



Ontario
Securities
Commission

Commission des
valeurs mobilières
de l'Ontario

P.O. Box 55, 19th Floor
20 Queen Street West
Toronto ON M5H 3S8

CP 55, 19^e étage
20, rue queen ouest
Toronto ON M5H 3S8

**IN THE MATTER OF THE SECURITIES ACT,
R.S.O. 1990, c. S.5, AS AMENDED**

- and -

**IN THE MATTER OF HAHN INVESTMENT
STEWARDS & CO. INC.**

- and -

**IN THE MATTER OF A DECISION OF THE INVESTMENT INDUSTRY
REGULATORY ORGANIZATION OF CANADA**

REASONS AND DECISION

Hearing: March 12, 2009

Decision: October 19, 2009

Panel: Patrick J. Lesage, Q.C. - Commissioner and Chair of the Panel
Suresh Thakrar - Commissioner
Margot C. Howard - Commissioner

Counsel: Jeffrey Larry - For Hahn Investment Stewards & Co. Inc.
Danny Kastner

Brian Gover - For Investment Industry Regulatory
Andrea Gonsalves Organization of Canada

Yvonne B. Chisholm - For the Ontario Securities Commission
Matthew Thompson

Luis Sarabia - For TSX Inc.
Linus Yung

TABLE OF CONTENTS

I. OVERVIEW.....	1
A. INTRODUCTION.....	1
B. THE PARTIES	2
1. <i>Hahn Investment Inc.</i>	2
2. <i>IIROC</i>	2
3. <i>The TSX</i>	2
4. <i>Staff</i>	2
II. BACKGROUND.....	2
A. TRADING ON THE TSX	2
1. <i>The TSX's role with respect to trading on the Exchange</i>	2
2. <i>IIROC's role with respect to trading on the Exchange</i>	3
3. <i>The opening of trading on the Exchange</i>	3
B. ETFs	3
C. CHRONOLOGY OF RELEVANT EVENTS.....	4
1. <i>Events before trading on October 14, 2008</i>	4
2. <i>Events during trading on October 14, 2008</i>	5
3. <i>Events after trading was halted on October 14, 2008</i>	5
4. <i>IIROC's Decision</i>	6
III. THE ISSUES	8
IV. ANALYSIS	9
A. WHAT IS THE REGULATORY FRAMEWORK AND APPROPRIATE STANDARD OF REVIEW UNDER SECTION 21.7 OF THE ACT?.....	9
1. <i>Parties' Submissions</i>	9
2. <i>Law</i>	12
3. <i>Analysis</i>	13
4. <i>Conclusion</i>	14
B. DID IIROC ERR IN LAW OR PROCEED ON AN INCORRECT PRINCIPLE BY FAILING TO PROPERLY APPLY ITS OWN POLICIES AND PROCEDURES?.....	15
1. <i>Parties' Submissions</i>	15
2. <i>Law</i>	18
3. <i>Analysis</i>	18
4. <i>Conclusion</i>	24
C. DID IIROC OVERLOOK ANY MATERIAL EVIDENCE?	24
1. <i>Parties' Submissions</i>	24
2. <i>Law</i>	26
3. <i>Analysis</i>	26
4. <i>Conclusion</i>	29
D. IS THERE NEW AND COMPELLING EVIDENCE BEFORE THE COMMISSION THAT WAS NOT PRESENTED TO IIROC?.....	29
1. <i>Parties' Submissions</i>	29
2. <i>Law</i>	31
3. <i>Analysis</i>	31
4. <i>Conclusion</i>	35
V. CONCLUSION	36
VI. REASONS OF COMMISSIONER THAKRAR (DISSENTING IN PART):.....	37
A. OVERVIEW	37
B. IS THERE NEW AND COMPELLING EVIDENCE BEFORE THE COMMISSION THAT WAS NOT PRESENTED TO IIROC OR KNOWN TO IIROC?.....	37
1. <i>The underlying security of XIN is a single NYSE listed security, and not many securities</i>	37
2. <i>Prior testified that the information regarding EFA, being the underlying asset for XIN, was "new"</i>	38

3.	<i>Prior testified that the information regarding EFA, being the underlying asset for XIN, as “very significant and material” information</i>	39
4.	<i>The availability of the new information regarding XIN/EFA would have changed IIROC’s decision</i>	42
5.	<i>Conclusion</i>	44
C.	RESPONSIBILITY FOR UPDATING INFORMATION	45
D.	THE APPROPRIATE REMEDY	45
1.	<i>Parties’ submissions on the XIN trades at issue</i>	45
2.	<i>Submissions on amendments to policies, rules and procedures re ETFs</i>	47
3.	<i>Analysis</i>	49
E.	CONCLUSION	51
F.	OTHER MATTERS	52

REASONS AND DECISION

I. OVERVIEW

A. Introduction

[1] On March 12, 2009, we heard an application (the “Application”) by Hahn Investment Stewards & Co. Inc. (“Hahn Investment”) for a Hearing and Review of the decision of the Investment Industry Regulatory Organization of Canada (“IIROC”) made October 17, 2008 refusing to vary or cancel certain trades made in Exchange Traded Funds (“ETFs”).

[2] Hahn Investment requests a variation or cancellation of the ETF trades made on its behalf on October, 14, 2008 between 9:30 a.m. and the suspension of trading in some of these ETFs commencing around 9:36 a.m., because of the significant divergence that day between the underlying values of the indices that the ETFs track and the traded prices of the ETFs on the Toronto Stock Exchange (the “Exchange”).

[3] On October 14, 2008, the day of the trades at issue, Hahn Investment’s broker-dealer, Penson Worldwide (“Penson”) requested that IIROC rule that the trades were unreasonable and thus cancel or reprice them, pursuant to paragraph 10.9(d) of the Universal Market Integrity Rules (“UMIR”). Chris Lewer (“Lewer”), IIROC’s Manager of Market Supervision refused Penson’s request (the “Initial Decision”).

[4] On October 15, 2008, Wilfred Hahn (“Hahn”), the President and Chief Executive Officer of Hahn Investment contacted Michael Prior (“Prior”), Vice President Surveillance of IIROC, asking him to reconsider the Initial Decision. On October 16, 2008, pursuant to this request, Prior conducted an internal review of the Initial Decision and concluded that the decision was correct (the “Internal Review”).

[5] On October 16, 2008, pursuant to Rule 11.3 of UMIR, Barclays Global Investors Canada Limited (“Barclays”), the manufacturer of the ETFs at issue, made a formal appeal to Rosemary Chan (“Chan”), the Senior Vice-President and General Counsel of IIROC of the Initial Decision. On October 17, 2008, IIROC made its appeal decision which denied Barclays’ appeal (the “Chan Decision”).

[6] Hahn Investment, through its application filed on November 13, 2008, seeks a Hearing and Review of the Chan Decision before a panel of the Ontario Securities Commission (the “Commission”). The Application requires us to consider, based on the facts and circumstances in this case, whether we should confirm IIROC’s decision or make such other decision as proper pursuant to section 21.7 of the *Securities Act*, R.S.O. 1990, c. S.5, as amended (the “Act”).

[7] It is clear that the trade fills that occurred were within the parameters of how they were entered into the market from a technical basis. It is also clear that the results of these trades were not what was expected and we accept that this is not a case of an Investment Counsel and Portfolio Manager (“ICPM”) or buyer trying to cancel a trade as a result of a “bad fill”. We must decide whether we are prepared to substitute our decision for IIROC’s decision.

B. The Parties

1. Hahn Investment Inc.

[8] Hahn Investment is a wealth manager that was founded in 2001, and is licensed as an ICPM in Ontario and British Columbia. It has a head office located in Kelowna, British Columbia and a regional office located in Oakville, Ontario. Hahn Investment manages portfolios of assets for individual investors. Hahn Investment employs an investment strategy comprised exclusively of ETFs.

2. IIROC

[9] IIROC is a self-regulatory organization (“SRO”) that oversees all investment dealers and trading activity on debt and equity marketplaces in Canada. IIROC was formed in 2008 through the consolidation of Market Regulation Services Inc. (“RS”) and the Investment Dealers Association of Canada (“IDA”).

3. The TSX

[10] TSX Inc. (“TSX”) is a company organized under the *Business Corporations Act*, R.S.O. 1990, c. B.16. The TSX owns and operates the Exchange and TSX Venture Exchange. The Exchange is a virtual marketplace where participating organizations of the Exchange “meet” to buy and sell securities on a computer-based platform in what is known as a “central limit order book”.

[11] The TSX sought and obtained intervenor status in this proceeding to address assertions regarding its conduct with regards to the ETFs that are the subject of the Application.

4. Staff

[12] Staff of the Commission (“Staff”) is also a party to the Hearing and Review proceeding before the Commission. Staff’s written and oral submissions focused on the appropriate standard of review that the Commission should apply, and on the appropriate remedy, if any, that the Commission should impose in the circumstances.

II. BACKGROUND

A. Trading on the TSX

1. The TSX’s role with respect to trading on the Exchange

[13] The TSX facilitates trading on both the Exchange and the TSX Venture Exchange by managing the computer-based central limit order book, including monitoring the daily opening of trading in accordance with the Exchange’s rules.

2. IIROC's role with respect to trading on the Exchange

[14] The TSX has delegated its authority over market regulation services to IIROC. IIROC sets and enforces market integrity rules, the UMIR, regarding trading activity on Canadian equity marketplaces. Among its responsibilities, IIROC has authority under Rule 10.9(1)(d) to “vary or cancel any trade which, in the opinion of [an IIROC] Market Integrity Official, is unreasonable or not in compliance with” the UMIR. The authority under Rule 10.9(1)(d) is referred to as a “Trade Ruling”.

3. The opening of trading on the Exchange

[15] Before reviewing the relevant facts, it is necessary to outline certain background information regarding trading on the TSX. This information is necessary for a proper understanding of the relevant facts.

[16] Trading on the Exchange normally opens at 9:30 a.m. and closes at 4:00 p.m. (EST) every business day. Participating organizations may place orders for any security beginning at 7:00 a.m. prior to the opening of trading on a given day. Orders placed before the opening of trading are not immediately filled. If these orders are “market buy” they are filled at the lowest existing offer to sell or the Calculated Opening Price (the “COP”) once the market opens. If these orders are “limit buy” they can be filled up to their specified limit price.

[17] The COP is a figure which is determined by a computer program, during the pre-opening of the Exchange. The COP of a particular security is based on the buy and sell orders in the central limit order book prior to opening.

[18] An updated COP value of each security is continuously provided to market participants, prior to the opening of trading. During this time, participating organizations are permitted to adjust or withdraw orders if the COP varies from their desired execution price.

[19] The Exchange's computer system automatically prompts the TSX's Trading Services Team if the COP of a particular security exhibits significant volatility relative to its previous closing price (“Opening Alert”) or if a single order would create significant volatility relative to the last completed trade (“Trade Freeze”).

B. ETFs

[20] One type of security traded on the Exchange is an ETF. An ETF is a hybrid investment vehicle in that it is both an open-ended fund and a listed security which trades on a public stock exchange. ETFs are securities that state legal right of ownership over part of a basket of other securities. ETFs usually replicate the composition of the stocks that comprise an index such as the S&P 500. During 2008, the aggregate value of trades in ETFs on the Exchange was \$152 billion, as stated on the TSX's website.

[21] A unique characteristic of ETFs is the fact that, pursuant to an agreement with the manufacturer of the ETF, a registered broker or a dealer, generally referred to as a “Designated Broker” and sometimes referred to as an “Authorized Participant” may create shares of the ETF

for sale and will generally purchase the individual stocks contained in the ETF basket of stocks in the relevant market to offset their liability. The creation process and a similar redemption process helps to keep the share price of an ETF very close to the net asset value (“NAV”) of the ETF.

[22] The ETFs at issue are:

- (a) XIN, an ETF, which we now know owns a single security, EFA. EFA is XIN’s U.S. counterpart which trades on the NYSE during the same hours that XIN trades on the Exchange. EFA tracks the Morgan Stanley Capital International Europe Australasia and Far East stock index (the “MSCI EAFE”). The MSCI EAFE is commonly used as a measure of broad international stock performance;
- (b) XSP is an ETF that tracks the Standard & Poor (“S&P”) 500 index of stocks. The S&P 500 index is comprised of 500 large cap stocks which trade actively in the United States;
- (c) XIC is an ETF that tracks the S&P/TSX Capped Composite index of stocks. This index is comprised of a selection of the largest and most liquid securities on the TSX; and
- (d) XFN is an ETF that tracks the S&P/TSX Capped Financial index of stocks.

C. Chronology of Relevant Events

1. Events before trading on October 14, 2008

[23] On Monday, October 13, 2008, the Exchange was closed for trading for Canadian Thanksgiving Day. On the same day, the Dow Jones Industrial Average, in the United States, advanced 976 points, the largest advance ever during a session and the largest advance on a percentage basis since 1932.

[24] On that day, Tyler Mordy (“Mordy”) of Hahn Investment contacted Penson with a request to execute a number of trades on the Exchange and the New York Stock Exchange (“NYSE”). As the Canadian markets were closed, only the U.S. trades were effected. Mordy instructed Penson’s trader Farah Kamal (“Kamal”) to enter the Canadian orders at the opening of trading on October 14, 2008.

[25] In the written transcripts of the phone conversations between Mordy and Kamal on October 13 and 14, 2008, prior to the opening of trading on the Exchange, Mordy requested that Kamal place the requested orders at “fill upon opening” to get the opening prices for each ETF on October 14, 2008 but asked Kamal to “work” the orders and indicates that he did not want to move the market. Kamal cautioned that the volume of the orders placed by Mordy was very large and offered to refer him to a specialist, however there is no record of a conversation between Mordy and a Penson specialist.

[26] Given the extreme market movements on October 13, 2008 in the United States, while the Exchange was closed, it was anticipated that there would be significant market activity on

October 14, 2008. In particular, the TSX anticipated that a large number of buy offers would significantly drive up the COP for most if not all stocks on October 14, 2008.

[27] Prior to the opening of trading on the Exchange on October 14, 2008, a large number of securities produced Opening Alerts. Because of the significant number of Opening Alerts, the Trading Services Team was physically unable to investigate and clear all the alerts before opening. All of the ETFs in issue in this proceeding caused Opening Alerts.

2. Events during trading on October 14, 2008

[28] Penson entered its first limit buy order for 75,000 shares of XIN at \$25.00 at 8:44:52 a.m., 45 minutes before the Exchange was scheduled to open. The COP of XIN had steadily increased from \$22.20 at 8:00 a.m. to \$25.00 after Penson placed this order. Just prior to the placement of this order, the COP was \$24.00. The COP remained constant at \$25.00 until Penson placed a second limit buy order for an additional 50,000 shares of XIN at \$28.00. The placement of this limit buy order above the COP of \$25.00 at that point increased the COP to \$28.00, until additional sell orders entered the market that reduced the COP back to \$25.00 at 9:29:33 a.m. At 9:33:43 a.m., just before XIN was cleared to open, Penson entered its third limit buy order for 55,900 shares of XIN at \$23.00 (for a total of 180,900 shares valued at approximately \$4.5 million).

[29] As a result of the market volatility, an Opening Alert for XIN was triggered and the TSX decided not to clear XIN to trade at 9:30 a.m. XIN was cleared to open at 9:34:30 a.m. The decision to clear XIN to open was based, in part, on the fact that the TSX believed the COP of XIN to be showing reasonable stability.

[30] The TSX considered the COPs of XIC, XIU and XFN stable and cleared each ETF to open at 9:30 a.m. XSP was cleared to open at 9:31:34 a.m.

[31] By 9:36 a.m., market volatility had caused XIN, and other securities, to trigger Trade Freezes. The backlog of Trade Freezes prevented TSX staff from releasing delayed and frozen stocks and forced a halt in trading of XIN from 9:36 a.m. to 11:30 a.m. Like XIN, market volatility triggered a Trade Freeze on XIC, XIU and XFN and due to the backlog of Trade Freezes, trading in these ETFs was also halted from 9:36 a.m. to 11:30 a.m.

[32] Prior to trading being halted, Penson had buy orders for 125,000 shares of XIN filled at \$25.00 each. Once Mordy learned of the prices at which the ETFs had been purchased, he requested that remaining unfilled orders be cancelled and both Penson and Hahn Investment personnel began contacting IIROC.

3. Events after trading was halted on October 14, 2008

[33] When trading of XIN resumed, the trading price was \$17.00.

[34] At 11:47 a.m. on October 14, 2008, Joe Skaf (“Skaf”) of Penson called IIROC to request a Trade Ruling on the opening trades of XIN. IIROC surveillance considered the request. Lewer made the decision that the trades would stand.

[35] Lewer was empowered to make such a ruling by virtue of paragraph 10.9(1)(d) of the UMIR– Power of Market Integrity Officials, which states the following:

(1) A Market Integrity Official may, in governing trading in securities on the marketplace:

...

(d) vary or cancel any trade which, in the opinion of such Market Integrity Official, is unreasonable or not in compliance with UMIR or any Policy;

[36] In his request to Prior, on October 15, 2008, Hahn outlined Hahn Investment’s position on the alleged mispricing and Penson’s actions and provided Prior with an account of the events that led up to the trades in dispute. When Prior received Hahn’s request, Prior was in Philadelphia with other IIROC Staff, attending a conference.

[37] On October 16, 2008, Penson contacted IIROC and asked for a reconsideration of the Initial Decision. Penson provided IIROC with email and telephone recordings which outlined the correspondence between Hahn Investment and Penson personnel regarding the trades. Prior had electronic access to the emails and telephone recordings submitted by Hahn Investment. Prior’s Internal Review concluded that Lewer had properly ruled that the trades were not unreasonable after considering IIROC’s internal policies on the exercise of IIROC’s authority under Rule 10.9 of UMIR, and all the information that was available, including all the information provided by Hahn Investment and Penson.

[38] Later that same day, Barclays, on behalf of RBC DS, MD Management, Edward Jones and Hahn Investment, appealed to Chan under Rule 11.3 of UMIR, for a review of the Initial Decision (and implicitly Prior’s Internal Review). On October 17, 2008, Chan concluded that the trades at issue were not unreasonable and thus, decided to let the Initial Decision stand.

[39] Barclays appeal to Chan was made pursuant to Rule 11.3 of UMIR – Review or Appeal of Market Regulator Decisions, which states the following:

Any person directly affected by any direction or decision of a Market Integrity Official or a Market Regulator made in connection with the administration of UMIR shall request a review of the direction or decision by an executive officer of the Market Regulator prior to applying to the applicable securities regulatory authority for a hearing and review or appeal.

[40] On November 13, 2008, Hahn Investment filed this Application, seeking a review of the Chan Decision.

4. IIROC’s Decision

[41] In its request to Chan for a review of the Initial Decision pursuant to Rule 11.3 of the UMIR, Barclays put forward the following arguments:

- (a) XIN, XFN, and XIC opened at premiums to their previous closing price of 67%, 27% and 36% respectively, and maintained these levels during their brief trading session;
- (b) To ensure the integrity of any marketplace, the rules and procedures which govern market opening and freezing must apply in a consistent, non-discretionary and transparent manner and must result in predictable outcomes;
- (c) In the abnormal circumstances that prevailed on the morning of October 14, these standards were clearly not met and the result was:
 - (i) Markets which should have been frozen were permitted to open; and
 - (ii) The price levels at which those markets opened, and at which participants subsequently traded, were unreasonable and would not have prevailed in an appropriately ordered market opening.
- (d) The only appropriate recourse in this case is the re-pricing or reversal of all trades which took place under these circumstances.

[42] By letter dated October 17, 2008, Chan communicated her decision to let the Initial Decision stand.

[43] With respect to XFN and XIC, Chan stated the following:

I have concluded that the trades in the ETFs trading under the symbols XFN and XIC were not unreasonable, given the prices at which those trades occurred and prevailing market conditions. The prices at which the trades occurred in these securities are within the acceptable parameters set out in our internal policies.

[44] With respect to XIN, Chan stated that while the prices at which the trades in XIN occurred initially appear to raise concerns about the reasonableness of those trades, the Initial Decision was correct based on the following:

- (a) By its nature, an ETF does not trade at the net asset value of the fund, but trades at a premium or discount to net asset value based on investor sentiment;
- (b) During the pre-open on October 14, the S&P/TSX futures indicated that the Exchange was going to move significantly higher when it opened;
- (c) XIN indicated a COP of \$24.00 prior to the entry of the first client order on behalf of Hahn Investment by Penson at approximately 8:45 a.m.;
- (d) In observing the COP of \$24.00, Penson entered a portion of the Hahn Investment order with a limit of \$25.00. Penson indicated to Mordy, of Hahn Investment, that the size of the order would likely impact the opening price and sought guidance as to how it should proceed. Hahn Investment

was specific in that it desired a fill at the opening price if at all possible but not to “chase” the ETF. Following this conversation, Penson entered an additional order on behalf of Hahn Investment to buy XIN with a limit of \$28.00. This order did not significantly impact the COP which rose slightly then returned to the \$25.00 level shortly afterwards. Shortly after 9:30 a.m., the S&P TSX Composite Index was up approximately 16% over the previous closing level and appeared to be climbing higher. It was under these circumstances that Penson executed additional trades on Hahn Investment’s behalf;

- (e) In cases where hedge trades in the underlying securities cannot readily be executed (as is the case for XIN because most of the securities that underlie XIN are foreign), spreads for ETFs generally widen. In such circumstances, pricing of such ETFs is impacted more by supply and demand than it is by the value of the underlying securities. The COP demonstrated that there was strong demand for XIN during the pre-open on October 14; and
- (f) The determination under paragraph 10.9(1)(d) of the UMIR as to whether or not a trade is unreasonable is made as of the time at which the trade occurred. Given the circumstances, outlined above, the trades by Hahn Investment in XIN were not unreasonable, notwithstanding the price at which those trades occurred.

[45] Barclays’ appeal did not address XSP.

[46] Following the Chan Decision, on November 13, 2008, Hahn Investment filed this Application seeking a Hearing and Review of the Chan Decision. The Application raises several issues which we have set out below.

III. THE ISSUES

[47] When considering the Application, we must consider the following issues:

- (a) What is the regulatory framework and appropriate standard of review under section 21.7 of the Act?
- (b) Did IIROC err in law or proceed on an incorrect principle by failing to properly apply its own Policies and Procedures?
- (c) Did IIROC overlook any material evidence?
- (d) Is there new and compelling evidence before this Commission that was not presented to IIROC?
- (e) In the event that we were to determine that IIROC’s decision requires to be reviewed, what is the appropriate remedy?

IV. ANALYSIS

A. What is the regulatory framework and appropriate standard of review under section 21.7 of the Act?

1. Parties' Submissions

a) Hahn Investment

[48] In its written submissions, Hahn Investment submits that by reason of subsection 21.7(2) of the Act, the Commission exercises original jurisdiction when exercising its power of review under subsection 21.7(1) and thus, is free to substitute its decision for that of IIROC, without deference. However, during oral submissions, Hahn Investment agreed that deference should be given to IIROC's decisions.

[49] Hahn Investment submits that the Commission is particularly free to substitute its own decision where the Commission has the benefit of a much more complex and extensive record than was before IIROC as it is in a better position to make a decision. Hahn Investment cites *Investment Dealers Assn. of Canada v. Taub.* (2007), 30 O.S.C.B. 4739 at paras. 26-27 ("*Taub*") and *Investment Dealers Assn. of Canada v. Boulieris* (2005), 2005 CarswellOnt 1995 (Ont. Div. Ct.) at para. 19; affirming *Investment Dealers Assn. of Canada v. Boulieris* (2004), 27 O.S.C.B. 1597 ("*Boulieris*") in support of its position.

[50] Hahn Investment submits that the Commission has held that it will interfere with a decision of an SRO, such as IIROC, if one of the following grounds is present:

- (a) the SRO has proceeded on an incorrect principle;
- (b) the SRO has erred in law;
- (c) the SRO has overlooked some material evidence;
- (d) new and compelling evidence is presented to the Commission that was not presented to the SRO; or
- (e) the SRO's perception of the public interest conflicts with that of the Commission.

[51] Hahn Investment cites *Taub*, *Boulieris* and *Re Canada Malting Co.* 1986, 9 O.S.C.B. 3566 at 3587 ("*Re Canada Malting*") in support of this submission.

[52] Hahn Investment submits that it is clear that IIROC made fundamental legal errors that require IIROC's decision be reversed. Hahn Investment further submits that the integrity of the capital markets and confidence in the capital markets will be compromised if the unreasonable trades are allowed to stand.

b) IIROC

[53] IIROC submits that its authority under subrule 10.9(1) of the UMIR is a discretionary one to be exercised according to its mandate and expertise.

[54] IIROC submits that the established standard of review is reasonableness. IIROC relies on the definition of deference provided by the Supreme Court of Canada in *New Brunswick (Board of Management) v. Dunsmuir*, [2008] 1 S.C.R. 190, at paras. 48-49.

[55] IIROC submits that the Commission should accord deference to factual determinations of the SRO that are central to the SRO's specialized competence, and should not lightly set aside a decision of an SRO that involves such determinations. IIROC cites *Re Shamblau* (2002), 25 O.S.C.B. 1850 in support of this position.

[56] IIROC submits that it has developed a considerable expertise with respect to the issue of market integrity and that a decision falling within the scope of that expertise, such as that under review, merits appropriate deference on review.

[57] IIROC submits that the circumstances in which it must make Trade Rulings support a deferential standard of review. IIROC submits that it must make Trade Rulings within a few minutes of the trade but at worst before settlement, which usually happens within days of the trade, because of the disruption to trading that will result if it decides to cancel or vary a trade.

[58] IIROC submits that timely decisions are central to market integrity as investors must have confidence that a trade, once made, will be permanent. IIROC further submits that the more time that passes before a trade is varied or cancelled, the more it will prejudice a party who is not responsible for any error and thus rulings to cancel or vary trades pose a particularly significant risk to market integrity.

[59] IIROC submits that it cannot be empowered and required to make a decision in real time and then have that decision second-guessed based on hindsight and on an expanded record. Accordingly, IIROC submits that the heightened record available to the Commission in this review proceeding should not be considered significant, notwithstanding the Commission's original jurisdiction.

[60] IIROC submits that applying the reasonableness standard of review, the Commission has no basis on which to interfere with the Chan Decision. IIROC submits that it followed the principles as set out in UMIR and its procedures manual and made no error in law.

[61] IIROC submits that given the general market conditions at the time of Hahn Investment's Trade Ruling request, had it made the Trade Ruling requested in this case, the floodgates would not have just opened, they would have broken off entirely. IIROC further submits that deference is essential to allow it to properly perform its regulatory functions in times of unprecedented market volatility, such as those that existed on the day of this trade.

c) The TSX

[62] The TSX agrees with IIROC that the Commission should exercise a deferential standard of review for a Trade Ruling.

[63] The TSX submits that where IIROC is called upon to review a trade, its decision should be seen to be authoritative and final only to be overturned in the most exceptional of circumstances.

d) Staff

[64] Staff agrees with Hahn Investment's submission that in *Re Canada Malting*, the Commission established the principles that dictate when it will intervene pursuant to an application filed under section 21.7 of the Act.

[65] Staff submits that in *Re Canada Malting*, the Commission made clear that it would intervene if one of the five grounds was made out. Staff further submits that the Commission described the applicants as having a "heavy burden" of showing that their case fits within one of five grounds established in *Re Canada Malting*.

[66] Staff submits that highly technical decisions are more likely to engage the specific expertise of the SRO and in respect of those decisions, a more deferential posture on the part of the Commission will generally be appropriate.

[67] Staff submits that the Chan Decision was a highly technical, factually specific and time sensitive one which engaged IIROC's expertise. Staff further submits that a review of Commission hearing and review cases suggests that this is the sort of decision which should not be lightly set aside.

[68] Staff cites *Re Security Trading Inc.* (1994), 17 O.S.C.B. 6097 ("*Security Trading*") in support of its position. Staff submits that *Security Trading* involved a review of a decision by the Board of Governors of the TSX by which it revoked the rights and privileges of membership of Security Trading Inc. The Commission found that given that *Security Trading* involved the suitability of a firm for membership with the TSX, it should defer to the decision of the TSX.

[69] Staff also cites *Re Cavalier Energy Ltd.* (1991), 14 O.S.C.B. 1480 ("*Cavalier Energy*") in support of its position. Staff submits that in *Cavalier Energy* the TSX's Board of Governors imposed certain conditions on its approval of the original listing of Cavalier Energy Limited on the Exchange. The Commission expressed its reluctance to substitute its own view for that of the TSX, if the conclusions of the TSX were based on some evidence that could support its decision, acting reasonably.

[70] Staff submits that, although the Commission did not defer to the TSX in *Re HudBay Minerals Inc.* (2009), 32 O.S.C.B. 1089, the Commission affirmed that it generally defers to the judgment of the TSX, particularly in the areas of the TSX's expertise.

[71] Staff also submits that though the Commission intervened in *Re Shambleau* and intervened in part in *Boulieris*, in both cases the Commission affirmed that it will accord deference to factual determinations central to the specialized competence of recognized stock exchanges and SROs.

[72] Finally, Staff cites *Re Berry* (2008), 31 O.S.C.B. 5441 as another example of the Commission affirming its “restraint approach” to intervening in the decisions of SROs even though in that case the Commission did intervene on the grounds that the SRO in that case did not have unique or special expertise in the contested issue.

[73] Staff submits that generally speaking, the cases demonstrate that the Commission has been more likely to intervene when broad based principles are at issue, and less likely to intervene when the SRO has made a technical decision which requires it to call upon the SRO’s expertise.

[74] While Staff is generally in agreement with IIROC’s submissions on the standard of review, Staff submits that the Commission should not import a reasonableness standard akin to that employed by courts in reviewing decisions of administrative tribunals. In Staff’s view, the existing body of Commission cases provide ample guidance for the determination and application of the standard of review to the Chan Decision.

[75] Staff submits that the Chan Decision under review involves a technical issue squarely within the expertise of IIROC and thus, the Commission should not lightly interfere with the Chan Decision.

2. Law

[76] Section 21.7 of the Act empowers the Commission to hold a hearing and review of a direction, decision, order or ruling of an SRO such as IIROC. Section 21.7 of the Act states:

Review of decisions

21.7 (1) The Executive Director or a person or company directly affected by, or by the administration of, a direction, decision, order or ruling made under a by-law, rule, regulation, policy, procedure, interpretation or practice of a recognized stock exchange, recognized self-regulatory organization, recognized quotation and trade reporting system or recognized clearing agency may apply to the Commission for a hearing and review of the direction, decision, order or ruling.

Procedure

(2) Section 8 applies to the hearing and review of the direction, decision, order or ruling in the same manner as it applies to a hearing and review of a decision of the Director.

[77] Section 8 of the Act outlines the procedures that must be followed and the powers of the Commission when conducting a hearing and review. Subsection 8(3) grants the Commission the

power to confirm the decision being reviewed or make any other decision it deems proper. Subsection 8(3) of the Act states:

Power on review

- (3) Upon a hearing and review, the Commission may by order confirm the decision under review or make such other decision as the Commission considers proper.

3. Analysis

[78] IIROC, the TSX and Staff all agree, in both their oral and written submissions, that the Commission should generally show deference to a decision of an SRO. While Hahn Investment states in its written submissions that the Commission is “free to substitute its judgment for that of IIROC, without deference”, in its oral submissions Hahn Investment agreed that the Commission should show deference to these decisions.

[79] As Staff submitted to us, there exists an extensive body of case law of the Commission, dealing with standard of review that provides ample guidance for the determination and application of the standard of review to the Chan Decision.

[80] *Re Canada Malting* stands as the foundational case of the Commission, on the standard of review. In that case, the Commission outlined the five grounds on which it might intervene with a decision of an SRO. The SRO in *Re Canada Malting* was the TSX as it then was. The five grounds established by the Commission in *Re Canada Malting* are:

- (a) the self-regulatory entity has proceeded on an incorrect principle;
- (b) the self-regulatory entity has erred in law;
- (c) the self-regulatory entity has overlooked some material evidence;
- (d) new and compelling evidence is presented to the Commission that was not presented to the self-regulatory entity; or
- (e) the self-regulatory entity’s perception of the public interest conflicts with that of the Commission.

Re Canada Malting, supra at para. 24.

[81] We affirm that the Commission will not intervene simply because it may disagree with a decision (see *Security Trading, supra* at para. 37).

[82] More recently, in *Re Berry*, the Commission affirmed that we will employ a restrained approach to intervening in decisions of SROs, notwithstanding our broad powers of review (*Re Berry, supra* at para. 62).

[83] Deference to factual determinations made by SROs where those factual determinations are based on the specialized competences of the SRO will be the norm, consistent with our broad powers of review (*Re Shambleau, supra* at para. 15 and *Boulieris, supra* at para. 27).

[84] IIROC's mandate, as outlined in IIROC's Recognition Order (2008), 31 O.S.C.B. 5615 at 5615, is, in part, to:

[...]

e. provide services to exchanges and quotation and trade reporting systems (QTRSs) (together with ATSS, Marketplace Members) that choose to retain it as a regulation services provider, as that term is defined under National Instrument 21-101 *Marketplace Operation*;

f. if retained by an exchange or QTRS, administer, monitor and/or enforce rules pursuant to a regulation services agreement between IIROC and that exchange or QTRS (RSA);

[...]

[85] IIROC was exercising its authority under Rule 10.9 of the UMIR to deny a request for a cancellation or variation of a trade. The size, complexity and time sensitive nature of the trading which occurs on the Exchange requires that the institution, and its personnel possess unique knowledge and expertise about trading on the Exchange.

[86] We agree that the Chan Decision was very fact specific and time sensitive and, we therefore agree with the submissions of all the parties, that it is deserving of deference and should not be lightly set aside. Further, the predominant concern of the Commission should be market integrity, investor protection, and public interest considerations over the specific financial or business implications of our decision.

[87] When the Commission decides to intervene, we should explicitly state on what grounds we are intervening (*Boulieris, supra* at para. 35).

4. Conclusion

[88] Having reviewed the relevant case law cited above, we agree with the submissions of the parties, that deference should be afforded to a decision of an SRO under section 21.7 of the Act, and that we should be guided by the test set out in *Re Canada Malting*.

[89] While Hahn Investment made written submissions arguing that "IIROC made fundamental legal errors", this position was not pursued with much vigour in oral or written submissions. Lewer was authorized pursuant to paragraph 10.9(1)(d) of the UMIR to make a Trade Ruling and Chan was authorized pursuant to Rule 11.3 of the UMIR to conduct a review of Lewer's Trade Ruling. The Trade Ruling and Chan's review required factual determinations and analysis. We find that Lewer and Chan were clearly authorized to make the decisions they made.

[90] In the appropriate circumstances, we have the authority to substitute our own decision for an SRO's decision if we deem such a substitution in the public interest, however there were no submissions that IIROC's perception of the public interest conflicts with that of the Commission's, nor do we find any grounds for making such a ruling after reviewing the record.

[91] In light of these preliminary observations, we will focus our analysis on the remaining grounds for intervention set out in *Re Canada Malting*.

B. Did IIROC err in law or proceed on an incorrect principle by failing to properly apply its own Policies and Procedures?

1. Parties' Submissions

a) Hahn Investment Inc.

[92] Hahn Investment submits that IIROC misapplied its internal policy or misapprehended the evidence. The IIROC procedure sets 10% as a threshold for considering whether a price difference will impair market integrity. In particular:

- (a) the trades of XIC were filled at \$19.95, which was almost 36% higher than the closing price on the previous day of trading, while the underlying index, the S&P/TSX Capped Composite, was only 18.84% higher. As such, the fill price of XIC was almost 20% above fair value, and far above the 10% threshold contemplated in the IIROC's internal policy; and
- (b) IIROC misapplied its own procedure with respect to the trades in XIC and, therefore erred in deciding that it was unnecessary to conduct the full unreasonableness analysis of the XIC trades.

[93] With respect to XFN, Hahn Investment submits that it purchased XFN at \$24.00. This price reflected a 26.65% increase over the previous closing price, while the underlying index saw a price increase of 19.97%. Although this variance (of approximately 7%) is not as dramatic as the variances in the other ETFs in question, this variance is still unreasonable for an ETF, particularly one which tracks a large cap domestic index.

[94] With respect to XIN, Hahn Investment submits that:

- (a) The discrepancy of more than 50% between XIN's trading price and the performance of the underlying index is, in itself, overwhelming and conclusive evidence of the unreasonableness of the trades.
- (b) It is simply not credible to suggest that the trades were "deliberate" and that Hahn somehow expected, or even assumed the risk, that XIN would trade at \$25.00, a price that would indicate a one day jump in broad international stock market indexes of more than 60%; and
- (c) Regarding Penson, whether a civil remedy may be available is not a relevant consideration for IIROC or the Commission and that a fair and efficient capital

market requires that unreasonable trades be reversed without regard to whether a civil remedy may exist.

b) IIROC

[95] IIROC submits that its procedures manual requires it to begin its approach to Trade Rulings with the presumption that “the best course of action is for market forces to drive trading activity without interference by IIROC”. IIROC submits that it will only intervene where market integrity is at risk.

[96] Further, IIROC submits that while fair value is an important component of its inquiry, it is the beginning of the inquiry rather than the end. IIROC submits that its role is not to guarantee that securities will trade at fair value. According to IIROC, where there is a discrepancy between the trade price and the estimated fair value, the entire context of the trade must be considered to determine whether the discrepancy rises to the level of unreasonableness.

[97] IIROC submits that its role is to preserve market integrity, not to reverse trades that turn out to be unprofitable, and that it makes Trade Rulings based on whether or not the price paid was fair and reasonable at the time of the trade, not with the benefit of hindsight or after the markets have turned.

[98] IIROC submits that whether or not a trade is unreasonable under paragraph 10.9(1)(d) of the UMIR must be clear at the time it is made, and that there must be an expectation of due diligence on the part of the market participant and it is not the role of the SRO to do that due diligence. According to IIROC, a mere difference between the price of an ETF and the performance of its underlying index cannot be enough to make a trade unreasonable. IIROC further submits that its procedures manual expressly directs the Surveillance Officer (“SO”) to consider the price difference in the context of all other relevant factors. The COP and the market price of an ETF are functions of supply and demand. IIROC submits that it cannot be responsible for ensuring that market participants post orders that do not significantly deviate from an ETF’s NAV by reversing all trades where the difference is significant.

[99] In addition, IIROC points out that we should be considering the actions of Hahn Investment and Penson as they were entirely relevant to IIROC’s assessment of whether the trades were unreasonable. IIROC submits that one of the relevant factors listed in its procedures manual is whether the trades were made in error or were deliberate. IIROC relies on the evidence of Hahn Investment’s and Penson’s conduct, which can be summarized as follows:

- (a) Hahn Investment could have imposed a lower buy limit for the orders if it had a concern about paying too high a price; and
- (b) There was no indication from the volume or number of transactions that Hahn Investment’s orders were entered erroneously. The trading activity suggests that the person entering the trades had seen and considered the COP.

[100] With respect to XIN, IIROC submits that its internal procedures manual directs a SO to consider the price difference between the trade price and the estimated fair value, and suggests a 10% differential as a benchmark. IIROC submits that 10% is only a guideline. IIROC further

submits that a 10% differential is a reasonable guideline on an ordinary trading day; but in the context of the historic rise in the U.S. markets experienced on October 13, 2008, and the extreme volatility experienced by markets on October 14, 2008, the standards for an ordinary day did not apply.

[101] In oral testimony, Prior commented on this extreme volatility by noting that:

I think we gave more consideration and more weighting to the fact that the market had fallen 800 points during that two-hour period [The two hour period during which trading on the TSX was halted].

[102] With respect to XIC, XSP and XFN, IIROC submits that none of those securities exhibited a price differential that IIROC considered to be significant given the context in which the trades were made.

c) The TSX

[103] The TSX submits that the reasonableness of a trade should be determined with respect to the actions of a reasonable market participant in the circumstances. The TSX submits that under paragraph 10.9(1)(d) of the UMIR, a trade is unreasonable only if no reasonable market participant would have made the trade in the circumstances.

[104] The TSX submits that the actions of other market participants are strong evidence of the reasonableness of the trades at issue:

- (a) Despite the quoted COP, a significant number of sellers did not enter the market at that price;
- (b) After the opening of trading in XIN on October 14, 2008, 249 unique trades were executed at or above the price of \$25.00 per share, the price Hahn paid, which they now seek to rescind or reprice. 209 of these trades did not involve Hahn Investment as a buyer; and
- (c) Sophisticated market participants such as TD Securities, RBC Capital Markets, National Bank Financial Inc., Canaccord Capital Corp. and Penson Financial Services Canada Inc. also were willing to purchase XIN at or above \$25.00 per share.

[105] The TSX submits that the number of market participants including very sophisticated participants who executed trades in volume similar to Hahn Investment's trades is compelling evidence that the trades in question were reasonable.

[106] Further, the TSX agrees with the conclusion reached by Chan that any security trading on the Exchange is not bound to the NAV of the security but "reflects either a discount or a premium to the [NAV] based on investor sentiment".

[107] According to the TSX, market regulators and trading service providers should not be asked to assess the relative value of securities. The TSX concurs with the position of IIROC that

in making a Trade Ruling, “the best course of action is for market forces to drive trading activity without interference”.

[108] The TSX further submits that it is the responsibility of market participants to attribute a value to securities they acquire. The TSX further submits that market participants will frequently attribute different values to the same security. The TSX submits that the mere fact that market forces price a trade outside of a particular calculation of NAV does not by itself render that trade unreasonable.

d) Staff

[109] Staff made no submissions on this point.

2. Law

[110] As established in *Re Canada Malting* and discussed above, where it finds that an SRO has erred in law, has proceeded on an incorrect principle or has made an unreasonable decision, the Commission will intervene in the SRO’s decision.

3. Analysis

[111] As explained above, IIROC made two decisions related to Hahn Investment’s October 14, 2008 trades and conducted the Internal Review. Lewer declined Penson’s request made pursuant to paragraph 10.9(1)(d) of the UMIR to vary or cancel the trades; Prior’s Internal Review concluded that the Initial Decision was correct; and Chan declined Barclay’s request pursuant to rule 11.3 of the UMIR to overrule the Initial Decision.

a) The Initial Decision

[112] IIROC received the initial request for a Trade Ruling at 11:47 a.m. on October 14, 2008 from Skaf and communicated its decision to Skaf at 2:01 p.m. In making his decision, Lewer considered the following:

- (a) Trading in over 100 securities was delayed at the opening due to extreme price changes;
- (b) The market as a whole opened significantly higher than the previous close and continued to rise following the open;
- (c) The Manager, Market Quality, TSX had reviewed the opening price between 9:30 a.m. and 9:34 a.m. during the delay and had determined that the price was reasonable and released the stock;
- (d) The length of time that had passed between the time of the trades (9:34 a.m.) and the request for a ruling (11:47 a.m.); and
- (e) The market had changed direction since the trades had occurred.

b) Prior's Internal Review of the Initial Decision

[113] On October 15th at 3:50 p.m., Hahn asked Prior to reconsider the Initial Decision. On October 16, 2008 at 10:08 a.m., in an email correspondence, Prior made the following request to Hahn:

We would like to know:

- (1) the terms of the orders when entered including buy or sell, quantity, security, executing dealer, time of entry;
- (2) market quote or indicated opening price at the time your orders were entered;
- (3) execution price, theoretical fair value based upon either current market price or indicated opening price of the underlying securities at time of entry and at time of execution; and
- (4) any other factors that you may consider relevant to this matter.

[114] IIROC requested that Penson provide "...whatever information it had concerning the trades...". The information provided by Penson consisted of email and telephone conversations between Mordy and Penson which occurred on October 13, 2008, and during the pre-market open period on October 14, 2008.

[115] In his affidavit, Prior testifies that he spent several hours reviewing the Initial Decision, the information that was provided and TOQ reports showing trading history which was provided by IIROC's Trade Review and Analysis staff. Prior also spoke with Lewer about the Initial Decision and the context in which that decision was made.

[116] Prior testifies that his conclusion was not conveyed to Hahn Investment or Barclays because it was internal.

c) Chan's consideration of the Appeal of the Initial Decision

[117] On October 16, 2008, Barclays formally requested that Chan review the Initial Decision. After receipt of Barclay's formal appeal of the Initial Decision, Chan asked Prior for an explanation of the process that Prior had followed and the grounds for his conclusion. Prior reviewed the circumstances of the trades, Lewer's analysis and Prior's own conclusions, with Chan.

[118] In her decision dated October 17, 2008, Chan stated the following, with regards to the steps taken to review the Initial Decision:

In the course of this review, IIROC staff have reviewed order and trade information, tape recordings of telephone conversations between certain of the appellants identified in your letter and their investment dealers, and other relevant information. We have also reviewed and applied IIROC's internal policies governing the exercise of the powers under UMIR s. 10.9.

d) IIROC Policies and Procedures

[119] In his affidavit, Prior testified that IIROC's approach to Trade Rulings has been developed by benchmarking the practices of other market regulators, applying IIROC staff's long term experience with market surveillance, and regulatory precedents. Rulings are made in real time, and analysis is usually made within minutes of the request. Analysis and decisions are based on a 6-step process, as outlined in IIROC's procedures manual.

[120] IIROC's process for conducting an analysis and making a decision includes the following:

- (a) First, the SO shall determine whether the buyer and/or seller have contacted IIROC to request a cancellation or variation, whether IIROC should proactively contact the buyer and seller, and/or whether a buyer and seller to a trade disagree on the proper course of action;
- (b) The SO will then determine the current fair value for the security;
- (c) The SO will determine the difference in price between the order or trade that is the subject of the inquiry and the current fair value for the security;
- (d) The SO must consider the context of the price difference, whether the volume of the order or trade that is the subject of the inquiry is relevant in the circumstances, and any other relevant circumstances;
- (e) In light of that context, the SO must decide whether the variation or cancellation of the order or trade, or halting or suspension is required; and
- (f) Once the decision is made, the SO will issue the ruling (including a ruling settling a dispute between a buyer and seller, if necessary) and commence the halt, cancellation or variation, and communicate that ruling to all relevant parties.

[121] In addition, amongst other things, IIROC's procedures manual requires compliance with subrule 10.9(2) of the UMIR, which states the following:

In determining whether any quotation or trade in a security is unreasonable, the Market Regulator shall consider:

- (a) prevailing market conditions;
- (b) the last sale price of the security as displayed in a consolidated market display;
- (c) patterns of trading in the security on the marketplace including volatility, volume and number of transactions;
- (d) whether material information concerning the security is in the process of being disseminated to the public; and

- (e) the extent of the interest of the person for whose account the order is entered in changing the price or quotation for the security.

[122] IIROC's procedures manual also requires that an SO consider all relevant factors, including the following:

- (a) Prevailing market conditions;
- (b) The amount of time that has passed since the subject order or trade was entered into the marketplace;
- (c) Impact the request would have on the maintenance of an orderly market;
- (d) The difference between the trade price and estimated fair value of the security. Is the difference greater than 10%?
- (e) Recent trading patterns of the security on the marketplace;
- (f) Was the trade made in error or was it the result of a deliberate trade?

e) Discussion

[123] With respect to XSP, we choose not to review IIROC's decision not to cancel, reprice or vary the trades in XSP that took place on October 14, 2008. Rule 11.3 of the UMIR is reproduced below.

Any person directly affected by any direction or decision of a Market Integrity Official or a Market Regulator made in connection with the administration of UMIR *shall* request a review of the direction or decision by an executive officer of the Market Regulator prior to applying to the applicable securities regulatory authority for a hearing and review or appeal.

[Emphasis added]

[124] As the Trade Rulings in XSP were not appealed to an executive officer of IIROC, we decline to exercise our discretion to review the trades in XSP.

[125] While IIROC's procedures manual provides a 6-step process for analyzing whether or not a trade is reasonable, the overall process appears to be greatly impacted by the context within which the decision is made. This is evidenced by Prior's testimony that trades that result in a change in price of less than 10% are generally not reviewed. Prior testified that:

Actually, we tend to consider anything under 10 percent as what other markets would call a "no bust zone". So if you're not at least 10 percent away we're probably not going to give consideration to a cancellation or adjustment.

[126] It is worth clarifying that there are two 10% references in the record. The first, which is the initial threshold level that determines if further analysis will be completed is based on the change in price of the security in question. The second, which is referred to in IIROC's

procedures manual, is part of the analysis once the 10% threshold has been breached and a more detailed analysis undertaken. This second 10% reference, relates to the difference between the trade price and estimated fair value.

[127] Prior also testified that in markets that are experiencing significant swings in prices, the 10% threshold is automatically increased to 20% or greater. As the price variances for XIC and XFN were less than 20%, IIROC did not engage in further analysis of these ETFs and ruled that the trades in these ETFs were not unreasonable.

[128] Hahn Investment submits that the policy of doubling the threshold to 20% ought to slide downwards when you are dealing with an ETF that tracks the largest index in Canada and one that is readily predictable and understandable.

[129] IIROC's procedures manual is not public and the policy of increasing the initial threshold to review a trade to 20% appears to be an unwritten internal policy. While there is likely value in having a more transparent process that is widely available to the public, we recognize IIROC's need for flexibility when determining whether or not to conduct a trade review. The maintenance of efficient markets dictates that IIROC make decisions very quickly and flexibility is necessary where quick decisions are required.

[130] We found that Prior's articulation of IIROC's policy, including the move to a 20% or greater threshold, in these circumstances, did not seem unreasonable.

[131] Based on the evidence presented to us, we therefore understand IIROC's process as: first a determination as to whether the loss in question meets the threshold and then if the threshold is met, a full analysis as to the reasonableness of the trade, using the 6-step analysis process, and at all times, considering the context surrounding the trade in question.

[132] Hahn Investment submits that a proxy for determining the difference between fair value and trade price was to compare the increase in price of the ETFs in question to the increase in price of the underlying indices of each ETF. IIROC submits that the determination of fair value is not conclusive, but rather is the beginning of the review process. The evidence before us suggests that IIROC appropriately followed its policy, as articulated to us in both written and oral evidence.

[133] The chart below, with the exception of the fourth and eighth columns which we added, was submitted by Hahn Investment and outlines the variance between the increase in each of the ETFs at issue and the increase in their respective underlying index from the close of trading on Friday October 10, 2008, to the close of trading on Tuesday October 14, 2008.

1	2	3	4	5	6	7	8
Symbol	Tracked Index	Closing Price (Oct. 10/08)	(Oct. 13/08) - Dow Jones Industrial Average, in the United States, advanced a record 976 points	Trade Fill Price (Oct.14/08)	Increase in price over (Oct.10/08)	Increase in Underlying Index from close of Oct. 10 to close of Oct. 14	Increase in ETF price less the Increase in Underlying Index
XIN	MSCI EAFE	\$15.25		\$25.00	63.9%	7.9%	56.0%
XSP	S&P 500	\$11.10		\$13.25	19.4%	12.3%	7.1%
XIC	S&P/TSX Capped Composite	\$14.70		\$19.95	35.7%	18.8%	16.9%
XFN	S&P/TSX Capped Financials	\$18.95		\$24.00	26.7%	20.0%	6.7%

[134] Based on Hahn Investment’s submissions, the increase in price of XIN between the close of trading on October 10, 2008 and the time Hahn Investment’s order was filled on October 14, 2008 was approximately 56% greater than the increase in the underlying index between the close of trading on October 10, 2008 and the close of trading on October 14, 2008. The corresponding variance for XSP, XIC and XFN were 7.1%, 16.9% and 6.7%.

[135] We note that the increases in the underlying indices submitted by Hahn were based on the values at the end of trading on October 14, 2008 while the actual trades occurred at the opening. Given the volatility on the morning of October 14, 2008, it is likely that the index values at the time Hahn Investment’s orders were filled would have been greater than their closing values and thus would have resulted in smaller variances between the increase in price of each ETF and the increase in value of each respective underlying the index.

[136] The record provides ample evidentiary support for the conclusion that at the time of the trades at issue stocks on the Toronto market were trading at levels materially higher than the levels at which they ultimately closed.

- (a) In the Chan Decision, Chan notes that “[s]hortly after 9:30 a.m., the S&P/TSX Composite Index was up approximately 16% over the previous closing level and appeared to be climbing higher”;
- (b) In oral testimony Victor Ciampini (“Ciampini”), Manager of Market Quality for the TSX, gave the following testimony with respect to what was anticipated on the morning of October 14, 2008:

It appeared from the indications, the U.S. future indications, that we were looking at another at least several-hundred-point rise in the U.S. markets, which meant that not only would we have to gain the

ground from Monday, we would also have to gain whatever rise occurred off the opening that morning as well. So add that onto the 1,000 points from the previous day, and that's likely what we were looking at right on the opening.

- (c) Finally, as referred to above, in oral testimony, Prior stated that the Toronto market fell by 800 points during the period when trading on the Exchange was halted.

[137] On October 13, 2008, the Dow Jones Industrial Average in the U.S. increased by a record 976 points or 11%. Given that the Exchange was closed in Toronto on October 13, 2008, significant market movement was anticipated once the markets opened on October 14, 2008. Accepting Prior's testimony that the policy of IIROC was to move to a 20% or greater threshold during periods of extreme market shifts, we find it acceptable that IIROC would have increased the threshold to 20% for trades that occurred on October 14, 2008.

[138] At a 20% threshold, IIROC was acting within its policy when it chose not to review the XSP, XFN and XIC trades.

[139] With respect to the XIN trades, consistent with its policy, IIROC did review these trades. Both Chan, in her letter to Barclays, and Prior, in his testimony, state that IIROC reviewed all the evidence it had before it and considered the context within which the trades were made. Without opining on the correctness of the decision reached by IIROC, we are satisfied that the process undertaken by IIROC was consistent with its policies and procedures.

4. Conclusion

[140] Given the foregoing analysis, we find that IIROC applied its own policies and procedures correctly. In particular, we conclude that:

- (a) IIROC considered all the information submitted by Penson, Hahn Investments and its staff;
- (b) IIROC, consistent with its policy, which it developed based on its specialized expertise, doubled the threshold percentage it uses to determine whether or not to intervene, given the prevailing market conditions. Also, consistent with its policy, IIROC only engaged in a detailed analysis of the single ETF whose change in price breached the threshold standard.

[141] We now turn to the issue of whether IIROC overlooked any material evidence.

C. Did IIROC overlook any material evidence?

1. Parties' Submissions

a) Hahn Investment Inc.

[142] Hahn Investment submits that Rule 10.9 of the UMIR requires an objective assessment of whether a trade is unreasonable.

[143] Hahn Investment submits that there was a discrepancy of more than 50% between XIN's trading price and the performance of the underlying index, which in itself, is overwhelming and conclusive evidence of the unreasonableness of the trades.

[144] Hahn Investment submits that IIROC failed to appreciate that EFA, which trades on the NYSE during the same hours that XIN trades on the Exchange, is the only security held by XIN and erroneously believed that the securities underlying XIN traded on foreign exchanges which were, or may have been closed at the time of the XIN trades.

[145] Hahn Investment further submits that IIROC failed to consider the performance of EFA. In particular, Hahn Investment points out:

- (a) That EFA did not trade at unreasonably high levels on October 14, 2008. EFA's opening price was 19% higher than its October 10, 2008 close as compared to XIN's opening price, which was 64% higher than its October 10, 2008 close;
- (b) That IIROC's procedures manual for unreasonable trades lists whether the security in question is inter-listed as a relevant factor to consider, and that this consideration is relevant because trading on one exchange will provide strong guidance about the fair value of the trades in question on another exchange;
- (c) That XIN is nothing more than EFA with a Canadian dollar hedge and thus, excluding foreign exchange considerations, XIN and EFA perform nearly identically. Further, Hahn Investment submits that the EFA's performance and trading history at the relevant times provides conclusive proof that the XIN trades were considerably in excess of fair value; and
- (d) Alternatively, this evidence about EFA may be characterized as new and compelling evidence that was not before IIROC at the time of making its decision, which goes to establish that the trades were unreasonable and ought to be reversed.

[146] Hahn Investment submits that the best indicator of the value of the ETFs is the underlying performance of the index and, for all ETFs in question, that information was available or could easily have been available.

b) IIROC

[147] IIROC submits that it did not overlook material evidence and in fact requested via email that Hahn Investment provide it with all information that was relevant to its request for a Trade Ruling.

c) The TSX

[148] The TSX made no submissions on this point.

d) Staff

[149] Staff made no submissions on this point.

2. Law

[150] As established in *Re Canada Malting*, the Commission will intervene in an SRO's decision where it finds that an SRO overlooked any material evidence.

3. Analysis

[151] As was discussed in the preceding section. Hahn requested that Prior reconsider the Initial Decision and in response Prior requested all relevant information from Hahn. Hahn provided Prior the following information:

- (a) A written email outlining Hahn Investment's position on why the trades were unreasonable;
- (b) A spreadsheet showing the volumes and potential losses associated with the 5 contested trades; and
- (c) A transcript of Mordy's recollections of conversations with Penson traders.

[152] Hahn and Hahn Investment failed to provide IIROC with any information on XIN's relationship relative to EFA, EFA's trading prices and volumes at the relevant times or changes in the US\$/C\$ foreign exchange rates which might have impacted XIN's trading value to EFA. Instead, Hahn submitted in his email, that since the XIN ETF trades went through at more than 60% above their prior close, the TSX Index would have had to trade in the vicinity of 16,000 points for the trades in XIN to be reasonable. It is worth noting that Penson, on behalf of Hahn, entered XIN orders with limits of \$25.00, \$28.00 and \$23.00, which is an arithmetic increase of 64%, 84% and 51% respectively versus the October 10, 2008 close of XIN.

[153] On October 16, 2008, Penson requested that IIROC reconsider the Initial Decision. Penson provided IIROC with the email correspondence between Mordy and Penson of October 13 and 14 and the recordings of the telephone conversations between Mordy and Kamal of October 13 and October 14.

[154] Prior testified that he spent several hours considering the trades and Lewer's ruling, emails between Penson and Hahn Investment, voice recordings provided by Hahn Investment and TOQ reports of the trading history provided by IIROC's Trade Review and Analysis staff. Piror also testified that he reviewed this process and his conclusion with Chan.

[155] In his affidavit, Prior indicates that his conclusion was based on the following nine factors:

XIN is based on European, Australasian and Far East stocks. Those markets experienced significant volatility on October 13 and 14;

Many of the overseas markets were closed by the time the TSX opened on October 14. Many of the underlying securities were not available for trading and potential sellers had no guarantee they could suitably hedge a low sale

price in the ETF. Anyone selling the ETF at the opening on October 14 could remain unhedged until the foreign markets responded for trading the next day;

The COP of XIN hovered around \$25 and higher for an hour before the TSX opened XIN for trading on October 14. Even then, some sellers refused to sell at that price;

TSX staff had reviewed the opening price of XIN during the time that it was delayed and had determined that it was reasonable to allow it to open at \$25;

The Penson trader appeared to have observed that the COP was at \$24 prior to the entry of the order and had made a decision to pay \$25 in order to guarantee participation at the open;

The XIN price increased after Hahn Investment's order was filled;

The COP of XIN was at \$24 at the time the Penson trader entered a portion of Hahn Investment's order with a limit of \$25. While that order likely drove the COP of \$25, subsequent orders pushed the COP even higher, to \$26;

Mordy appeared to be unaware of the COP until after the orders were filled, but he confirmed that the Penson trader should put in the order "at the opening price", and he had the means available to him to determine the COP;

Given the activity of other markets on October 13, Mordy would have known that the price of XIN was likely to increase from the previous close of October 10.

[156] In cross-examination, Prior testified that an additional factor, though a "small factor", considered by IIROC was the fact that the securities were available for trading on alternative trading systems in Canada.

[157] In oral testimony, Prior testified that his email request to Hahn sought information that would help IIROC determine:

- (a) Whether the trades were erroneously entered by a trader or whether the bid prices were entered correctly;
- (b) What Hahn believed the price of the respective ETFs should have been as cancellation was probably not possible and thus any remedy would have been some kind of price adjustment.

[158] Prior further testified that Hahn's response was inconclusive as to what the fair value should have been and only served to reinforce the difficulty of determining fair value.

[159] Given Prior's testimony with regards to the information he requested, obtained and considered and his testimony that he reviewed this information, and the process with Chan, there

is no basis for finding that IIROC overlooked information that it obtained from Hahn Investment or Penson.

[160] In cross-examination and closing submissions, Hahn Investment appears to make the claim that at the time of the Chan Decision, IIROC failed to consider information which would have informed it as to how the MSCI EAFE performed at the relevant times. This information was not available at the time of the Initial Decision but was available at the time of the Chan Decision.

[161] In cross-examination, Hahn Investment's counsel asked Prior the following question:

By the time you got to Ms. Chan's decision you didn't just have that information available [information on the previous market close of the MSCI EAFE index]; you did have information available to you that – you could have had information available to you about what did the MSCI EAFE Index do on that day [October 14, 2008]. That information was certainly available wasn't it?

[162] Prior agreed on cross-examination that information regarding the MSCI EAFE index could have been obtained. Prior also agreed that IIROC probably assumed that the MSCI EAFE index, the S&P/TSX Composite and the S&P 500 Index would generally move in similar directions.

[163] However, Prior also testified on cross-examination that the MSCI EAFE index was not trading at the time Lewer made his decision and thus information related to that index was not overlooked by Lewer. Prior also testified that while information regarding how MSCI EAFE traded on October 14, 2008 was available, but not reviewed, by the time Chan made her decision, IIROC must review the Initial Decision in the context within which he made his decision. Prior testified as follows:

But the point I'm making was that index [the MSCI EAFE] was not openly trading at the time Lewer made the decision. Yes, we had now the benefit of hindsight, what happened eight, ten hours after Mr. Lewer's decision as to what happened to the MSCI Index. But we don't typically use information like that subsequent to market movements that weren't available at the time to go back and revisit the decision. We have to rely on the information that we had at the time of the decision. You can't modify decisions based upon subsequent information that becomes available.

[164] Prior further testified that Hahn had suggested the TSX as a proxy for determining fair value of XIN. Therefore to assist them to determine what the fair value of XIN should have been, IIROC compared the change in the TSX index to the change in price of XIN.

[165] With respect to IIROC's efforts to determine the fair value of XIN, we find the following statements by Hahn, in his email reply to Prior, rather instructive:

A great difficulty for us is to calculate what the theoretical index values should have been at the opening, given that these themselves will be reliant on the smooth functioning of the indices themselves (at least one of the contested trades

being linked to the S&P/TSX Index). *In the meantime, we are getting assistance from a major trading firm based in New York to help attempt to compute what value should have been. Likely, this will prove impossible* and as such will put us in a very vulnerable position with respect to our fiduciary client responsibilities.

[Emphasis added]

[166] When reviewing the evidence, including the above quote, in the context of a deferential standard of review, accepting that IIROC made a technical decision which utilized its particular expertise, we do not find that IIROC overlooked material evidence.

[167] As the statement from Hahn suggests, in the immediate aftermath of the trades and at the time a Trade Ruling and a subsequent appeal were requested, it was unclear, to all involved, how to best estimate fair value. Using the information and recommendation of Hahn, IIROC made a judgment as to the best proxy for fair value and subsequently whether there was any need for further reasonableness analysis.

[168] Information regarding exactly what security was held by XIN was presented to IIROC well after the Chan Decision which is at the heart of this Application.

4. Conclusion

[169] It is clear that Hahn Investment whose expertise and principal area of trading is ETFs ought to have known that EFA was the only security held by XIN at the time IIROC was reviewing the trades at issue. It is also clear at the time IIROC was reviewing the trades at issue, Hahn Investment knew or ought to have known that the trades in XIN deviated from the values at which EFA was trading. However, Hahn Investment failed to provide this information to IIROC despite Prior's request for any information that Hahn Investment considered relevant.

[170] When one analyzes all the evidence and the context in which the trades were made, including the time sensitive nature of its decisions, we are satisfied that IIROC adequately reviewed all the information it had and did not overlook any material information which it had before it.

[171] We will now address the new information which was presented to the Commission.

D. Is there new and compelling evidence before the Commission that was not presented to IIROC?

1. Parties' Submissions

a) Hahn Investment Inc.

[172] Although the Chan Decision did not deal specifically with XSP, Hahn Investment submits that the Commission has the power to address the trades in XSP and ought to reverse or re-price them. Hahn Investment purchased XSP at \$13.25. This price on the morning of October 14th reflected a 19.4% increase over the previous closing price, while the underlying index saw a price increase of 12.3% by the end of the day.

[173] Hahn Investment submits that XIN holds only one security, the shares of EFA, its U.S. counterpart which trades on the NYSE, and that this is new and compelling evidence that was not presented to IIROC. According to Hahn Investment, this is new and compelling evidence because it challenges one of the basis for IIROC's ruling, as in its ruling IIROC relied on the assumption that there was no "suitable hedge" for XIN shares.

[174] Hahn Investment submits that it was entitled to assume that the market regulator would have current information before it and it is not its fault that IIROC did not know that XIN's only holding is EFA. Before Mordy's supplemental affidavit, Lewer, Prior and Chan believed that XIN tracked the MSCI EAFE directly. Prior testified that IIROC used the original listing statements of the TSX to ascertain what index each ETF tracks to help it determine how to best benchmark each ETFs value. The original listing statement for XIN showed its underlying index to be MSCI EAFE. The TSX does not update the original listing statement and unbeknownst to IIROC, Barclays had changed the underlying assets of XIN to EFA several years earlier. Hahn Investment further submits that EFA was a suitable hedge that was trading on October 14, 2008 on the NYSE.

b) IIROC

[175] IIROC submits that, at the time it considered Hahn Investment's request for a Trade Ruling, it was not aware that XIN's sole underlying security was EFA or that EFA was a NYSE-listed ETF.

[176] IIROC submits that despite Hahn Investment's obligation under Subrule 10.9(3) of the UMIR to provide IIROC with any information in its possession or control that might be relevant to the decision, Hahn Investment failed to provide the information it now submits regarding the EFA. In any event, IIROC submits that there is no evidence that Hahn Investment considered EFA in deciding what price it was willing to pay for XIN.

[177] IIROC submits that Hahn Investment concedes that some explanation for the difference in performance between the underlying foreign index and securities such as XIN and EFA that track it, is due to the fact that the underlying index has different trading hours than those of the TSX. IIROC therefore submits that it cannot be said that XIN will under all circumstances replicate the performance of EFA.

[178] According to IIROC, fair value could not be assessed solely by looking at the NAV and the performance of the underlying assets, particularly in times of volatility.

[179] Further, Hahn Investment had repeatedly instructed Penson to place the buy orders at the "opening price" with knowledge that based on the preceding days activities the markets were likely to open substantially higher. IIROC further submits that Hahn Investment made the trade request without checking the COP or discussing a price with Penson, and the COP of XIN had been accurately displayed before Penson entered the first order.

[180] IIROC submits that the expanded record and consideration of the EFA do not address the fact that the COP of XIN was precisely what Hahn Investment ended up paying for the XIN shares purchased on behalf of its clients.

[181] IIROC submits that market forces and investor sentiment established the opening price for XIN and the other ETFs at issue.

c) The TSX

[182] The TSX made no submissions on this point.

d) Staff

[183] Staff submits that the enhanced record in a hearing and review of a time-sensitive decision of a SRO is different than the case of a hearing and review of a listing decision or disciplinary decision. Staff submits that in the present case, IIROC was making a time-sensitive decision, both at first instance and in the Chan's decision. Therefore, in assessing the expanded record, Staff submits that the Commission should not scrutinize IIROC's decision on a standard of perfection but should understand and appreciate the structures within which IIROC was working.

2. Law

[184] As established in *Re Canada Malting*, the Commission will intervene, in an SRO's decision, where it finds that there is new and compelling evidence before the Commission that was not presented to the SRO.

3. Analysis

[185] In determining if the information regarding EFA is "new and compelling information", we will first discuss the fact that Hahn Investment is a sophisticated market participant, a point that is relevant as to the timing of when the EFA information was brought to the attention of IIROC. We will then discuss what is meant by "new and compelling" in the circumstances of this case and assess whether the EFA information is "new and compelling".

[186] By all accounts Hahn Investment is a sophisticated market participant generally, and with respect to ETFs should be considered as having expertise. Hahn Investment is a licensed ICPM in Ontario and British Columbia and employs an investment strategy comprised exclusively of ETFs. In his affidavit dated November 13, 2008, Mordy states that "Hahn [Investment] has one of the longest track records in the industry for managing ETF-only portfolios."

[187] To execute its trades, Hahn Investment employs the services of Penson. No evidence was provided regarding Penson's history as a broker, however we have no reason to believe that Penson is not an experienced and sophisticated broker.

[188] Prior testified and we agree that the deliberateness of the actions taken to effect the trade was an important consideration. Specifically, Prior testified that:

Yes, it told us that a trader, a professional trader had managed the order, had taken a look at the market price for the security prior to entering the order, and had put a limit that the trader felt was appropriate under the circumstances for that particular day and at that particular time, which suggested to us that it was not an

erroneous order entry, that the price was not keyed in incorrectly or the volume or the symbol mistakenly applied.

[189] We are satisfied that it is clear that all the trades at issue were completed by and at the direction of informed individuals at Penson and Hahn Investments and agree with Prior that this is an important consideration. The following exchange between Mordy and Kamal on October 13, 2008 at 10:44 a.m. supports this conclusion:

Mordy: ...wondering about the Canadian markets because they're obviously going to pop tomorrow too. Is there any way you can put 'em in for like the opening'?

Kamal: Ya, definitely. Did you want just the calculated opening price on those?

Mordy: Ya, just get the opening price.

Kamal: o.k. I'll do that then.

Mordy: And uh just put em in right away, if you can

Kamal: Oh ya definitely I will...so we'll get the opening prices for all the Canadian stuff for you

Mordy: Ok Fantastic – so you can do that then, you can just say fill upon opening?

Kamal: Yah exactly

Mordy: Ok perfect

[190] This exchange was followed by another on the morning of October 14, 2008 at 9:13 a.m., a portion of which is re produced below:

Mordy: So it would be I guess X..XIN & XFP... would be the big ones

Kamal: ya exactly, the big ones

Mordy: ok so uhm ya I mean if you can work those, that'd be great

Kamal: Ya we can definitely work those for you.

Mordy: Ya

Kamal: Just cuz I mean right now even uhm there's not that much volume on the offering

Mordy: Really on..

Kamal: Ya well especially in the morning, like I know these are pretty big and they're pretty liquid but uhm in the morning, we don't want to drive up the pricing either

Mordy: Right right

Kamal: Uhm.. we could talk to a specialist if you lime uhm..like and then see..uhh

Mordy: Sure ya...I mean I, I, we just wanted to get...I wanted to get in on Friday as you know

[191] We note that Penson placed limit orders on behalf of Hahn Investment, however the issue as to whether Penson should have done more to secure a more favourable price for Hahn Investments is not an issue for this Commission to decide.

[192] Having established that Hahn Investment is a sophisticated market participant with expertise in ETFs, we are satisfied that it is reasonable to conclude that Hahn Investment ought to have known that the EFA ETF was the only security owned by XIN at the time of the trades, and that, at the time of the request for a ruling, the trades were executed at prices that deviated from expectations.

[193] Despite these reasonable expectations, the evidence provided to us establishes that Hahn Investment did not provide IIROC with the information that EFA was the underlying security of XIN. In fact, Hahn's email stated that there would be great difficulty in establishing theoretical values. Prior testified that the EFA information was the type of information that he was seeking from Hahn when he made his email request for further information, which we referred to earlier. Prior testified that IIROC monitors 5000 different securities, and given the immediacy of the Trade Ruling request, IIROC cannot "be experts in every single security within a very short period of time."

[194] Hahn Investment's failure to inform IIROC of the relationship between XIN and EFA, despite our reasonable expectation that they ought to have known of this relationship at the time of the Initial Decision and the Chan Decision is an important factor that we considered in determining if this information was "new and compelling". IIROC was not made aware of the relationship between EFA and XIN until Mordy's supplemental affidavit dated February 13, 2009, filed in support of this Application.

[195] We reiterate here that we are reviewing the actions of IIROC with deference, accepting that the decision as to whether or not a trade is unreasonable is a technical one within the particular expertise of IIROC. The determination as to whether or not the disclosure of EFA's relationship to XIN is new and compelling must be made in this context.

[196] Given the time sensitive nature of Trade Rulings, and the impact that reversing, cancelling or varying a trade can have on the market place, especially when done months after the trade in question took place, we are concerned with parties classifying as new, evidence which that party knew or ought to have known at the time of the Trade Ruling.

[197] Absent, compelling explanatory evidence to the contrary, we are of the view that in the circumstances of this case, "new" means information that was not known to the party purporting to introduce it as new at the time of the SRO's decision. However, even if the information regarding EFA that was provided to IIROC in February 2009 was considered new evidence, we do not find this evidence to be compelling.

[198] In our view, that information would be considered “compelling” if it would have changed the SRO’s decision, had it been known at the time of the decision.

[199] Applying this standard of “new and compelling”, the information regarding EFA is not new as it ought to have been known by Hahn Investment at the time of the trades, given Hahn Investment’s expertise in ETFs. For reasons to be discussed below, we are also not satisfied that this information is compelling.

[200] Hahn Investment’s argument is that as the only security of XIN, EFA is the best indicator of the fair value of XIN. We agree that EFA provides better, more precise, information as to the fair value of XIN. However we are not satisfied that IIROC would have changed or would likely have changed its decision if it had the EFA information. Thus, this information is not compelling.

[201] The evidence indicates that the EFA’s opening price on October 14, 2008 was 19% greater than its closing price on October 10, 2008, while XIN’s opening price on October 14, 2008 was 64% greater than its closing price on October 10, 2008.

[202] We understand Hahn Investment’s argument to be that if IIROC had the information regarding EFA, it would have seen that EFA, the underlying security of XIN, only increased by 19% while XIN increased by 64%. Therefore, the increase in XIN was 45% greater than the increase in EFA. This variance, Hahn Investment believes, would have caused IIROC to find the trades in XIN unreasonable.

[203] However, Prior testified that IIROC probably assumed that all major indices would generally move in similar directions (see paragraph 162) and Hahn Investment’s email reinforced this by pointing out that the TSX would have had to trade at 16,000 to make sense of the level that XIN traded at. This implies the S&P/TSX Index was in the vicinity of 10,000 before trading commenced. Hahn Investment recommended the S&P/TSX Index as a proxy for the underlying value of XIN. From the Chan Decision, we also know that the S&P/TSX Index was up 16% at the beginning of trading on October 14, 2008, while XIN was up 64%. Using the S&P/TSX Index as a proxy for the fair value of the underlying index of XIN, IIROC would have believed that at the opening of trading on October 14, 2008, the increase in value of XIN was 48% greater than the increase in value of the index, it was using as a proxy for fair value.

[204] At the time of its decisions, IIROC therefore knew that there was a dramatic increase in the price of XIN over the instrument being used to assess its underlying value. It is worth noting that the approximate variance between the increase in XIN and the S&P/TSX Index at the opening of trading on October 14, 2008 – 48% – is similar to the variance between the increase in XIN and EFA – 45%.

[205] Even with the EFA information, IIROC’s arithmetic estimation of the price variance from fair value, using the EFA as the underlying security would have been very similar to the arithmetic calculation it obtained using the TSX Index as the underlying index of XIN.

[206] Notwithstanding Prior’s testimony that the information regarding EFA’s relationship to XIN is “significant and material evidence”, the above analysis shows that this information,

cannot, in and of itself, lead to a different conclusion. This conclusion is supported by Prior's testimony.

[207] Prior testified that even if IIROC had known that EFA is the sole underlying security of XIN he cannot say that IIROC's opinion on the reasonableness of the trades would have changed.

[208] In explaining the above comments during direct examination Prior stated:

While it would have had a significant weighting in our decision, some of the other factors that we considered such as the COP being displayed for 45 minutes and then the ETF continuing to trade at or above the price for a period of time following the open, and the fact that the trader had selected the limit after reviewing the COP, those were factors that really carried significant weighting in our decision. It would be hypothetical for me to recreate now what the actual frame of mind would have been at the time.

We also were looking at this in the context of literally hundreds of stocks that had moved significantly, a number of other ETFs (sic). You know, those were all factors that played significant weighting in our decision. So this is just one other factor.

4. Conclusion

[209] For these reasons, we are not satisfied that the EFA information would have changed the decision of IIROC.

[210] Rather, we believe that even with the EFA information, the dramatic nature of trading on October 14, 2008 would have influenced IIROC's decision. We think it important to reiterate the following:

(a) On October 13, 2008 the Dow Jones Industrial Average, in the United States, advanced 976, the largest ever advance during a session and the largest advance on a percentage basis since 1932.

(b) Ciampini, testified that:

(i) It appeared from the indications, the U.S. future indications, that we were looking at *another at least several-hundred-point rise in the U.S. markets*, which meant that not only would we have to gain the ground from Monday, *we would also have to gain whatever rise occurred off the opening that morning as well. So add that onto the 1,000 points from the previous day, and that's likely what we were looking at right on the opening.*

[Emphasis added]

- (c) On October 14, 2008, the TSX Index increased by 16% immediately, then fell by 800 points during the two hour period that trading was halted;
- (d) Mordy's instruction to Kamal was to get in at the open, "just get the opening prices";
- (e) Penson's placed limit orders, which showed that there was a deliberate consideration as to the price at which XIN was selling and a conscious attempt to control the price at which Hahn Investment purchased XIN. The price at which the Penson orders, on behalf of Hahn Investment, were filled was within the limit set by Penson, on behalf of Hahn Investment.

[211] We accept, in these circumstances, IIROC's submission that where there is a discrepancy between the trade price and the estimated fair value, the entire context of the trade must be considered.

V. CONCLUSION

[212] Penson, at the direction of and on behalf of Hahn Investment, attempted to get into the market as quickly as possible on the morning of October 14, 2008. The prices at which the ETFs at issue were available upon market opening was known before the orders were placed on behalf of Hahn Investment.

[213] IIROC appropriately followed its internal policies and procedures and concluded that it should not cancel, reprice or vary the trades at issue. Information regarding EFA being the only security owned by XIN, which was brought to IIROC's attention in February 2009, almost 4 months after the date of the trade, ought to have been known to Hahn Investment at the date of the trades. In any event, while this information gives more precise information, it does not materially change the picture that IIROC was looking at.

[214] Submissions were made regarding the Hearing and Review being illusory in that the Commission may not have been able to cancel, reprice or vary the trades, even if it felt that the trades were unreasonable. With respect, we do not agree. Had we concluded that the trades were unreasonable, it would have been within our authority to order a cancellation, repricing or variation of trades.

[215] For all the reasons discussed above, Commissioner Thakrar dissenting in part, we dismiss the Application.

Dated this 19th day of October, 2009.

"Patrick J. LeSage"

Patrick J. LeSage, Q.C.

"Margot C. Howard"

Margot C. Howard

VI. REASONS OF COMMISSIONER THAKRAR (DISSENTING IN PART):

A. Overview

[216] I concur with the following conclusions reached by the Majority:

- (a) when conducting a review of a decision of an SRO under section 21.7 of the Act, we should be guided by the test set out in *Re Canada Malting*;
- (b) IIROC applied its own policies and procedures correctly and considered all the information submitted by Penson, Hahn Investment, TSX and its staff and appropriately relied on its knowledge and expertise to determine whether or not to intervene, given the prevailing market conditions; and
- (c) IIROC did not overlook any material information it had before it.

[217] However, I am unable to concur with the conclusion of the Majority with respect to the issue of whether there is “new and compelling evidence” regarding XIN (which showed the greatest increase in trading price from its previous day closing price). I find that the evidence presented to the panel clearly demonstrates that EFA was the sole underlying security for XIN. This information constitutes “new and compelling” information that was not presented or known to IIROC at the time of the Initial Review or the Chan Decision.

B. Is there new and compelling evidence before the Commission that was not presented to IIROC or known to IIROC?

1. The underlying security of XIN is a single NYSE listed security, and not many securities

[218] Prior, for the purposes of his Internal Review, in concluding that Lewer had properly ruled that the trades were not unreasonable, relied on the following factors that were inaccurate:

- XIN is based on European, Australasian and Far East stocks. Those markets experienced significant volatility on October 13 and 14; and
- Many of the overseas markets were closed by the time the TSX opened on October 14. As a result, many of the underlying securities were not available for trading and potential sellers had no guarantee they could suitably hedge a low sale price in the ETF. Anyone selling the ETF at the opening on October 14 could remain unhedged until the foreign markets responded for trading the next day.

Chan also relied upon this inaccurate information in her decision.

[219] We now know, from the new evidence, that XIN holds only one underlying security, the shares of EFA, its U.S. counterpart, which trades on the NYSE. The correct product characteristics and structure of XIN and EFA are:

XIN is the TSX ticker symbol for the iShares Canadian MSCI EAFE Index Fund 100% hedged to Canadian dollars. The investment strategy of XIN is to invest primarily in the U.S. based iShares EFA Fund (that tracks the MSCI EAFE index) and to hedge any resulting foreign currency exposure back to Canadian dollars. For XIN there is only one currency exposure, US\$.

EFA is the trading symbol for the U.S. based iShares MSCI EAFE Index Fund listed on the NYSE. The investment strategy of EFA is to seek investment results that correspond generally to the price and yield of the MSCI EAFE Index.

The MSCI EAFE Index, EFA's underlying index, has been developed by MCSI Inc. as an equity benchmark for its international stock performance. The EAFE index includes stocks from Europe, Australasia, Far East, it consists of 21 developed market indexes and is designed to measure the equity market performance of developed markets, excluding the U.S. & Canada. The benchmark captures approximately 85% of the market capitalisation in approximately 21 countries.

[220] Based on this new XIN information, I conclude that the Initial Review and the Chan Decision relied on what we know now to be incorrect information. This is not to suggest that IIROC erred in its review of the information or overlooked material information for concluding that the XIN opening trades were reasonable.

2. Prior testified that the information regarding EFA, being the underlying asset for XIN, was “new”

[221] Prior testified that he and IIROC first became aware of the fact that EFA was the sole underlying asset of XIN upon reading Mordy's Supplemental Affidavit filed February 13, 2009:

IIROC was not aware at the time [October 2008] when it considered Hahn's request for a Trade ruling that XIN's sole underlying security was EFA or that EFA was a NYSE-listed ETF based upon the same underlying assets. In fact, the documents available to us suggested otherwise.

[Emphasis added]

[222] Before Mordy's Supplemental Affidavit, Prior and Chan believed that XIN directly tracked the MSCI EAFE index. Prior testified that IIROC relied on the original listing statement of the TSX dated September 7, 2001 to ascertain what index XIN tracks to help it determine how to best benchmark XIN's fair value:

We relied on the original listing statement for XIN, which indicated that *XIN's underlying assets were “exchange-traded futures”* that replicate the indices that make up the EAFE index. Such “exchange-traded futures” could only be purchased in foreign markets, many of which were closed at the time of Hahn's trade on October 14, 2008.

[Emphasis added]

[223] The original listing statement for XIN showed its underlying index to be MSCI EAFE. The TSX does not update original listing statements and unbeknownst to IIROC, Barclays (iShares) had changed the underlying assets of XIN to EFA several years earlier. Prior testified:

After reading the Supplemental Affidavit of Mordy, IIROC learned that several years ago, Barclays changed the underlying assets of XIN to a basket of EFA ETFs. The TSX did not update its documentation.

[224] This clearly demonstrates that the XIN information was “new” to IIROC and was not presented to or known to IIROC and its reviewers and decision makers at the time of the Initial Decision, the Initial Review or the Chan Decision.

3. Prior testified that the information regarding EFA, being the underlying asset for XIN, as “very significant and material” information

[225] Prior testified that IIROC, at the time of its various decisions, believed that there would be a difference between the prices of XIN and its underlying securities because IIROC assumed the underlying securities to be exchange-traded futures on foreign markets, markets that IIROC believed to be closed at the time of the trades in question. However, this was not the case for XIN.

[226] Prior agreed there can be no better indicator as to XIN’s price than by observing the performance of EFA, its underlying security. Prior testified that EFA and XIN are “interchangeable”. Prior also acknowledged the importance of the information that EFA is the only stock held by XIN. He testified that he considers it to be a “significant piece of information” and, on multiple occasions, he characterized it as both significant and material.

[227] On the interchangeability, significance and materiality of the XIN/EFA information, Prior testified as follows:

Counsel for Hahn Investment: Right. *But in terms of the performance of XIN, there can be no better indicator than the performance of EFA* because that's the *only thing* that it is.

Prior: *Correct.*

Counsel for Hahn Investment: You will agree with me?

Prior: Oh, yes. Yes.

Counsel for Hahn Investment: They're one and the same thing.

Prior: *They're interchangeable, yes.*

Counsel for Hahn Investment: And you say that if you had that information at the time, you said in your affidavit -- to be fair to you, I don't want to misstate. I think you said you couldn't say whether your –

Prior: It may have made a difference and it may not have because of all of the other factors as well considered in their entirety.

Counsel for Hahn Investment: *I think you will certainly agree with me that this is material information –*

Prior: *It's a very significant piece of information.*

Counsel for Hahn Investment: *-- that is before this Commission today that you didn't have the benefit of at the time?*

Prior: *Correct.*

[Emphasis added]

[228] With respect to the significance and materiality of the actual trading activity on the NYSE of EFA (the underlying security for XIN) on Tuesday, October 14, 2008, when XIN was trading on the TSX, Prior testified as follows:

Counsel for Hahn Investment: These are showing there are three charts for EFA, and the highlighted in yellow shows the open, high, low and close of EFA on October 14th. Do you see that sir?

Prior: Yes, I do..

Counsel for Hahn Investment: And I'll suggest to you that an open of (\$50.41; its high was hardly much above that at all, (\$50.89; a low of a couple – 3 percent less on my math or a couple of percent less; and then a close of again, just a couple percent less than the open?

Prior: Yes.

Counsel for Hahn Investment: So *I would suggest it traded fairly regularly that day; you will agree with that?*

Prior: *Yes, they did.*

Counsel for Hahn Investment: *And if that information was available to you, I trust you would consider that to be significant.*

Prior: It would have been, yes. *That's a significant factor.*

Counsel for Hahn Investment: Right. And it's *significant and material evidence that's before this Commission, you will agree?*

Prior: *Yes.*

[Emphasis added]

[229] With respect to the actual trading activity of EFA on the NYSE on previous days, Friday, October 10 and Monday, October 13, 2008 (when TSX was closed), Prior agreed that EFA did not experience any “wild swings” in trading and this information would have been a factor in his review:

Counsel for Hahn Investment: ...And then also attached are the same information for October 13th and October 10th for EFA, if you want to look at those.

Prior: Yes.

Counsel for Hahn Investment: I would also put it to you *that there were no wild swings in any of the trading on that day, it traded fairly regularly.*

Prior: *Yes.*

Counsel for Hahn Investment: *Again, if that information was before you, you would have considered it significant?* Not as significant as the date in question.

Prior: *Yes, Yes. Yes. It would have been a factor.*

[Emphasis added]

[230] In answer to a question about the predominant consideration in the price of an ETF, Prior testified as follows:

Well, the first thing we would look at is what are the underlying securities to the ETF and use that as a way to try to gauge what the fair value should be. And the trading price would normally be somewhat similar to fair value.

[231] Prior also agreed that where a security trades on two exchanges, trading on one exchange can be the best indicator of fair value of the security on the other exchange. He further agreed that the underlying index is perhaps the best indicator of fair value for an ETF, if the market for the underlying index is open.

[232] It is worth noting that Prior is IIROC’s Vice-President of Surveillance and has 16 years of experience in market surveillance. His use of terms such as: “significant factor”, “significant and material”, “significant piece of information”, “information would have been a factor” when describing the EFA information, and his characterization of EFA as being “interchangeable” with XIN, strongly suggests that he and IIROC would have considered this new information as “compelling information”.

[233] XIN had only one underlying foreign security, denominated in one currency, requiring only one foreign currency hedge in a primary global currency and generally trading on an exchange with similar trading hours of operation. This is in sharp contrast with the original understanding by IIROC that XIN had many foreign securities, based on 21 developed market indices, denominated in as many currencies, requiring multiple foreign currency hedges, and trading on various exchanges incorporating most time zones. In my view, this new evidence that

XIN holds only one underlying security, the shares of EFA, is unambiguously “new” and very “compelling”.

4. The availability of the new information regarding XIN/EFA would have changed IIROC’s decision

[234] Prior’s specific comments about EFA are strongly supportive of the fact that the new EFA information is “new and compelling information”. On this basis, I believe that IIROC’s decisions (Initial Decision, Initial Review and Chan Decision) would have been different if IIROC had the information that XIN has only one underlying asset, EFA, which was trading at the same time on NYSE.

[235] At the time of the Initial Review and the Chan Decision, without the knowledge about EFA being the only security of XIN, IIROC had to estimate the fair value for XIN using another proxy as many of the foreign markets were closed at the time of the trades. It was within this context that IIROC used the TSX index, as a proxy for the fair value of underlying securities of XIN. As Prior stated in cross examination:

Well, we had some proxies for an estimated value, yes. We had the Standard & Poor’s Index, we had the previous closing index of the MSCI, but, of course, those markets were closed at the time so we could only imagine what they might be worth at that point in time.

Based on this, IIROC concluded that the significant variance (between the trade price of XIN and the proxy fair value of the underlying assets) of 45%, as discussed earlier, indicated that the XIN trades occurred at prices beyond its published 10% threshold differential for a trade review and even beyond its internal unpublished threshold of 20%. As such the trades deserved and received due consideration by IIROC.

[236] However, the significant variance of more than 4 times its published threshold was not sufficient by itself to lead IIROC to a ruling that the trades in XIN were unreasonable. IIROC believed it had to adjust for potential multiple foreign exchange hedges, and it believed that such foreign exchange-traded futures could only be purchased in foreign markets, many of which were closed at the time of the trades on October 14th. These assumptions led IIROC to further discount the 45% variance to the point it no longer exceeded its threshold test. This decision made in real time appears to be reasonable at the time, given IIROC’s understanding that XIN is based on European, Australasian and Far East stocks.

[237] The importance and relevance of the new XIN information is also underscored by the following passage from the Chan Decision:

In cases where hedge trades in the underlying securities cannot readily be executed (as is the case for XIN because most of the securities that underlie XIN are foreign), spreads for ETFs generally widen.

The Chan Decision also assumed that the underlying securities of XIN were securities trading on numerous foreign stock exchanges (and in many foreign currencies) that were closed at the time XIN was trading on the TSX on the morning of October 14, 2008. Given this belief, Chan in her

review of the Initial Decision also assumed that foreign exchange hedge trades in multiple foreign currencies could not be readily executed.

[238] IIROC's 6-step process for Trade Rulings (defined at para. 120 above) highlights how important the fair value calculation is to the analysis that IIROC undertook. The fair value calculation is the second step of the 6-step process. The four remaining steps – steps (3) to (6) – are dependent on the determination of current fair value. If the fair value calculation is inaccurate, the entire analytical process is skewed. This conclusion provides a convincing and compelling argument that had IIROC known that the underlying security of XIN is EFA, its whole analysis for fair value, and assumptions for discounting the variance between the XIN's trade price and its estimated fair value, would have been totally different.

[239] In her appeal decision, Chan also relied on the “supply and demand” factor stating that where hedge trades in the underlying securities cannot be readily executed (as is the case with XIN), pricing of such ETFs is impacted more by supply and demand than by the NAV.

[240] We also heard testimony that a unique characteristic of ETFs is the fact that a “Designated Broker” may create or redeem shares of the ETF, which tends to keep the share price of an ETF very close to its net asset value and the underlying index.

[241] I note that the creation/redemption features of ETFs significantly weaken the argument that supply and demand dictates the pricing. In a non-ETF security, the factors of supply and demand are determinative as the supply of shares of a security that is trading in the marketplace is finite. The price of such a security will reflect market liquidity, a function of the supply and demand of that security. However, the ETF product structure is designed such that the price of an ETF normally stays in line with the net asset value of the ETF as a result of the creation/redemption features.

[242] ETFs can essentially provide unlimited liquidity through the creation/redemption features. The creation feature allows a Designated Broker to create on-demand new units of the ETF whenever demand for that ETF drives up the price beyond the net asset value of the ETF or demand exceeds the supply. The redemption feature works in reverse. Thus, if the supply of units of an ETF exceeds demand and there seems to be limited liquidity in the marketplace, the Designated Broker can redeem units of an ETF; this will tend to keep the trading price close to its net asset value.

[243] The impact of the creation/redemption features is also illustrated by the measurement of tracking errors, another unique feature of ETFs. A tracking error is a difference between the total return of an ETF and the NAV of the underlying index or securities that make up the ETF. It is also a measure used to see how consistently the ETF returns match its benchmark. We heard submissions that would suggest that tracking errors are irrelevant because what matters is supply and demand. We also heard other submissions that suggest that tracking errors should not be greater than a fraction of a percentage point. In the case of XIN, evidence submitted indicated that the historical tracking error was 1.8% from the time of XIN's inception (November 17, 2005) until the close of trading on October 10, 2008 (the last day of trading prior to the trading in question).

[244] While submissions were made that suggested that the prospectus of the ETF at issue here warned investors of tracking errors, the very same prospectus also informed investors that large tracking errors were not the norm, as described below:

The Units of the iShares Funds may trade below, at, or above their respective Net Asset Values per Unit. The Net Asset Values per Unit will fluctuate with changes in the market value of an iShares Fund's holdings. The trading prices of the Units will fluctuate in accordance with changes in the applicable iShares Fund's Net Asset Value per Unit, as well as market supply and demand on the TSX. *However, given that unitholders may subscribe for or exchange a Prescribed Number of Units of any iShares Funds at the Net Asset Value per Unit, Barclays Canada believes that large discounts or premiums to the Net Asset Value per Unit of the iShares Funds should not be sustained.*

[Emphasis added]

[245] We have now been provided with new information that XIN had only one underlying security, EFA, to which a US\$ hedge is attached. IIROC did not have to estimate the fair value for XIN. There was in fact an easily available and incontrovertible measure for determining fair value, in the form of the trading value of its underlying security that was trading on the NYSE at the same time.

[246] As both the U.S. and Canadian financial and capital markets, including NYSE and TSX, were open with the same trading hours, real time current information was readily available on October 14, 2008. As such, the trading value of XIN's underlying security EFA was readily available on the NYSE. As EFA is a NYSE listed security and is the only security held by XIN, the only hedge that had to be considered was a US\$/C\$ hedge. For the same reasons, a foreign exchange hedge trade, for US\$/C\$, in fact could have been easily estimated or executed.

[247] As a result, no significant assumptions or adjustments for the currency hedge would be required, and the "supply and demand" factor would not be a relevant factor. As such, no significant discounting of the variance would have been imputed by IIROC in analysing its threshold tests. It is fair to conclude and expect that had IIROC had the accurate information that EFA was the only security held by XIN, its analysis and review would have and should have been different, with a different outcome.

5. Conclusion

[248] In my view, had this new information that XIN had only one underlying security denominated in one foreign currency been available to IIROC, it would have significantly impacted its review and analysis of the reasonableness of the XIN trades. Its estimation of fair value would have been different based on the new factors and assumptions: XIN has one underlying security, EFA; hedging is required for only one currency (US\$); financial and capital markets were open; real time current information was readily available; discounting, if any, for the variance between fair value and trading price would have been minimal; and the "supply and demand" factor would not have been as significant. In my view, this would have led IIROC to a different conclusion and a different ruling.

[249] We heard that comparing the opening trading price of XIN and the value of its actual underlying security, EFA, showed a variance of 64%. This is very substantial for an ETF that has a tracking error averaging 1.8% over the past 3 years. This huge variance, combined with the uniqueness of ETFs, where a Designated Broker is able to create new units to keep the actual price of the ETF in line with the value of its underlying assets, also strongly suggests that IIROC would have found the trades at issue had to be unreasonable.

[250] For this reason, I find the evidence presented regarding EFA as being the sole underlying security of XIN “new and compelling evidence” as contemplated in *Re Canada Malting*. This information was not presented or known to IIROC when it made its Trade Ruling. In my opinion, IIROC with this “new and compelling” information would have ruled that the opening trades in XIN were unreasonable.

[251] On this basis, I find the opening trades in XIN on October 14th were unreasonable within the meaning of Rules 10.9(1)(d) and 10.9(2) of UMIR.

C. Responsibility for Updating Information

[252] The Majority place significance on the fact that Hahn Investment failed to inform IIROC that EFA was the sole underlying security of XIN. While I agree that Hahn Investment bears some responsibility for failing to provide IIROC with this XIN information, I note that it is unclear as to who was ultimately responsible for ensuring that IIROC had the relevant ETF information at the time of the Initial Decision. Was it IIROC as market regulator, the TSX as a stock exchange, Hahn Investment as ICPM, Penson as broker/dealer and trader, or Barclays as trustee and manager of the iShare Funds?

[253] Prior testified that since this matter, IIROC has amended its policies so as not to rely on clients to provide the most up to date information on the underlying security of an ETF. We were told that IIROC has amended its procedures to ascertain that information independently.

D. The Appropriate Remedy

[254] Having found that opening trades in XIN on October 14th were unreasonable, I now turn to the issue of the appropriate remedy in the circumstances. The parties provided submissions regarding remedy which the Majority did not have to consider in light of their conclusion that there are no grounds to intervene in IIROC’s decision.

1. Parties’ submissions on the XIN trades at issue

a) Hahn Investment Inc.

[255] Hahn Investment submits that if the trades were unreasonable, failing to cancel or vary the trades would make IIROC the final and only arbiter for Trade Rulings. It argues that this is not in the public interest and it would impair investor confidence if an unreasonable trade was permitted to stand.

[256] Hahn Investment submits that sophisticated counterparties and designated market makers who spotted the huge pricing anomaly or saw an arbitrage opportunity must vary the trades they

entered into. It argues that varying the trades will instill more confidence in the markets to know that trades have to be fair and for fair value. It restores integrity to markets to know that unfair, unreasonable prices ought not to be allowed to stand, and, on further review, this Commission will not allow them to stand.

[257] Hahn Investment argues that the Act contemplates and permits a hearing and review by the Commission of IIROC's Trade Rulings. This right of appeal to the Commission must be meaningful; a hearing and review without a potential remedy would be meaningless. It submits that, while it recognizes the general importance of bringing finality to trading, the need for the Commission to intervene in this case far outweighs the general objective of finality.

b) IIROC

[258] IIROC submits that the nature of financial markets dictates that IIROC must make Trade Rulings quickly, and as close to real time as possible. To overturn its decisions and cancel or vary the trades at this stage, several months after the trades occurred, would undermine investor confidence in the market and market integrity.

[259] IIROC submits that as between Hahn Investment and the counterparties to the trades, it is only fair that Hahn Investment bear the costs of the trades. In the circumstances of this case, the decision that was made ought not to be undone.

[260] Further, IIROC submits that the appropriate remedy is to require IIROC to amend its policies and procedures for determining whether a trade is unreasonable and to ensure proper rulings in the future. It believes this remedy is appropriate to its role as market regulator acting in the public interest.

c) The TSX

[261] The TSX submits that Hahn Investment knowingly placed orders to purchase ETFs at the market driven opening price and assumed that natural market forces would price the ETFs in accordance with the underlying NAV.

[262] The TSX submits that where a security is improperly priced too high, market forces naturally "correct" the mispricing by providing incentive for more sellers to enter the market at the higher price. Sellers need to be assured of the certainty of their trades before they enter the market. An order by the Commission to vary or cancel the trades in question will create uncertainty. An order to vary or cancel the trades will negatively effect innocent counterparties.

[263] The TSX further submits that an order to cancel or re-price the trades would adversely affect market integrity. As a matter of protecting market integrity, it is preferable to deny relief to the party that failed to take the most rudimentary cautionary steps before entering into the market transactions than to vary or cancel trades involving hundreds of thousands of units and dozens of innocent ETF unitholders none of whom have been consulted or even identified to date and many of whom have since altered their financial position or ETF unit ownership.

[264] The TSX submits that the most appropriate measure would be to require IIROC to amend its policies and procedures for determining whether a trade is reasonable.

d) Staff

[265] Staff submits that the determination of this case has implications for the market generally. Accordingly, the Commission should consider whether in all the circumstances it is appropriate to intervene, including whether concerns for market efficiency and integrity militate toward granting or denying the relief sought by Hahn Investment.

[266] Staff further submits that the Commission should consider the impact that the cancellation or re-pricing of the trades would have on the confidence of market participants in the certainty and finality of settled trades.

2. Submissions on amendments to policies, rules and procedures re ETFs

[267] In response to the TSX and IIROC's submissions on remedies, we requested at the Hearing for submissions on potential amendments that could be made to the policies, rules and procedures specific to ETFs, the parties made written submissions after the hearing. The salient points are summarised below.

a) IIROC

[268] IIROC acknowledges that it was in possession of outdated information and that it is desirable that IIROC make its decisions based on the best information available to it.

[269] IIROC submits that it might revise its Procedures Manual with respect to information gathering in the following three ways:

- (a) IIROC can make revisions to expressly widen the sources it consults for information relevant to Trade Ruling. IIROC's procedure manual could direct its SOs to take reasonable steps to consult accurate, reliable and current independent sources to obtain information relevant to the nature of the security, its theoretical fair value at the time of the trade/order and its typical trading performance;
- (b) IIROC accepts that particularly where a Trade Ruling involves an ETF, information about the underlying security may be a factor. IIROC's procedure manual could direct its SOs to consult available reliable sources to obtain recent and accurate information on the underlying assets of an ETF prior to making a Trade Ruling;
- (c) Revise the manual to recognize that in the case of ETF securities, in certain circumstances, IIROC may require information about the underlying assets of the ETF in order to vary a trade.

[270] In response to a question in oral argument, counsel for IIROC suggested that UMIR might be amended to reflect a more formal information-gathering process when IIROC is required to make a Trade Ruling. However, in its written submissions, IIROC submits that any such rule amendment must be done cautiously and after appropriate public consultation.

[271] IIROC submits that as an SRO, it exercises its rule-making power following due deliberation and in accordance with its recognition orders. UMIR was developed and is amended

through an on-going process, drawing on IIROC's institutional expertise, benchmarking the rules of regulators in other jurisdictions, and consulting with the public and stakeholders. IIROC will review UMIR in light of the decision the Commission reaches in this matter. And, in this respect, IIROC submits that its careful, consultative process for rule changes should be respected and supported by the Commission and that the Commission should not use this Hearing and Review to direct IIROC to make any amendments to UMIR.

b) Hahn Investments

[272] Hahn Investment submits the following proposed rule changes:

- (a) That an exchange be required to maintain up-to-date listing statements for all securities that trade on that exchange;
- (b) That the TSX and IIROC align and harmonize their procedures, policies and education in respect of the role and importance of ETFs;
- (c) That for purposes of determining whether trades in ETFs are unreasonable IIROC must refrain from focusing on factors of "supply and demand" and instead focus more prominently on the ETF's NAV which at all times is a near perfect reflection of an ETF's fair value;
- (d) Similarly, for determining the COP of an ETF or assessing whether an ETF exceeds internal volatility parameters, the TSX must consider the NAV. As the TSX itself recognizes and advertises on its website, an ETF's price will always be very true to its NAV, which makes ETFs different from every other type of security which trades on the TSX;
- (e) That IIROC develop a transparent, non-arbitrary set of rules to determine the role of "fair value" in its trade dispute determinations involving ETFs. As a result of ETFs' unique creation and redemption process, market volatility and other market factors do not meaningfully impact upon ETFs and should not be a significant factor considered in trade rulings;
- (f) That for ETFs, IIROC's Procedures Manual be amended to adjust downwards the 10% threshold for determining whether a price variance will impair market integrity and that IIROC's arbitrary practice of increasing the 10% threshold to 20% in "volatile" markets ought not to apply to ETFs for the reasons stated above; and,
- (g) That IIROC and TSX establish guidelines for Designated Brokers (market makers) who have an unfair advantage over all other market participants by reason of the fact that they can create or redeem units to sell and buy into the market if they see the opportunity to arbitrage a price anomaly where the price varies substantially from "fair value". To ensure a fair and equitable marketplace, IIROC and the TSX must ensure that Designated Brokers use this preferential authority only to ensure that ETFs maintain a low price variance to the NAV and not for their own benefit.

c) The TSX

[273] The TSX initially indicated that it had no submissions with respect to rule and policy amendments; however in response to Hahn Investment's submissions, TSX filed a letter objecting to the proposals put forward by Hahn Investment.

[274] The TSX submits that it would be inappropriate for the Commission to attempt to direct the implementation of policy and regulatory changes outside the legislative and regulatory processes which already exist.

[275] With respect to the specific proposals made by Hahn Investment, the TSX raises the following objections:

- (a) The TSX submits that it is entirely inappropriate for Hahn Investment to request the Commission to impose any order upon the TSX as Hahn Investment's factum and its oral submissions do not challenge the propriety of any of TSX's actions or procedures;
- (b) The TSX submits that there is no basis for the Commission to impose any order upon Designated Brokers as Designated Brokers have no contractual relationship with TSX or IIROC and there is no evidence before the Commission to suggest that the legal free market actions of Designated Brokers are subject to sanction by IIROC or TSX;
- (c) The TSX submits that there is no basis for the Commission to make an order requiring a change to IIROC's price variance thresholds. TSX submits that such an order would fundamentally alter the regulation of all securities within IIROC's regulatory jurisdiction without arguments or evidence being advanced on the issue;
- (d) The TSX submits that there is no basis for the Commission to make an order requiring NAV to be the sole factor in assessing unreasonable trades. TSX submits that this would have the effect of changing the fundamental policy of both IIROC and TSX that market forces are the appropriate mechanism by which security prices are determined.

3. Analysis

a) XIN Trades at issue

[276] Mordy submitted that Hahn Investment:

- (a) has one of the longest track records in the industry for managing ETF-only portfolios;
- (b) employs an investment strategy comprised exclusively of ETFs;
- (c) has developed and utilizes sophisticated investment management software;

- (d) has a strong reputation in the Canadian wealth management industry; and
- (e) has a leading reputation as an innovative user of ETFs.

[277] On this basis, Hahn Investment ought to have known that EFA was the only security owned by XIN and could have brought this information to the attention of IIROC. Absent this failure on the part of Hahn Investment, this matter might very well have been settled in a different way on October 14, 2008.

[278] Market integrity would be undermined if the relevant trades were cancelled, repriced or varied months after the date of the actual trades. Such a decision could severely undermine the certainty and finality of settled trades, and introduce uncertainty that could have serious consequences on the orderly conduct of the market.

b) Potential amendments to the policies, rules and procedures specific to ETFs

[279] While I acknowledge that IIROC's role is to enforce market integrity rules regarding trading activity on Canadian equity marketplaces and while I do not seek to direct IIROC's actions, this case has highlighted the need for IIROC to review and amend its policies and procedures with respect to how it regulates market conduct related to ETFs. IIROC in its submission also concurs that such a review is appropriate to its role as market regulator acting in the public interest.

[280] We received submissions that: trading in ETFs now account for approximately 10% of the average daily trading volume on the TSX, compared to only 2% two years ago; the aggregate value of trades in ETFs during 2008 was \$152 billion; the 2008 trading activity in ETFs of 6.3 million trades with 7 billion units traded was a substantial increase over 2007; and 36 new ETFs were listed in 2008 representing 29% of the new listings on TSX for 2008. These numbers highlight the popularity and the significant growth of the ETF product in our marketplace.

[281] We heard submissions that IIROC's policies and procedures including UMIR, and the TSX's policies and procedures including determining COP, need to be reviewed to address these unique characteristics of ETFs (such as, the underlying security, existence of tracking error, creation and redemption features, designated broker, etc.). In fact, Prior testified "there's nothing specific in [IIROC's] policies regarding ETFs".

[282] We also heard arguments that simply relying on the supply and demand forces to determine fair value when making trade rulings in respect of trades in ETFs is not sufficient; and a further analysis is required for ETFs in such circumstances and IIROC should articulate that additional level of analysis in its procedures and policies.

[283] Hahn Investment raised questions about the obligations on Designated Brokers due to their ability to create ETF units with a goal to keeping the price of an ETF in line with the NAV of the underlying security(ies), including the opportunity for significant arbitrage profits by the Designated Broker. These are questions that regulators and industry need to tackle to ensure that

the regulatory structure adequately addresses the ETF product features in order to foster fair and efficient capital markets and provide protection to investors from unfair practices.

[284] Prior also testified that depending on the market activity at the time of the trades in question, IIROC may adjust the price change threshold that it uses to determine if a detailed trade ruling analysis is required. In the present case, IIROC increased the threshold to 20%. While I recognize IIROC's need to make real-time, timely decisions, there appears to be a lack of transparency to this process. To provide greater certainty to market participants, I would urge IIROC to review and publish all guidelines about its threshold considerations and numerical levels and the conditions under which those numerical thresholds will be either increased or decreased; and if they should be lower and/or different for ETFs.

[285] I note that subsequent to the Chan Decision, IIROC has amended its policies with respect to how it will gather information on the underlying securities of ETFs. This significant change to IIROC's policy and procedures is a welcome development. However, I believe that various questions raised by this matter have emphasized that a more comprehensive review of policies, rules, procedures and guidelines regarding ETFs needs to be undertaken.

E. Conclusion

[286] For the reasons and considerations discussed above, I would not order a cancellation, repricing or variation of the opening trades in XIN which were made on behalf of Hahn Investment on October 14, 2008. The main reasons and considerations are:

- (a) Hahn Investment ought to have known the underlying security of XIN and to have communicated that information to IIROC;
- (b) the unprecedented and abnormal nature of market trading on the morning of October 14, 2008;
- (c) the market volatility and the resulting Opening Alerts and Trade Freezes;
- (d) the importance of certainty of settled trades;
- (e) the uncertainty that would be introduced into the market if relevant trades are cancelled, repriced or varied almost a year after they were completed; and
- (f) the concerns for market integrity and efficiency.

[287] In my view, an order for a cancellation, repricing or variation of the opening trades in XIN at this stage, almost a year later, would disrupt the orderly conduct of capital markets and would not meet the Commission's mandate of fostering fair and efficient capital markets.

[288] While it would not be appropriate to order IIROC to amend its policies, it is appropriate to highlight that ETFs have experienced exponential growth in a very short time without the attendant adjustment to our regulatory framework to keep pace with the innovative and unique nature of ETFs; unique characteristics that are different from other traditional exchange traded securities. To protect investors and the public interest, it is important to ensure that our

regulatory oversight, policies, rules, procedures and processes are keeping pace with this innovative product which is becoming an important and growing component of investors portfolio.

[289] The Commission should not attempt to direct the implementation of policy and regulatory changes outside of the existing legislative and regulatory protocols and processes. Fostering fair and efficient capital markets and confidence in those capital markets includes acknowledging potential regulatory gaps and encouraging the appropriate regulatory bodies to address those gaps through established regulatory processes.

[290] For these reasons, I would suggest that IIROC, in its role as market regulator acting in the public interest, review the regulatory framework as it relates to ETFs with the objective of amending its policies, rules and procedures for determining whether a trade is unreasonable.

F. Other Matters

[291] There are other issues surrounding ETFs raised by the parties, such as: the role of the designated broker, supply and demand considerations, the appropriate levels of numerical thresholds, and the value and determination of the COP, which may also require consideration by other regulators and market participants. A timely and proactive response to innovation and market developments is an important responsibility of regulators, including SROs.

Dated this 19th day of October, 2009.

“Suresh Thakrar”

Suresh Thakrar