

COMPANION POLICY 23-101, *TRADING RULES*

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PART 1 INTRODUCTION**1.1 Introduction**

The purpose of this Policy Statement is to state the views of the Canadian securities regulatory authorities on various matters related to Regulation 23-101 Respecting Trading Rules (the "Regulation"), including

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

1.2 Just and Equitable Principles of Trade

While the Regulation 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 2 APPLICATION OF THE REGULATION**2.1 Application of the Regulation**

Section 2.1 of the Regulation provides an exemption from subsection 3.1(1) and Parts 4 and 5 of the Regulation 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 Regulation directly, a recognized quotation and trade reporting system that monitors and enforces requirements set under subsection 7.3(1) of the Regulation 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 Regulation. 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 Regulation prohibits the practices of price 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 Regulation provides that despite subsection 3.1(1) of the Regulation, 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 Regulation, 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 Regulation, 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 Regulation 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 Regulation 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 Regulation does not apply to an ATS that is registered as a dealer. However, the best execution obligation does apply to a dealer acting in its role as an intermediary for its client.
- (2) Subsection 4.2(1) of the Regulation requires a dealer acting as agent for a client to make reasonable efforts to ensure that the client receives the best execution price on a purchase or sale of securities by the client.
- (3) For inter-listed securities, the Canadian securities regulatory authorities are of the view that in making reasonable efforts, a dealer should also consider whether it would be appropriate in the particular circumstances to look at markets outside of Canada.
- (4) Subsection 4.2(2) of the Regulation prohibits a dealer acting as agent for a client in any marketplace from "trading through" a better-priced order on another marketplace or with another dealer. In an environment where there are multiple competing marketplaces, it is important that all investors have access to the best price for their orders at time of execution. Without consolidation of these markets, fragmentation may occur if investors are not given information about the best price available or if they are unable to access the best price. In order to mitigate possible negative effects of fragmenting the markets, it is important for these markets to be integrated to prevent trading through a better price existing in another marketplace.
- (5) The Canadian securities regulatory authorities are of the view that in satisfying its fiduciary obligations to its client, a dealer should make reasonable efforts to obtain a lower price on an order to buy or a higher price on an order to sell than is currently available by posting a better bid or offer. In order to achieve this price improvement for a client, the dealer should have an order management system that has the capability of providing price improvement. In addition, the dealer should make reasonable efforts by using facilities providing information regarding orders.
- (6) The Canadian securities regulatory authorities are of the view that dealers should ensure best execution price to clients for their purchases or sales of foreign exchange-traded securities. To meet this obligation, dealers should look to the foreign markets upon which the securities trade to ensure that the client receives the best execution price on that purchase or sale of securities.
- (7) Subsection 4.2(3) of the Regulation requires that a dealer make reasonable efforts to use facilities providing information regarding orders. These reasonable efforts refer to the use of the information displayed by the information processor or, if there is no information processor, by an information vendor that meets that standards set out by a regulation services provider.

- (8) In order to meet best execution obligations, where securities trade on multiple marketplaces in Canada, a dealer should consider information from all marketplaces (not just marketplaces where the dealer is a participant). This does not necessarily mean that a dealer must have access to real-time data feeds from each marketplace but that it should establish reasonable policies and procedures for best execution that include taking into account order and/or trade information from all appropriate marketplaces in the particular circumstances. The policies and procedures should be monitored on a regular basis. A dealer should also take steps, where appropriate, to access orders which may include making arrangements with another dealer who is a participant of a particular marketplace or routing an order to a particular marketplace.

PART 5 REGULATORY HALTS**5.1 Regulatory Halts**

In the view of the Canadian securities regulatory authorities, an order may trade on a marketplace despite the fact that 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 Regulation and Regulation 21-101 Respecting Marketplace operation ("Regulation 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 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 Regulation and Regulation 21-101.

PART 6 TRADING HOURS**6.1 Trading Hours**

- (1) Section 6.1 of the Regulation 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 Regulation, a recognized exchange will set its own requirements governing the conduct of its members. Under section 7.3 of the Regulation, 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 Regulation 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 Regulation 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 Regulation. The ATS and its subscribers are considered to be in compliance with the Regulation 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 Regulation requires that a regulation services provider set requirements governing the conduct of an inter-dealer bond broker. Under section 9.2 of the Regulation, 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 Regulation provides inter-dealer bond brokers with an exemption from sections 9.1 and 9.2 of the Regulation 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 Regulation 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 10.3 of the Regulation, 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 Regulation 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 that they receive. 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

Subsection 11.2(5) of the Regulation requires that a dealer and an inter-dealer bond broker provide to the securities regulatory authority or the regulation services provider information as required by the securities regulatory authority or the regulation services provider, within 10 business days, in electronic format as required by a securities regulatory authority or the regulation services provider. This requirement is triggered only when the securities regulatory authority or the regulation services provider sets requirements to transmit information.

8.3 Electronic Audit Trail

Subsection 11.2(6) of the Regulation requires dealers and inter-dealer bond brokers to transmit certain information to a securities regulatory authority or a regulation services provider in electronic form as prescribed by a securities regulatory authority or the regulation services provider. The Canadian securities regulatory authorities and the self-regulatory entities are working with the industry to develop standards for these requirements.