Twiss, Senior Counsel, Market Surveillance at 416.646.7277; or email RS at inquiries@regulationservices.com.

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