Market Integrity Notice

Guidance

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

October 28, 2005

No. 2005-034

Suggested Routing

- Trading
- Legal and Compliance

Key Topics

- Moving the Market
- Portfolio Trades
- Risk-Bid Tender
- Risk Premium
- Usual Agency Commission

UMIR Provisions Referenced

- Rule 1.1 – Definitions – "Net Cost" and "Net Proceeds"
- Rule 7.5 – Recorded Prices
- Rule 11.1 – General Exemptive Relief
- Policy 2.1, Just and Equitable Principles of Trade - Part 2 – Moving Markets to Execute Trades

Market Integrity Notices Referenced

- 2005-012 – Request for Comments – Provisions Respecting "Off-Marketplace" Trades (April 29, 2005)

RISK-BID TENDERS – TRADING A PORTFOLIO OF SECURITIES AS PRINCIPAL

Summary

This Market Integrity Notice provides guidance on the price restrictions imposed by the Universal Market Integrity Rules on a Participant when executing and printing trades resulting from a risk-bid tender. In particular, guidance is provided on:

- the obligation to move the prevailing market prices if the transactions can not be executed within the applicable price restrictions; and
- the interpretation of "usual agency commission" in the context of a risk-bid tender.

Questions / Further Information

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RISK-BID TENDERS – TRADING A PORTFOLIO OF SECURITIES AS PRINCIPAL

Summary

This Market Integrity Notice provides guidance on the price restrictions imposed by the Universal Market Integrity Rules ("UMIR") on a Participant when executing and printing trades resulting from a risk-bid tender. In particular, guidance is provided on:

- the obligation to move the prevailing market prices if the transactions can not be executed within the applicable price restrictions; and
- the interpretation of "usual agency commission" in the context of a risk-bid tender.

Definition of a "Risk-Bid Tender"

A risk-bid tender occurs when a Participant, acting as principal, is asked by a client to provide a set price for the purchase or sale of a portfolio of securities. One or more Participants may be asked to bid as principal on the transaction. The securities which are included in the portfolio trade may be fully disclosed or the request may be for a bid on a "blind" basis. In some cases, the Participant will be asked to provide a price for each security in the portfolio.

For the purposes of a risk-bid tender, a "portfolio trade" is a trade involving the simultaneous purchase and sale of at least 10 listed or quoted securities, provided that no single security comprises more than 20% of the total value of the transaction. Under Rule 11.1 of UMIR, Market Regulation Services ("RS") may grant an exemption for a particular transaction that fails to meet the requirements for the minimum number of securities or the maximum percentage of value to be considered a "portfolio trade" if RS believes that such a determination is not prejudicial to the public interest or to the maintenance of a fair and orderly market. For example, RS may grant an exemption if the risk-bid tender involves less than 10 securities but no security comprises more than 20% of the total value of the transaction or if the risk-bid tender involves 10 or more securities but one of the securities comprises slightly more than 20% of the total value of the transaction.

Restrictions on Recorded Prices

Rule 7.5(2) of UMIR provides that a Participant may not execute a principal trade on a marketplace if the recorded price is:

- in the case of a sale to a client, lower than net cost to the client by more than the usual agency commission for a client order of that size, or
- in the case of a purchase from a client, higher than the net proceeds to the client by more than the usual agency commission for a client order of that size.

UMIR defines "net cost" as the amount by which the sum of the total cost of the trade on the purchase of securities based on the purchase price on the marketplace and any commission charged to the client by the Participant exceeds the amount of any allowance, discount, rebate and any other benefit with a monetary value that is allowed to the client on the trade by the Participant or any other person.

The term "net proceeds" is defined as the amount by which the sum of the total proceeds of the trade on the sale of securities based on the sale price on the marketplace and the amount of any allowance, discount, rebate and other benefit with a monetary value that is allowed to the client on the trade by the Participant or any other person exceeds any commission charged to the client by the Participant.

Usual Agency Commission in a Risk-Bid Tender

Market Regulation Services Inc. ("RS") expects that the amount of the "commission" that would be charged by a Participant in a risk-bid tender will be greater than the "usual agency commission for an order of the same size" due to the additional risk assumed by the Participant in agreeing to act as principal in relation to the transaction (the "risk-bid premium"). If a risk-bid portfolio is presented to the Participant as a blind portfolio, RS expects the applicable risk-bid premium to be greater than the risk-bid premium for a fully-disclosed portfolio.

Overall, in complying with Rule 7.5(2) of UMIR in the context of a portfolio trade in a risk-bid tender, the Participant can not provide for a "negative commission". A Participant who undertakes a "risk-bid" transaction must execute:

- the sales to the client at an aggregate net cost to the client which is not greater than the aggregate recorded prices of the portfolio by more than the aggregate usual agency commission for orders of the same size (including an appropriate risk-bid premium); or
- the purchases from the client for aggregate net proceeds to the client which are not less than the aggregate recorded prices of the portfolio by more than the aggregate usual agency commission for orders of the same size (including an appropriate risk-bid premium).

In the context of a risk-bid tender, if the parties agreed upon a single price for the portfolio the Participant must calculate the aggregate net cost or net proceeds for the entire portfolio. The Participant must then compare the aggregate net cost or net proceeds of the portfolio to the aggregate recorded price for the execution of the portfolio. The difference must not be greater than the aggregate usual agency commission for orders of the same size, with an allowance made for an appropriate risk-bid premium. If the bid is structured such that there is a price agreed upon for each security comprising the portfolio, the Participant must calculate the net cost or net proceeds for each particular security included in the portfolio. The Participant must then compare the net cost or net proceeds of each security to the price for each security as recorded on the marketplace. The difference must not be greater than the usual agency commission that would be charged in relation to that individual security if that security was traded on it own outside of the portfolio (with an allowance made for an appropriate risk-bid premium).

"Moving the Market" to Execute a Risk-Bid Tender

If the agreed aggregate value of the portfolio differs from the aggregate value of the portfolio recorded by the marketplace by more than the aggregate amount of the usual agency commissions for orders of the same size (including the risk-bid premium), then the Participant, in the course of executing the trades on a marketplace, must move the market prices of one or more of the securities comprising the portfolio in an orderly manner. The Participant must move the market such that the difference between the agreed upon aggregate value of the portfolio and the aggregate value of the portfolio as recorded on the marketplace does not exceed the aggregate usual agency commission that would be charged on such trades (including the risk-bid premium).

A Participant is entitled to utilize its discretion in determining:

- the particular securities comprising the portfolio for which the market price will be moved; and
- the amount of price movement for any individual security comprising the portfolio.

All executions must be made at prices which are in compliance with UMIR requirements. In moving the price of any security, the Participant must be aware of the provisions of Part 2 of Policy 2.1, which currently sets out guidelines relating to moving the market to execute a trade. This Part provides that any Participant or Access Person desiring to move the market for a security more than the prescribed amount (more than $1 for a security selling below $20 or more than $2 for a security selling for $20 or more) must obtain the prior approval of a Market Regulator and must move the prevailing market prices in an orderly manner in accordance with directions from a Market Integrity Official.

One of the proposed amendments to UMIR described in Market Integrity Notice 2005-012 – *Request for Comments – Provisions Respecting "Off-Marketplace" Trades* (April 29, 2005) would replace the current dollar thresholds for determining the obligation to move the market with a sliding scale. If the price would move the market the greater of 10 price increments and either 5% above the best ask price or 5% below the best bid price, the Participant would be required to enter orders over a period of not less than 5 minutes in order to move the market in an orderly fashion. In keeping with the notion of a sliding scale, a period of not less than 10 minutes to "move the market" would be required if the price movement is more than 10%. The proposed amendments would also limit the obligation to a Participant or Access Person entering a pre-arranged trade or intentional cross (rather than "any" trade as is currently the requirement).

Example

The following example is provided only for guidance on the interpretation of the application of the UMIR provisions to a risk-bid tender.

If a client asked a Participant to purchase the portfolio of securities outlined in the following table, the aggregate of the "printed" or recorded price can not be more than $2,645 higher than the agreed price paid to the client. In this example, $2,645 is the sum of the aggregate “usual commission” that the Participant would charge for the individual trades (taking into consideration the risk-bid premium). If the prevailing markets were such that the portfolio could not be printed at an aggregate value at or between $835,000 (the aggregate agreed price) and $837,645 (the aggregate agreed price plus the aggregate usual agency commission including the risk-bid premium), the Participant would be obligated to move the market price for one or more of the securities such that the aggregate of the recorded prices for the portfolio would fall within the acceptable range.

Security	Order Size in Portfolio	Per Share			Total		
		Agreed Price	Recorded Marketplace Price	Usual Agency Commission (including Risk-Bid Premium)	Agreed Price	Recorded Marketplace Price	Usual Agency Commission (including Risk-Bid Premium)
ABC	10,000	$10.00	$10.05	$0.03	$100,000	$100,500	$300
DEF	500	$20.00	$19.90	$0.10	$10,000	$9,950	$50
GHI	7,000	$15.00	$15.01	$0.04	$105,000	$105,070	$280
JKL	3,000	$10.00	$10.00	$0.05	$30,000	$30,000	$150
MNO	5,000	$5.00	$5.05	$0.05	$25,000	$25,250	$250
PQR	10,000	$15.00	$15.05	$0.03	$150,000	$150,500	$300
STU	12,500	$10.00	$9.99	$0.03	$125,000	$124,875	$375
VWX	10,000	$15.00	$14.98	$0.03	$150,000	$149,800	$300
YZA	8,000	$5.00	$5.00	$0.03	$40,000	$40,000	$240
BCD	20,000	$5.00	$5.05	$0.02	$100,000	$101,000	$400
			Aggregate for Portfolio		**$835,000**	**$836,945**	**$2,645**

Questions / Further Information

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