

1.1.4 OSC Staff Notice 21-706 – Marketplaces' Initial Operations and Material System Changes

OSC STAFF NOTICE 21-706 – MARKETPLACES' INITIAL OPERATIONS AND MATERIAL SYSTEM CHANGES

I. Background

OSC Staff (Staff) have been examining the regulatory requirements for recognized exchanges (Exchanges) and alternative trading systems (ATs) set out in National Instrument 21-101 *Marketplace Operation* (NI 21-101) and in National Instrument 23-101 *Trading Rules* (together, the Marketplace Rules). We have also been reviewing the practices set out around those requirements in various recognition orders, rule protocols and staff practices. The purpose of our review was to update and, where appropriate, to align the regulatory requirements and processes for review of new operations and changes to the operations of Exchanges and ATs.

As a first step, we issued OSC Staff Notice 21-703 – *Transparency of the Operations of Stock Exchanges and Alternative Trading Systems* (OSC Staff Notice 21-703), where we described Staff's process for reviewing the initial filings for Exchanges and ATs and changes to certain of their operations. In that notice, we also set out our expectation that Exchanges and ATs maintain an appropriate degree of transparency for certain aspects of their operations to ensure that investors and market participants are better informed as to how securities trade on these marketplaces. We described the types of information that marketplaces should publish in order to obtain feedback from other market participants regarding certain proposed changes to marketplace operations, and to increase transparency of marketplace features and operations. We also described the process for publication and Staff review.

Since the publication of OSC Staff Notice 21-703, the Marketplace Rules have been amended on several occasions, in part to harmonize, where appropriate, the application of the rules to Exchanges and ATs and to increase the transparency of marketplace operations. The processes for filing, publication, review and approval of changes in marketplace operations, previously documented in OSC Staff Notice 21-703, have been set out in the Marketplace Rules and in protocols for the review and approval of rules or changes to marketplace operations, which each marketplace must adhere to (the Marketplace Protocols). The Marketplace Protocols also establish requirements regarding the timing for the launch of new marketplaces and the implementation by existing marketplaces of material changes to their systems.

II. Purpose of this notice

The purpose of this notice is to set out Staff's process for the review of initial filings by entities applying for recognition by the Commission as an Exchange or for registration by the Commission as an ATs, together with Staff's expectations regarding the type of information that will be made public in connection with those applications. This notice also sets out Staff's views on the application of certain provisions of the Marketplace Protocols regarding the timing for the launch of new marketplaces and the implementation by existing marketplaces of material changes to their systems.

This notice incorporates and updates the content of OSC Staff Notice 21-703 and replaces that notice.

III. Review of initial operations

(a) Exchanges

An applicant that seeks to carry on business as an Exchange in Ontario must file an application for recognition under section 21 of the *Securities Act* (Ontario) (Application). The Application must include a description of the operations of the Exchange and how the Exchange would meet the provisions of NI 21-101 and certain recognition criteria such as governance, fees, access, regulation of products and participants, rulemaking, clearing and settlement, and systems and technology. The rules of the Exchange also form part of the Application and often describe the order types and structure of the Exchange. As part of the process, an applicant for recognition as an Exchange must also file Form 21-101F1 *Information Statement Exchange or Quotation and Trade Reporting System* (F1).¹ The F1 contains detailed information about many of the aspects described in the Application, and is confidential as it contains proprietary financial, commercial and technical information.

The Application, along with the Exchange's rules, policies and a draft recognition order are published in the OSC Bulletin and on the OSC website, typically for a 30-day comment period. Once all the issues raised during the comment process and Staff's own review of the application materials and the F1 are resolved, the Commission may exercise its discretion to recognize the Exchange.² If recognized, Staff will publish a notice indicating the approval of the Exchange recognition (Notice of Approval of Exchange Recognition) and the final recognition order.

¹ The F1 contains information about the Exchange that describes, among other things, the governance of the Exchange, the manner of operation of its trading system, the means of access to the market and the Exchange's listing criteria, fees and regulation.

² Some of the factors that would be considered by the Commission are described in Part 4 of 21-101CP.

(b) ATs

Pursuant to section 6.1 of NI 21-101, an ATS cannot carry on business in Ontario unless it registers as a dealer and is a member of a self-regulatory entity. Currently, the Investment Industry Regulatory Organization of Canada (IIROC) is the only applicable self-regulatory entity. An ATS must also file Form 21-101F2 *Information Statement Alternative Trading System (F2)* at least 45 days before it begins to carry on business.³ The information in the F2 is similar to that provided in an Exchange's F1 and is also confidential for the same reasons.

An ATS is also expected to file a notice providing summary information regarding its operations, similar to that in an Exchange's Application, but modified accordingly to reflect the fact that an ATS does not perform regulation functions (Notice of Initial Operations). The information to be included in the Notice of Initial Operations is set out in the next section.

The ATS's Notice of Initial Operations, together with a Staff notice, is published in the OSC Bulletin and on the OSC website, typically for a 30-day comment period. The review process by Staff is similar to the review process for an Exchange Application. Once all of the issues associated with the ATS's filing(s) are resolved, including any issues with the associated registration application, the registration as an investment dealer is issued and staff will publish a notice indicating that Staff's review is complete (Notice of Completion of Staff Review).

Where an existing registered investment dealer is proposing to operate an ATS, the same filing, publication and review processes apply.

IV. Information regarding initial operations

As noted above, when a marketplace plans to start operations and files the applicable documents, certain information is made publicly available to ensure transparency regarding the proposed operations of the marketplace and to give market participants an opportunity to provide feedback.

This information must be sufficiently detailed to allow marketplace participants to understand and assess the marketplace's proposed operations, given that the F1 or F2 is not published. As described in the previous section, in the case of an Exchange, this information would be contained in the Application and in the rules and policies that are published along with the Application. In the case of an ATS, the information would be contained in the Notice of Initial Operations. At a minimum, the Application or Notice of Initial Operations should include a description of:

- the structure of the marketplace, including how orders are entered, displayed (if applicable), executed, how they interact, and how they are cleared and settled;
- the marketplace's fees and fee model, if known;
- the services provided by the marketplace, including the hours of operation;
- the means of access to the market or facility and its services;
- the order types it offers;
- other information disseminated by the marketplace and the recipients of that information, such as indications of interest disseminated by a marketplace that operates without pre-trade transparency;
- the types of securities listed, quoted or traded on the marketplace, as applicable; and
- the types of marketplace participants.

If applicable, the materials published may include additional information, such as a description of the marketplace's policies and procedures to manage conflicts of interest, referral, outsourcing or custody arrangements, or any other information relevant to the entity's operations.

After the commencement of operations, a marketplace is required to maintain information regarding its operations on its website, in accordance with the disclosure requirements applicable to all marketplaces set out in section 10.1 *Disclosure by Marketplaces* of NI 21-101. Information regarding changes to a marketplace's operations, as reflected in changes to its F1 or F2, as applicable, may also be published for comment. The information to be filed for changes to a marketplace's F1 or F2 and the criteria and process for publication are set out in the Marketplace Protocols.

³ See subsection 3.1(2) of NI 21-101.

V. Start of operations and systems changes

Before a marketplace commences operations or makes any material system change (including introducing a new market or trading facility), it must make publicly available the technology requirements to interface with or access the marketplace or trading facility, and must make testing facilities available. Specifically, NI 21-101 requires that a marketplace make all technology requirements publicly available at least three months before it begins operations or before it implements a material change to its technology requirements.⁴ NI 21-101 also requires a marketplace to make testing facilities available at least two months before beginning operations or before implementing a material change to its technology requirements.⁵

In addition to these requirements, the Marketplace Protocols establish requirements regarding the timeframe for when a new marketplace may begin operations or an existing marketplace may implement material systems changes, following notification by the Commission that a new marketplace has been recognized or registered or that the material changes to an existing marketplace's systems have been approved. The Marketplace Protocols provide that a new marketplace must not begin operations until the later of three months after the marketplace is notified that it has been recognized or registered by the Commission or a reasonable period of time after the marketplace is notified that it has been recognized or registered by the Commission. The Marketplace Protocols further provide that where a marketplace proposes a change to any of the systems, operated by or on behalf of the marketplace, described in section 12.1 of NI 21-101, the change will not be effective until a reasonable period of time after the marketplace is notified by the Commission that the change is approved.⁶

In determining whether it is reasonable for a marketplace to begin operations later than three months following notification of recognition or registration, Staff will be guided by the impact of the change on marketplace participants and service vendors. This will include consideration of the amount of development effort reasonably required to be carried out by marketplace participants and service vendors to complete the systems work and testing required to connect to the new marketplace. What is reasonable in the circumstances may also depend on the need to accommodate previously announced regulatory or marketplace changes and the need to ensure that marketplace participants and service vendors do not have to prepare for multiple significant technology changes simultaneously.

For the implementation of material systems changes by existing marketplaces, Staff generally considers three months following notification that the Commission has approved the change to be a reasonable period of time. However, depending on the nature of the change, Staff may consider periods longer or shorter than three months following notification to be reasonable. As with the launch of a new marketplace, what is reasonable in the circumstances of a material systems change by an existing marketplace depends on the impact of the change on marketplace participants and service vendors, including factors such as the need to accommodate previously announced regulatory or marketplace changes and the need to ensure that marketplace participants and service vendors do not have to prepare for multiple significant technology changes simultaneously. Normally, the impact on marketplace participants will be greater for markets that display details of orders (and are subject to the Order Protection Rule) than for marketplaces that do not provide pre-trade transparency of orders.

VI. Questions

Questions may be referred to any of:

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⁴ Subsection 12.3(1) of NI 21-101.

⁵ Subsection 12.3(2) of NI 21-101.

⁶ Section 12.1 of NI 21-101 references each system, operated by or on behalf of the marketplace, that supports order entry, order routing, execution, trade reporting, trade comparison, data feeds, market surveillance and trade clearing.