

13.1.5 OSC Staff Notice of Approval –Amendments to the Universal Market Integrity Rules Respecting Dark Liquidity

INVESTMENT INDUSTRY REGULATORY ORGANIZATION OF CANADA

AMENDMENTS TO THE UNIVERSAL MARKET INTEGRITY RULES RESPECTING DARK LIQUIDITY

NOTICE OF COMMISSION APPROVAL

The Ontario Securities Commission approved proposed amendments to the Universal Market Integrity Rules (UMIR) respecting the use of dark liquidity on Canadian equity marketplaces (the UMIR Amendments). In addition, British Columbia Securities Commission did not object to, and the Alberta Securities Commission, the Autorité des marchés financiers, the Saskatchewan Financial Services Commission, the Financial Services Regulation Division of the Department of Government Services of Newfoundland and Labrador, the Nova Scotia Securities Commission and the New Brunswick Securities Commission have approved the UMIR Amendments.

The UMIR Amendments, effective October 10, 2012, will implement the regulatory framework for dark liquidity in Canada, which was developed jointly by the Canadian Securities Administrators (CSA) and IIROC and is the result of a lengthy consultation process with market participants. It consists of the following key elements:

1. a minimum size threshold for posting dark orders in a marketplace;
2. a minimum price improvement of one trading increment, or half a trading increment if the difference between the best bid and the best ask price of a security is one trading increment;
3. a requirement that orders below a certain size be provided price improvement in order to be executed against dark orders; and
4. a requirement that transparent orders must be executed before dark orders at the same price on the same marketplace.

The UMIR Amendments implement the majority of the components of the regulatory framework for dark liquidity by:

1. revising the UMIR definition of “better price” to mean a minimum of one trading increment or one-half of one trading increment when the difference between the best ask price and best bid price for a security is one trading increment;
2. providing that an order entered on a marketplace trade with visible order on that marketplace at the same price before trading with dark orders entered on that marketplace at the same price;
3. introducing price improvement requirements for orders entered on a marketplace in order to trade with dark orders on that marketplace, unless the former exceed a certain size threshold; and
4. introducing other related technical amendments to the UMIR.

One part of the regulatory framework for dark liquidity was implemented through amendments to National Instrument 21-101 *Marketplace Operation* which, subject to Ministerial approval, will be effective July 1, 2012. These amendments will introduce a minimum size threshold for posting orders in a marketplace that will be established by IIROC. The process for setting the size threshold will involve consultation with the CSA and market participants is described in IIROC Notice 12-0130 published today and included at Appendix A. While a size threshold has not been proposed at this time, the CSA and IIROC plan to monitor market developments, as well as the impact of the other components of the dark liquidity framework implemented through the UMIR Amendments, to determine whether a size threshold should be proposed and whether additional regulatory requirements are needed.

Throughout the consultation process on dark liquidity issues, market participants indicated that the CSA and IIROC should not focus their efforts solely on dark liquidity and should review other issues that impact market structure, such as the use of broker preferencing, dealer internalization of order flow, the marketplaces’ fee models and high-frequency trading. We acknowledge these concerns and note that a number of initiatives are currently in place to review these issues. Specifically:

- staff of the Ontario Securities Commission are reviewing information received from dealers relating to dealer internalization and broker preferencing practices and will be considering next steps.
- we are aware of the concerns raised regarding marketplace fees and marketplaces’ fee models, particularly the use of the maker-taker fee model, and are considering next steps to address the issues. A review of market data fees is currently underway.

- with respect to high-frequency trading, we support IIROC's work relating to high-frequency trading and its impact on market quality. In addition, proposed National Instrument 23-103 *Electronic Trading and Direct Electronic Access to Marketplaces* includes provisions that focus on the risks associated with automated trading and direct electronic access, including high-frequency trading.

The UMIR Amendments were published for comment on July 29, 2011. Non-material changes were made since their publication, mostly to address public comments. The summary of comments and IIROC's response, as well as a blacklined version of the UMIR amendments showing these changes are included at Appendix A.