

Re Questrade & Eydelman

IN THE MATTER OF:

**The Rules of the Investment Industry Regulatory Organization of
Canada**

and

The Universal Market Integrity Rules

and

Alexey Eydelman

and

Questrade Inc.

2013 IIROC 25

Investment Industry Regulatory Organization of Canada
Hearing Panel (Ontario)

Heard: April 22, 2013

Decision: May 13, 2013

Hearing Panel:

Paul M. Moore, Q.C – Chair, Guenther Kleberg and Donald Lawson

Appearances:

Andrew Werbowski, IIROC Enforcement Counsel

Robert Brush, Counsel for the Respondents

Clarke Tedesco, Counsel for the Respondents

REASONS FOR APPROVAL OF SETTLEMENT AGREEMENT

¶ 1 These are the reasons delivered orally by Paul M. Moore, Q.C., chair of the panel, on April 22, 2013 at the end of the hearing. This version is based on the transcript of the hearing which has been modified and approved by the chair of the panel for publication to provide a public record of the reasons. Reference may be made to the settlement agreement, published in the IIROC bulletin, for a description of the facts and agreed sanctions presented to the panel.

¶ 2 The Key factors in this particular case are:

1. There was no intention to manipulate and profit by it.
2. Whether one characterizes the personal respondent's conduct as negligence – a difficult term to use – or not, we do put great stock in the fact that the personal respondent, Eydelman, did not profit personally by the closing bid prices.
3. The scale of the respondent's actions was not horrendous. It was over a seven-month period and there was no evidence that great dollar amounts were lost by anyone.

4. We do recognize that any kind of market manipulation is very harmful to the market.
5. We took into account the submission of counsel that the size and scale of the operations of Questrade needed to be taken into account in determining whether or not a \$70,000.00 fine is significant. We accepted that it is not insignificant for a firm of this size. We believed that the Standard Securities case was quite apt as a precedent.

There really is only one key question for a panel in a settlement hearing, and that is whether the settlement agreement is within the parameters of acceptability, as far as the sanctions are concerned. If they are, then the panel should approve the agreement. The other factors are important and have to be considered, but they are not what determines whether a settlement agreement should be approved as being in the public interest.

¶ 3 Those and other factors, such as whether the sanctions provide a deterrence, are important in order to determine appropriate sanctions and to see whether they are within the parameters of acceptability.

¶ 4 This was not a difficult case. It fits comfortably with the precedents that were presented to us.

¶ 5 Finally, in approving the settlement as noted the problem of adequate supervision has been rectified. As far as the agreement on costs, we determined that the amount was within acceptable parameters, especially taken into account that this was a settlement hearing and not a lengthy hearing.

¶ 6 In conclusion, we approved of this Settlement Agreement with respect to these two respondents.

The foregoing version of the reasons is hereby approved at Toronto this 13th day of May, 2013.

Paul M. Moore, Q.C.

Guenther Kleberg

Donald Lawson

OFFER OF SETTLEMENT

INTRODUCTION

1. The Enforcement Department Staff (“Staff”) of the Investment Industry Regulatory Organization of Canada (“IIROC”) has conducted an investigation (the “Investigation”) into the conduct of Alexey Eydelman (“Eydelman”) and Questrade Inc. (“Questrade”), (collectively the “Respondents”).
2. The Investigation has disclosed matters for which IIROC seeks certain sanctions against the Respondents pursuant to Rule 10.5 of the Universal Market Integrity Rules (“UMIR”).
3. If this Offer of Settlement is accepted by the Respondents, the resulting settlement agreement (the “Settlement Agreement”) which has been negotiated in accordance with Part 3 of UMIR Policy 10.8, is conditional upon approval by a hearing panel appointed pursuant to IIROC Transitional Rule No. 1, Schedule C.1 (the “Hearing Panel”).
4. The Respondents agree to waive all rights under UMIR to a hearing or to an appeal or review if the Settlement Agreement is approved by the Hearing Panel.
5. The Respondents consent to be subject to the jurisdiction of IIROC and its relevant disciplinary process and rules in relation to this matter.
6. Staff and the Respondents jointly recommend that the Hearing Panel accept this Settlement Agreement.

AGREEMENT AS TO REQUIREMENTS CONTRAVENED

7. The Respondent Eydelman agrees that:

- (i) Between August 2009 and February 2010, he entered orders on the Toronto Stock Exchange that

he ought reasonably to have known could reasonably be expected to create an artificial bid price for Quebecor Inc. Class A securities (“QBR.A”) contrary to UMIR 2.2 and UMIR Policy 2.2.

8. The Respondent Questrade agrees that:
- (i) From August 2009 until February 2010, it failed to have adequate policies and procedures in place and a supervision system sufficient to prevent and detect potential artificial bid prices, contrary to UMIR 7.1 and UMIR Policy 7.1.

ADMITTED FACTS

9. For the purposes of this Settlement Agreement, Staff and the Respondents agree with and rely upon the admitted facts and conclusions which are set out in the Statement of Allegations attached as Appendix “A” to this Settlement Agreement.

DISPOSITION - EYDELMAN

10. For the contraventions in paragraph 7(i) above, Staff and Eydelman have agreed upon disposition on the basis of:
- (i) a three month suspension from access to an IIROC-regulated marketplace, to commence 30 days from the date of approval of this Settlement Agreement;
 - (ii) a fine of \$30,000, payable by Eydelman to IIROC; and
 - (iii) costs in the amount of \$5,000, payable by Eydelman to IIROC.

DISPOSITION - QUESTRADE

11. For the contraventions in paragraph 7(ii) above, Staff and Questrade have agreed upon disposition on the basis of:
- (i) a fine of \$70,000, payable by Questrade to IIROC; and
 - (ii) costs in the amount of \$10,000, payable by Questrade to IIROC.

PROCEDURES FOR ACCEPTANCE OF OFFER OF SETTLEMENT AND APPROVAL OF SETTLEMENT AGREEMENT

12. The Respondents shall have until the close of business on April 10, 2013 to sign this Settlement Agreement and serve an executed copy thereof on Staff.
13. This Settlement Agreement shall be presented to the Hearing Panel at a hearing (the “Approval Hearing”) held for the purpose of approving the Settlement Agreement, in accordance with the procedures described in UMIR Policy 10.8 in addition to any other procedures as may be agreed upon between the parties. The Respondents acknowledge that IIROC shall notify the public and media of the Approval Hearing in such manner and by such media as IIROC sees fit.
14. Pursuant to Part 3.4 of UMIR Policy 10.8, the Hearing Panel may accept or reject this Settlement Agreement.
15. In the event the Settlement Agreement is accepted by a Hearing Panel, the matter becomes final, there can be no appeal or review of the matter, the disposition of the matter agreed upon in this Settlement Agreement will be included in the permanent record of IIROC in respect of the Respondents and IIROC will publish a summary of the Requirements contravened, the facts, and the disposition agreed upon in the Settlement Agreement.
16. In the event the Hearing Panel rejects the Settlement Agreement, IIROC may proceed with a hearing of the matter before a differently constituted Hearing Panel pursuant to Part 3.7 of UMIR Policy 10.8 and this Settlement Agreement may not be referred to without the consent of both parties.
17. The Respondents that, in the event either fails to comply with any of the terms of the Settlement

Agreement, IIROC may enforce this settlement in any manner it deems appropriate.

18. The Respondents agree that neither they nor anyone on their behalf will make a public statement inconsistent with this Settlement Agreement.

IN WITNESS WHEREOF the parties have signed this Settlement Agreement as of the dates noted below.

DATED at Toronto, Ontario on the 3rd day of April, 2013.

| | |
|---------------------|------------------|
| “Lawrence Horowitz” | “Alexy Eydelman” |
| Witness Signature | Alexey Eydelman |
| Lawrence Horowitz | |
| Name of Witness | |

DATED at Toronto, Ontario on the 3rd day of April, 2013.

| | |
|-------------------|------------------------|
| Lawrence Horowitz | “Edward Kholodenko” |
| Witness Signature | QUESTRADE INC. |
| Lawrence Horowitz | Per: Edward Kholodenko |
| Name of Witness | President and CEO |

DATED at Toronto, Ontario on the 3rd day of April, 2013.

Per: “Elsa Renzella”
ELSA RENZELLA
ACTING VICE-PRESIDENT, ENFORCEMENT
Investment Industry Regulatory Organization of Canada
Suite 2000, 121 King Street West
Toronto, Ontario M5H 3T9

This foregoing Settlement Agreement is hereby approved this 22nd day of April, 2013, by the following hearing panel constituted to review the terms thereof:

Per: “Paul Moore”
Panel Chair

Per: “Guenther Kleberg”
Panel Member

Per: “Donald Lawson”
Panel Member

APPENDIX “A”

INVESTMENT INDUSTRY REGULATORY ORGANIZATION OF CANADA

IN THE MATTER OF:

**THE RULES OF THE INVESTMENT INDUSTRY REGULATORY
ORGANIZATION OF CANADA
AND**

THE UNIVERSAL MARKET INTEGRITY RULES

AND

ALEXEY EYDELMAN

AND

QUESTRADE INC.

STATEMENT OF ALLEGATIONS

I. REQUIREMENTS CONTRAVENED

1. Between August 2009 and February 2010 (the “Relevant Period”), Alexey Eydelman (“Eydelman”), a proprietary trader employed by Questrade Inc. (“Questrade”), entered orders on the Toronto Stock Exchange (“TSX”) that he ought reasonably to have known could reasonably be expected to create an artificial bid price for Quebecor Inc. Class A securities (“QBR.A”) contrary to Universal Market Integrity Rules (“UMIR”) 2.2(2) and UMIR Policy 2.2, for which he is liable under UMIR 10.4(1).
2. Between August 2009 and February 2010, Questrade failed to comply with its trading supervision obligations contrary to UMIR 7.1 and UMIR Policy 7.1 by failing to have adequate policies and procedures in place and a sufficient supervision system.
3. Schedule “B” sets out the text of the relevant UMIR Requirements.

II. RELEVANT FACTS AND CONCLUSIONS

Overview

4. During the Relevant Period, Eydelman entered orders that established the high closing bid price for QBR.A in circumstances where he ought reasonably to have known the orders could be seen to create an artificial price. On seven month-end trading days during the Relevant Period, Eydelman’s trading set the closing bid in QBR.A and created anomalous price increases in that security.
5. During the Relevant Period, Questrade failed to implement a trade supervision system that was adequate, taking into account its business and affairs, to ensure compliance with UMIR 2.2 and UMIR Policy 2.2. Questrade failed to ensure that the risks associated with its proprietary trading group had been identified and that appropriate supervision practices and procedures to manage those risks had been implemented. Questrade failed to adequately review and monitor Eydelman’s order entry activity and failed to prevent or detect Eydelman’s violations of UMIR 2.2(2).

Parties

6. Questrade is registered as an investment dealer and is a Participant under UMIR.
7. Eydelman has been registered since 1988 and was employed by various investment dealers prior to joining Questrade in September 2008. Eydelman is employed by Questrade as a registered trader and is the V.P. and Director of Pro Trading. Eydelman is a proprietary trader and also a market maker for the TSX for a number of securities.

Trading in QBR.A

8. During the Relevant Period, QBR.A was a relatively illiquid security.
9. QBR.A shares are multiple voting shares convertible on a one-for-one basis at the request of the holder into QBR.B subordinate voting shares.
10. Between May 2009 and March 2010, Eydelman accumulated a long position in QBR.A and a short position in QBR.B in his inventory account. Eydelman accumulated the majority of his position in QBR.A and QBR.B between May and November 2009 (see Schedule “A”, Table 1 and 2). By the end

of February 2010, he held 270,618 shares of QBR.A and a short position of 271,500 shares in QBR.B.

11. According to Eydelman, his trading strategy was to enter into a hedged position to attempt to profit from a price difference between the two securities. Between January 2007 and mid-2008, QBR.A had regularly traded at a premium to QBR.B. After the position was established and QBR.A was trading at a premium, Eydelman intended to offer his position to either institutional investors or insiders interested in obtaining the voting rights. He could then realize a profit on the liquidation of the hedged position. Otherwise, as a last resort, he could exit the position at any time by converting the QBR.A shares into the QBR.B shares.
12. In March 2010, Eydelman decided to exit his positions by converting his QBR.A shares into QBR.B shares.
13. Eydelman's stated parameters for accumulating the position in QBR.A had been to purchase the QBR.A shares at a discount, at par, or at a 3% to 5% premium to QBR.B.
14. During the Relevant Period, Eydelman consistently paid a premium but usually, although not exclusively, paid a premium in the range of 3% to 5% for the shares of QBR.A at the end of the trading day at month-end.
15. On seven consecutive month-end trading days (August 2009 to February 2010), Eydelman established the closing bid in QBR.A.
16. The chart below shows the daily price difference between the closing bid on QBR.A and the closing offer on QBR.B between May 2009 and April 2010. The chart shows the anomalous price increases in the closing bid in QBR.A at month-end in relation to the closing offer on QBR.B that occurred as a result of Eydelman's closing bid activity.



17. The following table sets out the price difference between Eydelman's month-end closing bids for QBR.A and the closing offer on QBR.B at month-end:

| Month | Eydelman's Closing Bid QBR.A | Closing Offer QBR.B | Difference QBR.A Closing Bid – QBR.B Closing Offer |
|--------------------|------------------------------|---------------------|--|
| August 31, 2009 | 25.30 | 24.77 | 0.53 |
| September 20, 2009 | 25.40 | 24.50 | 0.90 |

| Month | Eydelman's Closing Bid QBR.A | Closing Offer QBR.B | Difference QBR.A Closing Bid – QBR.B Closing Offer |
|-------------------|---------------------------------|------------------------|--|
| October 30, 2009 | 23.00 | 22.15 | 0.85 |
| November 30, 2009 | 27.70 | 26.41 | 1.29 |
| December 31, 2009 | 28.50 | 27.23 | 1.27 |
| January 29, 2010 | 29.69 | 28.67 | 1.02 |
| February 26, 2010 | 31.05 | 30.05 | 1.00 |

The Respondent's Position

Context of Eydelman's Trading

18. According to Eydelman, his trading objective was to acquire 250,000 to 300,000 QBR.A shares. During the Relevant Period, the market for QBR.A shares was largely illiquid, and shares were difficult to acquire. During the Relevant Period, Eydelman accounted for 34% to 56% of all monthly purchases in the market.
19. In addition, Eydelman formed the view that the daily trading in QBR.A was dominated by a small number of computer-based 'algorithmic' traders, who would instantly outbid offers of more than one lot size, thereby neutralizing the previous bid and depressing both price and volume. During the Relevant Period, he believed that these algorithmic traders would be active from the beginning until the last few minutes of the trading day. Eydelman found that he was unable to make significant bids for QBR.A while the algorithmic traders were active, as any significant bids would be instantly outbid.
20. As a result, in order to advance his trading strategy and acquire a significant number of shares in QBR.A, Eydelman believed that he needed to: (1) place bids for fairly large lot sizes at the end of the day, and (2) increase the bid price significantly to correct for the depression in price caused by the algorithmic traders and to 'catch the attention' of prospective sellers. As Eydelman's position in QBR.A grew, he was of the view that it further reduced the available supply and required greater price premiums. Eydelman would bid most aggressively at the end of the month as a result of his belief that the algorithmic traders were programmed to 'even out' their positions at month end.

Eydelman's Compensation Arrangement

21. Due to the terms of Eydelman's compensation agreement, he had no motive to artificially increase the bid price of QBR.A at month-end.
22. Because Eydelman's Quebecor trading strategy included a hedge, with a long position in QBR.A and corresponding short position in QBR.B, any increase in the price of QBR.A would increase the 'conversion loss' that would be suffered in the event the position was liquidated by converting the QBR.A shares to QBR.B shares.
23. Pursuant to his compensation agreement with Questrade, Eydelman put up his own capital for his trading (not just the firm's capital) and was responsible for covering his proportionate share of the potential conversion loss in the Quebecor position. Questrade required Eydelman to maintain sufficient capital with the firm to cover this potential conversion loss. Consequently, Eydelman's proportionate share of any trading gain resulting from an increase in the price of QBR.A was offset by the corresponding increase in his proportionate share of the potential conversion loss.
24. As a result, Eydelman did not profit from any of the month-end high closing bids.

Summary – Eydelman's Trading

25. The purpose of UMIR 2.2(2) and Policy 2.2 is to protect the marketplace from false or misleading

trading or artificial pricing, which undermines the integrity of the marketplace and erodes investor confidence.

26. During the Relevant Period, Eydelman's orders created the high closing bid price for QBR.A on the relevant day. As an experienced trader and market maker, Eydelman ought reasonably to have known that his closing bids could reasonably be expected to create an artificial price for the security.

Questrade's Supervision

27. UMIR 7.1 and Policy 7.1 requires each participant to:
- (1) adopt written policies and procedures that are adequate, taking into account the business and affairs of the participant to ensure its trading activities are in compliance with UMIR and each Policy; and
 - (2) supervise orders entered on a marketplace.
28. Prior to the Relevant Period, RS Trades Desk Reviews & IIROC Trading Conduct Compliance ("TCC") reviews noted deficiencies in Questrade's Policies and Procedures regarding missing or inadequate reviews of unfilled orders. A 2007 Trade Desk Review finding required Questrade to update its Policies and Procedures to include review of unfilled orders entered late in the day. Similarly, a 2009 TCC Review noted as a deficiency that the policies and procedures were not sufficient in the description and detail of the review of unfilled orders.
29. The September 2010 TCC review noted Supervision of Artificial Pricing as an "Other Deficiency" and that Questrade had insufficient policies and procedures for the testing of unexecuted orders entered near the close and that the results of the testing were not quantified and summarized in monthly reports.
30. During the Relevant Period, Questrade's proprietary orders and trades were done through the IRESS trading platform. Shortly before the Relevant Period, Questrade began using Position Watch as an information system.
31. During the Relevant Period, as a result of vendor delays, Questrade did not have access to unfilled order history from the Position Watch system and was therefore unable to perform required supervision of unfilled orders prior to close.
32. Questrade failed to meet its obligations under UMIR 7.1 and Policy 7.1 in that it failed to adopt adequate policies and procedures to adequately address the risks associated with its proprietary trading group and specifically did not conduct sufficient inquiries into Eydelman's trading.
33. Questrade had discussions with Eydelman about his trading activity and accepted his explanation as to the trading strategy employed. The trading was not identified as a potential violation of UMIR until it was noted by IIROC Market Surveillance Staff.

Summary – Questrade's Supervision

34. During the Relevant Period, Questrade failed to implement a trade supervision system that was adequate, taking into account its business and affairs, to ensure compliance with UMIR. Specifically, Questrade failed to ensure that the risks associated with its proprietary trading group had been identified and that the appropriate supervision practices to manage those risks had been implemented.

April 3, 2013

Investment Industry Regulatory
Organization of Canada

Suite 2000 – 121 King St. West

Toronto, Ontario

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Schedule "A"

The following tables show the volume of QBR.A and QBR.B shares Eydelman traded between May 2009 and April 2010, the amount that volume represented of the total market volume, and the accumulated position in the inventory account.

Table 1 - QBR.A Position

| Month | Total Market Volume | Eydelman's Buy Volume | Eydelman's % Market Buy Volume | Eydelman's Sell Volume | Eydelman's % Market Sell Volume | Month Net Position | Accumulated Account Position |
|----------------|---------------------|-----------------------|--------------------------------|------------------------|---------------------------------|--------------------|------------------------------|
| May 2009 | 559,021 | 85,400 | 15.28% | 15,000 | 2.68% | 70,400 | 74,100 |
| June 2009 | 104,329 | 38,600 | 37.00% | 10,100 | 9.68% | 28,500 | 102,600 |
| July 2009 | 91,150 | 48,200 | 52.88% | 12,700 | 13.93% | 35,500 | 138,100 |
| August 2009 | 127,372 | 54,109 | 42.48% | 6,000 | 4.71% | 48,109 | 186,209 |
| September 2009 | 76,127 | 26,400 | 34.68% | 3,600 | 4.73% | 22,800 | 209,009 |
| October 2009 | 64,550 | 26,200 | 40.59% | - | 0 | 26,200 | 235,209 |
| November 2009 | 44,753 | 15,809 | 35.33% | 1,000 | 2.23% | 14,809 | 250,018 |
| December 2009 | 9,209 | 5,200 | 56.47% | 200 | 2.17% | 5,000 | 255,018 |
| January 2010 | 25,547 | 10,900 | 42.67% | 1,100 | 4.31% | 9,800 | 264,818 |
| February 2010 | 13,717 | 6,400 | 46.66% | 600 | 4.37% | 5,800 | 270,618 |
| March 2010 | 24,036 | 7,000 | 29.12% | 3,500 | 14.56% | 3,500 | 274,118 |
| April 2010 | 5,176 | 700 | 13.52% | 400 | 7.73% | 300 | 418 |

Table 2 - QBR.B Position

| Month | Total Market Volume | Eydelman's Buy Volume | Eydelman's % Market Buy Volume | Eydelman's Sell Volume | Eydelman's % Market Sell Volume | Month Net Position | Accumulated Account Position |
|----------------|---------------------|-----------------------|--------------------------------|------------------------|---------------------------------|--------------------|------------------------------|
| May 2009 | 3,354,439 | 58,900 | 1.76% | 132,400 | 3.95% | -73,500 | -73,500 |
| June 2009 | 2,235,043 | 39,200 | 1.75% | 66,300 | 2.97% | -27,100 | -100,600 |
| July 2009 | 1,741,297 | 79,000 | 4.54% | 116,600 | 6.70% | -37,600 | -138,200 |
| August 2009 | 2,047,906 | 36,500 | 1.78% | 79,500 | 3.88% | -43,000 | -181,200 |
| September 2009 | 1,884,993 | 23,000 | 1.22% | 45,100 | 2.39% | -22,100 | -203,300 |
| October 2009 | 1,865,494 | 9,600 | 0.51% | 35,200 | 1.89% | -25,600 | -228,900 |
| November 2009 | 1,906,065 | 13,200 | 0.69% | 34,000 | 1.78% | -20,800 | -249,700 |
| December 2009 | 1,273,024 | 18,500 | 1.45% | 18,600 | 1.46% | -100 | -249,800 |

| Month | Total Market Volume | Eydelman's Buy Volume | Eydelman's % Market Buy Volume | Eydelman's Sell Volume | Eydelman's % Market Sell Volume | Month Net Position | Accumulated Account Position |
|---------------|---------------------|-----------------------|--------------------------------|------------------------|---------------------------------|--------------------|------------------------------|
| January 2010 | 1,390,650 | 12,300 | 0.88% | 26,500 | 1.91% | -14,200 | -263,600 |
| February 2010 | 1,104,442 | 8,900 | 0.81% | 16,800 | 1.52% | -7,900 | -271,500 |
| March 2010 | 2,543,037 | 19,700 | 0.77% | 23,300 | 0.92% | -3,600 | -274,200 |
| April 2010 | 1,303,740 | 800 | 0.06% | 1,200 | 0.09% | -400 | -400 |

Schedule "B"

EXCERPTS FROM THE UNIVERSAL MARKET INTEGRITY RULES

2.2 Manipulative and Deceptive Activities

...

- (2) A Participant or Access Person shall not, directly or indirectly, enter an order or execute a trade on a marketplace if the Participant or Access Person knows or ought reasonably to know that the entry of the order or the execution of the trade will create or could reasonably be expected to create:
- (a) a false or misleading appearance of trading activity in or interest in the purchase or sale of the security; or
 - (b) an artificial ask price, bid price or sale price for the security or a related security.

POLICY 2.2. – MANIPULATIVE AND DECEPTIVE ACTIVITIES

Part 2 – False or Misleading Appearance of Trading Activity or Artificial Price

For the purposes of subsection (2) of Rule 2.2 and without limiting the generality of that subsection, if any of the following activities are undertaken on a marketplace and create or could reasonably be expected to create a false or misleading appearance of trading activity or interest in the purchase or sale of a security or an artificial ask price, bid price or sale price, the entry of the order or the execution of the trade shall constitute a violation of subsection (2) of Rule 2.2:

- (a) *entering an order or orders for the purchase of a security with the knowledge that an order or orders of substantially the same size, at substantially the same time and at substantially the same price for the sale of that security, has been or will be entered by or for the same or different persons;*
- (b) *entering an order or orders for the sale of a security with the knowledge that an order or orders of substantially the same size, at substantially the same time and at substantially the same price for the purchase of that security, has been or will be entered;*
- (c) *making purchases of, or offers to purchase, a security at successively higher prices or in a pattern generally of successively higher prices;*
- (d) *making sales of or offers to sell a security at successively lower prices or in a pattern generally of successively lower prices;*
- (e) *entering an order or orders for the purchase or sale of a security to:*
 - (i) *establish a predetermined sale price, ask price or bid price,*
 - (ii) *effect a high or low closing sale price, ask price or bid price, or*

- (iii) *maintain the sale price, ask price or bid price within a predetermined range;*
- (f) *entering an order or a series of orders for a security that are not intended to be executed;*
- (g) *entering an order for the purchase of a security without, at the time of entering the order, having the ability or the reasonable expectation to make the payment that would be required to settle any trade that would result from the execution of the order;*
- (h) *entering an order for the sale of a security without, at the time of entering the order, having the reasonable expectation of settling any trade that would result from the execution of the order; and*
- (i) *effecting a trade in a security, other than an internal cross, between accounts under the direction or control of the same person.*

If persons know or ought reasonably to know that they are engaging or participating in these or similar types of activities those persons will be in breach of subsection (2) of Rule 2.2 irrespective of whether such activity results in a false or misleading appearance of trading activity or interest in the purchase or sale of a security or an artificial ask price, bid price or sale price for a security or a related security.

Part 3 – Artificial Pricing

For the purposes of subsection (2) of Rule 2.2, an ask price, bid price or sale price will be considered artificial if it is not justified by real demand or supply in a security. Whether or not a particular price is "artificial" depends on the particular circumstances.

Some of the relevant considerations in determining whether a price is artificial are:

- (a) *the prices of the preceding trades and succeeding trades;*
- (b) *the change in the last sale price, best ask price or best bid price that results from the entry of the order on a marketplace;*
- (c) *the recent liquidity of the security;*
- (d) *the time the order is entered and any instructions relevant to the time of entry of the order; and*
- (e) *whether any Participant, Access Person or account involved in the order:*
 - (i) *has any motivation to establish an artificial price, or*
 - (ii) *represents substantially all of the orders entered or executed for the purchase or sale of the security.*

The absence of any one or more of these considerations is not determinative that a price is or is not artificial.

7.1 Trading Supervision Obligations

- (1) Each Participant shall adopt written policies and procedures to be followed by directors, officers, partners and employees of the Participant that are adequate, taking into account the business and affairs of the Participant, to ensure compliance with these Rules and each Policy.
- (2) Prior to the entry of an order on a marketplace by a Participant, the Participant shall comply with:
 - (a) applicable regulatory standards with respect to the review, acceptance and approval of orders;
 - (b) the policies and procedures adopted in accordance with subsection (1); and
 - (c) all requirements of these Rules and each Policy.
- (3) Each Participant shall appoint a head of trading who shall be responsible to supervise the trading activities of the Participant in a marketplace.
- (4) The head of trading together with each person who has authority or supervision over or

responsibility to the Participant for an employee of the Participant shall fully and properly supervise such employee as necessary to ensure the compliance of the employee with these Rules and each Policy.

POLICY 7.1 – TRADING SUPERVISION OBLIGATIONS

Part 1 – Responsibility for Supervision and Compliance

For the purposes of Rule 7.1, a Participant shall supervise its employees, directors and officers and, if applicable, partners to ensure that trading in securities on a marketplace (an Exchange, QTRS or ATS) is carried out in compliance with the applicable Requirements (which includes provisions of securities legislation, UMIR, the Trading Rules and the Marketplace Rules of any applicable Exchange or QTRS). An effective supervision system requires a strong overall commitment on the part of the Participant, through its board of directors, to develop and implement a clearly defined set of policies and procedures that are reasonably designed to prevent and detect violations of Requirements. The board of directors of a Participant is responsible for the overall stewardship of the firm with a specific responsibility to supervise the management of the firm. On an ongoing basis, the board of directors must ensure that the principal risks for non-compliance with Requirements have been identified and that appropriate supervision and compliance procedures to manage those risks have been implemented.

Management of the Participant is responsible for ensuring that the supervision system adopted by the Participant is effectively carried out. The head of trading and any other person to whom supervisory responsibility has been delegated must fully and properly supervise all employees under their supervision to ensure their compliance with Requirements. If a supervisor has not followed the supervision procedures adopted by the Participant, the supervisor will have failed to comply with their supervisory obligations under Rule 7.1(4).

When the Market Regulator reviews the supervision system of a Participant (for example, when a violation occurs of Requirements), the Market Regulator will consider whether the supervisory system is reasonably well designed to prevent and detect violations of Requirements and whether the system was followed.

The compliance department is responsible for monitoring and reporting adherence to rules, regulations, requirements, policies and procedures. In doing so, the compliance department must have a compliance monitoring system in place that is reasonably designed to prevent and detect violations. The compliance department must report the results from its monitoring to the Participant's management and, where appropriate, the board of directors, or its equivalent. Management and the board of directors must ensure that the compliance department is adequately funded, staffed and empowered to fulfil these responsibilities.

The obligation to supervise applies whether the order is entered on a marketplace:

- by a trader employed by the Participant,*
- by an employee of the Participant through an order routing system,*
- directly by a client and routed to a marketplace through the trading system of the Participant, or*
- by any other means.*

In performing the trading supervision obligations, the Participant will act as a "gatekeeper" to help prevent and detect violations of applicable Requirements.

Where an order is entered on a marketplace without the involvement of a trader (for example by a client with a systems interconnect arrangement in accordance with Policy 2-501 of the Toronto Stock Exchange), the Participant retains responsibility for that order and the supervision policies and procedures should adequately address the additional risk exposure which the Participant may have for orders that are not directly Part 7 – Trading in a Marketplace UMIR 7.1-2 May 26, 2006 handled by staff of the Participant. For example, it may be appropriate for the Participant to sample for compliance testing a higher percentage of orders that have been entered directly by clients than the percentage of orders sampled in other circumstances.

In addition, the “post order entry” compliance testing should recognize that the limited involvement of staff of the Participant in the entry of orders by a direct access client may restrict the ability of the Participant to detect orders that are not in compliance with specific rules. For example, “post order entry” compliance testing may be focused on whether an order entered by a direct access client:

- has created an artificial price contrary to Rule 2.2;*
- is part of a “wash trade” (in circumstances where the client has more than one account with the Participant);*
- is an unmarked short sale (if the trading system of the Participant does not automatically code as “short” any sale of a security not then held in the account of the client); and*
- has complied with order marking requirements and in particular the requirement to mark an order as from an insider or significant shareholder (unless the trading system of the Participant restricts trading activities in affected securities).*

Part 2 – Minimum Element of a Supervision System

For the purposes of Rule 7.1, a supervision system consists of both policies and procedures aimed at preventing violations from occurring and compliance procedures aimed at detecting whether violations have occurred.

The Market Regulator recognizes that there is no one supervision system that will be appropriate for all Participants. Given the differences among firms in terms of their size, the nature of their business, whether they are engaged in business in more than one location or jurisdiction, the experience and training of its employees and the fact that effective jurisdiction can be achieved in a variety of ways, this Policy does not mandate any particular type or method of supervision of trading activity. Furthermore, compliance with this Policy does not relieve Participants from complying with specific Requirements that may apply in certain circumstances. In particular, Participants are reminded that, in accordance with subsection (2) of Rule 10.1, the entry of orders must comply with the Marketplace Rules on which the order is entered and the Marketplace Rules on which the order is executed. (For example, for Participants that are Participating Organizations of the TSE, reference should be made to the Policy on “Connection of Eligible Clients of Participating Organizations”).

Participants must develop and implement supervision and compliance procedures that exceed the elements identified in this Policy where the circumstances warrant. For Part 7 – Trading in a Marketplace UMIR 7.1-3 May 26, 2006 example, previous disciplinary proceedings, warning and caution letters from the Market Regulator or the identification of problems with the supervision system or procedures by the Participant or the Market Regulator may warrant the implementation of more detailed or more frequent supervision and compliance procedures.

Regardless of the circumstances of the Participant, however, every Participant must:

- 1. Identify the relevant Requirements, securities laws and other regulatory requirements that apply to the lines of business in which the Participant is engaged (the “Trading Requirements”).*
- 2. Document the supervision system by preparing a written policies and procedures manual. The manual must be accessible to all relevant employees. The manual must be kept current and Participants are advised to maintain a historical copy.*
- 3. Ensure that employees responsible for trading in securities are appropriately registered and trained and that they are knowledgeable about the Trading Requirements that apply to their responsibilities. Persons with supervisory responsibility must ensure that employees under their supervision are appropriately registered and trained. The Participant should provide a continuing training and education program to ensure that its employees remain informed of and knowledgeable about changes to the rules and regulations that apply to their responsibilities.*
- 4. Designate individuals responsible for supervision and compliance. The compliance function must be conducted by persons other than those who supervised the trading activity.*

5. *Develop and implement supervision and compliance procedures that are appropriate for the Participant's size, lines of business in which it is engaged and whether the Participant carries on business in more than one location or jurisdiction.*
6. *Identify the steps the Participant will take when a violation or possible violation of a Requirement or any regulatory requirement has been identified. These steps shall include the procedure for the reporting of the violation or possible violation to the Market Regulator if required by Rule 10.16. If there has been a violation or possible violation of a Requirement identify the steps that would be taken by the Participant to determine if:*
 - *additional supervision should be instituted for the employee, the account or the business line that may have been involved with the violation or possible violation of a Requirement; and*
 - *the written policies and procedures that have been adopted by the Participant should be amended to reduce the possibility of a future violation of the Requirement.*
7. *Review the supervision system at least once per year to ensure it continues to be reasonably designed to prevent and detect violations of Requirements. More frequent reviews may be required if past reviews have detected problems with supervision and compliance. Results of these reviews must be maintained for at least five years.*
8. *Maintain the results of all compliance reviews for at least five years.*
9. *Report to the board of directors of the Participant or, if applicable, the partners, a summary of the compliance reviews and the results of the supervision system review. These reports must be made at least annually. If the Market Regulator or the Participant has identified significant issues concerning the supervision system or compliance procedures, the board of directors or, if applicable, the partners, must be advised immediately.*

Part 3 - Minimum Compliance Procedures for Trading on a Marketplace

A Participant must develop and implement compliance procedures for trading in securities on a marketplace that are appropriate for its size, the nature of its business and whether it carries on business in more than one location or jurisdiction. Such procedures should be developed having regard to the training and experience of its employees and whether the firm or its employees have been previously disciplined or warned by the Market Regulator concerning the violations of the Requirements.

In developing compliance procedures, Participants must identify any exception reports, trading data and/or other documents to be reviewed. In appropriate cases, relevant information that cannot be obtained or generated by the Participant should be sought from sources outside the firm including from the Market Regulator.

The following table identifies minimum compliance procedures for monitoring trading in securities on a marketplace that must be implemented by a Participant. The compliance procedures and the Rules identified below are not intended to be an exhaustive list of the Rules and procedures that must be complied with in every case. Participants are encouraged to develop compliance procedures in relation to all the Rules that apply to their business activities.

The Market Regulator recognizes that the requirements identified in the following table may be capable of being performed in different ways. For example, one Participant may develop an automated exception report and another may rely on a physical review of the relevant documents. The Market Regulator recognizes that either approach may comply with this Policy provided the procedure used is reasonably designed to detect violations of the relevant Rule. The information sources identified in the following table are therefore merely indicative of the types of information sources that may be used.

Minimum Compliance Procedures for Trading Supervision

| <i>Rules and Policies</i> | <i>Compliance Review Procedures</i> | <i>Potential Information Sources</i> | <i>Frequency and Sample Size</i> |
|---|---|---|--|
| <i>Synchronization of Clocks Rule 10.14</i> | <ul style="list-style-type: none"> • <i>confirm accuracy of clocks and computer network times</i> • <i>remove unused or non-functional machines</i> | <ul style="list-style-type: none"> • <i>time clocks</i> • <i>Trading Terminal system time</i> • <i>OMS system time</i> | <ul style="list-style-type: none"> • <i>Daily</i> |
| <i>Audit Trail Requirements Rule 10.11</i> | <ul style="list-style-type: none"> • <i>ensure the presence of:</i> <ul style="list-style-type: none"> - <i>time stamp</i> - <i>quantity</i> - <i>price (if limit order)</i> - <i>security name or symbol</i> - <i>identity of trader (initial or sales code) -client name or account number-special instructions from any client</i> - <i>information required by audit trail requirements</i> • <i>for CFOd orders, ensure the presence of second time stamp and clear quantity or price changes</i> | <ul style="list-style-type: none"> • <i>order tickets</i> • <i>the Diary List</i> | <ul style="list-style-type: none"> • <i>quarterly</i> • <i>check 25 original client tickets selected randomly over the quarter</i> |
| <i>Electronic Records Rule 10.11</i> | <ul style="list-style-type: none"> • <i>verify that electronic order information is:</i> <ul style="list-style-type: none"> -<i>being stored</i> -<i>retrievable</i> -<i>accurate</i> | <ul style="list-style-type: none"> • <i>firm and service bureau systems</i> | <ul style="list-style-type: none"> • <i>annually</i> |
| <i>Manipulative and Deceptive Trading Rule 2.2(1), (2) Policy 2.2</i> | <ul style="list-style-type: none"> • <i>review trading activity for:</i> <ul style="list-style-type: none"> -<i>wash trading</i> -<i>unrelated accounts that may display a pattern of crossing securities</i> -<i>off-market transactions which require execution on a Marketplace</i> | <ul style="list-style-type: none"> • <i>order tickets</i> • <i>the diary list</i> • <i>new client application forms</i> • <i>monthly statements</i> | <ul style="list-style-type: none"> • <i>quarterly</i> • <i>review sampling period should extend over several days</i> |

| | | | |
|--|--|---|---|
| <p><i>Establishing Artificial Prices</i></p> <p><i>Rule 2.2(1), (3)</i></p> <p><i>Policy 2.2</i></p> | <ul style="list-style-type: none"> • review tick setting trades entered at or near close • look for specific account trading patterns in tick setting trades • review accounts for motivation to influence the price • review separately, tick setting trades by Market on Close (MOC) or index related orders | <ul style="list-style-type: none"> • order tickets • the diary list • Equity History Report (available on TSE market data website for TSE-listed securities) • closing report from Market Regulator (delivered to Participants) • new client application forms | <ul style="list-style-type: none"> • monthly • emphasis on trades at the end of month, quarter or year (for trades not on MOC or index related) • for MOC or index related orders, check for reasonable price movement |
| <p><i>Grey or Watch List</i></p> <p><i>Rule 2.2</i></p> | <ul style="list-style-type: none"> • review for any trading of Grey or Watch List issues done by proprietary or employee accounts | <ul style="list-style-type: none"> • order tickets • the diary list • trading blotters • firm Grey List or Watch List • monthly statements | <ul style="list-style-type: none"> • daily |
| <p><i>Restricted List</i></p> <p><i>Rule 2.2</i></p> <p><i>Rule 7.8</i></p> <p><i>Rule 7.9</i></p> | <ul style="list-style-type: none"> • review for any trading of restricted list issues done by proprietary or employee accounts | <ul style="list-style-type: none"> • order tickets • the diary list • trading blotters • firm Restricted List • monthly statements | <ul style="list-style-type: none"> • daily |
| <p><i>Frontrunning</i></p> <p><i>Rule 4.1</i></p> | <ul style="list-style-type: none"> • review trading activity of proprietary and employee accounts prior to: <ul style="list-style-type: none"> - large client orders - transactions that would impact the market | <ul style="list-style-type: none"> • order tickets • the diary list • equity history report | <ul style="list-style-type: none"> • quarterly • sample period should extend over several days |
| <p><i>Sales from Control Blocks</i></p> <p><i>Securities legislation incorporated by Rule 10.1</i></p> | <ul style="list-style-type: none"> • review all known sales from control blocks to ensure regulatory requirements have been met • review large trades to determine if they are undisclosed sales from control block | <ul style="list-style-type: none"> • order tickets • trading blotter • new client application form • OSC bulletin • Exchange company bulletins | <ul style="list-style-type: none"> • as required • sample trades over 250,000 shares |

| | | | |
|--|---|--|---|
| <p><i>Order Handling Rules</i></p> <p>Rule 5.1 Rule 5.3 Rule 6.3 Rule 8.1</p> | <ul style="list-style-type: none"> • review client-principal trades of 50 standard trading units or less for compliance with order exposure and client principal transactions rules • verify that orders of 50 standard trading units or less are not arbitrarily withheld from the market | <ul style="list-style-type: none"> • order tickets • equity history report • trading blotters • the diary list | <ul style="list-style-type: none"> • quarterly • sample, specifically: -trader managed orders of 50 standard trading units |
| <p><i>Order Markers</i></p> <p>Rule 6.2 Marketplace Rules incorporated by Rule 10.1 (for marketplaces on which the order is entered or executed)</p> | <ul style="list-style-type: none"> • verify that appropriate client, employee, and proprietary trade markers are being employed • ensure that client orders are not being improperly entered with pro markers • verify that appropriate order designations are included on orders | <ul style="list-style-type: none"> • order tickets • trading blotters • the diary list | <ul style="list-style-type: none"> • quarterly • samples should include one full day of trading for orders not entered through the OMS system |
| <p><i>Trade Disclosures</i> Securities legislation incorporated by Rule 10.1</p> | <ul style="list-style-type: none"> • verify appropriate trade disclosures are made on client confirmations <p>-principal -average price -related Issuer</p> | <ul style="list-style-type: none"> • trading blotters • client confirmations • the diary list • order tickets | <ul style="list-style-type: none"> • quarterly • sample should include non-OMS trades |
| <p><i>Normal Course Issuer Bids</i> Marketplace Rules (e.g. Rule 6-501 and Policy 6-501 of TSE and Policy 5.6 of CDNX)</p> | <ul style="list-style-type: none"> • review NCIBs for: <ul style="list-style-type: none"> -maximum stock purchase limits of 5% in 1 year or 2% in 30 days are observed -purchases for NCIBs are not occurring while a sale from control is being made -purchases are not made on upticks -trade reporting to Exchange (if the firm reports on behalf of issuer) | <ul style="list-style-type: none"> • order tickets • the diary list • trading blotters • new client application form | <ul style="list-style-type: none"> • quarterly |

Part 4 – Specific Procedures Respecting Client Priority and Best Execution

Participants must have written compliance procedures reasonably designed to ensure that their trading does not violate Rule 5.3 or 5.1. At a minimum, the written compliance procedures must address employee education and post-trade monitoring.

The purpose of the Participant’s compliance procedures is to ensure that pro traders do not knowingly trade ahead of client orders. This would occur if a client order is withheld from entry into the market and a person with knowledge of that client order enters another order that will trade ahead of it. Doing so could take a

trading opportunity away from the first client. Withholding an order for normal review and order handling is allowed under Rules 5.3 and 5.1, as this is done to ensure that the client gets a good execution. To ensure that the Participants' written compliance procedures are effective they must address the potential problem situations where trading opportunities may be taken away from clients.

Potential Problem Situations

Listed below are some of the potential problem situations where trading opportunities may be taken away from clients.

- 1. Retail brokers or their assistants withholding a client order to take a trading opportunity away from that client.*
- 2. Others in a brokerage office, such as wire operators, inadvertently withholding a client order, taking a trading opportunity away from that client.*
- 3. Agency traders withholding a client order to allow others to take a trading opportunity away from that client.*
- 4. Proprietary traders using knowledge of a client order to take a trading opportunity away from that client.*
- 5. Traders using their personal accounts to take a trading opportunity away from a client.*

Written Compliance Procedures

It is necessary to address in the written compliance procedures the potential problem situations that are applicable to the Participant. Should there be a change in the Participant's operations where new potential problem situations arise then these would have to be addressed in the procedures. At a minimum, the written compliance procedures for employee education and post-trade monitoring must include the following points.

Education

- Employees must know the Rules and understand their obligation for client priority and best execution, particularly in a multiple market environment.*
- Participants must ensure that all employees involved with the order handling process know that client orders must be entered into the market before non-client and proprietary orders, when they are received at the same time.*
- Participants must train employees to handle particular trading situations that arise, such as, client orders spread over the day, and trading along with client orders.*

Post-Trade Monitoring Procedures

- All brokers' trading must be monitored as required by Rule 7.1.*
- Complaints from clients and Registered Representatives concerning potential violations of the rule must be documented and followed-up.*
- All traders' personal accounts and those related to them, must be monitored daily to ensure no apparent violations of client priority occurred.*
- At least once a month, a sample of proprietary inventory trades must be compared with contemporaneous client orders.*
- In reviewing proprietary inventory trades, Participants must address both client orders entered into order management systems and manually handled orders, such as those from institutional clients.*
- The review of proprietary inventory trades must be of a sample size that sufficiently reflects the trading activity of the Participant.*

- *Potential problems found during these reviews must be examined to determine if an actual violation of Rule 5.3 or 5.1 occurred. The Participant must retain documentation of these potential problems and examinations.*
- *When a violation is found, the Participant must take the necessary steps to correct the problem.*

Documentation

- *The procedures must specify who will conduct the monitoring.*
- *The procedures must specify what information sources will be used.*
- *The procedures must specify who will receive reports of the results.*
- *Records of these reviews must be maintained for five years.*
- *The Participant must annually review its procedures.*

Part 5 – Specific Procedures Respecting Manipulative and Deceptive Activities and Reporting and Gatekeeper Obligations

Each Participant must develop and implement compliance procedures that are reasonably well designed to ensure that orders entered on a marketplace by or through a Participant are not part of a manipulative or deceptive method, act or practice nor an attempt to create an artificial price or a false or misleading appearance of trading activity or interest in the purchase or sale of a security. The minimum compliance procedures for trading supervision in connection with Rule 2.2 and Policy 2.2 are set out in the table to Part 3 of this Policy.

In particular, the procedures must address:

- *the steps to be undertaken to determine whether or not a person entering an order is:

 - o *an insider,*
 - o *an associate of an insider, and*
 - o *part of or an associate of a promotional group or other group with an interest in effecting an artificial price, either for banking and margin purposes, for purposes of effecting a distribution of the securities of the issuer or for any other improper purpose;**
- *the steps to be taken to monitor the trading activity of any person who has multiple accounts with the Participant including other accounts in which the person has an interest or over which the person has direction or control;*
- *those circumstances when the Participant is unable to verify certain information (such as the beneficial ownership of the account on behalf of which the order is entered, unless that information is required by applicable regulatory requirements);*
- *the fact that orders which are intended to or which effect an artificial price are more likely to appear at the end of a month, quarter or year or on the date of the expiry of options where the underlying interest is a listed security; and*
- *the fact that orders which are intended to or which effect an artificial price or a false or misleading appearance of trading activity or investor interest are more likely to involve securities with limited liquidity.*

A Participant will be able to rely on information contained on a “New Client Application Form” or similar know-your-client record maintained in accordance with requirements of securities legislation or a self-regulatory entity provided such information has been reviewed periodically in accordance with such requirements and any additional practices of the Participant.

While a Participant cannot be expected to know the details of trading activity conducted by a client through

another dealer, nonetheless, a Participant that provides advice to a client on the suitability of investments should have an understanding of the financial position and assets of the client and this understanding would include general knowledge of the holdings by the client at other dealers or directly in the name of the client. The compliance procedures of the Participant should allow the Participant to take into consideration, as part of its compliance monitoring, information which the Participant has collected respecting accounts at other dealers as part of the completion and periodic updating of the “New Client Application Form”.

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