

IIROC NOTICE

Rules Notice Request for Comments

UMIR

Comments Due By: June 20, 2016

Please distribute internally to:

Institutional
Legal and Compliance
Senior Management
Trading Desk
Retail

Contact:

Sonali GuptaBhaya

Director, Market Regulation Policy

Telephone: 416.646.7272

e-mail: sguptabhaya@iiroc.ca

16-0082

April 21, 2016

Proposed Amendments Respecting the Reporting of Certain Trades on Acceptable Foreign Trade Reporting Facilities

Executive Summary

IIROC is proposing amendments to the Universal Market Integrity Rules (“UMIR”) to allow certain trades to be reported to an acceptable foreign trade reporting facility (“Proposed Amendments”).

The Proposed Amendments would:

- introduce a new definition of “acceptable foreign trade reporting facility”, and
- add a new provision to UMIR 6.4(2) that would allow a trade in a listed security or quoted security over 50 standard trading units **and** over \$100,000 in value to be reported to an acceptable foreign trade reporting facility.

The purpose of the Proposed Amendments is to accommodate certain existing trading practices and help ensure large orders have access to “upstairs” liquidity pools in the U.S. that under current requirements are difficult to access.

If implemented, it is not expected that Participants or marketplaces will need to make changes to their systems as a result of the Proposed Amendments.



If approved, the Proposed Amendments would become effective approximately **90** days after publication of the notice of approval.

How to Submit Comments

Comments are requested on all aspects of the Proposed Amendments, including any matter which they do not specifically address. Comments on the Proposed Amendments should be in writing and delivered by **June 20, 2016** to:

Sonali GuptaBhaya,
Director, Market Regulation Policy
Investment Industry Regulatory Organization of Canada
Suite 2000
121 King Street West
Toronto, Ontario M5H 3T9
e-mail: sguptabhaya@iroc.ca

A copy should also be provided to the Recognizing Regulators by forwarding a copy to:

Susan Greenglass
Director, Market Regulation
Ontario Securities Commission
Suite 1903, Box 55
20 Queen Street West
Toronto, Ontario M5H 3S8
Fax: (416) 595-8940
e-mail: marketregulation@osc.gov.on.ca

Commentators should be aware that a copy of their comment letter will be made publicly available on the IIROC website at www.iroc.ca. A summary of the comments contained in each submission will also be included in a future IIROC Notice.



Rules Notice - Table of Contents

1.	Description of Proposed Amendments	4
2.	Analysis	5
2.1	<i>FORM Guidance</i>	5
2.2	<i>Comments on FORM Guidance</i>	6
2.3	<i>Regulation of FINRA Trade Reporting Facilities</i>	6
2.4	<i>Application of Best Execution Requirements to Orders Not Entered on a Marketplace</i>	7
2.5	<i>Trades Below Proposed Thresholds</i>	8
3.	Impacts.....	8
3.1	<i>Dealer Impacts</i>	8
3.2	<i>Marketplace Impacts</i>	8
3.3	<i>Other Impacts</i>	8
4.	Implementation	8
5.	Questions	9
6.	Policy Development Process.....	9
6.1	<i>Regulatory Purpose</i>	9
6.2	<i>Regulatory Process</i>	9
	Appendix A – Proposed UMIR Amendments	10
	Appendix B – Text of UMIR to Reflect Proposed Amendments Respecting the Reporting of Certain Trades on Foreign Trade Reporting Facilities	11



1. Description of Proposed Amendments

The Proposed Amendments would add an additional paragraph to UMIR subsection 6.4(2) to allow trades that are over 50 standard trading units **and** over \$100,000 in value to be reported to an acceptable foreign trade reporting facility. A list of acceptable trade reporting facilities would be published on IIROC’s website and would initially only include the following Financial Industry Regulatory Authority (“FINRA”) facilities:

- Over-the-Counter Reporting Facility (“ORF”), and
- FINRA/Nasdaq Trade Reporting Facility and FINRA/NYSE Trade Reporting Facility (collectively “TRF”).

The definition of “foreign organized regulated market” (“FORM”) in UMIR would not be amended.

An important policy objective of the Proposed Amendments is to help ensure large (over 50 standard trading units and over \$100,000 in value) orders have access to certain liquidity that, under current requirements, may be denied access to such liquidity given that it is difficult for foreign providers of this liquidity to execute such trades on a FORM. Participants have advised IIROC that they typically face greater challenges in finding sufficient liquidity domestically for larger sized orders than smaller sized orders. However, we are of the view that smaller sized orders can typically find sufficient liquidity without relying on upstairs liquidity and accordingly, smaller orders executed outside of Canada would continue to be required to be executed on a FORM

We note that the size threshold of over 50 standard trading units and value threshold of over \$100,000 would be imposed on trades rather than orders.¹ This would ensure that the trades being reported to an acceptable foreign trade reporting facility are of a large enough size to warrant the need to be executed in the upstairs market.

Another important policy objective of the Proposed Amendments is to accommodate existing practices related to multi-legged option trades. We have heard from Participants that access to derivative liquidity outside of Canada is important and that in the U.S., a contingent order related to a derivative transaction would customarily be reported to the ORF or TRF rather than be executed on a FORM. The Proposed Amendments would therefore allow a trade over 50 standard trading units and over \$100,000 in value originating from a contingent order to a derivative transaction occurring outside of Canada to be reported to an acceptable foreign trade reporting facility to accommodate this practice.

The initial list of acceptable foreign trade reporting facilities would only include the TRF and ORF. Our research into the regulation of the TRF and ORF indicated a regime and level of

¹ In contrast, UMIR 6.3 *Exposure of Client Orders* specifies the size of orders that must be displayed rather than size of trades.



oversight that we believe is sufficiently similar to the type of marketplace regulation in Canada.

Given that:

1. we are not aware of the level of regulation of all other trade reporting facilities globally; and
2. part of the policy objective of the Proposed Amendments is to accommodate certain long-standing trading practices;

we do not think it is appropriate to widen the initial list of acceptable foreign trade reporting facilities beyond the TRF and ORF at this time.

The text of the Proposed Amendments is set out in Appendix “A” and a blackline of the changes is set out in Appendix “B”. If approved, the Proposed Amendments would be effective approximately **90** days after the publication of the notice of approval.

2. Analysis

2.1 FORM Guidance

On December 15, 2014, IIROC published guidance on the definition of FORM (“Guidance”).² The Guidance reminded Participants that trading “off-marketplace” must be in compliance with UMIR 6.4 and specifically that a Participant who relies on the UMIR 6.4(2)(d) exemption to execute trades in listed securities “off-marketplace” must execute the trades on a FORM.³

The FORM definition was implemented with the stated objective that trades conducted by a Participant in a listed or quoted security outside of Canada should be conducted on a market that has substantially the same regulatory monitoring and dissemination of data to the public

² See IIROC Notice [14-0293](#) - *Guidance on the Definition of “Foreign Organized Regulated Market”*, December 15, 2014.

³ UMIR defines FORM as a market outside of Canada:

- (a) that is an exchange, quotation or trade reporting system, alternative trading system or similar facility recognized by or registered with a securities regulatory authority that is an ordinary member of the International Organization of Securities Commissions;
 - (b) on which the entry of orders and the execution or reporting of trades is monitored for compliance with regulatory requirements at the time of entry and execution or reporting by a self-regulatory organization recognized by the securities regulatory authority or by the market if the market has been empowered by the securities regulatory authority to monitor the entry of orders and the execution or reporting of trades on that market for compliance with regulatory requirements; and
 - (c) that displays and provides timely information to information vendors, information processors or persons providing similar functions respecting the dissemination of data to market participants for that market of at least the price, volume and security identifier of each trade at the time of execution or reporting of the trade on that market,
- but, for greater certainty, does not include a facility of a market to which trades executed over-the-counter are reported unless:
- (d) the trade is required to be reported and is reported to the market forthwith following execution;
 - (e) at the time of the report, the trade is monitored for compliance with securities regulatory requirements; and
 - (f) at the time of the report, timely information respecting the trade is provided to information vendors, information processors or persons providing similar functions respecting the dissemination of data to market participants for that market.



as would be present if the trade had been conducted on a marketplace in Canada.⁴ Trade reporting facilities such as the TRF and ORF do not meet the definition of a FORM.

2.2 Comments on FORM Guidance

IIROC received comments on the Guidance through public comment letters and through discussions with Participants. Public comments included that the Guidance significantly impacts long-standing business practices and access to U.S. markets by Canadian dealers. One commenter cited that roughly 28% of U.S. trade activity is printed directly to the FINRA trade reporting facilities rather than being executed on a U.S. marketplace and that the FINRA trade reporting facilities act as cross reporting facilities for U.S. dealers in a similar way as a Canadian dealer may print crosses on Canadian marketplaces. This commenter explained that these trades represent block crosses in the upstairs market, broker-to-broker trades, early and late prints, average price crosses and derivative hedges as well as retail executions by wholesale dealers and that the Guidance prevents Canadian dealers from participating in this entire segment of the U.S. market. We were also informed in discussions with a Participant that the FORM definition specifically encroaches on the two following long-standing trading practices regarding institutional orders:

1. where the Canadian dealer works a large trade and finds the other side at a U.S. broker (essentially, the cross-border upstairs market), the U.S. broker-dealer usually matches the order and reports it directly to the ORF or TRF. The U.S. broker-dealer would not typically print these trades on a FORM as this is not common industry practice in the U.S.; and
2. with respect to multi-legged option trades, large institutional clients will marry a put or sell a call and a market maker in the U.S. will often put a contingent derivative trade in the book and execute as agency while at the same time internalizing the underlying equity trade and reporting this trade to the ORF or TRF rather than executing on a FORM. A concern was raised that if an ORF or TRF report is unavailable to a Participant, the U.S. option market maker may not be prepared to provide the derivative liquidity.

2.3 Regulation of FINRA Trade Reporting Facilities

To address the above concerns, IIROC examined whether allowing the reporting of certain executions to the ORF and TRF to accommodate these long-standing trading practices would harm market integrity and negate the original policy reasons for requiring executions to take place on a FORM.⁵

⁴ See Market Integrity Notice [2008-008](#) – Amendment Approval – *Provisions Respecting “Off-Marketplace” Trades* (May 16, 2008). At the time it was noted the FORM definition excluded the bulletin board then known as “Pink Sheets” as well as the OTC Bulletin Board outside of the NASD operating hours and certain reporting facilities then operated by Nasdaq and the NASD.

⁵ The FORM definition was implemented in part to ensure trades conducted by a Participant in a listed or quoted security outside of Canada would be conducted on a market that has substantially the same regulatory monitoring as would be present if the trade had been conducted on a marketplace in Canada.



FINRA oversees the operation of the ORF and TRF. They create and perform surveillance on an audit trail of the reported trades. The audit trail includes:

- market participant symbols
- symbol of security traded
- price
- size
- time of trade

FINRA reviews the trades for, among other things, compliance with Regulation NMS, best execution and short sale requirements. These trades are also subject to FINRA enforcement.

We believe the regulation of these trade reporting facilities is sufficiently similar to marketplace regulation in Canada. Therefore allowing certain trades to be reported to the ORF or TRF would not negatively impact market integrity and would not contravene the original policy objective of the FORM definition.

Under the Proposed Amendments, there would be no pre-trade transparency if trades were allowed to be reported to the ORF or TRF. However, we believe printing a trade that is greater than 50 standard trading units and over \$100,000 in value to the ORF or TRF would be similar to such executions occurring in the dark in Canada especially given that trades greater than 50 standard trading units or over \$100,000 in value are not subject to price improvement requirements.⁶

To address the concerns raised by the commentators, we therefore propose to amend UMIR to accommodate the reporting of a trade to the ORF or TRF where the trade is greater than 50 standard trading units and over \$100,000 in value for the following reasons:

1. Canadian dealers are not likely able to change long-standing trading practices in the U.S.
2. The costs to market efficiency in restricting certain orders from accessing the large pool of upstairs market liquidity in the U.S. outweigh the benefits of providing pre-trade transparency in the U.S.

We believe this would address the above concerns raised by the commenters.

2.4 Application of Best Execution Requirements to Orders Not Entered on a Marketplace

All orders executed outside of Canada, including those resulting in trades reported to the TRF or ORF, must comply with best execution requirements. This is consistent with Part 5 of

⁶ UMIR 6.6 *Provision of Price Improvement by a Dark Order*.



Policy 6.4.⁷ Therefore, Participants would need to take into account all relevant factors for the purpose of achieving best execution before deciding to execute an order outside of Canada.

2.5 Trades Below Proposed Thresholds

We would expect that a trade that does not meet the proposed threshold of greater than 50 standard trading units and over \$100,000 in value would continue to be required to execute on a FORM when Participants rely on the UMIR 6.4(2)(d) exemption. Each Participant must therefore ensure that its executions outside of Canada comply with UMIR 6.4 requirements for these types of trades.

3. Impacts

3.1 Dealer Impacts

The most significant impact of the adoption of the Proposed Amendments would be to allow a trade over 50 standard trading units and over \$100,000 in value to be reported to the ORF or TRF which would ensure that Canadian investors may continue to access the large upstairs market liquidity pool in the U.S.

Participants may need to review current practices relating to the execution of smaller sized orders outside of Canada for compliance with UMIR 6.4.

3.2 Marketplace Impacts

We do not anticipate the Proposed Amendments to have any technological impact on marketplaces.

3.3 Other Impacts

IIROC may be required to make changes to its compliance operations, including Trading Conduct Compliance's modules and reviews.

4. Implementation

We do not anticipate any technological implications on Participants or marketplaces because of the Proposed Amendments. If approved, the Proposed Amendments would become effective approximately **90** days after publication of the notice of approval.

⁷ Part 5 of Policy 6.4 *Trades to be on a Marketplace* states that certain provisions of UMIR, including UMIR 5.1 *Best Execution Obligation*, apply to every order handled by a Participant, even if the order is not executed on a marketplace. IIROC Notice 15-0277 *Proposed Provisions Respecting Best Execution* (December 10, 2015) proposed to move IIROC's best execution requirements from UMIR 5.1 to Dealer Member Rule 3300.



5. Questions

While we request comments on all aspects of the Proposed Amendments, we would also request specific comment on the following questions:

1. Is the proposed minimum size requirement of over 50 standard trading units and over \$100,000 in value sufficient to support the printing of contingent equity orders related to derivative transactions occurring outside of Canada?
2. Would more order flow be driven southbound if no minimum size requirements were applied to contingent orders related to derivative transactions occurring outside of Canada?

6. Policy Development Process

6.1 Regulatory Purpose

The Proposed Amendments would:

- ensure Participants that wish to execute a large trade (over 50 standard trading units and over \$100,000 in value) have access to liquidity that under current UMIR requirements is difficult to access; and
- help facilitate long-standing trading practices with respect to certain orders.

6.2 Regulatory Process

The Board of Directors of IIROC (“Board”) has determined the Proposed Amendments to be in the public interest and on March 30, 2016 approved them for public comment.

The Market Rules Advisory Committee (“MRAC”) of IIROC considered this matter.⁸ MRAC is an advisory committee comprised of representatives of each of the marketplaces for which IIROC acts as a regulation services provider, Participants, institutional investors and subscribers, and the legal and compliance community.

After considering the comments on the Proposed Amendments received in response to this Request for Comments together with any comments of the Recognizing Regulators, IIROC may recommend revisions to the applicable proposed amendments. If the comments or revisions are not of a material nature, the Board has authorized the President to approve the revisions on behalf of IIROC and the applicable proposed amendments as revised will be subject to approval by the Recognizing Regulators. If we receive material comments from the public or the Recognizing Regulators or propose revisions that are material, the applicable proposed amendments as revised will be submitted to the Board for approval. If approved by the Board, any proposed material revisions will be published for comment.

⁸ Consideration by MRAC should not be construed as approval or endorsement of the Proposed Amendments. Members of MRAC are expected to provide their personal advice on topics and that advice may not represent the views of their respective organizations as expressed during the public comment process.



Appendix A – Proposed UMIR Amendments

The Universal Market Integrity Rules are hereby amended as follows:

1. Section 1.1 is amended by inserting the following definition of “acceptable foreign trade reporting facility”:

“Acceptable Foreign Trade Reporting Facility” means a trade reporting facility or similar facility outside Canada:

- (a) on which the reporting of trades is monitored for compliance with regulatory requirements at the time of reporting by an organization that is a member of the International Organization of Securities Commissions;
 - (b) that displays and provides timely information of the price, volume and security identifier of each trade at the time of the reporting of the trade; and
 - (c) included on a list of acceptable foreign trade reporting facilities published on the IIROC website.
2. Subsection (2) of Rule 6.4 is amended by:
 - (a) deleting in clause (h) the word “or” immediately following “issuer;”;
 - (b) replacing “.” in clause (i) with “;or” ; and
 - (c) inserting the following as clause (j):
 - (j) **Acceptable Foreign Trade Reporting Facility** – in a listed security or quoted security that is reported to an acceptable foreign trade reporting facility and is more than 50 standard trading units and has a value of more than \$100,000.



Appendix B – Text of UMIR to Reflect Proposed Amendments Respecting the Reporting of Certain Trades on Foreign Trade Reporting Facilities

Text of Provision Following Adoption of the Proposed UMIR Amendments	Text of Current Provisions Marked to Reflect Adoption of the Proposed UMIR Amendments
<p>“Acceptable Foreign Trade Reporting Facility” means a trade reporting facility or similar facility outside Canada:</p> <p>(a) on which the reporting of trades is monitored for compliance with regulatory requirements at the time of reporting by an organization that is a member of the International Organization of Securities Commissions;</p> <p>(b) that displays and provides timely information of the price, volume and security identifier of each trade at the time of the reporting of the trade; and</p> <p>(c) included on a list of acceptable foreign trade reporting facilities published on the IROC website.</p>	<p>“Acceptable Foreign Trade Reporting Facility” <u>means a trade reporting facility or similar facility outside Canada:</u></p> <p>(a) <u>on which the reporting of trades is monitored for compliance with regulatory requirements at the time of reporting by an organization that is a member of the International Organization of Securities Commissions;</u></p> <p>(b) <u>that displays and provides timely information of the price, volume and security identifier of each trade at the time of the reporting of the trade; and</u></p> <p>(c) <u>included on a list of acceptable foreign trade reporting facilities published on the IROC website.</u></p>
<p>6.4 Trades to be on a Marketplace</p> <p>(1) A Participant acting as principal or agent may not trade nor participate in a security by means other than the entry of an order on a marketplace.</p> <p>(2) Subsection (1) does not apply to a trade:</p> <p>(h) Prospectus and Exempt Distributions – pursuant to a prospectus, take-over bid, issuer bid, amalgamation, arrangement or similar transaction including any distribution of previously unissued securities by an issuer;</p> <p>(i) Non-Regulatory Halt, Delay or Suspension – in a listed security or quoted security in respect of which trading has been halted, delayed or suspended in circumstances described in clause (3)(a) or subclause (3)(b)(i) of Rule 9.1 that is not listed, quoted or traded on a marketplace other than the Exchange or QTRS on which the security is halted, delayed or suspended provided such trade is reported to a marketplace; or</p> <p>(j) Acceptable Foreign Trade Reporting Facility – in a listed security or quoted security that is reported to an acceptable foreign trade reporting facility and is more than 50 standard trading units and has a value of more than \$100,000.</p>	<p>6.4 Trades to be on a Marketplace</p> <p>(1) A Participant acting as principal or agent may not trade nor participate in a security by means other than the entry of an order on a marketplace.</p> <p>(2) Subsection (1) does not apply to a trade:</p> <p>....</p> <p>(h) Prospectus and Exempt Distributions – pursuant to a prospectus, take-over bid, issuer bid, amalgamation, arrangement or similar transaction including any distribution of previously unissued securities by an issuer; or</p> <p>(i) Non-Regulatory Halt, Delay or Suspension – in a listed security or quoted security in respect of which trading has been halted, delayed or suspended in circumstances described in clause (3)(a) or subclause (3)(b)(i) of Rule 9.1 that is not listed, quoted or traded on a marketplace other than the Exchange or QTRS on which the security is halted, delayed or suspended provided such trade is reported to a marketplace; or</p> <p><u>(j) Acceptable Foreign Trade Reporting Facility – in a listed security or quoted security that is reported to an acceptable foreign trade reporting facility and is more than 50 standard trading units and has a value of more than \$100,000.</u></p>