

Chapter 13

SROs, Marketplaces and Clearing Agencies

13.1 SROs

13.1.1 IIROC Rules Notice – Request for Comments –Provisions Respecting Dark Liquidity

11-0225
July 29, 2011

IIROC RULES NOTICE – REQUEST FOR COMMENTS – PROVISIONS RESPECTING DARK LIQUIDITY PROVISIONS RESPECTING DARK LIQUIDITY

Summary

This IIROC Notice provides notice that, on June 29, 2011, the Board of Directors (“Board”) of the Investment Industry Regulatory Organization of Canada (“IIROC”) approved the publication for comment of proposed amendments (“Proposed Amendments”) to the Universal Market Integrity Rules (“UMIR”) respecting certain requirements governing “dark liquidity” on Canadian equity marketplaces.

The Proposed Amendments would:

- define “better price” to mean a minimum of one trading increment except, when the difference between the best ask price and the best bid price is one trading increment, the amount shall be a minimum of one-half of one trading increment;
- permit IIROC to designate a minimum size for orders that are not displayed in a consolidated market display;
- permit IIROC to designate a minimum size of an “iceberg” order that must be displayed in a consolidated market display;
- provide that an order entered on a marketplace must trade with visible orders on that marketplace at the same price before trading with dark orders at the same price on that marketplace;
- require, subject to certain exceptions, an order entered on a marketplace that trades with an order that has not been displayed in a consolidated market display to either:
 - receive a better price, or
 - be for more than 50 standard trading units or have a value of more than \$100,000;
- provide that a Participant or Access Person may not enter an order on a particular marketplace if they know that the handling of the order by the marketplace may result in the order or resulting trade not being in compliance with UMIR; and
- make a number of consequential or editorial amendments to the definition of “last sale price”, the requirements for order exposure and the reporting of trade execution prices.

Rule-Making Process

IIROC has been recognized as a self-regulatory organization by each of the Canadian provincial securities regulatory authorities (the “Recognizing Regulators”) and, as such, is authorized to be a regulation services provider for the purposes of National Instrument 21-101 (“Marketplace Operation Instrument”) and National Instrument 23-101.

As a regulation services provider, IIROC administers and enforces trading rules for the marketplaces that retain the services of IIROC.¹ IIROC has adopted, and the Recognizing Regulators have approved, UMIR as the integrity trading rules that will apply in any marketplace that retains IIROC as its regulation services provider.

The Market Rules Advisory Committee of IIROC ("MRAC") reviewed the Proposed Amendments prior to their consideration by the Board. 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.

The text of the Proposed Amendments is set out in Appendix "A". The Proposed Amendments are part of an overall strategy regarding dark liquidity in Canadian equity marketplace that has been developed in co-ordination with Canadian Securities Administrators and, as a result, the Board has determined the Proposed Amendment to be in the public interest. Comments are requested on all aspects of the Proposed Amendments, including any policy alternatives to the Proposed Amendments that commentators consider preferable and/or more effective to achieve the intended objectives. Comments should be in writing and delivered by **October 27, 2011** to:

James E. Twiss,
Vice President, Market Regulation Policy,
Investment Industry Regulatory Organization of Canada,
Suite 900,
145 King Street West,
Toronto, Ontario. M5H 1J8

Fax: 416.646.7265
e-mail: jtwiss@iiroc.ca

A copy should also be provided to 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 (www.iiroc.ca under the heading "Policy" and sub-heading "Market Proposals/Comments") upon receipt. A summary of the comments contained in each submission will also be included in a future IIROC Notice.

After considering the comments on the Proposed Amendments received in response to this Request for Comments together with any comments of the Recognizing Regulators, staff of IIROC may recommend that revisions be made to the Proposed Amendments. If the revisions are not of a material nature, the Board has authorized the President to approve the revisions on behalf of IIROC and the Proposed Amendments as revised will be subject to approval by the Recognizing Regulators. If the revisions are material, the Proposed Amendments as revised will be submitted to the Board for ratification and, if ratified, will be republished for further public comment.

Development of Proposals for the Canadian Market

Joint CSA/IIROC Consultation Paper

The publication of this IIROC Notice is the next step in a process that began in late 2009. In the Joint CSA/IIROC Consultation Paper 23-404 *Dark Pools, Dark Orders, and Other Developments in Market Structure in Canada*² ("Consultation Paper"), comment was sought on a number of issues, particularly the general impact of marketplaces that offer no pre-trade

¹ Presently, IIROC has been retained to be the regulation services provider for: the Toronto Stock Exchange ("TSX"), TSX Venture Exchange ("TSXV") and Canadian National Stock Exchange ("CNSX"), each as an "exchange" for the purposes of the Marketplace Operation Instrument ("Exchange"); and for Alpha Trading Systems ("Alpha"), Bloomberg Tradebook Canada Company, Chi-X Canada ATS Limited ("Chi-X"), Instinet Canada Cross Ltd. ("Instinet"), Liquidnet Canada Inc. ("Liquidnet"), Omega ATS Limited ("Omega") and TriAct Canada Marketplace LP (the operator of "MATCH Now"), each as an alternative trading system ("ATS"). CNSX presently operates an "alternative market" known as "Pure Trading" that is entitled to trade securities that are listed on other Exchanges and that presently trades securities listed on the TSX and TSXV.

² Published at (2009) 32 OSCB, beginning at page 7877.

transparency on any orders (“Dark Pools”), the introduction of dark order types, and the introduction of smart order routers. The Consultation Paper discussed these issues and their potential impact on the Canadian markets, including their impact on market liquidity, transparency, price discovery, fairness and integrity.³ The CSA and IIROC received 23 letters in response to the Consultation Paper, from a range of respondents including marketplaces, buy-side and sell-side representatives, and industry associations.

Dark Liquidity Forum

On March 23, 2010, the CSA and IIROC hosted a forum to discuss the issues raised in the Consultation Paper and in the response letters (“Forum”). The themes discussed at the Forum included:

- whether Dark Pools should be required to provide price improvement and if so, what is meaningful price improvement;
- the use of market pegged orders and whether those orders “free-ride” off the visible market;
- the use of sub-penny pricing;
- broker preferencing at the marketplace level and dealer internalization of order flow;
- the use of Indications of Interest (IOIs) by Dark Pools to attract order flow; and
- the fairness of a marketplace offering smart order router services that use marketplace data that is not available to other marketplace participants.

More details regarding the Forum were included in Joint CSA/IIROC Staff Notice 23-308 *Update on Forum to Discuss CSA/IIROC Joint Consultation Paper 23-404 “Dark Pools, Dark Orders and Other Developments in Market Structure in Canada” and Next Steps* published on May 28, 2010. That notice included a discussion of ongoing initiatives, proposed next steps to address some of the issues, and a summary of the comments received in response to the Consultation Paper.

Joint CSA/IIROC Position Paper

On November 19, 2010, the Investment Industry Regulatory Organization of Canada (“IIROC”) and the Canadian Securities Administrators published *Joint Canadian Securities Administrators/Investment Industry Regulatory Organization of Canada – Position Paper 23-405 – Dark Liquidity in the Canadian Marketplace* (“Position Paper”).⁴ The Position Paper set out CSA and IIROC’s position on the following questions:

- Under what circumstances should Dark Pools or marketplaces that offer dark orders be exempted from the requirements of pre-trade transparency under NI 21-101?
- Should Dark Orders be required to provide meaningful price improvement over the NBBO, and under what circumstances?
- Should visible (lit) orders have priority over dark orders at the same price on the same marketplace?
- What is a “meaningful” level of price improvement?

The recommendations in the Position Paper regarding these four issues were as follows:

- The only exemption to pre-trade transparency should be for orders that meet a minimum size threshold.
- Two dark orders meeting the minimum size exemption should be able to execute at the best ask price or the best bid price (“NBBO”). Meaningful price improvement should be required in all other circumstances, including all executions with orders not specifically marked in a manner indicating they are using the minimum size exemption.
- Visible orders on a marketplace should execute before dark orders at the same price on the same marketplace. However, an exception could be made where two dark orders meeting the minimum size threshold can be executed at that price.

³ See the Consultation Paper at page 7880.

⁴ IIROC Notice 10-0303 – Rules Notice – Request for Comments - UMIR – *Joint Canadian Securities Administrators/Investment Industry Regulatory Organization of Canada – Position Paper 23-405 - Dark Liquidity in the Canadian Marketplace* (November 19, 2010).

- Meaningful price improvement means that the price is improved over the NBBO by a minimum of one trading increment as defined in the UMIR, except where the NBBO spread is already at the minimum tick. In this case, meaningful price improvement would be at the mid-point of the spread.

Joint CSA/IIROC Response

A total of 20 comments were received on the Position Paper. These comments, and the responses of the CSA and IIROC, have been summarized in Appendix "A" of IIROC Notice 11-0226 ("Joint Notice").⁵ Reference should be made to the Joint Notice for a more detailed outline of the policy considerations underlying the Proposed Amendments. The Joint Notice also contains a discussion of the final report of the Technical Committee of the International Organization of Securities Commissions ("IOSCO") entitled "Principles on Dark Liquidity", which contains principles to assist securities markets authorities in dealing with issues concerning dark liquidity.

Summary of the Proposed Amendments

The following is a summary of the Proposed Amendments:

Definition of "Better Price"

Presently, UMIR defines a "better price" simply as a lower price than the best ask price in the case of a purchase and a higher price than the best bid price in the case of a sale. The term "better price" would be redefined to require at least one trading increment price improvement except when the difference between the best ask price and the best bid price is at least a single trading increment a half-increment would be accepted. The revised definition would set the minimum amount of price improvement that would be acceptable for a "small" order (being 50 standard trading units or less which is 5,000 units of a security trading at \$1.00 or more per unit, 25,000 units of a security trading at \$0.10 or more per unit and less than \$1.00 and 50,000 units when a security is trading at less than \$0.10 per unit) when it executes with a "Dark Order".

The revised definition would also be applicable to the requirements under the Order Exposure Rule (Rule 6.3 which permits small orders to be withheld from an immediate entry on a marketplace if executed at a "better price") and the Client-Principal Trading Rule (Rule 8.1 which requires that principal trades with small client orders be undertaken at a "better price" in order to avoid conflicts) and the amendments would provide greater certainty in the application of those rules. The revised definition makes clear that a "better price" applies in respect of each trade resulting from an order. For example, a "better price" would not be achieved if an order for 1,000 shares of a security executed in two trades with 100 shares receiving a \$0.01 price improvement and the balance of 900 shares executing at the NBBO. In order to be considered a "better price", all 1,000 shares must be executed with a minimum of \$0.01 price improvement.

Definition of "Dark Order"

The Proposed Amendments would introduce a definition of "Dark Order" for use in a number of substantive UMIR provisions dealing with:

- the size of Dark Orders;
- priority of execution; and
- price improvement requirements.

However, the term "Dark Order" would be defined in such a manner that a separate regulatory order marker would not be required. Instead, order types and functionality established by each marketplace would determine whether or not a particular order entered on that marketplace would be considered to be a "Dark Order". An order for which no portion is displayed at the time of entry on a marketplace in a consolidated market display would be a "Dark Order" but any order which is immediately executable on entry or which is a "specialty" type of order that may execute at a price outside of the best ask price/best bid price spread would be excluded from the definition of Dark Order.

The Proposed Amendments would add the following definition of "Dark Order":

"Dark Order" means an order no portion of which is displayed on entry on a marketplace in a consolidated market display but does not include an order entered on a marketplace as:

⁵ IIROC Notice 11-0226 – Rules Notice – Request for Comments – UMIR – *Joint Canadian Securities Administrators/Investment Industry Regulatory Organization of Canada Staff Notice 23-311 – Regulatory Approach to Dark Liquidity in the Canadian Marketplace* (July 29, 2011).

- (a) part of an intentional cross;
- (b) a market order;
- (c) a limit order that, based on orders displayed in a consolidated market display, is immediately executed in full on one or more marketplaces at the time of entry;
- (d) a Basis Order;
- (e) a Closing Price Order;
- (f) a Market-on-Close Order;
- (g) an Opening Order; or
- (h) a Volume-Weighted Average Price Order.

It is important to note that a Call Market Order is considered to be a "Dark Order". Generally, a small order that executes with a Call Market Order would have to receive "price improvement" in the form of an execution at a "better price". It is also important to note that an "iceberg" order (a portion of which is displayed in a consolidated market display) will not be considered a "Dark Order" and, as such, the hidden portion of the order would not have to provide "price improvement" on execution.

Definition of "Last Sale Price"

Presently, UMIR defines the "last sale price" as the price of the last sale of at least one standard trading unit of a particular security displayed in a consolidated market display but does not include the price of a sale resulting from an order that is:

- a Basis Order;
- a Call Market Order;
- a Closing Price Order;
- a Special Terms Order unless the Special Terms Order has executed with an order or orders other than a Special Terms Order; or
- a Volume-Weighted Average Price Order.

This definition contemplates that the "last sale price" will be set at a "trading increment". With the proposed introduction under the Proposed Amendments of a new definition of "better price", UMIR will specifically acknowledge that trades may execute (and be reported) at a fraction of a trading increment. For this reason, the Proposed Amendments would revise the definition of "last sale price" to provide that, if the trade executed at a price other than a trading increment, the price shall be rounded to the nearest trading increment and, if the trade executed at one-half of a trading increment, the price shall be rounded up to the next trading increment.

Currently, the concept of "last sale price" is used in a number of UMIR requirements including:

- the use of the "last sale price" in a consolidated display on a trading day for determining the size of the standard trading unit applicable to the particular security on the immediately following trading day;
- consideration of the "last sale price" in determining whether a particular price is "artificial" contrary to Rule 2.2 of UMIR;
- requiring that a short sale, subject to certain exceptions, be executed at a price not less than the "last sale price" in accordance with Rule 3.1 of UMIR;⁶ and
- consideration of the "last sale price" in determining whether the price which a Participant provides to a client on a principal trade is the "best available price".

⁶ IIROC has proposed the repeal of the "tick test" under Rule 3.1 of UMIR. See IIROC Notice 11-075 – Rule Notice – Request for Comments – UMIR – Provisions Respecting the Regulation of Short Sales and Failed Trades (February 25, 2011).

Use of full trading increments for the “last sale price” simplifies compliance with these provisions, particularly when a Participant or marketplace has automated the monitoring as is the case currently with the compliance with the “tick test” for short sales. Irrespective of the fractions of a trading increment at which an order may execute on a marketplace, UMIR requires that all orders entered on a marketplace be at full trading increment.

Clarification of Requirements of the Order Exposure Rule

The Proposed Amendments would make a clarification to Rule 6.3 of UMIR (the “Order Exposure Rule”). Since “transparent” marketplaces may introduce “Dark Orders”, the requirements under the Order Exposure Rule would be amended to ensure that any order required to be entered on a transparent marketplace is “for display” in a consolidated market display. Under the Proposed Amendments, a “small” client order could not be entered on a transparent marketplace as a Dark Order except with the express instruction or consent of the client.

Size Requirements for Dark Orders and Icebergs

The CSA has proposed to amend National Instrument 21-101 to permit a regulation services provider to designate the minimum size of a “Dark Order”.⁷ The Proposed Amendments would add Rule 6.5 to UMIR and provide IIROC with the specific power to make such a designation. In order to avoid potential gaming of this provision and the requirement for Dark Orders to provide price improvement in certain circumstances, the proposed Rule 6.5 would provide that an “iceberg” order must display at least one standard trading unit or such greater size as designated by IIROC.

Prior to IIROC proposing to designate, or to change any designation of, a number of units of a security for the purposes of Rule 6.5, IIROC would consult with the applicable securities regulatory authorities and IIROC would issue a notice requesting public comment in a period of not less than 30 days from the date of issuance of the notice. Provided the applicable securities regulatory authorities have approved of the designation or change in the designation, IIROC would issue a notice of the number of units of a security that have been designated for the purposes of clause (a) or (b) of Rule 6.5 and the effective date of the designation which would not be sooner than 10 trading days following the date of the issuance of the notice.

Until IIROC designates a minimum size for a Dark Order, a Dark Order may be any size. However, the effect of Order Exposure Rule means a client order to purchase or sell 50 standard trading units or less of a security that is not immediately executed at a better price or otherwise exempted from the requirements of the Order Exposure Rule⁸ may only be entered on a marketplace as a Dark Order with the express instruction or consent of the client. In addition, Dark Orders for 50 standard trading units or less may be entered on a marketplace by or for:

- a principal account;
- a non-client account;
- an Access Person (essentially a subscriber to an alternative trading system that is not a dealer);

⁷ Canadian Securities Administrators Notice of Proposed Amendments to National Instrument 21-101 Marketplace Operation and National Instrument 23-101 Trading Rules (2011) 34 OSCB (Supp-1) (March 18, 2011). In discussing the policy rationale for this proposed amendment to subsection 7.1(2) of NI 21-101, the CSA stated:

We acknowledge that, to date, there has been limited activity in dark pools and no evidence that dark liquidity has had a negative impact on the Canadian capital markets. However, we are of the view that it is important and timely to establish a regulatory framework so that we are in a position to respond expeditiously to future market developments. For this reason, in the proposed amendments to NI 21-101, we propose to introduce a requirement that order meet a minimum size established by a regulation services provider in order to be exempt from the transparency requirements in NI 21-101. However, at this time no minimum order size is being proposed. Any size threshold that may be proposed in the future would be set in consultation with the CSA and would follow the regular public comment process. The CSA and IIROC will continue to monitor the level of activity on non-transparent marketplaces and its impact on price discovery to determine whether and when to propose a specific size threshold.

⁸ Rule 6.3 - *Exposure of Client Orders* requires that an order for 50 trading units or less must be immediately entered on a transparent marketplace unless otherwise exempted. Permitted exemptions include:

- (a) if the client has specified different instructions;
- (b) if the order is executed immediately at a better price;
- (c) if the order is returned for the terms of the order to be confirmed;
- (d) if the order is withheld pending confirmation that the order complies with applicable securities requirements;
- (e) if entering the order based on market conditions would not be in the interests of the client;
- (f) if the order has a value greater than \$100,000;
- (g) if the order is part of a trade to be made in accordance with Rule 6.4 by means other than entry on a marketplace; or
- (h) if the client has directed or consented that the order be entered on a marketplace as a Call Market Order, an Opening Order, a Special Terms Order, a Volume-Weighted Average Price Order, a Market-on-Close Order, a Basis Order, or a Closing Price Order.

- a client account if the order entered as a Dark Order is part of a larger client order for the particular security which, when provided to the Participant, was for more than 50 standard trading units.

Price Improvement by a Dark Order

Under the Proposed Amendments, any order which trades with a “Dark Order” would have to receive price improvement on the execution unless the order, as entered on the marketplace, was for more than 50 standard trading units or had a value of more than \$100,000. If the order met either of these requirements, the order could trade with the Dark Order at the market price provided no displayed orders were available on that marketplace at the market price.⁹ If the order as entered on the marketplace exceeds the size parameters, any portion of the order which does not execute with visible orders on that marketplace may execute with a Dark Order provided that there are no visible orders on that marketplace at that price and there are no visible orders at a “better price” on another marketplace. The impact of this provision provides execution priority to visible orders on a marketplace at that same price as Dark Orders. Under the Proposed Amendments, a “large” order entered on a marketplace will be able to execute with a Dark Order at a particular price even though visible orders may be displayed on other marketplaces at that price.

There are a number of additional exceptions if the order that trades with the “Dark Order” is one of the “specialty” orders that can otherwise trade outside of the best ask – best bid spread (being: a Basis Order; a Call Market Order; a Closing Price Order; a Market-on-Close Order; an Opening Order or a Volume-Weighted Average Price Order).

The hidden portion of an “iceberg” order is not considered to be a Dark Order as at least one standard trading unit of the iceberg order must be displayed in a consolidated market display and thereby contribute directly to price discovery mechanism by being eligible to establish the best ask price or the best bid price for the purposes of UMIR. For this reason, the hidden portion of an iceberg order is not required to provide price improvement.

Inability to Rely on Marketplace Functionality

The Proposed Amendments would add a new provision to UMIR which would prohibit a Participant or Access Person from relying on marketplace functionality that they know will result in an order or trade failing to comply with UMIR. A Participant or Access Person would have breached UMIR if the Participant or Access Person enters an order on a marketplace and the Participant or Access Person knows or ought reasonably to have known that the functionality of that marketplace would permit the order to execute with a Dark Order without receiving price improvement or without providing priority to visible orders on that marketplace on the same side of the market. This provision is based on current guidance that IIROC has issued (in particular in connection with “locked” and “crossed” markets¹⁰) regarding the obligation of the Participant or Access Person when entering orders on a particular marketplace.

IIROC acknowledges that marketplaces presently offer functionality and orders types that would not guarantee sufficient price improvement to constitute a “better price” for the purposes of the proposed amendments.¹¹ If the Proposed Amendments are adopted, each marketplace would have to ensure that its system functionality and order types comply with the requirements in the Proposed Amendments for trade prices and execution priority otherwise Participants and Access Persons would be precluded from using such functionality or order types. (See “Technological Implications and Implementation Plan”.)

Execution Price of Orders

With the proposed change to the definition of “better price” under the Proposed Amendments, UMIR will specifically acknowledge that trades may execute at a fraction of a trading increment. Marketplaces, including transparent marketplaces, would be able to introduce order types or functionality that would allow for the execution of orders at a “better price”. For example, when the spread between the “best ask price” and the “best bid price” is at one trading increment executions could occur at the mid-point. Marketplaces could provide functionality for orders at the “best ask price” and the “best bid price” to indicate a willingness at the mid-point or other price level that would provide price improvement for both sides of the trade.

⁹ If the Proposed Amendments are adopted, previous guidance issued by IIROC to the effect that an order “routed to a non-transparent marketplace or facility to determine if liquidity is available on that marketplace or facility at prices that are the same or better than displayed in a consolidated market display would comply with the requirements of Rule 6.3” would be repealed since such order would not be able to execute at the “same” price displayed in a consolidated market display. See the response to question 1 under Market Integrity Notice 2007-019 – *Guidance – Entering Client Orders on Non-Transparent Marketplaces and Facilities* (September 21, 2007).

¹⁰ In particular, see the response to question 8 in IIROC Notice 11-0043 - Rules Notice – Guidance Note – UMIR – *Guidance on “Locked” and “Crossed” Markets* (February 1, 2011).

¹¹ For example, MATCH Now presently provides a minimum price improvement of 20% of the spread. When this functionality was originally approved, the average spread between the best ask price and the best bid price was approximately \$0.05 resulting in price improvement of approximately \$0.01. Since the introduction of MATCH Now, the spread on the most liquid securities has decreased significantly and for major parts of a trading day may be as little as a single trading increment. The proposed definition of “better price” attempts to ensure that there is meaningful price improvement over the prices of transparent orders regardless of changes in the average spread for securities.

For this reason, the Proposed Amendments would revise the provisions regarding the reporting of the trade price to allow any trade (and not just the trade price of a Basis Order, Call Market Order or a Volume-Weighted Average Price Order as contemplated by the current policy under Policy 6.1) to be reported, if permitted by the information processor or information vendor, at the increment established by the marketplace for execution. If the information processor or data vendor does not permit reporting in such partial trading increments, the reported trade price shall be rounded to the nearest trading increment and, if the trade executed at one-half of a trading increment, the price shall be rounded up to the next trading increment.

Variations from the Recommendations of the Position Paper

Definition of “Dark Order”

In the Position Paper, the term “dark order” was defined as “an order on any marketplace which is entered with no pre-trade transparency”. UMIR is structured to generally impose obligations at the time of entry of an order on a marketplace or on the execution of a trade. In order to accommodate the structure of UMIR, a more precise definition of “Dark Order” is included in the Proposed Amendments. The proposed definition confirms that market orders and certain limit orders will be excluded from the definition if the orders would immediately execute upon entry on a marketplace, thereby precluding the orders from being exposed in a consolidated display. The definition of “Dark Order” in the Proposed Amendments also excludes various specialty orders for which the execution price is not known at the time of entry and which are permitted to execute outside of the NBBO in accordance with the terms of the Order Protection Rule. Under UMIR, these specialty orders include: a Basis Order; a Closing Price Order; a Market-on-Close Order; an Opening Order; and a Volume-Weighted Average Price Order.

Minimum Size Requirement for Dark Orders

One of the recommendations in the Position Paper was that an exemption from the pre-trade transparency requirements should only be available for orders meeting a minimum size threshold. The Position Paper did not make a recommendation as to an appropriate size of an order for exemption from the pre-trade transparency requirements. The Position Paper sought specific feedback on the question of what would be an appropriate size. Based on the feedback, the CSA determined not to establish a minimum size requirement at this time but the CSA has proposed to amend the Marketplace Operation Instrument to provide that such a threshold may be established by a regulation services provider, which currently is IIROC.¹² The Proposed Amendments would introduce Rule 6.5 of UMIR which would allow IIROC to designate a minimum size for a Dark Order. The Proposed Amendments would also provide that an “iceberg” order must display at least one standard trading unit or such greater size as may be designated by IIROC.

No designation of a minimum size for Dark Orders or the displayed portion of icebergs would be made on the approval of the Proposed Amendments. However, in the coming month, the CSA and IIROC will examine the Canadian market and monitor market developments and regulatory approaches in other jurisdictions to determine the appropriate size threshold for Dark Orders. IIROC would only make such designations after public consultation and the approval of the CSA.

Price Improvement

The recommendation of the Position Paper was that a “Dark Order” had to provide meaningful price improvement except when it traded with another Dark Order that met minimum size requirements. Under the Proposed Amendments, any “Dark Order” irrespective of size would be able to trade:

- provided the other order received a “better price”; or
- at the NBBO if the other order at the time of entry on the marketplace was for more than 50 standard trading units or with a value of more than \$100,000.

This change from the recommendation of the Position Paper ensures that visible orders on the same marketplace are given execution priority over Dark Orders at the same price, while at the same time providing greater opportunity for Dark Orders to be executed.

¹² See subsection 7.1(2) of proposed amendments to NI 21-101. Canadian Securities Administrators Notice of Proposed Amendments to National Instrument 21-101 Marketplace Operation and National Instrument 23-101 Trading Rules (2011) 34 OSCB (Supp-1) (March 18, 2011).

Summary of the Impact of the Proposed Amendments

The following is a summary of the most significant impacts of the adoption of the Proposed Amendments. The Proposed Amendments would:

- ensure that visible orders on a marketplace are given execution priority over Dark Orders on that marketplace at the same price;
- require Dark Orders to provide meaningful price improvement except when executing with “large” orders; and
- provide that meaningful price improvement is at least one trading increment and, when the displayed market has a spread of only one trading increment, at least one-half of a trading increment.

Technological Implications and Implementation Plan

The Proposed Amendments would permit IIROC to impose obligations on Participants and Access Persons with respect to minimum size requirements for Dark Orders and displayed portions of iceberg orders. The Proposed Amendments would also require, subject to certain exceptions, that orders that execute with Dark Orders be provided with price improvement and that visible orders on the same marketplace be given execution priority over Dark Orders at the same price.

The technological implications of the Proposed Amendments on Participants, Access Persons, marketplaces or service providers are as follows:

- there would be no impact on the systems of transparent marketplaces that do not provide for “Dark Orders” nor iceberg orders with less than one standard trading unit being displayed;
- since the Proposed Amendments do not require the marking of “Dark Orders”, there would be no impact on the systems of Participants, Access Persons or service providers; and
- “Dark Pools” and transparent marketplaces that permit “Dark Orders” or icebergs with less than one standard trading unit being displayed would be required to ensure that their trading system functionality provides:
 - execution priority for visible orders on their marketplace over Dark Orders on their marketplace at the same price, and
 - meaningful price improvement of at least one trading increment (provided that when the displayed market has a spread of only one trading increment, at least one-half of a trading increment) to orders (other than “large” orders) that execute with Dark Orders.

IIROC would expect that if the Proposed Amendments are approved by the Recognizing Regulators, the amendments would become effective on the date IIROC publishes notice of the approval but implementation would be deferred for one hundred and eighty (180) days following the date IIROC publishes notice of the approval.

Questions

While comment is requested on all aspects of the Proposed Amendments, comment is specifically requested on the following questions:

1. If the restrictions at which a short sale may be made are repealed, do the other uses of the “last sale price” under UMIR justify the continuation of the restriction that the last sale price must be a full trading increment?
2. Presently UMIR provides that all orders entered on a marketplace must be priced at a “trading increment”. With the adoption of the definition of “better price” which will permit orders to execute at partial trading increments, should UMIR allow the entry of a “Better-Priced Intentional Cross” at a partial trading increment to facilitate compliance with the “better price” requirements of the Order Exposure Rule (Rule 6.3) and the Client-Principal Trading Rule (Rule 8.1)?

Appendices

- Appendix “A” sets out the text of the Proposed Amendments to UMIR respecting dark liquidity; and
- Appendix “B” contains the text of the relevant provisions of UMIR as they would read on the adoption of the Proposed Amendments.

Appendix "A"

Provisions Respecting Dark Liquidity

The Universal Market Integrity Rules are hereby amended as follows:

1. Rule 1.1 is amended by:
 - (a) deleting the definition of "better price" and substituting the following:

"better price" means, in respect of each trade resulting from an order for a particular security:

 - (a) in the case of a purchase, a price that is at least one trading increment lower than the best ask price at the time of the entry of the order to a marketplace provided that, if the best bid price is one trading increment lower than the best ask price, the price shall be at least one-half of one trading increment lower; and
 - (b) in the case of a sale, a price that is at least one trading increment higher than the best bid price at the time of the entry of the order to a marketplace provided that, if the best ask price is one trading increment higher than the best bid price, the price shall be at least one-half of one trading increment higher.
 - (b) adding the following definition of "Dark Order":

"Dark Order" means an order no portion of which is displayed on entry on a marketplace in a consolidated market display but does not include an order entered on a marketplace as:

 - (a) part of an intentional cross;
 - (b) a market order;
 - (c) a limit order that, based on orders displayed in a consolidated market display, is immediately executed in full on one or more marketplaces at the time of entry;
 - (d) a Basis Order;
 - (e) a Closing Price Order;
 - (f) a Market-on-Close Order;
 - (g) an Opening Order; or
 - (h) a Volume-Weighted Average Price Order.
 - (c) amending the definition of "last sale price" by inserting the phrase "provided that, if the trade executed at a price other than a trading increment, the price shall be rounded to the nearest trading increment and, if the trade executed at one-half of a trading increment, the price shall be rounded up to the next trading increment" immediately following the word "display".
2. Rule 6.3 is amended by inserting the phrase "for display" immediately following the word "enter".
3. Part 6 is amended by adding the following as Rule 6.5:

Minimum Size Requirements of Certain Orders Entered on a Marketplace

A Participant or Access Person shall not enter an order for the purchase or sale of a security on a marketplace if:

- (a) the order is a Dark Order and the order does not exceed the number of units as designated from time to time by the Market Regulator for the purposes of this clause; or
- (b) less than one standard trading unit of the order or such greater number of units as designated from time to time by the Market Regulator for the purposes of this clause will be displayed in a

consolidated market display on the entry of the order on the marketplace and at any time prior to the full execution of the order.

4. Part 6 is amended by adding the following as Rule 6.6:

Provision of Price Improvement by a Dark Order

- (1) If a Participant or Access Person enters an order on a marketplace for the purchase or sale of a security that order may execute with a Dark Order provided the order entered by the Participant or Access Person is executed:
- (a) at a better price;
 - (b) in the case of a purchase, at the best ask price if:
 - (i) the order on entry to the marketplace is for more than 50 standard trading units or has a value of more than \$100,000, and
 - (ii) on the execution of the trade with the Dark Order, no orders for the sale of the security are displayed on that marketplace at that best ask price; or
 - (c) in the case of a sale, at the best bid price if:
 - (i) the order on entry to the marketplace is for more than 50 standard trading units or has a value of more than \$100,000, and
 - (ii) on the execution of the trade with the Dark Order, no orders for the purchase of the security are displayed on that marketplace at that best bid price.
- (2) Subsection (1) does not apply if the order entered by the Participant or Access Person is:
- (a) a Basis Order;
 - (b) a Call Market Order;
 - (c) a Closing Price Order;
 - (d) a Market-on-Close Order;
 - (e) an Opening Order; or
 - (f) a Volume-Weighted Average Price Order.

5. Part 7 is amended by adding the following as Rule 7.12:

Inability to Rely on Marketplace Functionality

A Participant or Access Person shall not enter an order on a particular marketplace if the Participant or Access Person knows or ought reasonably to know that the handling of the order by the marketplace and the trading systems of the marketplace may result in the display of the order or the execution of the order not being in compliance with any of the applicable requirements of UMIR.

The Policies to the Universal Market Integrity Rules are hereby amended as follows:

1. Part 1 of Policy 6.1 is deleted and the following substituted:

Part 1 – Execution Price of Orders

An order may execute at such price increment as established by the marketplace for the execution of such orders provided, unless otherwise permitted by the information processor or information vendor, that the marketplace shall report the price at which the trade was executed to the information processor or an information vendor as the nearest trading increment and if the price results in one-half of a trading increment the price shall be rounded up to the next trading increment.

Appendix "B"

Text of UMIR to Reflect Proposed Amendments Respecting
Dark Liquidity

Text of Provisions Following Adoption of the Proposed Amendments	Text of Current Provisions Marked to Reflect Adoption of the Proposed Amendments
<p>1.1 Definitions</p> <p>"better price" means, in respect of each trade resulting from an order for a particular security:</p> <p>(a) in the case of a purchase, a price that is at least one trading increment lower than the best ask price at the time of the entry of the order to a marketplace provided that, if the best bid price is one trading increment lower than the best ask price, the price shall be at least one-half of one trading increment lower; and</p> <p>(b) in the case of a sale, a price that is at least one trading increment higher than the best bid price at the time of the entry of the order to a marketplace provided that, if the best ask price is one trading increment higher than the best bid price, the price shall be at least one-half of one trading increment higher.</p>	<p>1.1 Definitions</p> <p>"better price" means, in respect of each trade resulting from an order for a particular security:</p> <p>(a) <u>a price lower than the best ask price</u>, in the case of a purchase, <u>a price that is at least one trading increment lower than the best ask price at the time of the entry of the order to a marketplace provided that, if the best bid price is one trading increment lower than the best ask price, the price shall be at least one-half of one trading increment lower;</u> and</p> <p>(b) <u>a price higher than the best bid price</u>, in the case of a sale, <u>a price that is at least one trading increment higher than the best bid price at the time of the entry of the order to a marketplace provided that, if the best ask price is one trading increment higher than the best bid price, the price shall be at least one-half of one trading increment higher.</u></p>
<p>1.1 Definitions</p> <p>"Dark Order" means an order no portion of which is displayed on entry on a marketplace in a consolidated market display but does not include an order entered on a marketplace as:</p> <p>(a) part of an intentional cross;</p> <p>(b) a market order;</p> <p>(c) a limit order that, based on orders displayed in a consolidated market display, is immediately executed in full on one or more marketplaces at the time of entry;</p> <p>(d) a Basis Order;</p> <p>(e) a Closing Price Order;</p> <p>(f) a Market-on-Close Order;</p> <p>(g) an Opening Order; or</p> <p>(h) a Volume-Weighted Average Price Order.</p>	<p>1.1 Definitions</p> <p>"Dark Order" means an order no portion of which is <u>displayed on entry on a marketplace in a consolidated market display but does not include an order entered on a marketplace as:</u></p> <p>(a) <u>part of an intentional cross;</u></p> <p>(b) <u>a market order;</u></p> <p>(c) <u>a limit order that, based on orders displayed in a consolidated market display, is immediately executed in full on one or more marketplaces at the time of entry;</u></p> <p>(d) <u>a Basis Order;</u></p> <p>(e) <u>a Closing Price Order;</u></p> <p>(f) <u>a Market-on-Close Order;</u></p> <p>(g) <u>an Opening Order; or</u></p> <p>(h) <u>a Volume-Weighted Average Price Order.</u></p>
<p>1.1 Definitions</p> <p>"last sale price" means the price of the last sale of at least one standard trading unit of a particular security displayed in a consolidated market display provided that, if the trade executed at a price other than a trading increment, the price shall be rounded to the nearest trading increment and, if the trade executed at one-half of a trading increment, the price shall be rounded up to the next trading increment but does</p>	<p>1.1 Definitions</p> <p>"last sale price" means the price of the last sale of at least one standard trading unit of a particular security displayed in a consolidated market display <u>provided that, if the trade executed at a price other than a trading increment, the price shall be rounded to the nearest trading increment and, if the trade executed at one-half of a trading increment, the price shall be rounded up to the next trading increment but does</u></p>

Text of Provisions Following Adoption of the Proposed Amendments	Text of Current Provisions Marked to Reflect Adoption of the Proposed Amendments
<p>not include the price of a sale resulting from an order that is:</p> <ul style="list-style-type: none"> (a) a Basis Order; (b) a Call Market Order; (c) a Closing Price Order; (d) a Special Terms Order unless the Special Terms Order has executed with an order or orders other than a Special Terms Order; or (e) a Volume-Weighted Average Price Order. 	<p>not include the price of a sale resulting from an order that is:</p> <ul style="list-style-type: none"> (a) a Basis Order; (b) a Call Market Order; (c) a Closing Price Order; (d) a Special Terms Order unless the Special Terms Order has executed with an order or orders other than a Special Terms Order; or (e) a Volume-Weighted Average Price Order.
<p>6.3 Exposure of Client Orders</p> <p>(1) A Participant shall immediately enter for display on a marketplace that displays orders in accordance with Part 7 of the Marketplace Operation Instrument a client order to purchase or sell 50 standard trading units or less of a security unless:</p> <p>...</p>	<p>6.3 Exposure of Client Orders</p> <p>(1) A Participant shall immediately enter <u>for display</u> on a marketplace that displays orders in accordance with Part 7 of the Marketplace Operation Instrument a client order to purchase or sell 50 standard trading units or less of a security unless:</p> <p>...</p>
<p>6.5 Minimum Size Requirements of Certain Orders Entered on a Marketplace</p> <p>A Participant or Access Person shall not enter an order for the purchase or sale of a security on a marketplace if:</p> <ul style="list-style-type: none"> (a) the order is a Dark Order and the order does not exceed the number of units as designated from time to time by the Market Regulator for the purposes of this clause; or (b) less than one standard trading unit of the order or such greater number of units as designated from time to time by the Market Regulator for the purposes of this clause will be displayed in a consolidated market display on the entry of the order on the marketplace and at any time prior to the full execution of the order. 	<p>6.5 <u>Minimum Size Requirements of Certain Orders Entered on a Marketplace</u></p> <p><u>A Participant or Access Person shall not enter an order for the purchase or sale of a security on a marketplace if:</u></p> <ul style="list-style-type: none"> (a) <u>the order is a Dark Order and the order does not exceed the number of units as designated from time to time by the Market Regulator for the purposes of this clause; or</u> (b) <u>less than one standard trading unit of the order or such greater number of units as designated from time to time by the Market Regulator for the purposes of this clause will be displayed in a consolidated market display on the entry of the order on the marketplace and at any time prior to the full execution of the order.</u>
<p>6.6 Provision of Price Improvement by a Dark Order</p> <p>(1) If a Participant or Access Person enters an order on a marketplace for the purchase or sale of a security that order may execute with a Dark Order provided the order entered by the Participant or Access Person is executed:</p> <ul style="list-style-type: none"> (a) at a better price; (b) in the case of a purchase, at the best ask price if: <ul style="list-style-type: none"> (i) the order on entry to the marketplace is for more than 50 standard trading units or has a value of more than \$100,000, and (ii) on the execution of the trade with the Dark Order, no orders for the sale of the security are displayed on that marketplace at that best 	<p>6.6 <u>Provision of Price Improvement by a Dark Order</u></p> <p>(1) <u>If a Participant or Access Person enters an order on a marketplace for the purchase or sale of a security that order may execute with a Dark Order provided the order entered by the Participant or Access Person is executed:</u></p> <ul style="list-style-type: none"> (a) <u>at a better price;</u> (b) <u>in the case of a purchase, at the best ask price if:</u> <ul style="list-style-type: none"> (i) <u>the order on entry to the marketplace is for more than 50 standard trading units or has a value of more than \$100,000, and</u> (ii) <u>on the execution of the trade with the Dark Order, no orders for the sale of the security are displayed on that marketplace at that best</u>

Text of Provisions Following Adoption of the Proposed Amendments	Text of Current Provisions Marked to Reflect Adoption of the Proposed Amendments
<p>ask price; or</p> <p>(c) in the case of a sale, at the best bid price if:</p> <p>(i) the order on entry to the marketplace is for more than 50 standard trading units or has a value of more than \$100,000, and</p> <p>(ii) on the execution of the trade with the Dark Order, no orders for the purchase of the security are displayed on that marketplace at that best bid price.</p> <p>(2) Subsection (1) does not apply if the order entered by the Participant or Access Person is:</p> <p>(a) a Basis Order;</p> <p>(b) a Call Market Order;</p> <p>(c) a Closing Price Order;</p> <p>(d) a Market-on-Close Order;</p> <p>(e) an Opening Order; or</p> <p>(f) a Volume-Weighted Average Price Order.</p>	<p><u>ask price; or</u></p> <p><u>(c) in the case of a sale, at the best bid price if:</u></p> <p><u>(i) the order on entry to the marketplace is for more than 50 standard trading units or has a value of more than \$100,000, and</u></p> <p><u>(ii) on the execution of the trade with the Dark Order, no orders for the purchase of the security are displayed on that marketplace at that best bid price.</u></p> <p><u>(2) Subsection (1) does not apply if the order entered by the Participant or Access Person is:</u></p> <p><u>(a) a Basis Order;</u></p> <p><u>(b) a Call Market Order;</u></p> <p><u>(c) a Closing Price Order;</u></p> <p><u>(d) a Market-on-Close Order;</u></p> <p><u>(e) an Opening Order; or</u></p> <p><u>(f) a Volume-Weighted Average Price Order.</u></p>
<p>7.12 Inability to Rely on Marketplace Functionality</p> <p>A Participant or Access Person shall not enter an order on a particular marketplace if the Participant or Access Person knows or ought reasonably to know that the handling of the order by the marketplace and the trading systems of the marketplace may result in the display of the order or the execution of the order not being in compliance with any of the applicable requirements of UMIR.</p>	<p><u>7.12 Inability to Rely on Marketplace Functionality</u></p> <p><u>A Participant or Access Person shall not enter an order on a particular marketplace if the Participant or Access Person knows or ought reasonably to know that the handling of the order by the marketplace and the trading systems of the marketplace may result in the display of the order or the execution of the order not being in compliance with any of the applicable requirements of UMIR.</u></p>
<p>Policy 6.1 – Entry of Orders to a Marketplace</p> <p>Part 1 – Execution Price of Orders</p> <p>An order may execute at such price increment as established by the marketplace for the execution of such orders provided, unless otherwise permitted by the information processor or information vendor, that the marketplace shall report the price at which the trade was executed to the information processor or an information vendor as the nearest trading increment and if the price results in one-half of a trading increment the price shall be rounded up to the next trading increment.</p>	<p>Policy 6.1 – Entry of Orders to a Marketplace</p> <p>Part 1 – Exceptions for Certain Types <u>Execution Price of Orders</u></p> <p>Notwithstanding that all orders for a security at a price of \$0.50 or more must be entered on a marketplace at a price that does not include a fraction or a part of a cent, an order which is entered on a marketplace as a Basis Order, Call Market Order or a Volume-Weighted Average Price Order An order may execute at such price increment as established by the marketplace for the execution of such orders provided, unless otherwise permitted by the information processor or information vendor, that the marketplace shall report the price at which the trade was executed to the information processor or an information vendor as the nearest trading increment and if the price results in one-half of a trading increment the price shall be rounded up to the next trading increment.</p>