

**Companion Policy 23-101CP
to National Instrument 23-101
Trading Rules**

Table of Contents

<u>PART</u>	<u>TITLE</u>
PART 1	INTRODUCTION
1.1	Introduction
1.2	Just and Equitable Principles of Trade
PART 1.1	DEFINITIONS
1.1.1	Definition of best execution
PART 2	APPLICATION OF THE INSTRUMENT
2.1	Application of the Instrument
PART3	MANIPULATION AND FRAUD
3.1	Manipulation and Fraud
PART 4	BEST EXECUTION
4.1	Best Execution
PART 5	REGULATORY HALTS
5.1	Regulatory Halts
PART 6	TRADING HOURS
6.1	Trading Hours
PART 7	MONITORING AND ENFORCEMENT
7.1	Monitoring and Enforcement Requirements Set By a Recognized Exchange or Recognized Quotation and Trade Reporting System
7.2	Monitoring and Enforcement Requirements for an ATS
7.3	Monitoring and Enforcement Requirements for an Inter-Dealer Bond Broker
7.4	Monitoring and Enforcement Requirements for a Dealer Executing Trades of Unlisted Debt Securities Outside of a Marketplace
PART 8	AUDIT TRAIL REQUIREMENTS
8.1	Audit Trail Requirements
8.2	Transmission of Information to a Regulation Services Provider
8.3	Electronic Form

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PART 1 INTRODUCTION

1.1 Introduction - The purpose of this Companion Policy is to state the views of the Canadian securities regulatory authorities on various matters related to National Instrument 23-101 Trading Rules (the "Instrument"), including

- (a) a discussion of the general approach taken by the Canadian securities regulatory authorities in, and the general regulatory purpose for, the Instrument; and
- (b) the interpretation of various terms and provisions in the Instrument.

1.2 Just and Equitable Principles of Trade - While the Instrument deals with specific trading practices, as a general matter, the Canadian securities regulatory authorities expect marketplace participants to transact business openly and fairly, and in accordance with just and equitable principles of trade.

Part 1.1 – Definitions

1.1.1 Definition of best execution –

(1) In the Instrument, best execution is defined as the “most advantageous execution terms reasonably available under the circumstances”. In seeking best execution, a dealer or adviser may consider a number of elements, including:

- a. price;
- b. speed of execution;
- c. certainty of execution; and
- d. the overall cost of the transaction.

These four broad elements encompass more specific considerations, such as order size, reliability of quotes, liquidity, market impact (i.e. the price movement that occurs when executing an order) and opportunity cost (i.e. the missed opportunity to obtain a better price when an order is not completed at the most advantageous time). The overall cost of the transaction is meant to include, where appropriate, all costs associated with accessing an order and/or executing a trade that are passed on to a client, including fees arising from trading on a particular marketplace, jitney fees (i.e. any fees charged by one dealer to another for providing trading access) and settlement costs. The commission fees charged by a dealer would also be a cost of the transaction.

(2) The elements to be considered in determining “the most advantageous execution terms reasonably available” (i.e. best execution) and the weight given to each will vary depending on the instructions and needs of the client, the particular security, the prevailing market conditions and whether the dealer or adviser is responsible for best execution under the circumstances. Please see a detailed discussion below in Part 4.

PART 2 APPLICATION OF THE INSTRUMENT

2.1 Application of the Instrument – Section 2.1 of the Instrument provides an exemption from subsection 3.1(1) and Parts 4 and 5 of the Instrument if a person or company complies with similar

requirements established by a recognized exchange that monitors and enforces the requirements set under subsection 7.1(1) of the Instrument directly, a recognized quotation and trade reporting system that monitors and enforces requirements set under subsection 7.3(1) of the Instrument directly or a regulation services provider. The requirements are filed by the recognized exchange, recognized quotation and trade reporting system or regulation services provider and approved by a securities regulatory authority. If a person or company is not in compliance with the requirements of the recognized exchange, recognized quotation and trade reporting system or the regulation services provider, then the exemption does not apply and that person or company is subject to subsection 3.1(1) and Parts 4 and 5 of the Instrument. The exemption from subsection 3.1(1) does not apply in Alberta, British Columbia, Ontario, Québec and Saskatchewan and the relevant provisions of securities legislation apply.

PART 3 MANIPULATION AND FRAUD

3.1 Manipulation and Fraud

(1) Subsection 3.1(1) of the Instrument prohibits the practices of manipulation and deceptive trading, as these may create misleading price and trade activity, which are detrimental to investors and the integrity of the market.

(2) Subsection 3.1(2) of the Instrument provides that despite subsection 3.1(1) of the Instrument, the provisions of the *Securities Act* (Alberta), the *Securities Act* (British Columbia), the *Securities Act* (Ontario), the *Securities Act* (Québec) and *The Securities Act, 1988* (Saskatchewan), respectively, relating to manipulation and fraud apply in Alberta, British Columbia, Ontario, Québec and Saskatchewan. The jurisdictions listed have provisions in their legislation that deal with manipulation and fraud.

(3) For the purposes of subsection 3.1(1) of the Instrument, and without limiting the generality of those provisions, the Canadian securities regulatory authorities, depending on the circumstances, would normally consider the following to result in, contribute to or create a misleading appearance of trading activity in, or an artificial price for, a security:

(a) Executing transactions in a security if the transactions do not involve a change in beneficial or economic ownership. This includes activities such as wash-trading.

(b) Effecting transactions that have the effect of artificially raising, lowering or maintaining the price of the security. For example, making purchases of or offers to purchase securities at successively higher prices or making sales of or offers to sell a security at successively lower prices or entering an order or orders for the purchase or sale of a security to:

- (i) establish a predetermined price or quotation,
- (ii) effect a high or low closing price or closing quotation, or
- (iii) maintain the trading price, ask price or bid price within a predetermined range.

(c) Entering orders that could reasonably be expected to create an artificial appearance of investor participation in the market. For example, entering an order for the purchase or sale of a security with the knowledge that an order of substantially the same size, at substantially the same time, at substantially the same price for the sale or purchase, respectively, of that security has been or will be entered by or for the same or different persons.

(d) Executing prearranged transactions that have the effect of creating a misleading appearance of active public trading or that have the effect of improperly excluding other marketplace participants from the

transaction.

- (e) Effecting transactions if the purpose of the transactions is to defer payment for the securities traded.
- (f) Entering orders to purchase or sell securities without the ability and the intention to
 - (i) make the payment necessary to properly settle the transaction, in the case of a purchase; or
 - (ii) deliver the securities necessary to properly settle the transaction, in the case of a sale.

This includes activities known as free-riding, kiting or debit kiting, in which a person or company avoids having to make payment or deliver securities to settle a trade.

- (g) Engaging in any transaction, practice or scheme that unduly interferes with the normal forces of demand for or supply of a security or that artificially restricts or reduces the public float of a security in a way that could reasonably be expected to result in an artificial price for the security.
- (h) Engaging in manipulative trading activity designed to increase the value of a derivative position.
- (i) Entering a series of orders for a security that are not intended to be executed.

(4) The Canadian securities regulatory authorities do not consider market stabilization activities carried out in connection with a distribution to be activities in breach of subsection 3.1(1) of the Instrument, if the market stabilization activities are carried out in compliance with the rules of the marketplace on which the securities trade or with provisions of securities legislation that permit market stabilization by a person or company in connection with a distribution.

(5) Section 3.1 of the Instrument applies to transactions both on and off a marketplace. In determining whether a transaction results in, contributes to or creates a misleading appearance of trading activity in, or an artificial price for a security, it may be relevant whether the transaction takes place on or off a marketplace. For example, a transfer of securities to a holding company for *bona fide* purposes that takes place off a marketplace would not normally violate section 3.1 even though it is a transfer with no change in beneficial ownership.

(6) The Canadian securities regulatory authorities are of the view that section 3.1 of the Instrument does not create a private right of action.

(7) In the view of the Canadian securities regulatory authorities, section 3.1 includes attempting to create a misleading appearance of trading activity in or an artificial price for, a security or attempting to perpetrate a fraud.

PART 4 BEST EXECUTION

4.1 **Best Execution** – (1) The best execution obligation in Part 4 of the Instrument does not apply to an ATS that is registered as a dealer provided that it is carrying on business as a marketplace and is not handling any client orders other than accepting them to allow them to execute on the system. However, the best execution obligation does otherwise apply to an ATS acting as an agent for a client.

(2) Section 4.2 of the Instrument requires a dealer or adviser to make reasonable efforts to achieve

best execution (the most advantageous execution terms reasonably available under the circumstances) when acting for a client. The obligation applies to all securities.

(3) Although what constitutes “best execution” varies depending on the particular circumstances, to meet the “reasonable efforts” test, a dealer or adviser should be able to demonstrate that it has, and has abided by, its policies and procedures that (i) require it to follow the client’s instructions and the objectives set, and (ii) outline a process designed to achieve best execution. The policies and procedures should describe how the dealer or adviser evaluates whether best execution was obtained and should be regularly and rigorously reviewed. The policies outlining the obligations of the dealer or adviser will be dependent on the role it is playing in an execution. For example, in making reasonable efforts to achieve best execution, the dealer should consider the client’s instructions and a number of factors, including the client’s investment objectives and the dealer’s knowledge of markets and trading patterns. An adviser should consider a number of factors, including assessing a particular client’s requirements or portfolio objectives, selecting appropriate dealers and marketplaces and monitoring the results on a regular basis. In addition, if an adviser is directly accessing a marketplace, the factors to be considered by dealers may also be applicable.

(4) Where securities listed on a Canadian exchange or quoted on a Canadian quotation and trade reporting system are inter-listed either within Canada or on a foreign exchange or quotation and trade reporting system, in making reasonable efforts to achieve best execution, the dealer should assess whether it is appropriate to consider all marketplaces upon which the security is listed or quoted and where the security is traded, both within and outside of Canada.

(5) In order to meet best execution obligations where securities trade on multiple marketplaces in Canada, a dealer should consider information from all appropriate marketplaces (not just marketplaces where the dealer is a participant). This does not mean that a dealer must have access to real-time data feeds from each marketplace. However, its policies and procedures for seeking best execution should include the process for taking into account order and/or trade information from all appropriate marketplaces and the requirement to evaluate whether taking steps to access orders is appropriate under the circumstances. The steps to access orders may include making arrangements with another dealer who is a participant of a particular marketplace or routing an order to a particular marketplace.

(6) For foreign exchange-traded securities, if they are traded on an ATS in Canada, dealers should include in their best execution policies and procedures a regular assessment of whether it is appropriate to consider the ATS as well as the foreign markets upon which the securities trade.

(7) Section 4.2 of the Instrument applies to registered advisers as well as registered dealers that carry out advisory functions but are exempt from registration as advisers.

(8) Section 4.3 of the Instrument requires that a dealer or adviser make reasonable efforts to use facilities providing information regarding orders and trades. These reasonable efforts refer to the use of the information displayed by the information processor or, if there is no information processor, an information vendor.

PART 5 REGULATORY HALTS

5.1 Regulatory Halts – Section 5.1 of the Instrument applies when a regulatory halt has been imposed by a regulation services provider, a recognized exchange, recognized quotation and trade reporting system or an exchange or quotation and trade reporting system that has been recognized for the purposes of the Instrument and NI 21-101. A regulatory halt, as referred to in section 5.1 of the Instrument, is one that is imposed to maintain a fair and orderly market, including halts related to a timely disclosure policy, or

because there has been a violation of regulatory requirements. In the view of the Canadian securities regulatory authorities, an order may trade on a marketplace despite the fact that trading of the security has been suspended because the issuer of the security has ceased to meet minimum listing or quotation requirements, or has failed to pay to the recognized exchange, the recognized quotation and trading system or the exchange or quotation and trade reporting system recognized for the purposes of the Instrument and NI 21-101 any fees in respect of the listing or quotation of securities of the issuer. Similarly, an order may trade on a marketplace despite the fact that trading of the security has been delayed or halted because of technical problems affecting only the trading system of the recognized exchange, recognized quotation and trading system or exchange or quotation and trade reporting system recognized for the purposes of the Instrument and NI 21-101.

PART 6 TRADING HOURS

6.1 Trading Hours

(1) Section 6.1 of the Instrument provides that each marketplace shall set requirements in respect of the hours of trading to be observed by marketplace participants. A marketplace may have after hours trading at any prices.

(2) An ATS can trade after hours at prices outside of the closing bid price and ask price of a security set by the marketplace where that security is listed or quoted.

PART 7 MONITORING AND ENFORCEMENT

7.1 Monitoring and Enforcement of Requirements Set By a Recognized Exchange or Recognized Quotation and Trade Reporting System - Under section 7.1 of the Instrument, a recognized exchange will set its own requirements governing the conduct of its members. Under section 7.3 of the Instrument, a recognized quotation and trade reporting system will set its own requirements governing the conduct of its users. The recognized exchange or recognized quotation and trade reporting system can monitor and enforce these requirements either directly or indirectly through a regulation services provider. A regulation services provider is a person or company that provides regulation services and is either a recognized exchange, recognized quotation and trade reporting system or a recognized self-regulatory entity. Sections 7.2 and 7.4 of the Instrument require the recognized exchange or recognized quotation and trade reporting system that chooses to have the monitoring and enforcement performed by the regulation services provider to enter into an agreement with the regulation services provider in which the regulation services provider agrees to enforce the requirements of the recognized exchange or recognized quotation and trade reporting system.

7.2 Monitoring and Enforcement Requirements for an ATS – Section 8.2 of the Instrument requires the regulation services provider to set requirements that govern an ATS and its subscribers. Before executing a trade for a subscriber, the ATS must enter into an agreement with a regulation services provider and an agreement with each subscriber. These agreements form the basis upon which a regulation services provider will monitor the trading activities of the ATS and its subscribers and enforce its requirements. The requirements set by a regulation services provider must include requirements that the ATS and its subscribers will conduct trading activities in compliance with the Instrument. The ATS and its subscribers are considered to be in compliance with the Instrument and are exempt from the application of most of its provisions if the ATS and the subscriber are in compliance with the requirements set by a regulation services provider.

7.3 Monitoring and Enforcement Requirements for an Inter-Dealer Bond Broker -Section 9.1 of the Instrument requires that a regulation services provider set requirements governing the conduct of an inter-dealer bond broker. Under section 9.2 of the Instrument, the inter-dealer bond broker must enter into an agreement with the regulation services provider providing that the regulation services provider monitor the activities of the inter-dealer bond broker and enforce the requirements set by the regulation services provider. However, section 9.3 of the Instrument provides inter-dealer bond brokers with an exemption from sections 9.1 and 9.2 of the Instrument if the inter-dealer bond broker complies with the requirements of IDA Policy No. 5 Code of Conduct for IDA Member Firms Trading in Domestic Debt Markets, as amended, as if that policy was drafted to apply to the inter-dealer bond broker.

7.4 Monitoring and Enforcement Requirements for a Dealer Executing Trades of Unlisted Debt Securities Outside of a Marketplace - Section 10.1 of the Instrument requires that a regulation services provider set requirements governing the conduct of a dealer executing trades of unlisted debt securities outside of a marketplace. Under section 10.2 of the Instrument, the dealer must also enter into an agreement with the regulation services provider providing that the regulation services provider monitor the activities of the dealer and enforce the requirements set by the regulation services provider.

PART 8 AUDIT TRAIL REQUIREMENTS

8.1 Audit Trail Requirements - Section 11.2 of the Instrument imposes obligations on dealers and inter-dealer bond brokers to record in electronic form and to report certain items of information with respect to orders and trades. Information to be recorded includes any markers required by a regulation services provider (such as a significant shareholder marker). The purpose of the obligations set out in Part 11 is to enable the entity performing the monitoring and surveillance functions to construct an audit trail of order, quotation and transaction data which will enhance its surveillance and examination capabilities.

8.2 Transmission of Information to a Regulation Services Provider – Section 11.3 of the Instrument requires that a dealer and an inter-dealer bond broker provide to the regulation services provider information required by the regulation services provider, within ten business days, in electronic form. This requirement is triggered only when the regulation services provider sets requirements to transmit information.

8.3 Electronic Form – Subsection 11.3 of the Instrument requires any information required to be transmitted to the regulation services provider and securities regulatory authority in electronic form. Dealers and inter-dealer bond brokers are required to provide information in a form that is accessible to the securities regulatory authorities and the regulation services provider (for example, in SELECTR format).

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