

# Notice to Participating Organizations

March 7, 2002

2002-061

## UNIVERSAL MARKET INTEGRITY RULES

### Background

On December 1, 2001, National Instrument 21-101 – Marketplace Operation (the “Marketplace Operation Instrument”) and National Instrument 23-101 – Trading Rules (the “CSA Trading Rules”) became effective. These National Instruments are part of the initiative by the Canadian Securities Administrators (the “CSA”) to create a framework for the competitive operation of traditional exchanges, quotation and trade reporting systems (“QTRSS”) and Alternative Trading Systems (“ATSS”).

In accordance with the CSA Trading Rules, The Toronto Stock Exchange (the “TSE”), as a recognized exchange, must set requirements governing the conduct of its Participating Organizations. As an exchange, the TSE may either monitor or enforce these requirements in relation to its members directly or through a regulation services provider. The TSE has retained Market Regulation Services Inc. (“RS”) to be its regulation service provider effective March 1, 2002. Effective April 1, 2002, the TSE will adopt the Universal Market Integrity Rules (“UMIR”) as the rules governing the trading conduct of its Participating Organizations.

RS was established in 2001 as a joint initiative of the TSE and the Investment Dealers Association of Canada to provide an independent securities trading regulatory body. RS has been recognized as a self-regulatory organization (“SRO”) by the Alberta Securities Commission, British Columbia Securities Commission, Manitoba Securities Commission, Ontario Securities Commission and the Commission des valeurs mobilières du Québec (the “Recognizing Regulators”) and, as such, is authorized to be a regulation services provider for the purposes of the Marketplace Operation Instrument and the CSA Trading Rules.

As a regulation services provider, RS will administer and enforce trading rules for the marketplaces that retain the services of RS. RS has adopted, and the Recognizing Regulators have approved, UMIR as the integrity trading rules that will apply in any marketplace that retains RS as its regulation services provider. Appendix “A” is a chart outlining a summary of the obligations under UMIR that will be imposed on marketplaces and on persons who may obtain access to a marketplace. The text of

UMIR is contained in Appendix “B” and the text of the Policies adopted under UMIR is set out in Appendix “C”.

### **Effective Date of UMIR**

Effective April 1, 2002, UMIR will apply to trading on the TSE and govern the trading conduct of its Participating Organizations. Implementation of certain provisions of UMIR will be deferred to permit required systems development by the exchanges, information processors and data vendors and dealers. Implementation of the following provisions of UMIR will be deferred until June 3, 2002 or such later date as may be published by RS:

1. the requirement under Rule 6.2 that an order entered on a marketplace contain a designation if the order is entered for the account of a person who is an insider or a significant shareholder of the issuer of the security which is the subject of the order; and
2. the requirement under Rule 9.1 that order entry for a particular security be inhibited during a regulatory halt or suspension affecting that security.

### **Amendments to Rules and Policies of the TSE**

Upon the adoption of UMIR as the integrity trading rules for the TSE, the existing rules and policies of the TSE will be amended to delete or vary any provisions where the subject matter is covered by UMIR. Appendix “D” are the amendments to the Rules of the TSE to reflect the adoption of UMIR and Appendix “E” are the amendments to the Policies of the TSE.

The TSE will retain its rules and policies that are specific to its market, including provisions related to systems operation, market quality and market structure. These market specific rules and policies may also be amended in response to matters contained in the Marketplace Operation Instrument and the CSA Trading Rules. Any additional changes to the rules and policies of the TSE will be the subject of notices published by the TSE.

### **Summary of Material Differences Between TSE Rules and UMIR**

UMIR has been drafted using terminology consistent with the Marketplace Operation Instrument and the CSA Trading Rules and in a manner that the requirements apply to multiple marketplaces (including exchanges, quotation and trade reporting systems and alternative trading systems). As noted in Appendix “A”, UMIR also imposes certain requirements and obligations directly upon marketplaces and on persons with access to a marketplace who are not dealers.

For Participating Organizations, the **material differences** between the existing TSE Rules and Policies and the provisions of UMIR as approved by the Recognizing Regulators are set out in the following chart:

TSE Rule	UMIR Section	Summary Description of Differences between TSE Rule and UMIR Provision
1-101	1.1	<p><b>Definitions</b> - Under UMIR, a Participant when determining as “best ask price”, “best bid price”, “better price” and “last sale price” will make reference to data provided by an information processor or an information vendor that produces a consolidated market display containing information from multiple marketplaces. The TSE Rules make reference only to trading activity on the TSE. These definitions are used in UMIR in rules related to “best execution”, “client priority” and “client-principal trading”.</p> <p>The substitution of information processors and information vendors for a single data consolidator means the obligations of dealers will be subject to “information availability”. In discharging their obligations, dealers will be able to rely on information from a processor or vendor if it contains order and trade information from the principal market for the security.</p> <p>UMIR provides definitions for Call Market Order, Market-on-Close Order, Opening Order, Special Terms Order and Volume-Weighted Average Price Order that are not in the TSE Rules. These special types of orders are exempted from various UMIR provisions.</p> <p>The definitions of “client order”, “non-client order” and “principal order” have been varied in UMIR such that an order on behalf of the account of an Approved Person would be designated as a “non-client order” rather than a “principal order” as contemplated by the TSE Rules.</p>
3-103	9.1	<p><b>Regulatory Halts, Delays and Suspensions of Trading</b> - The provisions dealing with trading halts have been amended to clarify that trading in listed or quoted securities may continue on an ATS where trading has been delayed or suspended on an Exchange or QTRS as a result of a “Marketplace Rule” (being essentially any rule of an Exchange or QTRS which is not an integrity rule). The power of a Market Integrity Official to order a halt, delay or suspension in the trading of any security is specifically included in Rule 10.9. Order entry on a marketplace will be inhibited during the duration of any regulatory halt or suspension (but order entry will be permitted during a delay).</p>
4-101 4-102	6.4	<p><b>Trades to be on a Marketplace</b> - UMIR requires that all trades by a Participant be on a marketplace unless otherwise exempted. UMIR contains a number of exemptions that are patterned on the TSE Rule 4-102 but UMIR does not contain an exemption for securities of a foreign issuer (as these may be traded on an ATS) or for listed bonds (as these must be traded in accordance with the ATS Trading Rules if not traded on UMIR-regulated marketplace).</p>
4-201	2.1	<p><b>Just and Equitable Principles</b> - Unlike the existing TSE Rule, the ambit of the UMIR provision has been restricted to govern only activities related to trading on a marketplace or trading or otherwise dealing in securities that are eligible to be traded on a marketplace.</p>
4-202	2.2	<p><b>Manipulative or Deceptive Method of Trading</b> - Under the existing TSE Rule, the activity must create a false or misleading appearance of trading activity or an artificial price. UMIR expands the prohibition to include activity which “could</p>

TSE Rule	UMIR Section	Summary Description of Differences between TSE Rule and UMIR Provision
		reasonably be expected” to create false or misleading appearances. UMIR also expands the prohibition to activities that could have an effect on “related securities”. The UMIR provision specifically stipulates that a trade without a change in “economic ownership” (in addition to a change in beneficial ownership) is manipulative. UMIR also defines as manipulative attempts to “corner” the market in a security or to purchase a security with the intention of making a sale below the last sale price. UMIR also provides that when orders are entered to establish a predetermined price or quotation, effect a high or low closing price or quotation or maintaining the trading price, ask price or bid price within a predetermined range, or a series of order that are not intended to be executed is manipulative if done with the intention of creating or false or misleading appearance of trading activity or an artificial price.
4-204	4.1	<b>Frontrunning</b> - The existing TSE Rule precludes trading activity by Participants where there is knowledge of an “undisclosed” client order that could reasonably be expected to affect the market price of a security. UMIR extends the prohibition to “related securities” and precludes various activities prior to the entry of the client order. Prior to the entry of a material client order, UMIR precludes the solicitation of orders from any other person or the provision of information respecting the client order to any person. UMIR provides a number of exemptions that are not present in the current TSE Rule including the ability to enter principal order to fulfill a legally binding obligation entered into by the Participating Organization before having actual knowledge or the client order and where the order is entered for an arbitrage account.
4-206	7.4	<b>Contract Record and Official Transaction Record</b> -Under TSE Rule, the electronic record maintained by the TSE is the official record. For the purposes of UMIR the official record for the purposes of determining best ask price, best bid price and last sale price shall be the record as provided by a marketplace to an information processor or an information vendor.
4-301	3.1	<b>Restrictions on Short Selling</b> - Under UMIR, a short sale may not be made at a price that is less than the last sale price as displayed in a consolidated market display. UMIR expands the definition of a short sale to include any sale where the trade will be settled with borrowed securities (and the seller is not otherwise considered to own the security) or where the securities owned by the seller are subject to a restriction on sale imposed by securities legislation or by a marketplace as a condition of listing or quoting the security. UMIR also provides that where the short sale is as a result of a Call Market Order, Market-on-Close Order or a Volume-Weighted Average Price Order the order is exempt from the short sale pricing restriction. The current exemption in the TSE Rule permitting a short sale at or above the equivalent price of the last sale on a stock exchange in the United States has not been carried forward to UMIR.
4-304	7.8	<b>Restrictions on Trading During a Securities Exchange Take-over Bid</b> - Under TSE Rule 4-304, the TSE may request a dealer manager to undertake market balancing transactions. A dealer manager was also required to give prior notice of its intention to undertake market balancing transactions and required TSE consent to continue market balancing transactions in the event of a material change related to the transaction. The UMIR provision eliminates these requirements.
4-402	6.3	<b>Exposure of Client Orders</b> - The TSE Rules presently require the immediate entry of a client order on the TSE or another exchange if the order is for the purchase or sale of 1,200 shares or less. UMIR requires immediate entry on a marketplace and changes the threshold to client orders for 50 standard trading units or less (being for equity or similar securities, 5,000 units of a security trading at \$1.00 or more;

TSE Rule	UMIR Section	Summary Description of Differences between TSE Rule and UMIR Provision
		25,000 units of a security trade at \$0.10 or more and less than \$1.00 per unit; 50,000 units of a security trading at less than \$0.10 and being \$50,000 in principal amount for listed or quoted debt securities). UMIR also introduces a number of additional exemptions to the order exposure rule, including where the client order has a value of more than \$100,000 or where the client order is a Call Market Order, an Opening Order, a Special Terms Order, a Volume-Weighted Average Price Order or a Market-on-Close Order.
4-502	8.1	<b>Client-Principal Trading</b> - The TSE Rules presently require a Participant to provide price improvement when executing against a client order to buy or sell 5,000 shares or less. UMIR requires price improvement when executing against a client order to buy or sell for 50 standard trading units or less with a value of \$100,000 or less. Under both UMIR and the TSE Rule, the Participant must take steps to ensure that the price is justified by the condition of the market. UMIR specifically exempts client orders that are Call Market Orders, an Opening Order, a Market-on-Close Order or a Volume-Weighted Average Price Order from the application of the rule.
7-112	10.8	<b>Practice and Procedure</b> - Under TSE Rules, disciplinary and enforcement matters may be heard by a “hearing panel” or by the board of directors. A decision of a hearing panel could also be appealed to the board. Under UMIR, all disciplinary and enforcement matters will be heard by a hearing panel with a review or appeal of the decision to the applicable securities regulatory authority.
No Provision	5.2	<b>Best Price Obligation</b> - Unlike the TSE Rules, UMIR imposes a “best price obligation” on Participating Organizations. Under UMIR a Participant must make “reasonable efforts” prior to the execution of a client order to ensure that the client receives the best price. In determining whether a client will receive the “best price”, the Participating Organization may take into account any transaction fees payable to the marketplace. The UMIR obligation is subject to a number of exemptions including where the client order is a Call Market Order, a Volume-Weighted Average Price Order, a Market-on-Close Order or an Opening Order or, in certain cases, a Special Terms Order. Under UMIR, the best price obligation does not apply if a Market Regulator requires or permits the order to be executed other than on a marketplace.
Various Provisions	6.2	<p><b>Designations and Identifiers</b> – Unlike the TSE Rules, UMIR will require that orders by an insider or significant shareholder of the issuer that is the subject of the order be designated as such.</p> <p>UMIR requires that orders that are Call Market Orders, Opening Orders, Market-on-Close Orders, Special Terms Orders, Volume-Weighted Average Price Orders be so designated on entry to a marketplace.</p> <p>The TSE may continue to require particular designations on orders entered on the TSE in addition to those required by UMIR</p>

<b>TSE Rule</b>	<b>UMIR Section</b>	<b>Summary Description of Differences between TSE Rule and UMIR Provision</b>
No Specific Provision	10.4	<b>Extension of Restrictions</b> - Under TSE Rules, the requirement to conduct business in accordance with just and equitable principles applied to Participating Organizations while the rules on manipulative and deceptive methods of trading and short sales applied to Participants and "Approved Persons". The restrictions on frontrunning extended to a Participating Organizations, an Approved Person and a person "associated with a Participating Organization". UMIR extends the comparable rules to related entities (being an affiliate of a Participating Organization that is a dealer or adviser in securities in Canada) and to each director, officer, partner or employee of the Participating Organization or related entity.
No Specific Provision	10.11	<b>Audit Trail Requirements</b> - Dealers will be subject to the audit trail requirements set out in Part 11 of the CSA Trading Rules. UMIR has been amended to recognize the information provided in accordance with the CSA Trading Rules and to propose to augment those requirements with additional information (particularly as it relates to order designations). The CSA proposes that the electronic filing of the information be deferred until after December 31, 2003. The Market Regulator would co-ordinate the implementation of the UMIR requirement with the introduction of the electronic audit trail under the CSA Trading Rules.
No Specific Provision	10.12	<b>Retention and Inspection of Records and Instructions</b> - TSE Rules impose various time periods for maintaining records (e.g. under Rule 2-404, the record of a filled order had to be retained for five years while the record of an unfilled order had to be maintained for two years). UMIR standardizes the retention requirements at seven years with the record to be in a readily accessible location for the first two years. This time period is the same as required for record retention in accordance with the Marketplace Operation Instrument and CSA Trading Rules.
No Provision	10.14	<b>Synchronization of Clocks</b> - Unlike the TSE Rules that do not have a provision of synchronization, UMIR requires that Participating Organizations synchronize clocks used for the recording of data to the clock used by RS.

## Comparable UMIR and TSE Rules

The following chart sets out a number of provisions of UMIR that are the **same** or will have **substantially the same effect** on Participating Organizations as existing TSE Rules.

<b>TSE Rule</b>	<b>UMIR Section</b>	<b>Summary Description of UMIR Provision</b>
2-307	11.10	<b>Indemnification and Limited Liability of the Market Regulator</b> – provides for the indemnification and limited liability of the Market Regulator and directors, officers and employees of the Market Regulator in a manner similar to that provided to the TSE if the regulatory functions had not be assumed by a regulation services provider.
2-401	7.1	<b>Trading Supervision Obligations</b> – requirement to have written trading policies and procedures, appointment of supervisory staff and review of orders prior to entry to a marketplace
3-203	10.9	<b>Power of Market Integrity Officials</b> – provides the general power required to administer UMIR and regulate the marketplaces

<b>TSE Rule</b>	<b>UMIR Section</b>	<b>Summary Description of UMIR Provision</b>
4-207	7.3	<b>Liability for Bids, Offers and Trades</b> – provides that all bids and offers accepted on marketplace become binding contracts and the responsibility for the order and contracts by a Participant or ATS where the order has been entered on the ATS by an Access Person
4-203 & 4-502(6) and (7)	7.5	<b>Recorded Prices</b> – limits negative commissions on trades with clients and provides that the recorded price of principal trades cannot vary from the net cost or net proceeds to a client by more than the usual commission for an order of the same size.
4-205	7.6	<b>Cancelled Trades</b> – provides that a cancelled trade does not effect validity of subsequent trades
4-302	10.10	<b>Report of Short Positions</b> – requirement to provide information on short positions to the Market Regulator
4-303	7.7	<b>Restrictions on Trading by a Participant Involved in a Distribution</b> – restricts trading in a listed security or quoted security on a marketplace by an underwriter
4-405	7.2	<b>Proficiency Obligations</b> – requirement that persons entering orders to a marketplace have demonstrated proficiency in trading rules and the ATS to have the obligation to ensure Access Persons are trained in the rules
4-501	5.1 5.3	<b>Best Execution of Client Orders</b> – general obligation to ensure a client order is executed on most advantageous terms  <b>Client Priority</b> – priority for client orders over principal and non-client orders
7-101 & 7-102	10.2	<b>Investigations</b> – general power of the Market Regulator to require information in connection with an investigation
7-106 & 7-107	10.5	<b>Powers and Remedies</b> – sets out penalties and remedies which the Market Regulator may impose for a breach of UMIR
7-108, 7-109 & 7-110	10.3	<b>Extension of Responsibility</b> – makes Participants and Access Persons liable for conduct of their directors, officers, partners and employees and supervisors liable for actions of employees that they supervise
7-111	10.7	<b>Assessment of Expenses</b> – power of the Market Regulator to assess expenses in connection with an order.
7-112	10.8	<b>Practice and Procedure</b> – provides the ability of the Market Regulator to adopt practice and procedures related to hearings and appeals
8-101	11.4	<b>Method of Giving Notice</b> – general requirement for the provision of notice to any person
8-102	11.5	<b>Computation of Time</b> – general rule respecting the calculation of time periods
8-103	11.6	<b>Waiver of Notice</b> – ability to waive any notice requirement
8-104	11.7	<b>Omissions or Errors in Giving Notice</b> – saving provision when notice is improperly given

## **Appendices**

The following appendices are attached to this Notice:

Appendix "A" – Summary of Obligations of Marketplaces and Persons with Access

Appendix "B" - Text of the Universal Market Integrity Rules

Appendix "C" – Text of Policies under the Universal Market Integrity Rules

Appendix "D" - Text of Amendments to the Rules of the TSE on the Adoption of the Universal Market Integrity Rules

Appendix "E" - Text of Amendments to the Policies of the TSE on the Adoption of the Universal Market Integrity Rules

## **Questions**

Questions concerning this notice may be directed to:

James E. Twiss  
Senior Counsel  
Regulatory & Market Policy  
Market Regulation Services Inc.  
Exchange Tower  
Toronto, Ontario. M5X 1J2  
fax: (416) 947-4398  
e-mail: james.twiss@regulationservices.com

BY ORDER OF THE BOARD OF DIRECTORS

LEONARD PETRILLO  
VICE PRESIDENT  
GENERAL COUNSEL & SECRETARY