

# IIROC NOTICE

## **Rules Notice Notice of Approval**

UMIR

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**12-0130**  
**April 13, 2012**

## **Provisions Respecting Dark Liquidity**

### **Executive Summary**

On April 13, 2012, the applicable securities regulatory authorities approved amendments (“Amendments”) to UMIR respecting dark liquidity on Canadian equity marketplaces.<sup>1</sup> The Amendments, which are **effective October 10, 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;
- permit IIROC to designate a minimum size for orders that are not displayed in a consolidated market display;
- permit IIROC to designate a minimum size of an iceberg order that must be displayed in a consolidated market display;

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<sup>1</sup> Reference should be made to IIROC Notice 11-0225 – Rules Notice – Request for Comments – UMIR – *Provisions Respecting Dark Liquidity* (July 29, 2011) with which the proposed amendments were published for public comment (the “Proposed Amendments”). See Appendix B for the summary of comments received on the Proposed Amendments and the responses of IIROC. Column 1 of the table highlights the changes made to the Amendments as approved from the Proposed Amendments.



- provide that an order entered on a marketplace must trade with visible orders on that marketplace at the same price before trading with dark orders at the same price on that marketplace;
- require, subject to certain exceptions, an order entered on a marketplace that trades with an order that has not be 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; and
- provide that a Participant or Access Person may not enter an order on a particular marketplace if they know that the handling of the order by the marketplace may result in the order or resulting trade not being in compliance with UMIR.

The technological implications of the Amendments on Participants, Access Persons, marketplaces or service providers are as follows:

- there would be no impact on the systems of transparent marketplaces that do not provide for Dark Orders nor iceberg orders with less than one standard trading unit being displayed;
- since the Amendments do not require the marking of Dark Orders, there would be no impact on the systems of Participants, Access Persons or service providers; and
- Dark Pools and transparent marketplaces that permit Dark Orders or icebergs with less than one standard trading unit being displayed will be required to ensure that their trading system functionality provides:
  - execution priority for visible orders on their marketplace over Dark Orders on their marketplace at the same price, and
  - a “better price” to orders (other than “large” orders) that execute with Dark Orders.

The Amendments are the result of a joint initiative between IIROC and the Canadian Securities Administrators (“CSA”) that commenced in 2009 with the publication of a consultation paper on dark pools, dark orders and other developments in market structure in Canada.<sup>2</sup> In addition to the Amendments, both IIROC and the CSA, either jointly or separately, are undertaking a number of complimentary initiatives to address certain issues and concerns raised during the consultation process.<sup>3</sup>

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<sup>2</sup> See “Development of Proposals for the Canadian Market” on pages 3 to 7 of this Rules Notice.

<sup>3</sup> For more details of these initiatives, see “Related IIROC and CSA Initiatives” on pages 6 and 7 of this Rules Notice.



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### 1. Development of Proposals for the Canadian Market

#### 1.1 *Joint CSA/IIROC Consultation Paper*

The publication of this IIROC Notice is the last step in a process that began in late 2009. In the Joint CSA/IIROC Consultation Paper 23-404 *Dark Pools, Dark Orders, and Other Developments in Market Structure in Canada*<sup>4</sup> (“Consultation Paper”), comment was sought on a number of issues, particularly the general impact of marketplaces that offer no pre-trade transparency on any orders (“Dark Pools”), the introduction of dark order types, and the introduction of smart order routers. The Consultation Paper discussed these issues and their potential impact on the Canadian markets, including their impact on market liquidity, transparency, price discovery, fairness and integrity.<sup>5</sup>

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<sup>4</sup> Published at (2009) 32 OSCB, beginning at page 7877.

<sup>5</sup> See the Consultation Paper at page 7880.



## **1.2 Dark Liquidity Forum**

On March 23, 2010, the CSA and IIROC hosted a forum to discuss the issues raised in the Consultation Paper and in the response letters (“Forum”). The themes discussed at the Forum included:

- whether Dark Pools should be required to provide price improvement and if so, what is meaningful price improvement;
- the use of market pegged orders and whether those orders “free-ride” off the visible market;
- the use of sub-penny pricing;
- broker preferencing at the marketplace level and dealer internalization of order flow;
- the use of Indications of Interest (IOIs) by Dark Pools to attract order flow; and
- the fairness of a marketplace offering smart order router services that use marketplace data that is not available to other marketplace participants.

More details regarding the Forum were included in Joint CSA/IIROC Staff Notice 23-308 *Update on Forum to Discuss CSA/IIROC Joint Consultation Paper 23-404 “Dark Pools, Dark Orders and Other Developments in Market Structure in Canada” and Next Steps* published on May 28, 2010 (“Update”). That notice included a discussion of ongoing initiatives, proposed next steps to address some of the issues, and a summary of the comments received in response to the Consultation Paper.

## **1.3 Joint CSA/IIROC Position Paper**

On November 19, 2010, the CSA and IIROC published a joint position paper (“Position Paper”)<sup>6</sup> that set out CSA and IIROC’s position on the following questions:

- Under what circumstances should Dark Pools or marketplaces that offer dark orders be exempted from the requirements of pre-trade transparency under NI 21-101?
- Should Dark Orders be required to provide meaningful price improvement over the best bid price or the best ask price (“NBBO”), and under what circumstances?
- Should visible (lit) orders have priority over dark orders at the same price on the same marketplace?
- What is a “meaningful” level of price improvement?

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<sup>6</sup> IIROC Notice 10-0303 – Rules Notice – Request for Comments - UMIR – *Joint Canadian Securities Administrators/Investment Industry Regulatory Organization of Canada – Position Paper 23-405 - Dark Liquidity in the Canadian Marketplace* (November 19, 2010).



The recommendations in the Position Paper regarding these four issues were as follows:

- The only exemption to pre-trade transparency should be for orders that meet a minimum size threshold.
- Two dark orders meeting the minimum size threshold should be able to execute at the NBBO. Meaningful price improvement should be required in all other circumstances, including all executions with orders not specifically marked in a manner indicating they are using the minimum size exemption.
- Visible orders on a marketplace should execute before dark orders at the same price on the same marketplace. However, an exception could be made where two dark orders meeting the minimum size threshold can be executed at that price.
- Meaningful price improvement means that the price is improved over the NBBO by a minimum of one trading increment as defined in the UMIR, except where the NBBO spread is already at the minimum tick. In this case, meaningful price improvement would be at the mid-point of the spread.

#### **1.4 Joint CSA/IIROC Regulatory Approach to Dark Liquidity in Canada**

On July 29, 2011, concurrent with the publication of the Proposed Amendments, IIROC and the CSA published a joint notice on the regulatory approach to dark liquidity in Canada (“Joint Notice”).<sup>7</sup> Reference should be made to the Joint Notice for a more detailed outline of the policy considerations underlying the Amendments. The Joint Notice also contains a discussion of:

- the final report of the Technical Committee of the International Organization of Securities Commissions (“IOSCO”) entitled “Principles on Dark Liquidity”, which contains principles to assist securities markets authorities in dealing with issues concerning dark liquidity; and
- other relevant current international initiatives, particularly proposals from the Australian Securities and Investments Commission, the European Securities and Markets Authority and the Joint CFTC-SEC Advisory Committee on Emerging Regulatory Issues.

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<sup>7</sup> IIROC Notice 11-0226- Rules Notice – Request for Comments – UMIR – *Joint Canadian Securities Administrators/Investment Industry Regulatory Organization of Canada Staff Notice 23-311 – Regulatory Approach to Dark Liquidity in the Canadian Market* (July 29, 2011). Appendix “A” to that notice contained a summary of the 20 comments received on the Position Paper and the responses of the CSA and IIROC.



### **1.5 Related IIROC and CSA Initiatives**

The comments which IIROC received on the Proposed Amendments are summarized in Appendix B of this Notice. Following the comment period, IIROC reviewed with stakeholders that made submissions on the Proposed Amendments their comments that:

- dark liquidity does not pose a threat to the price discovery mechanism;
- regulators should focus on “more important issues”, with the one most often mentioned being the effects of high frequency trading;
- orders, particularly those of “uninformed investors” or those initiated without the benefit of sophisticated technology, will face possible manipulation on displayed markets;
- active order fees will increase dealer costs;<sup>8</sup> and
- dealers will direct order flow to the United States to maintain favourable trading costs.<sup>9</sup>

IIROC acknowledges that the Amendments will not address a number of these concerns, particularly as some of the concerns are beyond the jurisdiction of IIROC. Therefore, in order to address:

- questions related to the impact of dark liquidity on the operation of the price discovery mechanism, IIROC proposes to continue to monitor trading trends with particular attention on bid-ask spreads;<sup>10</sup>
- concerns about new forms of “high tech” manipulations, IIROC will be issuing additional guidance on activities that may constitute manipulative and deceptive trading and introducing new surveillance alerts to monitor for such activities;
- other issues surrounding high frequency trading, IIROC will be:
  - completing and publishing the results of a study of high frequency trading and the impact of such activity on market quality in both transparent markets and Dark Pools, and
  - monitoring the impact of the new IIROC Regulation Fee model (which will recover the technology portion of the IIROC’s costs based on message traffic) particularly on variations in order-to-trade ratios and strategies for trading on displayed marketplaces;

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<sup>8</sup> Certain of the commentators believe that the Amendments will result in less liquidity being provided in Dark Pools or through Dark Orders. As a result, dealers would be required to send active orders to transparent markets that may charge higher fees for accessing liquidity thereby increasing trading costs to dealers.

<sup>9</sup> Certain of the commentators stated that the Amendments would provide an incentive for dealers to “sell” their order flow to “wholesalers” in the U.S.

<sup>10</sup> In the Joint Notice, IIROC and the CSA acknowledged that the historic levels of dark liquidity in Canada have not had a negative impact on the operation of the price discovery mechanism. See also footnote 13.



- possible impacts on trading costs, IIROC and the CSA continue to discuss next steps to examine this issue, though it should be noted that the CSA is presently undertaking a study of market data fees; and
- concerns that order flow may be directed away from the Canadian market, IIROC is proposing a separate anti-avoidance clarification of the Order Exposure Rule which would preclude the execution of certain orders on a foreign organized regulated market without either display or the execution of the order at a “better price”.<sup>11</sup>

IIROC and the CSA acknowledge that the implementation of the Amendments will have an impact on existing trading activities in Canada and on the development of marketplaces, order types and features available in the Canadian market. For this reason, IIROC and the CSA will be monitoring the impact of the Amendments, which will help to determine whether a minimum size for Dark Orders is required or preferable and whether any adjustments may need to be made to the requirements of the Amendments.

## **2. Discussion of the Amendments**

### **2.1 Definition of “Better Price”**

Until the Amendments come into force on October 10, 2012, UMIR defines a “better price” simply as a lower price than the best ask price in the case of a purchase and a higher price than the best bid price in the case of a sale. The term “better price” is redefined by the Amendments to require at least one trading increment price improvement except when the difference between the best bid price and the best ask price is a single trading increment in which case a half-increment would be accepted. The revised definition sets the minimum amount of price improvement that would be acceptable for a “small” order (being 50 standard trading units or less which is 5,000 units of a security trading at \$1.00 or more per unit, 25,000 units of a security trading at \$0.10 or more per unit and less than \$1.00 and 50,000 units when a security is trading at less than \$0.10 per unit) when it executes with a Dark Order.

The revised definition is also applicable to the requirements under the Order Exposure Rule (Rule 6.3 which permits small orders to be withheld from an immediate entry on a marketplace if executed at a “better price”) and the Client-Principal Trading Rule (Rule 8.1 which requires that principal trades with small client orders be undertaken at a “better price” in order to avoid conflicts) and the Amendments provide greater certainty in the application of those rules. The revised definition makes clear that a “better price” applies in respect of each trade resulting from an order. For example, a “better price” would not be achieved if an

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<sup>11</sup> See IIROC Notice 12-0131 - Rules Notice – Request for Comments – UMIR – *Provisions Respecting the Execution and Reporting of Certain “Off-Marketplace” Trades* (April 13, 2012).



order to purchase or sell 1,000 shares of a security executed in two trades with 100 shares receiving a \$0.01 price improvement and the balance of 900 shares executing at the NBBO. In order to be considered a “better price”, all 1,000 shares must be executed with a minimum price improvement of a trading increment (or one-half of an increment if the NBBO spread is only a single trading increment).

## **2.2 Definition of “Dark Order”**

The Amendments introduce a definition of Dark Order for use in a number of substantive UMIR provisions dealing with:

- the size of Dark Orders;
- priority of execution; and
- price improvement requirements.

However, the term Dark Order has been defined in such a manner that a separate regulatory order marker is not required. Instead, order types and functionality established by each marketplace would determine whether or not a particular order entered on that marketplace would be considered to be a Dark Order. An order for which no portion is displayed at the time of entry on a marketplace in a consolidated market display would be a Dark Order but any order which is immediately executed on entry or which is a “specialty” type of order that may execute at a price outside of the best bid price/best ask price spread would be excluded from the definition of Dark Order.

Under the Amendments, a “Dark Order” means:

- (a) an order no portion of which is displayed on entry on a marketplace in a consolidated market display; or
- (b) that portion of an order which on entry to a marketplace is not displayed in a consolidated market display if that portion may trade at a price other than the price displayed by that portion of the order included in the consolidated market display

but does not include an order entered on a marketplace as:

- (c) part of an intentional cross;
- (d) a market order that is immediately executed in full on one or more marketplaces at the time of entry;
- (e) a limit order that is immediately executed in full on one or more marketplaces at the time of entry;
- (f) a Basis Order;



- (g) a Call Market Order if that Call Market Order may only trade with other Call Market Orders and the matching of Call Market Orders occurs less frequently than once every minute;
- (h) a Closing Price Order;
- (i) a Market-on-Close Order;
- (j) an Opening Order; or
- (k) a Volume-Weighted Average Price Order.

It is important to note that a Call Market Order may be considered to be a Dark Order. Generally, a small order that executes with a Call Market Order would have to receive “price improvement” in the form of an execution at a “better price”. It is also important to note that an iceberg order (a portion of which is displayed in a consolidated market display) will not be considered a Dark Order and, as such, the hidden portion of the order would not have to provide “price improvement” on execution. However, if the hidden portion of the order could trade at a price other than the price displayed by the visible portion, the hidden portion of the order will be a Dark Order.

### **2.3 Clarification of Requirements of the Order Exposure Rule**

The Amendments make a clarification to the Order Exposure Rule. Since “transparent” marketplaces may introduce Dark Orders, the requirements under the Order Exposure Rule are amended to ensure that any order required to be entered on a transparent marketplace is “for display” in a consolidated market display. Under the Amendments, a “small” client order could not be entered on a transparent marketplace as a Dark Order except with the express instruction or consent of the client.

### **2.4 Size Requirements for Dark Orders and Icebergs**

The CSA has amended National Instrument 21-101 to permit a regulation services provider to designate the minimum size of a Dark Order.<sup>12</sup> The Amendments add Rule 6.5 to UMIR and

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<sup>12</sup> Canadian Securities Administrators Notice of Amendments to National Instrument 21-101 Marketplace Operation and Companion Policy 21-101 CP and to National Instrument 23-101 Trading Rules and Companion Policy 23-101 CP (2012) 35 OSCB (Supp-1) (March 23, 2012).

In discussing the policy rationale for this proposed amendment to subsection 7.1(2) of NI 21-101, the CSA stated:

We acknowledge that, to date, there has been limited activity in dark pools and no evidence that dark liquidity has had a negative impact on the Canadian capital markets. However, we are of the view that it is important and timely to establish a regulatory framework so that we are in a position to respond expeditiously to future market developments. For this reason, in the proposed amendments to NI 21-101, we propose to introduce a requirement that orders meet a minimum size established by a regulation services provider in order to be exempt from the transparency requirements in NI 21-101. However, at this time no minimum order size is being proposed. Any size threshold that may be proposed in the future would be set in consultation with the CSA and would follow the regular public comment process. The CSA and IROC will



provide IIROC with the specific power to make such a designation. In order to avoid potential gaming of this provision and the requirement for Dark Orders to provide price improvement in certain circumstances, Rule 6.5 also provides that an iceberg order must display at least one standard trading unit or such greater size as designated by IIROC.

In the event that IIROC proposes at some future time to designate, or to change any designation of, a number of units of a security for the purposes of Rule 6.5, IIROC will consult with the applicable securities regulatory authorities and will issue a notice requesting public comment during a comment period of at least 30 days. Following the comment period and upon the approval of the designation or change by the applicable securities regulatory authorities, IIROC will issue a notice of the number of units of a security that have been designated for the purposes of clause (a) or (b) of Rule 6.5 and the effective date of the designation which would allow for an appropriate notice period.

IIROC will ensure that there will be full public consultation prior to the initial establishment of any size requirements. As noted in section 1.5 of this Notice (Related IIROC and CSA Initiatives), IIROC and the CSA will be conducting an analysis of the impact of the Amendments. The results of this analysis will inform the deliberations on any future proposed designation of minimum sizes for Dark Orders. IIROC would expect to publish the results of the analysis as part of any initiative to designate any minimum size for Dark Orders or to propose any revisions to the Amendments or any other provisions of UMIR specifically related to dark liquidity.

Unless and until IIROC designates a minimum size, a Dark Order may be any size. However, the effect of the Order Exposure Rule means a client order to purchase or sell 50 standard trading units or less of a security that is not immediately executed at a better price or

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continue to monitor the level of activity on non-transparent marketplaces and its impact on price discovery to determine whether and when to propose a specific size threshold.

See Canadian Securities Administrators Notice of Proposed Amendments to National Instrument 21-101 Marketplace Operation and National Instrument 23-101 Trading Rules (2011) 34 OSCB (Supp-1) (March 18, 2011).



otherwise exempted from the requirements of the Order Exposure Rule<sup>13</sup> may only be entered on a marketplace as a Dark Order with the express instruction or consent of the client. In addition, Dark Orders for 50 standard trading units or less may be entered on a marketplace by or for:

- a principal account;
- a non-client account;
- an Access Person (essentially a subscriber to an alternative trading system that is not a dealer);
- a client account if the order entered as a Dark Order is part of a larger client order for the particular security which, when provided to the Participant, was for more than 50 standard trading units.

## **2.5 Price Improvement by a Dark Order**

Under the Amendments, any order which trades with a Dark Order would have to receive price improvement on the execution unless the order, as entered on the marketplace, is for more than 50 standard trading units or has a value of more than \$100,000. If the order meets either of these requirements, the order could trade with the Dark Order at the market price, provided no displayed orders are available on that marketplace at the market price.<sup>14</sup> If the

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<sup>13</sup> Rule 6.3 - *Exposure of Client Orders* requires that an order for 50 trading units or less must be immediately entered on a transparent marketplace unless otherwise exempted. Permitted exemptions include:

- (a) if the client has specified different instructions;
- (b) if the order is executed immediately at a better price;
- (c) if the order is returned for the terms of the order to be confirmed;
- (d) if the order is withheld pending confirmation that the order complies with applicable securities requirements;
- (e) if entering the order based on market conditions would not be in the interests of the client;
- (f) if the order has a value greater than \$100,000;
- (g) if the order is part of a trade to be made in accordance with Rule 6.4 by means other than entry on a marketplace; or
- (h) if the client has directed or consented that the order be entered on a marketplace as a Call Market Order, an Opening Order, a Special Terms Order, a Volume-Weighted Average Price Order, a Market-on-Close Order, a Basis Order, or a Closing Price Order.

IROC has proposed an amendment to clause (g) of Rule 6.3 which is intended to be an anti-avoidance provision to ensure that an execution on a foreign organized regulated market is not undertaken to avoid the application of the Order Exposure Rule or the Amendments. See IROC Notice 12-00\*\* - Rules Notice – Request for Comments – UMIR – *Provisions Respecting the Execution and Reporting of Certain “Off-Marketplace” Trades* (April 13, 2012). In particular, clause (g) of Rule 6.3 would be amended to read as follows:

- (g) the order is part of a trade to be made in accordance with Rule 6.4 by means other than entry on a marketplace provided, if the order was executed on a foreign organized regulated market, the order was:
  - (i) entered on a market which publicly displays and provides timely information on orders and the order executed on entry or was displayed, or
  - (ii) executed at a better price.

<sup>14</sup> Upon the Amendments becoming effective, previous guidance issued by IROC to the effect that an order “routed to a non-transparent marketplace or facility to determine if liquidity is available on that marketplace or facility at prices that are the same or better than displayed in a consolidated market display would comply with the requirements of Rule 6.3” will be repealed since such order would



order as entered on the marketplace exceeds the size parameters, any portion of the order which does not execute with visible orders on that marketplace may execute with a Dark Order provided that there are no visible orders on that marketplace at that price and there are no visible orders at a “better price” on another marketplace. This provision provides execution priority to visible orders on a marketplace at the same price as Dark Orders on that marketplace. Under the Amendments, a “large” order entered on a marketplace will be able to execute with a Dark Order at a particular price even though visible orders may be displayed on other marketplaces at that price.

There are a number of additional exceptions if the order that trades with the Dark Order is one of the “specialty” orders that can otherwise trade outside of the best bid – best ask spread (being: a Basis Order; a Call Market Order; a Closing Price Order; a Market-on-Close Order; an Opening Order or a Volume-Weighted Average Price Order).

The hidden portion of an “iceberg” order is not considered to be a Dark Order as at least one standard trading unit of the iceberg order must be displayed in a consolidated market display and thereby contribute directly to the price discovery mechanism by being eligible to establish the best ask price or the best bid price for the purposes of UMIR. For this reason, the hidden portion of an iceberg order is not required to provide price improvement.

## **2.6 Inability to Rely on Marketplace Functionality**

The Amendments add a new provision to UMIR which prohibits a Participant or Access Person from relying on marketplace functionality that they know will result in an order or trade failing to comply with UMIR. A Participant or Access Person will have breached UMIR if they enter an order on a marketplace and know or ought reasonably to have known that the functionality of that marketplace would permit the order to execute with a Dark Order without receiving price improvement if required by UMIR or without providing priority to visible orders on that marketplace on the same side of the market. This provision is consistent with current guidance that IIROC has issued (in particular in connection with “locked” and “crossed” markets<sup>15</sup>) regarding the obligation of the Participant or Access Person when entering orders on a particular marketplace.

IIROC acknowledges that marketplaces presently offer functionality and orders types that would not guarantee sufficient price improvement to constitute a “better price” for the purposes of the proposed amendments. As of October 10, 2012, the effective date of the Amendments, each marketplace will have to ensure that its system functionality and order types comply with the applicable requirements in the Amendments; otherwise Participants

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not be able to execute at the “same” price displayed in a consolidated market display. See the response to question 1 under Market Integrity Notice 2007-019 – *Guidance – Entering Client Orders on Non-Transparent Marketplaces and Facilities* (September 21, 2007).

<sup>15</sup> In particular, see the response to question 8 in IIROC Notice 11-0043 - Rules Notice – Guidance Note – UMIR – *Guidance on “Locked” and “Crossed” Markets* (February 1, 2011).



and Access Persons would be precluded from using such functionality or order types. (See “Technological Implications and Implementation Plan” on page 15.)

## **2.7 Execution Price of Orders**

With the change to the definition of “better price” under the Amendments, UMIR will specifically acknowledge that trades may execute at a fraction of a trading increment. Marketplaces will be able to introduce order types or functionality that allows for the execution of orders at a “better price”. For example, when the NBBO spread is at one trading increment, executions could occur at the mid-point. If the spread is more than one trading increment execution could occur at the mid-point or at another price level that would provide price improvement for both sides of the trade.

For this reason, the Amendments revise the provisions regarding the reporting of the trade price to allow any trade (and not just the trade price of a Basis Order, Call Market Order or a Volume-Weighted Average Price Order as contemplated by the current policy under Policy 6.1) to be reported at the execution price provided that, if required by the information processor or information vendor, the reported trade price shall be rounded to the nearest trading increment<sup>16</sup>.

## **2.8 Better-Priced Intentional Cross**

Rule 6.1 of UMIR requires that orders entered on a marketplace be at a price which is a full cent unless the price of the order is less than \$0.50 when the price may be one-half of one cent. Since the Amendments will permit executions at fractional trading increments, they introduce the exception to the “full trading increment” rule for an order entered as an intentional cross at a better price. Intentional crosses may be entered on a marketplace at a price which is a fraction of a trading increment provided the execution price is a better price for both the order to purchase and the order to sell. For example, if the spread between the best bid price and the best ask price for a security trading above \$0.50 is \$0.03, an intentional cross could be completed at the mid-point or at any other price permitted by the marketplace that is at least \$0.01 above the best bid price and \$0.01 below the best ask price.

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<sup>16</sup> If the trade executed at one-half of a trading increment, the price shall be rounded up to the next trading increment.



### **3. Changes from the Proposed Amendments**

Based on comments received from the public and the CSA, and the repeal of the tick test for short sales effective September 1, 2012,<sup>17</sup> the Amendments as approved vary from the Proposed Amendments in a number of areas including:

- clarifications to the proposed definition of Dark Order to include:
  - the non-disclosed portion of an iceberg order that is “pegged” and can trade at a different price than the disclosed portion,
  - a market order that does not fully execute on entry, and
  - a Call Market Order that is matched more often than once every minute;
- permitting reported trade prices and the “last sale price” to be a fraction of a trading increment;
- permitting the entry of an intentional cross at a fractional trading increment that is a better price to facilitate compliance with the requirements of the Order Exposure Rule and the Client-Principal Trading Rule;
- amending the Order Exposure Rule to clarify that an order which is withheld from entry for display “based on market conditions” cannot be entered as a Dark Order; and
- clarifying that a Dark Order when executing at the bid or the ask does not owe an obligation to any order on that marketplace that is not used to determine the best bid price or best ask price (e.g. odd lot- or Special Terms Orders).

### **4. Summary of the Impact of the Amendments**

The most significant impacts of the adoption of the Amendments are to:

- ensure that visible orders on a marketplace are given execution priority over Dark Orders on that marketplace at the same price;
- require Dark Orders to provide a better price, except when executing with “large” orders; and
- provide that a better price is at least one trading increment and, when the displayed market has a spread of only one trading increment, at least one-half of a trading increment.

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<sup>17</sup> The “tick test” under Rule 3.1 of UMIR has been repealed effective September 1, 2012. See IIROC Notice 12-0078 – Rule Notice – Notice of Approval – UMIR – *Provisions Respecting the Regulation of Short Sales and Failed Trades* (March 2, 2012).



## 5. Technological Implications and Implementation Plan

The technological implications of the Amendments on Participants, Access Persons, marketplaces or service providers are as follows:

- there will be no impact on the systems of transparent marketplaces that do not provide for Dark Orders nor iceberg orders with less than one standard trading unit being displayed;
- since the Amendments do not require the marking of Dark Orders, there will be no impact on the systems of Participants, Access Persons or service providers; and
- Dark Pools and transparent marketplaces that permit Dark Orders or icebergs with less than one standard trading unit being displayed will be required to ensure that their trading system functionality provides:
  - execution priority for visible orders on their marketplace over Dark Orders on their marketplace at the same price, and
  - a better price to orders (other than “large” orders) that execute with Dark Orders.

The Amendments have been approved by the Recognizing Regulators as of the date of this Rules Notice. However, implementation of the Amendments has been deferred and they will become effective on **October 10, 2012**, being one hundred and eighty (180) days following the date of this Rules Notice.



## Appendix A - Text of Provisions Respecting Dark Liquidity

The Universal Market Integrity Rules are hereby amended as follows:

1. Rule 1.1 is amended by:

(a) deleting the definition of “better price” and substituting the following:

**“better price”** means, in respect of each trade resulting from an order for a particular security:

- (a) in the case of a purchase, a price that is at least one trading increment lower than the best ask price at the time of the entry of the order to a marketplace provided that, if the best bid price is one trading increment lower than the best ask price, the price shall be at least one-half of one trading increment lower; and
- (b) in the case of a sale, a price that is at least one trading increment higher than the best bid price at the time of the entry of the order to a marketplace provided that, if the best ask price is one trading increment higher than the best bid price, the price shall be at least one-half of one trading increment higher.

(b) adding the following definition of “Dark Order”:

**“Dark Order”** means:

- (a) an order no portion of which is displayed on entry on a marketplace in a consolidated market display; or
- (b) that portion of an order which on entry to a marketplace is not displayed in a consolidated market display if that portion may trade at a price other than the price displayed by that portion of the order included in the consolidated market display

but does not include an order entered on a marketplace as:

- (c) part of an intentional cross;
- (d) a market order that is immediately executed in full on one or more marketplaces at the time of entry;
- (e) a limit order that is immediately executed in full on one or more marketplaces at the time of entry;
- (f) a Basis Order;



- (g) a Call Market Order if that Call Market Order may only trade with other Call Market Orders and the matching of Call Market Orders occurs less frequently than once every minute;
- (h) a Closing Price Order;
- (i) a Market-on-Close Order;
- (j) an Opening Order; or
- (k) a Volume-Weighted Average Price Order.

2. Rule 6.1 is amended by adding the following as subsection (3):

- (3) Notwithstanding subsection (1), an intentional cross may be entered on a marketplace at a price which is a fraction of a trading increment provided the execution price is a better price for both the order to purchase and the order to sell.

3. Rule 6.3 is amended by:

- (a) inserting in subsection (1) the phrase “for display” immediately following the word “enter”;
- (b) inserting in clause (e) of subsection (1) the phrase “on a marketplace” immediately following the word “order”); and
- (c) inserting in subsection (2) the phrase “on a marketplace” immediately before the word “based”.

4. Part 6 is amended by adding the following as Rule 6.5:

**Minimum Size Requirements of Certain Orders Entered on a Marketplace**

A Participant or Access Person shall not enter an order for the purchase or sale of a security on a marketplace if:

- (a) the order is a Dark Order and the order does not exceed the number of units as designated from time to time by the Market Regulator for the purposes of this clause; or
- (b) less than one standard trading unit of the order or such greater number of units as designated from time to time by the Market Regulator for the purposes of this clause will be displayed in a consolidated market display



on the entry of the order on the marketplace and at any time prior to the full execution of the order.

5. Part 6 is amended by adding the following as Rule 6.6:

**Provision of Price Improvement by a Dark Order**

- (1) If a Participant or Access Person enters an order on a marketplace for the purchase or sale of a security that order may execute with a Dark Order provided the order entered by the Participant or Access Person is executed:
  - (a) at a better price;
  - (b) in the case of a purchase, at the best ask price if:
    - (i) the order on entry to the marketplace is for more than 50 standard trading units or has a value of more than \$100,000, and
    - (ii) on the execution of the trade with the Dark Order, no orders for the sale of the security included in the calculation of the best ask price are displayed on that marketplace at that best ask price; or
  - (c) in the case of a sale, at the best bid price if:
    - (i) the order on entry to the marketplace is for more than 50 standard trading units or has a value of more than \$100,000, and
    - (ii) on the execution of the trade with the Dark Order, no orders for the purchase of the security included in the calculation of the best bid price are displayed on that marketplace at that best bid price.
- (2) Subsection (1) does not apply if the order entered by the Participant or Access Person is:
  - (a) a Basis Order;
  - (b) a Call Market Order;
  - (c) a Closing Price Order;
  - (d) a Market-on-Close Order;
  - (e) an Opening Order; or



(f) a Volume-Weighted Average Price Order.

6. Part 7 is amended by adding the following as Rule 7.12:

**Inability to Rely on Marketplace Functionality**

A Participant or Access Person shall not enter an order on a particular marketplace if the Participant or Access Person knows or ought reasonably to know that the handling of the order by the marketplace and the trading systems of the marketplace may result in the display of the order or the execution of the order not being in compliance with any of the applicable requirements of UMIR.

The Policies to the Universal Market Integrity Rules are hereby amended as follows:

1. Part 1 of Policy 6.1 is deleted and the following substituted:

**Part 1 – Execution Price of Orders**

An order may execute at such price increment as established by the marketplace for the execution of such orders and the marketplace shall report the execution price to the information processor and information vendor provided, if required by the information processor or information vendor, the marketplace shall report the price at which the trade was executed as the nearest trading increment and if the price results in one-half of a trading increment the price shall be rounded up to the next trading increment.



## **Appendix B - Comments Received in Response to Rules Notice 11-0225 - Request for Comments - UMIR - Provisions Respecting Dark Liquidity**

On July 29, 2011, the Investment Industry Regulatory Organization of Canada (“IIROC”) issued Rules Notice 11-0225 requesting comments on Provisions Respecting Dark Liquidity (“Proposed Amendments”). IIROC received comments on the Proposed Amendments from:

Alpha ATS (“Alpha”)  
Canadian Foundation for Advancement of Investor Rights (FAIR Canada) (“Fair”)  
Canadian Security Traders Association, Inc. (“CSTA”)  
Connor, Clark Lunn (“CCL”)  
Edward Jones (“EJ”)  
Investment Industry Association of Canada (“IIAC”)  
ITG Canada Corp. (“ITG”)  
Morgan Stanley (“MS”)  
RBC Dominion Securities Inc. (“RBC”)  
RBC Global Asset Management Inc. (“RBCGAM”)  
Scotia Capital Inc. (“Scotia”)  
Securities Industry and Financial Markets Association (“SIFMA”)  
TD Securities (“TD”)  
TMX Group Inc. (“TMX”)  
TriAct Canada Marketplace LP (“TriAct”)

A copy of the comment letter in response to the Proposed Amendments is publicly available on the website of IIROC ([www.iiroc.ca](http://www.iiroc.ca)) under the heading “Policy” and sub-heading “Market Proposals/Comments”. The following table presents a summary of the comments received on the Proposed Amendments together with the responses of IIROC to those comments. Column 1 of the table highlights the revisions to the Proposed Amendments made on the approval of the Amendments.



Text of Provision Following Adoption of the Proposed Amendments (Suggested Revisions to the Proposed Amendments Highlighted)	Commentator and Summary of Comment	IIROC Response to Commentator and Additional IIROC Commentary
<p><b>1.1 Definitions</b></p> <p><b>“better price”</b> means, in respect of each trade resulting from an order for a particular security:</p> <p>(a) in the case of a purchase, a price that is at least one trading increment lower than the best ask price at the time of the entry of the order to a marketplace provided that, if the best bid price is one trading increment lower than the best ask price, the price shall be at least one-half of one trading increment lower; and</p> <p>(b) in the case of a sale, a price that is at least one trading increment higher than the best bid price at the time of the entry of the order to a marketplace provided that, if the best ask price is one trading increment higher than the best bid price, the price shall be at least one-half of one trading increment higher.</p>	<p><b>Alpha, CSTA, EJ and TD</b> – Believe that the amended definition of better price will constrain growth of dark pools to large sized orders and leave retail orders with less available liquidity.</p>	<p>The revision to the definition of better price is designed not only to offer smaller orders the opportunity to receive meaningful price improvement, but also to protect those small orders displayed in a consolidated market display. As such, IIROC believes it is an appropriate balance. IIROC notes that “retail orders” will continue to be able to check dark pools for the possibility of execution at a “better” price even if a minimum size is prescribed for Dark Orders.</p>
	<p><b>CCL</b> – Supports the amended definition of better price, and believes it will reward dark pool liquidity providers with order flow if they contribute value.</p>	<p>IIROC acknowledges the comment.</p>
	<p><b>EJ</b> – Believes that the proposal will prevent orders from receiving price improvement for partial fills, and that this is less advantageous for the retail investor.</p>	<p>Smaller orders, including small retail orders of less than 50 standard trading units (generally 5,000 shares), will still be able to receive price improvement in partial fills, but the balance of the order must be executed with displayed orders on a visible market. This has not changed from current requirements. Currently, a small client order that is subject to the Order Exposure Rule may “pass through” a dark marketplace in search of an execution at a better price while on route to entry on a transparent marketplace. The Amendments prevent a Dark Order from providing a small order with price improvement only for a partial fill, and the marketplace then subsequently executing the balance of the small order with a Dark Order at the best ask price (in the case of a purchase by the small order or the best bid price (in the case of a sale).</p>
	<p><b>Fair and TMX</b> – Supports the amended definition of better price to ensure that incentives to enter orders on visible markets are not undermined.</p>	<p>IIROC acknowledges the comments.</p>
	<p><b>IIAC, ITG and TriAct</b> – Believe that the definition does not account for access and trading fees charged by visible markets, and that these fees should be considered in determining a definition for better price. IIAC also notes that there are no price improvement requirements in the U.S. which has a more developed dark liquidity market.</p>	<p>The definition of “better price” reflects the execution price of an order on a marketplace. IIROC maintains that any fees or rebates associated with the execution of that order may or may not be passed on by the executing dealer, and therefore cannot be considered in the determination of a better execution price. IIROC recognizes that the price improvement rules are different in the U.S. market, and</p>



Text of Provision Following Adoption of the Proposed Amendments (Suggested Revisions to the Proposed Amendments Highlighted)	Commentator and Summary of Comment	IIROC Response to Commentator and Additional IIROC Commentary
		notes that this does not necessarily mean that the same rules must be applied identically in all cases in Canada particularly given the differences in market liquidity and the need to protect the working of the price discovery mechanism in Canada.
	<b>ITG, MS, Scotia</b> and <b>SIFMA</b> – Believe that the better price increments proposed could result in loss of passive Dark Order flow to other jurisdictions, and would undermine the ability for Canadian marketplaces to compete.	IIROC notes the concern with respect to the potential loss of passive liquidity to other jurisdictions. However, the offsetting factor will be that the opportunity to obtain meaningful price improvement may attract more active order flow to “check” dark pools before being entered on a transparent market. Increased active flow checking a dark pool would, in turn, provide an incentive to post passive Dark Orders.
	<b>ITG</b> – Notes market makers on the TSX are able to participate in small trades without posting visible orders and offering price improvement, and the broker preferencing feature allows visible orders to jump the queue on lit markets.	Market makers on the TSX are able to participate in certain trades as a result of the Minimum Guaranteed Fill and automated market maker participation features. However, market makers also have associated obligations not required of other participants. The market maker orders are system-generated by the trading system of the TSX in accordance with marketplace rules that have been approved by the applicable securities regulatory authorities and which are transparent to the public. The market makers orders are generated at the same price as the visible order.  The concept of broker preferencing is a separate area of consideration in Canadian market structure. As indicated in Staff Notice 23-311, the concepts of broker preferencing and internalization of order flow are currently under review by the CSA and IIROC.
	<b>MS</b> – Believes current rule framework creates an “unlevel” playing field as visible marketplaces can execute Dark Orders at the NBBO without price improvement.	The Amendments address this imbalance by ensuring the same rules for provision of price improvement by Dark Orders are applicable to both visible and dark marketplaces. See Rule 6.6 introduced by the Amendments.
	<b>RBC</b> – Agrees that Dark Orders should have to provide price improvement over the NBBO, but disagrees with the increments proposed. Believes	The Amendments do not preclude the use of a “percentage of spread” concept but they merely impose a minimum amount to ensure that the price improvement is



Text of Provision Following Adoption of the Proposed Amendments (Suggested Revisions to the Proposed Amendments Highlighted)	Commentator and Summary of Comment	IIROC Response to Commentator and Additional IIROC Commentary
	<p>that an amount should be based on a “percentage of spread” concept.</p> <p><b>TD</b> – Does not support the proposed definition of better price and believes that marketplaces will merely modify their fee structures to get around the price improvement increments. Believes that a high level of price improvement subsidized by dealers is a violation of principles of fairness.</p>	<p>“meaningful”. The increments proposed recognize that spreads are often at the minimum increments allowable under UMIR, and have provided for the ability to offer a “percentage of spread” in those instances (subject to a minimum improvement of at least one trading increment or half of one trading increment when the spread is the minimum one increment). IIROC does not consider price improvement less than a full trading increment to be meaningful when the spread is wider than one trading increment.</p> <p>IIROC notes that marketplace fee structures are beyond the jurisdiction of UMIR. The focus of UMIR is to ensure that clients receive the best available price and best execution. However, IIROC is also aware of the potential impact of trading fees on order routing decisions. IIROC will be monitoring the impact of the Amendments and the interplay between the Amendments and changes in fee structures on trading activity will be one of the areas under analysis.</p>
<p><b>1.1 Definitions</b></p> <p><b>“Dark Order”</b> means:</p> <p>(a) an order no portion of which is displayed on entry on a marketplace in a consolidated market display; <u>or</u></p> <p>(b) <u>that portion of an order which on entry to a marketplace is not displayed in a consolidated market display if that portion may trade at a price other than the price displayed by that portion of the order included in the consolidated market display</u></p> <p>but does not include an order entered on a marketplace as:</p> <p>(c) part of an intentional cross;</p> <p>(d) a market order <u>that is immediately executed in full on one or more marketplaces at the time of entry;</u></p> <p>(e) a limit order that, <del>based on orders displayed in a consolidated market display,</del> is immediately executed in full on one or more marketplaces at the time of entry;</p>	<p><b>Alpha</b> - The definition of “Dark Order” does not exclude either call market orders or special terms orders. Call market orders are generally treated the same as the other excluded order types for all other purposes, and this is inconsistent and could lead to unintended consequences. Odd lot executions have been considered special terms orders and questions whether the Proposed Amendments intended to include odd lot orders as Dark Orders.</p> <p><b>MS</b> and <b>SIFMA</b> – Does not believe the proposed definition captures all forms of dark liquidity and could result in unintended consequences and</p>	<p>IIROC is of the opinion that it is not appropriate to exclude Call Market Orders and Special Terms Orders from the definition of a Dark Order. Such orders may execute against order flow that are market orders or would otherwise be booked as transparent orders. However, the Amendments were revised from the Proposed Amendments to exclude a Call Market Order from the definition to the extent that such order may only trade with other Call Market Orders. Odd lot orders and other Special Terms Orders may be displayed in a consolidated market display. To the extent that such odd lot orders and other Special Terms Orders are not displayed (but rather executed prior to the order being displayed by a market participant with odd lot or terms obligations) the orders will be considered Dark Orders.</p> <p>The definition of “Dark Order” is designed to refer to passive liquidity resting on a marketplace with no pre-trade transparency, and as a result excludes certain immediately</p>



Text of Provision Following Adoption of the Proposed Amendments (Suggested Revisions to the Proposed Amendments Highlighted)	Commentator and Summary of Comment	IIROC Response to Commentator and Additional IIROC Commentary
<p>(f) a Basis Order;</p> <p>(g) <u>a Call Market Order, provided such order may only trade with other Call Market Orders and the matching of Call Market Orders does not occur more frequently than once every minute;</u></p> <p>(h) a Closing Price Order;</p> <p>(i) a Market-on-Close Order;</p> <p>(j) an Opening Order; or</p> <p>(k) a Volume-Weighted Average Price Order.</p>	<p>potential ways to circumvent the intent of the regulation. Notes that the proposed definition excludes immediately executable orders, market orders, and VWAP orders, but that entire dark pools can be created solely for the execution of these order types.</p> <p><b>TD</b> – Supports the definition of Dark Orders but believes that marketplaces should publish statistics on iceberg orders to gain a more complete picture of dark liquidity in Canada.</p>	<p>executable orders which are not displayed on entry (among other types). With respect to dark pools being created solely for the execution of certain order types, IIROC notes that the Amendments capture the passive orders entered by dark liquidity providers.</p> <p>IIROC acknowledges the comment.</p> <p>The definition of Dark Order has been modified to reflect the expectation that any hidden reserve portion of a partially displayed order that would trade at a price other than that of the displayed portion would be considered a Dark Order for the purposes of UMIR. The Amendments were also revised to clarify that any portion of a market order that does not fully execute on entry may qualify as a Dark Order unless the unexecuted portion is included in a consolidated market display.</p>
<p><b>1.1 Definitions</b></p> <p><b>“last sale price”</b> means the price of the last sale of at least one standard trading unit of a particular security displayed in a consolidated market display <del>provided that, if the trade executed at a price other than a trading increment, the price shall be rounded to the nearest trading increment and, if the trade executed at one-half of a trading increment, the price shall be rounded up to the next trading increment</del> but does not include the price of a sale resulting from an order that is:</p> <p>(a) a Basis Order;</p> <p>(b) a Call Market Order;</p> <p>(c) a Closing Price Order;</p> <p>(d) a Special Terms Order unless the Special Terms Order has executed with an order or orders other than a Special Terms Order; or</p> <p>(e) a Volume-Weighted Average Price Order.</p>	<p><b>EJ</b> – Agrees with the proposed definition of last sale price, as it promotes greater clarity for rules relying on last sale price.</p> <p><b>MS</b> – Notes that a uniform definition of last sale price across all markets would make compliance with regulation simpler. Proposes that the definition reference the consolidated last sale price in the Canadian marketplace.</p>	<p>IIROC acknowledges the comment. However, based on the responses to Question 1 and the repeal of restrictions on short sales, IIROC has determined that the change to the definition of “last sale price” set out in the Proposed Amendments is not required.</p> <p>The consolidated market display only contains order and trade information from exchanges, QTRSs and alternative trading systems in Canada. UMIR has been structured to allow market participants to make decisions about “last sale price”, “best ask price” and “best bid price” based on the information which they have at the relevant time. IIROC recognizes that for various reasons, including data latencies, that not all market participants will “see” the market the same at any point in time.</p>



Text of Provision Following Adoption of the Proposed Amendments (Suggested Revisions to the Proposed Amendments Highlighted)	Commentator and Summary of Comment	IIROC Response to Commentator and Additional IIROC Commentary
<p><b>6.1 Entry of Orders to a Marketplace</b></p> <p><u>(3) Notwithstanding subsection (1), an intentional cross may be entered on a marketplace at a price which is a fraction of a trading increment provided the execution price is a better price for both the order to purchase and the order to sell.</u></p>		<p>The Amendments were revised to specifically permit the entry of an intentional cross at a fraction of a trading increment if both the buy and the sell side of the cross receive a “better price”. See Question 2 below.</p>
<p><b>6.3 Exposure of Client Orders</b></p> <p>(1) A Participant shall immediately enter for display on a marketplace that displays orders in accordance with Part 7 of the Marketplace Operation Instrument a client order to purchase or sell 50 standard trading units or less of a security unless:</p> <p>...</p> <p>(e) the Participant determines based on market conditions that entering the order <u>on a marketplace</u> would not be in the best interests of the client;</p> <p>....</p> <p>(2) If a Participant withholds a client order from entry <u>on a marketplace</u> based on market conditions in accordance with clause (1)(e), the Participant may enter the order in parts over a period of time or adjust the terms of the order prior to entry but the Participant must guarantee that the client receives:</p> <p>...</p>	<p><b>EJ</b> – Supportive of this clarification as it should be ensured that retail orders are reflected appropriately and fairly.</p> <p><b>RBC</b> – Believes that given the Proposed Amendments, the requirement for client consent on an order-by-order basis is not practical or necessary given the best execution obligations of dealers.</p>	<p>IIROC acknowledges the comment.</p> <p>As a general rule, IIROC believes that the mandatory exposure of small (retail-sized) client orders supports the working of the price discovery mechanism. Rule 6.3 permits the withholding of the small client order from a transparent marketplace with the specific consent of the client. Under the current provisions of UMIR and going forward, if the initial order received from a client is for more than 50 standard trading units, the Participant may enter on a marketplace all or any portion of that order as a Dark Order.</p> <p>The Amendments added the phrase “for display” to subsection (1). The revisions to clause (1)(e) and subsection (2) clarifies that the effect of the addition of this phrase does not permit the entry of the order as a Dark Order under clause (e).</p>
<p><b>6.5 Minimum Size Requirements of Certain Orders Entered on a Marketplace</b></p> <p>A Participant or Access Person shall not enter an order for the purchase or sale of a security on a marketplace if:</p> <p>(a) the order is a Dark Order and the order does not exceed the number of units as designated from time to time by the Market Regulator for the purposes of this clause; or</p> <p>(b) less than one standard trading unit of the order or such greater number of units as designated from time to time by the Market Regulator for the purposes of this clause will be displayed in a consolidated market display on the entry of the order on the marketplace and at any time prior to the full execution of the order.</p>	<p><b>Alpha</b> - Recommends clarifying that orders posted as Dark Orders cannot be amended to a size below the minimum size and if the volume of a Dark Order is reduced below the minimum size by partial fills, it can continue to be booked as a Dark Order.</p> <p><b>Alpha</b> – Notes that under the Proposed Amendments, the reserve volume of iceberg orders could execute ahead of a lit order at the same price, and that Price Improvement Icebergs could lead to dark liquidity trading with small active orders at the NBBO without truly contributing to the price discovery process.</p>	<p>In the ordinary course, IIROC would consider the entry of an order that met the minimum size requirement for a Dark Order that is followed immediately by an amendment of the order to reduce the size below the minimum size threshold to be behaviour that would constitute failure to conduct trading “openly and fairly”.</p> <p>IIROC notes that any changes in functionality which would allow the reserve volume of an iceberg order to trade ahead of a visible order at the same price would require CSA approval prior to implementation. The definition of “Dark Order” has been amended to reflect the expectation that the discretionary portion of a Price Improvement Iceberg would only be excluded from the definition of a Dark Order for</p>



Text of Provision Following Adoption of the Proposed Amendments (Suggested Revisions to the Proposed Amendments Highlighted)	Commentator and Summary of Comment	IIROC Response to Commentator and Additional IIROC Commentary
		<p>executions at a price equal to that of the displayed portion of the order.</p>
	<p><b>Alpha, EJ, IIAC, ITG, MS, Scotia, RBC and TD</b> – Believe that a minimum size threshold could reduce the number of liquidity providers in dark pools, and limit the options available for investors and traders.</p>	<p>IIROC recognizes the potential for reduced dark liquidity provision, but believes this provision of liquidity cannot come at the expense of the visible market and the price discovery process. On the other hand, the opportunity to receive meaningful price improvement in the form of a “better price” may result in additional flow “checking” dark pools and the possibility of this increased flow may encourage liquidity providers to stay in the dark pool.</p>
	<p><b>CCL</b> – Supportive of a minimum size requirement to avoid negative effects on visible market through increased trading of small Dark Orders.</p>	<p>IIROC, in conjunction with the CSA, will be monitoring the impacts of the Amendments on trading patterns and the development of “dark” orders and marketplaces. IIROC believes that it is appropriate to consider those impacts prior to making a determination on the designation of a minimum size for Dark Orders.</p>
	<p><b>CSTA, IIAC, ITG and SIFMA</b> – Believe there should be an exemption for small child orders which are part of a larger parent order.</p>	<p>IIROC acknowledges the concern. When proposing any minimum size threshold for Dark Orders, IIROC will also consider what exemptions, if any, may be appropriate given any size that may be designated.</p>
	<p><b>EJ and IIAC</b> – Do not believe a minimum size for Dark Orders is necessary, as the Order Exposure Rule already requires small client orders to be entered into a visible market.</p>	<p>The Order Exposure Rule applies to client orders only, and allows clients to “opt-out” on an order-by-order basis. A minimum size requirement would apply to all Dark Orders.</p>
	<p><b>Fair</b> – Supports limiting the exemption of Dark Orders to those meeting a size threshold to encourage transparency. Also believes that IIROC should designate a size threshold at the same time as other proposed amendments.</p>	<p>IIROC acknowledges the comment. However, IIROC believes that it is appropriate to undertake an analysis of the impact of the Amendments prior to making a determination on the designation of a minimum size for Dark Orders. IIROC also believes that it is appropriate for the results of this analysis to be available as part of the public consultation on any proposed minimum size for Dark Orders.</p>
	<p><b>ITG</b> – Concerned that a minimum size threshold would result in migration of dark liquidity on inter-listed order flow to the U.S.</p>	<p>Please see the response to Alpha, EJ et. al. above.</p>



Text of Provision Following Adoption of the Proposed Amendments (Suggested Revisions to the Proposed Amendments Highlighted)	Commentator and Summary of Comment	IIROC Response to Commentator and Additional IIROC Commentary
	<p><b>RBC</b> – Would prefer that any restrictions on the minimum size of iceberg disclosure be established by individual marketplaces, rather than regulators.</p>	<p>The requirement for the minimum disclosure of “iceberg” volume is an anti-avoidance provision to prevent gaming of the minimum Dark Order size when established. Based on the current requirements of UMIR, there would be no reason to establish a size greater than one standard unit.</p>
	<p><b>RBCGAM</b> – Supportive of the establishment of a minimum size threshold for Dark Orders, but believes that the minimum size should apply to both passive resting orders as well as the active orders.</p>	<p>It is the opinion of IIROC that smaller sized orders should still be able to benefit from the potential price improvement provided by dark liquidity. IIROC is aware that the imposition of a size limit on passive Dark Orders may result in “gaming” opportunities through the misuse of small active orders. This factor will be taken into account in the determination of any proposed size requirement.</p>
	<p><b>Alpha</b> and <b>Scotia</b> – Concerned that a minimum size of 5000 shares would result in significant information leakage.</p>	<p>IIROC recognizes the information leakage or gaming issue associated with any proposed minimum size, whether that threshold is 5,000 shares or otherwise. IIROC will consider this as part of the process in determining a minimum size, and weigh this risk against the ability of a market participant to protect their own orders using minimum fill options provided by certain marketplaces.</p>
	<p><b>Scotia</b> – Believes that if a minimum size must be implemented, that it should not be a fixed size across all securities.</p>	<p>The Amendments are merely designed to allow IIROC the flexibility to designate a minimum size. In the future, the determination process for such a threshold would examine various alternatives and would be subject to both public comment and CSA approval.</p>
	<p><b>SIFMA</b> – Notes there is in fact a minimum size requirement being established already, in that an order entered for more than 50 standard trading units or \$100,000 can execute at the NBBO with Dark Orders, but smaller orders must be price improved. Believes that Dark Orders of any size should be able to execute at the NBBO.</p>	<p>There is no minimum size being proposed on Dark Orders at this time. The size restrictions noted by the commenter are restrictions with respect to the provision of price improvement to liquidity removing orders. Smaller active orders must be provided with meaningful price improvement when executing against a passive Dark Order, but this passive Dark Order can currently be of any size. Similarly, a small passive Dark Order could execute at the NBBO against a contra order meeting the size requirements for execution without price improvement.</p>



Text of Provision Following Adoption of the Proposed Amendments (Suggested Revisions to the Proposed Amendments Highlighted)	Commentator and Summary of Comment	IIROC Response to Commentator and Additional IIROC Commentary
	<p><b>TD</b> – Believes that a minimum size threshold (as well as the proposed levels of price improvement) will cause dealers to route Canadian retail order flow to the U.S. markets to obtain better trading economics.</p>	<p>IIROC notes that any routing of retail order flow to other jurisdictions will still be subject to best execution and other obligations under UMIR. IIROC, in conjunction with the CSA will be monitoring the impacts of the Amendments on trading patterns following implementation.</p>
	<p><b>TMX</b> – Supports the proposal to allow IIROC to establish a minimum size, and believes that this will promote a strong visible market and prevent further costly fragmentation.</p>	<p>IIROC acknowledges the comment.</p>
	<p><b>TriAct</b> – Believes that the order exposure rule already accomplishes the objective of directing small orders to visible markets. Disagrees with dealers being bound to a hardcoded minimum size requirement when the order exposure rule currently allows for some flexibility in order placement by determining what is in the best interests of the client.</p>	<p>Although similar in outcome, the spirit of the Order Exposure Rule is different from that of a minimum size threshold for Dark Orders. The Order Exposure Rule is designed to protect the small orders of investors by ensuring that the executing dealer is not unnecessarily withholding them from the market without meeting one of the exceptions. A minimum size threshold is designed to ensure that the decision to place an order in a manner not contributing to the pre-trade price discovery process requires the commitment of a greater level of immediately achievable liquidity than that required of displayed orders.</p>
<p><b>6.6 Provision of Price Improvement by a Dark Order</b></p> <p>(1) If a Participant or Access Person enters an order on a marketplace for the purchase or sale of a security that order may execute with a Dark Order provided the order entered by the Participant or Access Person is executed:</p> <p>(a) at a better price;</p> <p>(b) in the case of a purchase, at the best ask price if:</p> <p>(i) the order on entry to the marketplace is for more than 50 standard trading units or has a value of more than \$100,000, and</p> <p>(ii) on the execution of the trade with the Dark Order, no orders for the sale of the security <b>included in the calculation of the best ask price</b> are displayed on that marketplace at that best ask price; or</p>	<p><b>Alpha</b> - It is not clear whether the intention of the Proposed Amendments was to measure the active order size before or after the best price routing for non-DAO orders.</p>	<p>The intention is to measure the active order size on entry to a marketplace, meaning after any routing decisions have been made.</p>
	<p><b>Alpha, Fair and CCL</b> – Support the principle that an order entered on a marketplace that trades with a Dark Order should receive price improvement, unless it meets a certain size threshold.</p>	<p>IIROC acknowledges the comments.</p>
	<p><b>Fair, CSTA, EJ, IIAC, ITG, MS, RBCGAM, Scotia, SIFMA, TD and TMX</b> – Support principle that visible orders should execute before Dark Orders at the same price on the same marketplace, as this will encourage visible liquidity, and protect orders in the lit market.</p>	<p>IIROC acknowledges the comments.</p>



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<p>(c) in the case of a sale, at the best bid price if:</p> <p>(i) the order on entry to the marketplace is for more than 50 standard trading units or has a value of more than \$100,000, and</p> <p>(ii) on the execution of the trade with the Dark Order, no orders for the purchase of the security <u>included in the calculation of the best bid price</u> are displayed on that marketplace at that best bid price.</p> <p>(2) Subsection (1) does not apply if the order entered by the Participant or Access Person is:</p> <p>(a) a Basis Order;</p> <p>(b) a Call Market Order;</p> <p>(c) a Closing Price Order;</p> <p>(d) a Market-on-Close Order;</p> <p>(e) an Opening Order; or</p> <p>(f) a Volume-Weighted Average Price Order.</p>	<p><b>EJ, IIAC, MS-</b> Do not support the size restrictions proposed for an order to be able to execute with dark liquidity with no price improvement. Believe that allowing orders of any size to interact with Dark Orders at the NBBO is not harmful to the market (provided the visible orders are executed first).</p>	<p>Allowing orders of any size to interact with Dark Orders at the NBBO after displacement of visible orders, would provide a dark pool the means to execute any small marketable order with no price improvement (as they would have no visible orders to displace first). This is not consistent with the policy objectives of the Amendments.</p>
	<p><b>IIAC</b> – Concerned that the matching priority requirement may provide a business advantage to visible venues which provide dark liquidity.</p>	<p>In the view of IIROC, a displayed order that has contributed directly to price discovery should be protected and have priority for execution at the displayed price. The Amendments permit “large” active orders to be executed at the same price on fully-dark marketplaces and visible venues with dark liquidity. The Amendments merely protect the visible orders on the particular marketplace at the execution price.</p>
	<p><b>RBCGAM</b> – Supportive of large Dark Orders being able to match at the NBBO without first having to displace visible orders as this is consistent with the underlying purpose of Dark Order types.</p>	<p>Although this concept was originally proposed in the Joint CSA/IIROC Position Paper 23-405 <i>Dark Liquidity in the Canadian Market</i><sup>18</sup>, the CSA and IIROC have reconsidered their position and believe that visible orders should always have priority over Dark Orders at the same price on the same marketplace.</p>
	<p><b>TD</b> – Requests clarification on the definition of “same marketplace” in the context of a single marketplace offering two separate order books.</p>	<p>The term “that marketplace” imposes a restriction on the ability of one order book with Dark Orders to execute a trade if visible orders at the same price are in another “order” book or facility offered by that marketplace. The definition of marketplace includes all order books and facilities of a particular exchange, QTRS or ATS.</p>
	<p><b>TMX</b> – Accepts the proposal that an order entered on a marketplace that trades with a Dark Order should receive price improvement, unless it meets a certain size threshold.</p>	<p>IIROC acknowledges the comment.</p>
		<p>The Amendments have been revised to clarify the orders to which a Dark Order may owe an execution obligation. The</p>

<sup>18</sup> Published at (2010) 33 OSCB, beginning at page 10764.



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		<p>Dark Order would have no obligation to a “visible” order on that marketplace that was of a “type” that was not included in the calculation of the “best ask price” or “best bid price” even if they were at a “better price”. The price of a Basis Order, Call Market Order, Closing Price Order, Market-on-Close Order, Opening Order, Special Terms Order or Volume-Weighted Average Price Order is excluded from the calculation of “best ask price” and “best bid price”. “Odd lots” are a type of “Special Terms Order”. The obligation has been clarified by adding in Rule 6.6(1)(b) (ii) after the word “security” the phrase “included in the calculation of the best ask price” and in the case of (c)(ii) “included in the calculation of the best bid price”.</p>
<p><b>7.12 Inability to Rely on Marketplace Functionality</b>  A Participant or Access Person shall not enter an order on a particular marketplace if the Participant or Access Person knows or ought reasonably to know that the handling of the order by the marketplace and the trading systems of the marketplace may result in the display of the order or the execution of the order not being in compliance with any of the applicable requirements of UMIR.</p>	<p><b>EJ, MS, SIFMA</b> – Believe that IIROC should consider placing the compliance burden on marketplaces, and not the participant. Concerned about ability for participants to meet best execution and Order Protection Rule requirements if they are unable to route orders to a marketplace with deficient functionality.</p>	<p>While IIROC is the regulation services provider for all marketplaces, IIROC does not have jurisdiction over any which are exchanges or QTRs and therefore cannot make impose a requirement that functionality be in accordance with UMIR requirements. “Best execution” is only achieved when the transaction is being done in accordance with regulatory requirements and therefore excluding the ability of a Participant or Access Person to rely on marketplace functionality in certain circumstances does not result in a breach of best execution.</p>
<p><b>Policy 6.1 – Entry of Orders to a Marketplace</b>  <b>Part 1 – Execution Price of Orders</b>  An order may execute at such price increment as established by the marketplace for the execution of such orders <u>and the marketplace shall report the execution price to the information processor and information vendor</u> provided, <u>if required unless otherwise permitted</u> by the information processor or information vendor, <del>that</del> the marketplace shall report the price at which the trade was executed <del>to the information processor or an information vendor</del> as the nearest trading increment and if the price results in one-half of a trading increment the price shall be rounded up to the next trading increment.</p>	<p><b>RBC</b> – Believes that reporting of fractional execution prices should be mandatory, as the rounding-up of trade prices skews the operation of VWAP-based executions resulting in price discrepancies between execution prices and reported prices.</p>	<p>The existing requirement permits the reporting of a fractional execution price. The Amendments were revised to provide that a fractional execution price shall be reported to the information processor and any information vendor unless otherwise required by the information processor or information vendor.  See the responses to Question 1 below.</p>
<p><b>Questions:</b></p>	<p><b>Alpha, CCL and Triact</b> – Do not believe that the last sale price must be a full trading increment.</p>	<p>The consensus of the commentators is in favour of removing the “full increment” restriction on the execution and</p>



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<p>1. If the restrictions at which a short sale may be made are repealed, do the other uses of the “last sale price” under UMIR justify the continuation of the restriction that the last sale price must be a full trading increment?</p>		<p>reporting of trade prices. In light of the repeal of price restrictions on short sales effective September 1, 2012, the Amendments were revised to eliminate the requirement that the “last sale price” be a full trading increment. Without the regulatory reason (short sale compliance) for the full increment, the preference of IIROC is to provide for full post-trade transparency while recognizing any limitations which may be imposed by the information processor or information vendors.</p>
	<p><b>CSTA</b> – Does not believe that the last sale price must be a full trading increment, and believes that all market data providers should be mandated to report the actual execution price.</p>	<p>See response above.</p>
	<p><b>RBCGAM</b> – Believes that the full trading increment restriction should remain in place.</p>	<p>See response above.</p>
	<p><b>Scotia</b> – Believes it is more straightforward to allow sub-tick increments on last sale prices, but expects system changes and development will be required to accommodate changes.</p>	<p>See response above.</p>
	<p><b>TD</b> – Recommends removing the requirement that the last sale price be a full trading increment, in the spirit of market transparency.</p>	<p>See response above.</p>
	<p><b>TMX</b> – Believes that the full trading increment should remain in place to avoid unnecessary complexity, and that there are a number of marketplace rules which function more effectively with a full-tick last sale price.</p>	<p>The change in the definition of “last sale price” for the purposes of UMIR does not preclude marketplaces from adopting a “revised” definition which the marketplaces believe is better suited for the purposes of their own requirements.</p>
<p>2. Presently UMIR provides that all orders entered on a marketplace must be priced at a “trading increment”. With the adoption of the definition of “better price” which will permit orders to execute at partial trading increments, should UMIR allow the entry of a “Better-Priced Intentional Cross” at a partial trading increment to facilitate compliance with the “better price” requirements of the Order Exposure Rule (Rule 6.3) and the Client-Principal Trading Rule (Rule 8.1)?</p>	<p><b>Alpha, CCL, CSTA, RBCGAM, Scotia and TD</b> – Believes that UMIR should allow the entry of a Better-Priced Intentional Cross.</p>	<p>IIROC recognizes that traders can adopt various strategies which would permit this result (such as splitting the orders and trading half on each side of the market). However, the Amendments have been revised to permit an automated solution. Market participants should be aware that IIROC is presently preparing a comprehensive proposal on order types and order markings that IIROC expects to publish for</p>



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		comment in the near future. Since the Amendments would not otherwise require any systems changes by Participants, Access Persons or service providers, market participants may wish to address this change in the context of the broader proposal on order types and order markings.
	<p><b>TMX</b> – Does not believe a Better-Priced Intentional Cross is necessary or valuable at this time. Believes that the better price definition serves to add clarity to executions against Dark Orders, but should not trigger further UMIR amendments that could have an impact on market structure.</p>	See response above.
	<p><b>TriAct</b> – Believes that the entry of a Better-Priced Intentional Cross for the purposes of the Client-Principal Trading Rule requires further consideration. Believes that sufficient price improvement for internalized client-principal orders may be different than what is necessary to when executing as agent with Dark Orders.</p>	See response above.
<p><b>General Comments</b></p>	<p><b>Alpha</b> – Notes that the implementation of a minimum size would become effective ten days after the notice, and believes this is insufficient time to complete the technological work required.</p>	IIROC acknowledges the concern and recognizes that a longer implementation period may be required for technological changes to be completed when the threshold is first designated, and that any subsequent changes could likely be made at a shorter interval. The initial designation will only be made after full public consultation. IIROC intends to release as part of the public consultation the results of IIROC’s evaluation of the impact of the other components of the Amendments
	<p><b>Alpha, CSTA, ITG and SIFMA</b> – Concerned that changes to dark liquidity rules are suggested with no evidence and/or data that it will improve the situation in Canada.</p>	In the opinion of IIROC, the operation of dark markets in certain jurisdictions has had a negative impact on the operation of price discovery. IIROC has acknowledged that dark liquidity in Canada has to date not had a negative impact on price discovery. The Amendments are designed to ensure that the anticipated growth of dark liquidity does not have such a negative impact. IIROC will be monitoring the impact of the Amendments and expects to publish the results of that analysis.



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	<p><b>CCL</b> – Encourages IIROC to address the issue of the fees paid by retail brokers to avoid the potential loss of order flow to U.S. trading venues.</p>	<p>While fees are one of the factors which a Participant may take into account in determining best execution, the over-riding requirement of a Participant is for the client to receive the highest net proceeds in the case of a sale or the lowest net cost in the case of a purchase. IIROC is aware that differences in the cost of executing a trade on each of the marketplaces is one of the factors considered by market participants in making order routing decisions. IIROC also recognizes that the ability of the marketplaces to compete on the basis of fees was one of the principal tenets of the introduction of multiple marketplaces. As indicated in the Update on Forum to Discuss Consultation Paper 23-404 – <i>Dark Pools, Dark Orders and Other Development in Market Structure in Canada</i>: “The CSA are currently conducting a review of all fees charged by marketplaces, including data fees. CSA staff’s goal is to ensure that the costs involved with accessing services provided by marketplaces, including data, trading and routing are compliant with fair access provisions in NI 21-101.”</p>
	<p><b>Fair</b> – Believes it is important for regulators to continue to monitor impact of dark pools as the market evolves.</p>	<p>IIROC will continue to monitor dark pools and Dark Order usage. In particular, IIROC will be monitoring the impact of the Amendments as part of the consideration of an “appropriate” minimum size to be proposed for Dark Orders.</p>
	<p><b>TD</b> – Recognizes the concern about protection of the visible markets, but believes the most effective approach for protection is to eliminate the price distortions caused by the make/take model, which have encouraged active orders to be directed away from the visible markets.</p>	<p>IIROC would also note that not all marketplaces employ a make/take model for trading fees and that trading fees were intended as one of the means by which marketplaces would be able to compete. Trading fees charged by a marketplace are not taken into account in determining the “best ask price” or “best bid price” and since such fees must be less than the minimum trading increment prescribed by UMIR (see section 8.2(4) of 21-101CP), the displayed price will always result for a client in the highest net proceeds or lowest net cost.</p>