

# Chapter 1

## Notices

### 1.1 Notices

#### 1.1.1 CSA Staff Notice 21-328 – Regulatory Approach to Foreign Marketplaces Trading Fixed Income Securities



Canadian Securities  
Administrators

Autorités canadiennes  
en valeurs mobilières

#### CSA Staff Notice 21-328

#### *Regulatory Approach to Foreign Marketplaces Trading Fixed Income Securities*

March 5, 2020

#### I. Introduction

The Canadian Securities Administrators (the **CSA** or **we**) have developed a framework for granting exemptions to foreign alternative trading systems trading fixed income securities (**foreign ATs**)<sup>1</sup> that request to carry on business in Canada. We are also providing notice that foreign multilateral trading facilities (**foreign MTFs**) may be permitted to trade fixed income securities.

The framework describes the approach that will be used to evaluate the requests and determine whether to recommend granting the exemptions. The approach considers the risks that need to be managed, the regulatory regime in the jurisdiction of the foreign ATS, and the key requirements that will need to be addressed. It is aimed at removing unnecessary regulatory burden to operating in Canada while maintaining high standards of investor protection and market integrity.

The nature of trading is increasingly global due to the reliance on technology by market participants. In this environment, more marketplaces are applying to carry on business in Canada. We have examined the regulatory approach historically followed with respect to foreign marketplaces that trade or are seeking to trade fixed income securities, taking into consideration potential market fragmentation,<sup>2</sup> regulatory duplication, and regulatory burden.

#### II. Background

Historically, alternative trading systems based in foreign jurisdictions have been permitted to conduct business in Canada. To do so, we have required that they create Canadian subsidiaries that are registered as investment dealers, members of the Investment Industry Regulatory Organization of Canada (**IIROC**), and subject to National Instrument 21-101 *Marketplace Operation (NI 21-101)*, National Instrument 23-101 *Trading Rules (NI 23-101)*, and National Instrument 23-103 *Electronic Trading and Direct Electronic Access to Marketplaces (NI 23-103)*, (together, the **Marketplace Rules**).

As access to markets becomes increasingly global, Canadian market participants want access to foreign markets. However, some foreign ATs wishing to offer their services to Canadian participants may choose not to do so for various reasons, such as concerns that the anticipated volume and size of activity in Canada may not be large enough to justify the business and regulatory costs of complying with the requirements to operate a marketplace.

In the context of foreign derivatives exchanges and swap execution facilities (**SEFs**) or foreign MTFs trading derivatives, we have for many years provided exemptions from licensing requirements.<sup>3</sup> Specifically, exemptions from the exchange recognition

<sup>1</sup> Fixed income securities do not include any crypto assets.

<sup>2</sup> See The Board of the International Organization of Securities Commissions, "Market Fragmentation & Cross-border Regulation Report" (June 2019), available at <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD629.pdf>.

<sup>3</sup> In Ontario, see OSC Staff Notice 21-702 Regulatory Approach for Foreign-Based Stock Exchanges, available at [https://www.osc.gov.on.ca/en/SecuritiesLaw\\_sn\\_20031031\\_21-702\\_foreignbased.jsp](https://www.osc.gov.on.ca/en/SecuritiesLaw_sn_20031031_21-702_foreignbased.jsp); OSC Staff Notice 21-707 Swap Execution Facilities – Exemption from Requirement to be Recognized as an Exchange, available at [https://www.osc.gov.on.ca/en/SecuritiesLaw\\_sn\\_20131010\\_21-707\\_swap-execution-facilities.htm](https://www.osc.gov.on.ca/en/SecuritiesLaw_sn_20131010_21-707_swap-execution-facilities.htm); and OSC Staff Notice 21-711 Multilateral Trading Facilities – Exemption from Requirement to be Recognized as an Exchange, available at [https://www.osc.gov.on.ca/en/SecuritiesLaw\\_20180104\\_21-711\\_multilateral-trading-facilities.htm](https://www.osc.gov.on.ca/en/SecuritiesLaw_20180104_21-711_multilateral-trading-facilities.htm). In Quebec, see Policy Statement Respecting the Authorization of Foreign-Based Exchanges, available at <https://lautorite.qc.ca/fileadmin/lautorite/reglementation/valeurs-mobilieres/instr-gen-bourses-etranangeres/2005-03-30/2005mars30-ig-boursesetranangeres-en.pdf>.

requirements of securities and derivatives legislation have been granted.<sup>4</sup> This approach has not yet been used for foreign ATSS or foreign MTFs trading products other than derivatives.

Recently, we have received inquiries from foreign ATSS and foreign MTFs that trade fixed income securities requesting exemptions from the Marketplace Rules on the grounds that they are subject to a comprehensive regulatory regime in their home jurisdiction.

Given these factors, the CSA has reviewed the approach to determine whether an exemption model similar to the one used for foreign futures exchanges, SEFs, and MTFs trading derivatives is appropriate. We reviewed the regulatory models applicable to several foreign ATSS and foreign MTFs trading fixed income securities, particularly those used in the United States and Europe, in order to understand whether they are comparable and, specifically, whether they may be relied on for investor protection and the promotion of a fair and efficient market.<sup>5</sup> We considered whether these regimes met certain criteria, identified below, such that we can rely on the home regulatory regime to manage the risks associated with these marketplaces.

This notice describes the outcome of that review: a proposed exemption model for foreign ATSS that would rely on the home jurisdiction for regulation but impose relevant regulatory terms and conditions on the operations of the foreign ATS within Canada. With respect to foreign MTFs, we will consider allowing them to trade fixed income securities under their existing exemption orders. We don't intend for the exemption model to be available to foreign marketplaces that facilitate the trading of securities other than fixed income securities.

### III. Regulatory Framework

#### a. Regulatory Framework for Exempting Foreign ATSS

Under the exemption model, foreign ATSS may be permitted to offer direct access to Canadian participants without having to establish a Canadian-based affiliate, provided they meet certain terms and conditions, including a requirement that they comply with the applicable regulation in their home jurisdiction.

To offer direct access to Canadian participants, a foreign ATS would need to apply for an exemption from the Marketplace Rules.<sup>6</sup> Below, we provide details on the application process, exemption criteria, and sample terms and conditions that may be included in a foreign ATS's exemption order. With respect to a foreign MTF seeking to offer direct trading in fixed income securities to Canadian participants, the MTF may apply to expand its existing exchange exemption order to allow for trading of fixed income securities. Additional terms and conditions may be appropriate to facilitate this trading.

We note that although the proposed exemption would grant foreign ATSS relief from the Marketplace Rules, depending on their model of operations, foreign ATSS or their participants may still be subject to registration under applicable securities legislation. Foreign ATSS may trigger registration requirements under applicable Canadian securities laws because they may engage in the business of trading. A common exemption available in these cases would be the International Dealer Exemption (**IDE**).<sup>7</sup> The IDE may be available where the foreign ATS offers trading in foreign securities.<sup>8</sup> Foreign ATSS should consider the registration requirement and available exemptions when determining which securities to offer for trading.

In the case of participants on foreign ATSS, they may also need to be registered where they are dealing with Canadian participants. For example, in the case of a request-for-quote system that results in agreements to trade where a foreign participant is interacting directly with Canadian participants, the foreign participant may need to be registered as a dealer or rely on a registration exemption.

#### b. Obtaining an Exemption

A foreign ATS seeking an exemption must file an application for exemption from the Marketplace Rules outlining the following:

1. How the foreign ATS is regulated by a government authority responsible for regulation of alternative trading systems (**home regulator**) and what authority and procedures the home regulator has in place for oversight of the foreign ATS, comparing the home regulatory regime to the Marketplace Rules;<sup>9</sup>

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<sup>4</sup> This exemptive relief was granted on the basis that these entities are subject to a comprehensive regulatory regime in their home jurisdictions.

<sup>5</sup> The characteristics of an efficient market, initially identified by the Toronto Stock Exchange in its 1997 report, *Market Fragmentation: Responding to the Challenge*, are considered by the CSA when evaluating the impact of any change to the Canadian market. They are market liquidity, transparency, price discovery, fairness, and market integrity.

<sup>6</sup> A foreign ATS would need to seek the exemption pursuant to the following provisions: s. 15.1 of NI 21-101 from NI 21-101 in whole; s. 12.1 of NI 23-101 from NI 23-101 in whole; and s. 10 of NI 23-103 from NI 23-103 in whole.

<sup>7</sup> See s. 8.18 of National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations (NI 31-103)*.

<sup>8</sup> Defined in s. 8.18(1) of NI 31-103.

<sup>9</sup> Preference will be given to foreign ATSS from jurisdictions where there is a memorandum of understanding in place between the foreign regulator and the applicable securities regulatory authorities.

2. What activities the foreign ATS carries out, noting that an exemption will only be available where the foreign ATS' activities are limited to those that fall within the definition of an alternative trading system as set out in NI 21-101;<sup>10</sup>
3. Who can access the foreign ATS and how access is provided;
4. Actual and potential conflicts of interest and the tools used to manage them;
5. How clearing and settlement is achieved. The foreign ATS needs to demonstrate that these functions are performed appropriately through a regulated clearing house;<sup>11</sup>
6. Whether the foreign ATS performs custody functions and if so, how;
7. The approach used to foster system resiliency, integrity, reliability, and cybersecurity of the foreign ATS;
8. Outsourcing of services and systems and how the outsourcing is managed;<sup>12</sup>
9. The transparency of operations of the foreign ATS, including disclosure relating to order execution, fees, and order priority;
10. How, if at all, the foreign ATS contributes to price discovery (i.e. pre- and/or post-trade transparency);
11. How the foreign ATS maintains adequate systems for the keeping of books and records, including a detailed audit trail, and how confidential information is maintained;
12. Whether the foreign ATS has sufficient financial resources for the proper performance of its functions and to meet its responsibilities;
13. How trading is monitored on the foreign ATS to prevent against market abuse or manipulation; and
14. The foreign ATS's mechanisms for sharing information and otherwise cooperating with the applicable regulatory authorities and their staff, self-regulatory organizations, other marketplaces, clearing agencies, investor protection funds, and other appropriate regulatory bodies.<sup>13</sup>

We note that, if the circumstances change, we may, at any time, re-evaluate whether it is appropriate for a foreign ATS to continue to operate under an exemption or whether it must comply with the Marketplace Rules, become an IROC member, and/or register with securities regulators in Canada.

### **c. Terms and Conditions of the Exemption**

The specific terms and conditions applicable to the foreign ATS may vary depending on its operations, the information in its application, the regulatory regime in its home jurisdiction, and any other matters relevant to the application. The terms and conditions focus on maintaining regulatory compliance in its home jurisdiction, providing the CSA with ongoing information about its operations and trading activity in Canada, and ensuring that there is sufficient transparency to participants of the regulatory structure, specifically the substituted compliance model. Generally, these terms and conditions will require:

1. Ongoing regulation and oversight of the foreign ATS by its home regulator;
2. Ongoing compliance with regulatory requirements in its home jurisdiction;
3. Prior notice of material changes to the business and operations of the foreign ATS or the information included in the application;
4. Information and limitations on the types of Canadian participants that may access the foreign ATS and the products available to Canadian participants;
5. Ad hoc and periodic filing requirements that would permit the CSA to monitor certain activities of the foreign ATS, trading by Canadian participants on the foreign ATS, and the financial conditions of the foreign ATS;

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<sup>10</sup> If the foreign ATS is an exchange or equivalent, the existing practice of exempting foreign exchanges is available.

<sup>11</sup> Note that the clearing house may also require recognition or an exemption from same.

<sup>12</sup> Please see the International Organization of Securities Commissions' "Principles on Outsourcing by Markets" (February 2009), available at <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD283.pdf>.

<sup>13</sup> See, for instance, the memorandums of understanding between the Financial Industry Regulatory Authority and IROC (available at <https://www.finra.org/sites/default/files/Industry/p122062.pdf>), as well as the Ontario Securities Commission (available at <https://www.finra.org/sites/default/files/Industry/p125113.pdf>) and the British Columbia Securities Commission (available at [https://www.bcsc.bc.ca/uploadedFiles/About\\_Us/Other\\_Jurisdictions/FINRA-BCSC\\_International\\_Information\\_Sharing\\_Memorandum\\_of\\_Understanding\\_\(effective\\_July\\_1\\_2016\).pdf](https://www.bcsc.bc.ca/uploadedFiles/About_Us/Other_Jurisdictions/FINRA-BCSC_International_Information_Sharing_Memorandum_of_Understanding_(effective_July_1_2016).pdf)).

6. Disclosure to participants regarding the regulatory structure, the implications of the exemption, and the legal rights of a participant;
7. Submission to jurisdiction and appointment of agent for service requiring the foreign ATS to submit to the non-exclusive jurisdiction of Canadian courts, administrative tribunals, and proceedings; and
8. General information sharing provisions to ensure that the CSA has access to any information required to carry out its mandate with respect to the marketplace activities of the foreign ATS in Canada.

A detailed, sample set of terms and conditions can be found in **Schedule A** to this notice. However, foreign ATSs should be aware that additional terms and conditions may be required depending on the operational model and regulatory structure under review. Foreign ATSs are also advised that any breach of a term and condition to their exemption orders may be a contravention of Canadian securities law.

#### **d. Exemption Application Process**

While the application process varies across the CSA, in most circumstances, a foreign ATS seeking an exemption must submit a draft order, along with an application detailing its history, business, and regulatory structure, and addressing how it meets the specific criteria outlined above. The application should also address if the foreign ATS is subject to any trade reporting and if so, what must be reported, when, and where. In Ontario, the application and order will be subject to a 30-day public comment period. Foreign ATSs that are currently regulated in Canada through a Canadian subsidiary and meet the criteria set out above could consider applying for a similar exemption.

The CSA will review applications for exemption and will work with foreign ATSs on the appropriate terms and conditions that may be included in a foreign ATS exemption order. The foreign ATS exemption regime ultimately aims to avoid market fragmentation and reduce regulatory duplication and burden while facilitating investor protection and promoting a fair and efficient market.

#### **IV. Questions**

Questions may be referred to:

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## SCHEDULE A

### SAMPLE TERMS AND CONDITIONS (ATS)

#### Regulation and Oversight of the ATS

1. The ATS will continue to be subject to the regulatory oversight of its home regulator;
2. The ATS will either be registered in an appropriate category or rely on an exemption from registration under Canadian securities laws;
3. The ATS will promptly notify the applicable securities regulatory authorities if its status in its home jurisdiction has been revoked, suspended, or amended, or the basis on which its status has significantly changed;

#### Access

4. The ATS will not provide direct access to a Canadian participant unless the Canadian participant is a permitted client as that term is defined in National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations*;
5. The ATS will require Canadian participants to provide prompt notification to the ATS if they no longer qualify as permitted clients;
6. The ATS must make available to Canadian participants appropriate training for each person who has access to trade on the ATS;

#### Trading by Canadian Participants

7. The ATS will permit Canadian participants to only trade fixed income securities;
8. Trading on the ATS by Canadian participants must be cleared and settled through a clearing agency that is regulated as a clearing agency by the clearing agency's home regulator;
9. The ATS will permit Canadian participants to only trade those securities which are permitted to be traded in the ATS' home jurisdiction under applicable securities laws and regulations;

#### Reporting

10. The ATS will promptly notify Staff at the applicable securities regulatory authorities of any of the following:
  - a. any material change to its business or operations or the information provided in its application for exemptive relief, including, but not limited to:
    - i. changes to its regulatory oversight;
    - ii. the access model, including eligibility criteria, for Canadian participants;
    - iii. systems and technology; and
    - iv. its clearing and settlement arrangements;
  - b. any material change in its regulations or the laws, rules, and regulations in the home jurisdiction relevant to the products traded;
  - c. any known investigations of, or regulatory action against, the ATS by its home regulator or any other regulatory authority to which it is subject;
  - d. any matter known to the ATS that may affect its financial or operational viability, including, but not limited to, any significant system failure or interruption; and
  - e. any default, insolvency, or bankruptcy of any participant known to the ATS or its representatives that may have a material, adverse impact upon the ATS or any Canadian participant;
11. The ATS will maintain the following updated information and submit such information in a manner and form acceptable to Staff of the applicable securities regulatory authorities on a bi-annual basis (within 30 days of the end of each six-month period), and at any time promptly upon the request of Staff of the applicable securities regulatory authorities:

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- a. a current list of all Canadian participants, organized on a provincial basis, specifically identifying for each Canadian participant the basis upon which it represented to the ATS that it could be provided with direct access;
- b. a list of all Canadian applicants for status as a Canadian participant, on a provincial basis, who were denied such status or access or who had such status or access revoked during the period;
  - i. for those Canadian participants who had their status revoked, an explanation as to why their status was revoked;
- c. for each product:
  - i. the total trading volume and value originating from Canadian participants, presented on a per provincial participant basis, and
  - ii. the proportion of worldwide trading volume and value on the ATS conducted by Canadian participants, presented in the aggregate for such Canadian participants on a provincial basis; and
- d. a list outlining each incident of a significant system outage that occurred at any time during the period for any system impacting Canadian participants' trading activity, including trading, routing, or data, specifically identifying the date, duration, and reason for the outage, and noting any corrective action taken;

## Disclosure

12. The ATS will provide to its Canadian participants disclosure that states that:
  - a. rights and remedies against it may only be governed by the laws of the home jurisdiction, rather than the laws of Canada, and may be required to be pursued in the home jurisdiction rather than in Canada;
  - b. the rules applicable to trading on the ATS may be governed by the laws of the home jurisdiction, rather than the laws of Canada; and
  - c. the ATS is regulated by the regulator in the home jurisdiction, rather than the CSA;

## Submission to Jurisdiction and Appointment of Agent for Service

13. With respect to a proceeding brought by an applicable securities regulatory authority arising out of, related to, concerning, or in any other manner connected with that securities regulatory authority's regulation and oversight of the activities of the ATS in Canada, the ATS will submit to the non-exclusive jurisdiction of (i) the courts and administrative tribunals of that securities regulatory authority's province or territory, and (ii) an administrative proceeding in that province or territory;
14. The ATS will submit to the applicable securities regulatory authorities a valid and binding appointment of an agent for service in those jurisdictions upon which the applicable securities regulatory authorities may serve a notice, pleading, subpoena, summons, or other process in any action, investigation, or administrative, criminal, quasi-criminal, penal, or other proceeding arising out of or relating to or concerning the applicable securities regulatory authorities' regulation and oversight of the ATS' activities in Canada;

## Information Sharing

15. The ATS must, and must cause its affiliated entities, if any, to promptly provide to the applicable securities regulatory authorities, on request, any and all data, information, and analyses in the custody or control of the ATS or any of its affiliated entities, without limitations, redactions, restrictions or conditions, including, without limiting the generality of the foregoing:
  - a. data, information, and analyses relating to all of its or their businesses; and
  - b. data, information, and analyses of third parties in its or their custody or control; and
16. The ATS must share information and otherwise cooperate with other recognized or exempt exchanges, recognized self-regulatory organizations, recognized or exempt clearing agencies, investor protection funds, and other appropriate regulatory bodies.