

Market Integrity Notice

Guidance



Market Regulation Services Inc.
Services de réglementation du
marché inc.

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Suggested Routing

- Fixed Income
- Legal and Compliance
- Trading

Key Topics

- Canadian Unlisted Board (“CUB”)
- Debt Security
- Grey Market Trading
- Listed Security
- Off-Marketplace
- Quoted Security
- Restricted Private Placement

UMIR Provisions Referenced

- Rule 1.1 – Definitions – “marketplace”
- Rule 6.4 – Trades to be on a Marketplace

Market Integrity Notices Referenced

- Market Integrity Notice 2003-010 – *Guidance – Trades in Debt Securities* (May 5, 2003)
- Market Integrity Notice 2003-026 – *Guidance – Trades in TSX-Listed Tier 1 Financing Securities* (December 5, 2003)
- Market Integrity Notice 2005-020 – *Guidance – Obtaining a Trade Exemption or Rule Interpretation* (June 13, 2005)

SPECIFIC QUESTIONS RELATED TO TRADING LISTED DEBT AND OTHER SECURITIES

Summary

This Market Integrity Notice provides guidance on specific questions related to the obligation of a Participant under the the Universal Market Integrity Rules to trade a security listed on an exchange in Canada through the entry of orders on a marketplace.

Questions / Further Information

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SPECIFIC QUESTIONS RELATED TO TRADING LISTED DEBT AND OTHER SECURITIES

Summary

This Market Integrity Notice provides guidance on specific questions related to the obligation of a Participant under the the Universal Market Integrity Rules (“UMIR”) to trade a security listed on an exchange in Canada (an “Exchange”) through the entry of orders on a marketplace.

Background

Under Rule 6.4 of UMIR, a Participant acting as principal or agent may not trade nor participate in a trade, subject to specific enumerated exceptions, other than through the entry of an order on a marketplace. Rule 6.4 applies to trading in any security that is listed on an Exchange or quoted on a Quotation and Trade Reporting System (“QTRS”) recognized by or registered with a Canadian securities regulatory authority. Currently, if a security is listed on the Toronto Stock Exchange (“TSX”), TSX Venture Exchange (“TSXV”) or Canadian Trading and Quotation System (“CNQ”), a Participant is obligated, subject to the exemptions in Rule 6.4, to trade these securities by the entry of orders on a marketplace. Rule 1.1 of UMIR defines a marketplace as a recognized Exchange, QTRS or an alternative trading system (“ATS”) that carries on business in Canada.

In accordance with Rule 6.4, a Participant may participate in the trade of a listed security or quoted security by means other than through the entry of an order on a marketplace when the trade is:

- required or permitted by a Market Regulator to be executed other than on a marketplace;
- to adjust for an error in connection with a client order;
- executed on an organized regulated market outside of Canada that publicly disseminates details of trades in that market;
- executed as principal with a non-Canadian account or as agent between two non-Canadian accounts (provided the trade is reported to a marketplace or an organized regulated market outside of Canada that publicly disseminates detail of trades in that market);
- as a result of a redemption, retraction, exchange or conversion of a security in accordance with the terms attaching to the security;
- as a result of the exercise of an option, right, warrant or similar pre-existing contractual arrangement; or
- involving previously unissued securities.

Questions and Answers

The following is a list of questions regarding the obligations of a Participant with respect to trading in a security is listed on an Exchange and that trades on a marketplace:

1. *When is a security considered to be “listed” on an Exchange?*

The rules of the Exchange as approved by the applicable securities regulatory authority will determine when a security is to be considered “listed”. For example, for securities listed on TSX, TSXV and CNQ, a security becomes “listed” at 5:00 p.m. on the trading day immediately preceding the trading day on which the security will be available for trading.

A security that has been “conditionally approved” for listing on an Exchange is not considered a “listed security” for the purposes of UMIR and trades in that security may be executed in the over-the-counter market until such time as the security becomes “listed”.

2. *Must trades in debt securities that are listed on an Exchange be executed on a marketplace?*

Rule 6.4 provides that, subject to enumerated exemptions, a Participant, acting as principal or agent, may not trade or participate in a trade other than through the entry of an order on a marketplace. RS issued Market Integrity Notice 2003-010 – Guidance – *Trades in Debt Securities* (May 5, 2003) which specifically provides that trades in debt securities that are listed on an exchange (or quoted on a QTRS) must be executed on a marketplace pursuant to Rule 6.4. However, an exception was made for trades in certain debt securities issued by Canadian financial institutions that are listed on the TSX and that had received special exemptions from either the TSX or the Montréal Exchange prior to the original listing of the specific debt securities to allow trades in principal amounts of more than \$100,000 to be executed “off-marketplace”. Reference should be made to Market Integrity Notice 2003-026 – Guidance – *Trades in TSX-Listed Tier 1 Financing Securities* (December 5, 2003) which provides a complete list of the specific debt securities that qualify for this exemption. It should be noted that trades in the specific debt securities in the principal amount of less than \$100,000 are not covered by the special exemption and must be made through a marketplace unless the trade is made pursuant to an exemption provided under Rule 6.4.

3. *Is there an exemption to permit “over-the-counter” trading of “listed debt” issued by a government or government agency?*

No. If a debt security is listed on an Exchange or quoted on a QTRS, a Participant must trade the security by means of the entry of orders on a marketplace. For example, several series of bonds issued by the Province of Manitoba (“Builder Bonds”) and the Manitoba Hydro-electric Board (“Manitoba Hydro Bonds”) are listed on CNQ. Trades in

these series of Builder Bonds and Manitoba Hydro Bonds may not be executed over-the-counter regardless of the principal amount involved in the trades. Unless otherwise exempted from Rule 6.4, a trade in these Builder Bonds and Manitoba Hydro Bonds must be completed on a marketplace in compliance with the other provisions of UMIR that apply to the trading of listed securities generally.

4. What steps must a Participant take to facilitate an “off-marketplace” trade in listed securities that are subject to a “hold period” under securities laws?

Under Rule 6.4(b) of UMIR, Market Regulation Services Inc (“RS”) may provide a regulatory exemption to permit a Participant to execute a trade, acting as agent or principal, by means other than entry of an order on a marketplace in order to maintain a fair and orderly market. One of the most common regulatory exemptions granted by RS to Participants is to permit the Participant to be involved in an “off-marketplace” trade for securities that are subject to statutory hold period (i.e. four-month hold securities).

As set out in Market Integrity Notice 2005-020 – Guidance - *Obtaining a Trading Exemption or Rule Interpretation* (June 13, 2005), RS Market Policy counsel will generally permit the sale of “hold period” stock to be completed by a Participant by means of an “off-marketplace” transaction in order to ensure that the transaction is completed without interference from investors who may not be qualified to hold the securities (i.e. non-accredited investors).

Reference should be made to Market Integrity Notice 2005-020 for a summary of the most common exemptions granted by RS Market Policy counsel involving “off-marketplace” trades and for general guidance on the procedure for applying for an “off-marketplace” exemption.

5. What is the obligation when trading a “unit” that consists of a listed security and an unlisted security?

A listed issuer may undertake a private placement or public offering of “units” comprised of a listed security together with an unlisted security, typically a purchase warrant. If the securities which comprise the “unit” must be traded together and the “units” are not listed on an Exchange or quoted on a QTRS, trades in the units cannot be executed on a marketplace and must be executed over-the-counter. To the extent that the unit is “severable”, that is, the listed security comprising part of the unit may trade separately from the unlisted component of the unit, trades in the listed security must be completed only by means of entry of an order on a marketplace unless the trade is specifically exempted from that requirement. Trades in the unlisted security comprising part of the unit must be traded over-the-counter.

If an unlisted unit (or any unlisted component of the unit) is traded over-the-counter in the so-called “grey market”, a Participant may be required to report such trade to the Canadian Unlisted Board (“CUB”) if the purchase or sale has been made in Ontario. Reference should be made to section 154 of Ontario Regulation 1015 as amended to

determine if and by whom a trade report to CUB may be required. It should be noted that only trades in listed securities must fit into one of the enumerated exemptions under Rule 6.4 to be traded “off-marketplace. Trades involving unlisted securities do not require an “off-marketplace” exemption from RS.

Questions / Further Information

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