

# IIROC NOTICE

## **Rules Notice Technical**

UMIR

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**12-0295**  
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## **Specific Questions Related to Dark Liquidity Rule Amendments**

### **Executive Summary**

This Rules Notice confirms the advice IIROC provided to marketplaces in response to specific questions on amendments to UMIR that become effective on October 15, 2012 respecting dark liquidity on Canadian equity marketplaces.

### **Background**

On April 13, 2012, IIROC published notice of the approval by the applicable securities regulatory authorities of various amendments to UMIR (“Amendments”) respecting dark liquidity on Canadian equity marketplaces.<sup>1</sup> The principal changes introduced by the Amendments are to:

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<sup>1</sup> IIROC Notice 12-0130 – Rules Notice – Notice of Approval – UMIR – *Provisions Respecting Dark Liquidity* (April 13, 2012) and IIROC Notice 12-0158 – Rules Notice – Notice of Implementation – UMIR – *Changes to Implementation Date for Provisions Respecting Regulation of Short Sales and Failed Trades and for Provisions Respecting Dark Liquidity* (May 8, 2012).



- define “better price” to mean a minimum of one trading increment except, when the difference between the best ask price and the best bid price is one trading increment, the amount shall be a minimum of one-half of one trading increment;
- provide that an order entered on a marketplace must trade with visible orders on that marketplace at the same price before trading with a Dark Order at the same price on that marketplace; and
- require, subject to certain exceptions, an order entered on a marketplace that trades with an order that has not been displayed in a consolidated market display to either:
  - receive a better price, or
  - be for more than 50 standard trading units or have a value of more than \$100,000.

## Questions and Answers

The following are specific questions respecting the Amendments and IIROC’s response to each question. The scenarios included in the responses show how orders must be treated in order to be in compliance with the Amendments and other provisions of UMIR:

### **1. Under the Amendments, how will priority of execution be impacted when orders are entered on a marketplace that offers both Dark Orders and displayed orders?**

#### **Scenario 1a**

The National Best Bid Offer (“NBBO”) is \$10.02-\$10.05.

Marketplace Quotes		
Marketplace - Order Type	Bid Volume	Bid Price
Marketplace A - dark	1,000	\$10.03
Marketplace A - dark	1,000	\$10.02
Marketplace A - displayed	2,000	\$10.02
Marketplace B - displayed	2,000	\$10.02
Marketplace A - displayed	1,000	\$10.01

Incoming order to sell 4000 shares IOC with a \$10.01 limit is sent to Marketplace A. The sell order can trade:

- 1,000 shares at \$10.03 with the Marketplace A Dark Order;



- 2,000 shares at \$10.02 with the Marketplace A displayed order; and
- 1,000 shares are cancelled.

Meaningful price improvement requires the Dark Order to execute at \$10.03 or better. The incoming sell order can trade with the Dark Order priced at \$10.03 because it is a better price. The incoming sell order will then execute against the displayed order at \$10.02 on Marketplace A. The remaining 1,000 shares of the sell order cannot be executed on Marketplace A because the Dark Order priced at \$10.02 is not a better price and because the displayed order priced at \$10.01 is outside the NBBO. The remaining 1,000 shares are cancelled by Marketplace A.

### **Scenario 1b**

NBBO is \$10.02-\$10.05. Best bid is on Marketplace A only.

<b>Marketplace Quotes</b>		
<b>Marketplace - Order Type</b>	<b>Bid Volume</b>	<b>Bid Price</b>
Marketplace A - dark	1,000	\$10.03
Marketplace A - dark	1,000	\$10.02
Marketplace A - displayed	2,000	\$10.02
Marketplace B - displayed	2,000	\$10.01
Marketplace A - displayed	1,000	\$10.01

Incoming order to sell 3,500 shares with a \$10.01 limit is sent to Marketplace A. The sell order can trade:

- 1,000 shares at \$10.03 with the Marketplace A Dark Order;
- 2,000 shares at \$10.02 with the Marketplace A displayed order; and
- 500 shares at \$10.02 with the Marketplace A Dark Order.

The incoming sell order can trade with the Dark Order priced at \$10.03 because it is a better price. The incoming sell order must then move next to trade against the displayed order at \$10.02 because the displayed order has priority over the Dark Order at the same price on the same marketplace. The sell order can then trade against 500 shares of the Dark Order priced at \$10.02 because the national best bid has shifted to \$10.01; therefore \$10.02 becomes a better price.



**2. Under the Amendments, how is priority of execution impacted when a directed action order (“DAO”) is entered on a marketplace that offers Dark Orders and displayed orders?**

**Scenario 2a**

The NBBO is \$10.00-\$10.01.

Marketplace Quotes		
Marketplace - Order Type	Bid Volume	Bid Price
Marketplace A - displayed	1,000	\$10.00
Marketplace A - dark	5,000	\$10.00
Marketplace B - displayed	1,000	\$10.00

Incoming DAO order to sell 3,000 shares at \$10.00 is sent to Marketplace A. The DAO sell order can trade:

- 1,000 shares at \$10.00 with the Marketplace A displayed order; and
- 2,000 shares will book on Marketplace A at \$10.00.

The DAO sell order cannot trade with the Marketplace A Dark Order because it is not a better price. The DAO marker gives instructions solely with respect to the CSA’s order protection rule.<sup>2</sup> The DAO marker does not impact the better price requirement and the interaction of Dark Orders with other orders. The remaining shares can be booked on Marketplace A at \$10.00 because the incoming order was marked DAO (even though this would create a locked market).

The Dark Order on Marketplace A can only match with the 2,000 booked shares to sell on Marketplace A at \$10.00 if one of the following two events occurs:

- the displayed order on Marketplace B is removed, resulting in the Dark Order on Marketplace A becoming a better price; or
- the Dark Order (or a portion thereof) is amended by the Participant to become an active order which can then execute against the booked shares on Marketplace A because it is no longer a Dark Order.

**Scenario 2b**

NBBO is \$10.10-\$10.11.

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<sup>2</sup> Reference National Instrument 23-101 *Trading Rules*, Part 6.



Marketplace Quotes		
Marketplace - Order Type	Bid Volume	Bid Price
Marketplace A - displayed	1,000	\$10.10
Marketplace A - dark	5,000	\$10.10
Marketplace B - displayed	1,000	\$10.10
Marketplace A - displayed	2,000	\$10.09
Marketplace C - displayed	1,000	\$10.09

Incoming DAO order to sell 4,000 shares with a \$10.09 limit is sent to Marketplace A. The DAO sell order can trade:

- 1,000 shares at \$10.10 with the Marketplace A displayed order;
- 2,000 shares at \$10.09 with the Marketplace A displayed order; and
- 1,000 shares will book on Marketplace A at \$10.09.

Because the sell order is marked DAO, Marketplace A can match the DAO sell order with its displayed orders without regard to displayed orders on other marketplaces. The DAO sell order cannot trade with the Marketplace A Dark Order because it is not a better price. The remaining shares can be booked on Marketplace A because the incoming order was marked DAO (even though this would create a crossed market).<sup>3</sup>

The Dark Order on Marketplace A can only match with the 1,000 booked shares to sell on Marketplace A at \$10.09 if one of the following two events occurs:

- the displayed order on Marketplace B is removed, resulting in the Dark Order on Marketplace A becoming a better price;<sup>4</sup> or
- the Dark Order (or a portion thereof) is amended by the Participant to become an active order which can then execute against the booked shares on Marketplace A at \$10.09 because it is no longer a Dark Order.

### **3. Do the Amendments change a Participant's obligation to mark all orders entered on a marketplace for "displacement" purposes as "bypass"?**

No. As is the case today, if a Participant sends a DAO order to a "protected marketplace"<sup>5</sup> to trade with the "disclosed volume"<sup>6</sup> and does not mark the order

<sup>3</sup> To address an internally crossed market, a marketplace may re-price Dark Orders.

<sup>4</sup> The execution price would be at \$10.10 to achieve the better price over the best bid at \$10.09 on Marketplace C.



“bypass”<sup>7</sup>, the Participant takes on the risk of not having the order interact with the intended disclosed volume. If the DAO order is sent with sufficient volume and is at a price that will fill the disclosed volume but is not marked “bypass” and encounters interference from undisclosed orders on the marketplace, the Participant will have traded-through a portion of the disclosed volume on the marketplace contrary to the Trading Rules.<sup>8</sup> IIROC has previously issued guidance on the use of the bypass order marker.<sup>9</sup>

#### **4. Do the Amendments permit an intentional cross to execute at a fractional trading increment?**

Yes. Intentional crosses may be entered at a price which is a fraction of a trading increment so long as the execution price is a better price for both the order to purchase and the order to sell. For example, if the best bid price is \$10.02 and the best ask price is \$10.05, an intentional cross can be completed at any price from \$10.03 up to and including \$10.04 so long as the marketplace’s functionality permits such executions.

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- <sup>5</sup> UMIR defines a “protected marketplace” as a marketplace that:
- (a) disseminates order data in real-time and electronically to the information processor or one or more information vendors in accordance with the Marketplace Operation Instrument;
  - (b) permits dealers to have access to trading in the capacity as agent;
  - (c) provides fully-automated electronic order entry; and
  - (d) provides fully-automated order matching and trade execution.
- <sup>6</sup> The term “disclosed volume” is defined as the aggregate of the number of units of a security relating to each order for that security entered on a protected marketplace and displayed in a consolidated market display that is offered at a price below the intended price of a trade in the case of a purchase or that is bid at a price above the intended price of a trade in the case of a sale, but does not include the volume of:
- (a) a Basis Order;
  - (b) a Call Market Order;
  - (c) a Market-on-Close Order;
  - (d) an Opening Order;
  - (e) a Special Terms Order; or
  - (f) a Volume-Weighted Average Price Order.
- <sup>7</sup> The term “bypass order” is defined as an order that is:
- (a) part of a designated trade; or
  - (b) to satisfy an obligation to fill an order imposed on a Participant or Access Person by any provision of UMIR or a Policy and that is entered on a protected marketplace to execute as against the disclosed volume on that marketplace prior to the execution or cancellation of the balance of the order.
- <sup>8</sup> Reference National Instrument 23-101 *Trading Rules*, section 6.4.
- <sup>9</sup> IIROC Notice 09-0128 – Rules Notice – Guidance Note – UMIR – *Specific Questions Related to the Use of the Bypass Order Marker* (May 1, 2009).