

CSA Notice and Request for Comment
Proposed Amendments to the Companion Policy to National Instrument 23-101
Trading Rules: Application of the Order Protection Rule to Marketplaces Imposing
Systematic Order Processing Delays

June 12, 2015

Introduction

The Canadian Securities Administrators (the CSA or we) are publishing for comment proposed amendments to the Companion Policy to National Instrument 23-101 *Trading Rules* (NI 23-101).

The text of the Proposed Amendments is outlined in Annexes A and B of this notice and is also available on websites of CSA jurisdictions, including:

www.lautorite.qc.ca
www.albertasecurities.com
www.bcsc.bc.ca
www.gov.ns.ca/nssc
www.fcnb.ca
www.osc.gov.on.ca
www.fcaa.gov.sk.ca
www.msc.gov.mb.ca

We have worked closely with staff of the Investment Industry Regulatory Organization of Canada (IIROC) in developing the Proposed Amendments, and we thank them for their participation and for sharing their knowledge and expertise. IIROC will be re-publishing amendments to the Universal Market Integrity Rules (UMIR) to reflect and support the Proposed Amendments.

Background

This notice requests comments on proposed amendments (the Proposed Amendments) to the Companion Policy to National Instrument 23-101 *Trading Rules* (23-101 CP). The Proposed Amendments provide an interpretation related to the application of the Order Protection Rule (OPR) with respect to marketplaces that impose a systematic order processing delay on orders received by the marketplace (including a market or facility operated by the marketplace). These order processing delays are commonly referred to as “speed bumps”. If a marketplace operates more than one market or facility and imposes a processing delay on orders entered on some, but not all of them, the Proposed Amendments would only apply to the market or facility on which the delay is imposed.

The Proposed Amendments follow the CSA OPR proposal published on May 15, 2014¹ (the 2014 Proposal). In response to that notice, we received many comments on the market share threshold approach and heard a number of concerns about the potential impact of that approach.

¹ Published at: http://www.osc.gov.on.ca/en/SecuritiesLaw_csa_20140515_23-101_rfc-pro-amd.htm

These comments were useful in our analysis of order processing delays and the impact of locked and crossed markets in an environment where there are both marketplaces displaying protected orders, and marketplaces displaying unprotected orders. Further, the comments received have caused us to re-examine all possible options and our approach as it relates to market share thresholds and the other elements of the 2014 Proposal. However, it is our view that because of commercial developments and their potential impact on the market, it is critical to address the implementation of order processing delays and how they intersect with OPR. As a result, we are publishing the Proposed Amendments for comment for 60 days.

If the Proposed Amendments are adopted, we would also recommend implementing a necessary amendment to section 6.5 of NI 23-101 regarding locked and crossed markets that was published as part of the 2014 Proposal. This is discussed under “Locked and Crossed Markets” below.

We acknowledge that upon implementation of changes to the trading policies of Alpha Exchange², and prior to the finalization of the amendment to section 6.5 of NI 23-101 noted above, Alpha will be displaying orders which will, due to terms and conditions imposed by the Ontario Securities Commission (OSC), not be considered protected orders for purposes of OPR. As a result, the OSC will not consider orders entered on other marketplaces that lock or cross orders displayed on Alpha as “intentional”³.

Substance and purpose

The purpose of the Proposed Amendments is to address the introduction of order processing delays by marketplaces, and how such delays impact the application of OPR.

Summary of the Proposed Amendments

The amendments being proposed to 23-101 CP would introduce OPR-related guidance to Part 1.1 of the Companion Policy which would reflect our view that where a marketplace has implemented a systematic order processing delay, none of the orders on that marketplace are considered to be “protected orders”.

Annexes

- A. Background and description of the Proposed Amendments; and
- B. Companion Policy 23-101CP, blacklined to show the proposed changes to the current 23-101CP.

² Changes to the Trading Policies of Alpha Exchange Inc. were approved by the Ontario Securities Commission on April 16, 2015, subject to terms and conditions. Details can be found at: http://www.osc.gov.on.ca/en/Marketplaces_alpha-exchange_20150421_noa-proposed-changes.htm

³ Section 6.5 of NI 23-101 prohibits the intentional locking or crossing of a protected order.

Deadline for Comments

Please submit your comments to the Proposed Amendments, in writing, on or before August 17, 2015. If you are not sending your comments by email, please send a CD containing the submissions (in Microsoft Word format).

Where to Send Your Comments

Address your submission to all of the CSA as follows:

British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumer Affairs Authority (Saskatchewan)
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumer Services Commission (New Brunswick)
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Yukon
Superintendent of Securities, Nunavut

Deliver your comments **only** to the addresses below. Your comments will be distributed to the other participating CSA jurisdictions.

The Secretary
Ontario Securities Commission
20 Queen Street West
22nd Floor
Toronto, Ontario M5H 3S8
Fax: 416-593-2318
comments@osc.gov.on.ca

M^e Anne-Marie Beaudoin
Corporate Secretary
Autorité des marchés financiers
800, square Victoria, 22e étage
C.P. 246, tour de la Bourse
Montréal, Québec H4Z 1G3
Fax : 514-864-6381
consultation-en-cours@lautorite.qc.ca

Comments Received will be Publicly Available

Please note that we cannot keep submissions confidential because securities legislation in certain provinces requires publication of a summary of the written comments received during the comment period. In this context, you should be aware that some information which is personal to you, such as your e-mail and address, may appear on certain CSA websites. It is important that you state on whose behalf you are making the submission.

All comments will be posted on the Ontario Securities Commission website at www.osc.gov.on.ca and on the Autorité des marchés financiers website at www.lautorite.qc.ca.

Questions

Please refer your questions to any of the following:

Tracey Stern Manager, Market Regulation Ontario Securities Commission 416-593-8167	Kent Bailey Trading Specialist, Market Regulation Ontario Securities Commission 416-595-8908
Timothy Baikie Senior Legal Counsel, Market Regulation Ontario Securities Commission 416-593-8136	Serge Boisvert Senior Policy Advisor Direction des bourses et des OAR Autorité des marchés financiers 514-395-0337 ext. 4358
Roland Geiling Derivatives Product Analyst Direction des bourses et des OAR Autorité des marchés financiers 514-395-0337 ext. 4323	Michael Brady Senior Legal Counsel British Columbia Securities Commission 604-899-6561
Lynn Tsutsumi Director, Market Regulation Alberta Securities Commission 403-297-4281	

ANNEX A

BACKGROUND AND DESCRIPTION OF THE PROPOSED AMENDMENTS

I. BACKGROUND

(a) *OPR*

National Instrument 23-101 *Trading Rules* (NI 23-101) contains OPR, which is a requirement designed to ensure that all immediately accessible, visible, better-priced limit orders are executed before inferior-priced limit orders and are not traded through. It is an obligation owed to the market as a whole and it cannot be waived. OPR is intended to foster the integrity of the market and to instill confidence on the part of all types of investors so that they contribute to price discovery through the entry of visible limit orders.

OPR was finalized in November 2009 and implemented in February 2011. Prior to implementation, existing trade-through requirements were an obligation of dealers, however OPR moved the onus for trade-through compliance from dealers to marketplaces. However, it also gave marketplace participants the option to assume the obligations under the rule and most marketplace participants choose to do so through the use of a directed-action order (DAO).

Where a marketplace participant chooses to assume the OPR obligations through the use of a DAO, the marketplace participant must establish, maintain and ensure compliance with written policies and procedures that are reasonably designed to prevent trade-throughs, subject to certain exceptions⁴.

(b) *Immediately executable orders*

In examining the principles underpinning the rule, we note that OPR is intended to apply where a marketplace offers immediate and automatic execution against displayed volume. The definition of “trade-through” refers to orders on a marketplace that provides automated functionality, which is defined in the rule as providing the ability to “immediately” execute orders against displayed volume. Historically, the term “immediately” has not been defined, and we continue to believe this is appropriate given the speed at which technology continues to evolve. However, we note that as it relates to the application of OPR, it is our expectation that execution against displayed orders would be immediate, subject to natural market or network latencies such as those that occur due to differences in technology or geographical location of marketplace systems.

(c) *The introduction of “speed bumps”*

Recently, marketplaces have proposed and are introducing functionality that delays the entry of orders into the trading engine and as a result would, for a period of time, prevent the execution of orders submitted to execute against displayed volume. While order execution is delayed by these “speed bumps”, liquidity-providing orders may ultimately be filled, changed or cancelled. This raises the question of whether a marketplace imposing an order processing delay is providing

⁴ For example, exceptions exist for flickering quotes, marketplace systems issues and calculated price orders.

automated functionality, and if not, whether OPR protection should apply to displayed orders on that marketplace. We also question whether for purposes of compliance with OPR, it is reasonable to expect market participants to route to execute against a best-priced order displayed on a marketplace where, due to latency that is intentionally introduced (and regardless of the amount of latency), liquidity may no longer exist. A number of similar comments were received during the public comment process related to the marketplace proposals noted above.

In our view, where there are order processing delays systematically built into the functionality of a marketplace, it is not reasonable to require marketplace participants to route orders to that marketplace for OPR compliance. The impact of the “speed bump” and the possible delay in execution could negatively impact execution quality and fill rates if liquidity providing orders disappear while the order routed to execute with displayed volume is delayed by the operation of the “speed bump”. We believe it should be the choice of a dealer and /or their client to determine whether to route orders to such marketplaces. This approach is consistent with the policy underpinnings of the OPR framework and is not an endorsement or criticism of low latency trading or systematic order processing delays.

There may be certain situations where, based on the type of order or class of market participant sending the order, only some of the orders routed to a marketplace are subject to an order processing delay. In these circumstances, some orders might be able to immediately execute against displayed volume, while others would not. In this circumstance, where a marketplace applies different treatment to liquidity-removing orders (deliberately adding latency to only some orders), applying different OPR protection would add significant complexity and execution uncertainty. We do not believe it is appropriate to introduce uncertainty into the concept of "protected order" and as a result it is our view that once a marketplace has introduced an order processing delay, it is no longer providing the functionality contemplated by OPR.

We note that going forward, there may be further models proposed by marketplaces which would introduce different or novel functionality that may not ultimately result in the “immediate” execution of an order against displayed volume. We will consider the application of OPR in the context of the definition of automated functionality for any such proposals.

II. DESCRIPTION OF THE PROPOSED AMENDMENTS

(a) OPR Proposed Amendments

As noted above, OPR was specifically designed to protect displayed orders that are immediately executable. In our view, if there is not a reasonable expectation of an immediate execution against displayed orders, then it follows that OPR should not apply to those orders.

As a result, we are proposing the following OPR-related guidance to be added to Part 1.1 of the 23-101CP, as section 1.1.2.1.

"With respect to the application of sections 6.1 and 6.4, it is our view that where a marketplace has implemented an intentional systematic delay in order processing, whether for all orders or certain orders only, that results in the inability of an order

entered on that marketplace to immediately execute against displayed volume, that marketplace does not provide “automated functionality” as defined in the Instrument. As a result, none of the orders on that marketplace are considered to be “protected orders”.

If a marketplace operates more than one market or facility and it implements an intentional systematic delay in order processing on one or more of them, only the market or facility with an order processing delay is considered not to provide automated functionality.

For greater certainty, an order processing delay that is imposed solely to comply with securities legislation is not considered a “systematic” delay.

Question 1: What are your views on whether OPR should apply to marketplaces that impose an order processing delay? If OPR should apply to marketplaces that impose an order processing delay, should it apply to some or all of them? What factors should be considered in determining whether OPR should apply to marketplaces that impose an order processing delay?

Question 2: In an environment where not all displayed orders on visible marketplaces are protected under OPR because marketplaces impose an order processing delay, what are your views with respect to the outcomes for protected and unprotected visible marketplaces and for trading on those marketplaces?⁵ In responding, please consider the impacts on:

- (a) various market participants including retail and institutional investors, and liquidity providers;**
- (b) liquidity on both protected and unprotected visible marketplaces;**
- (c) price discovery;**
- (d) complexities and changes you anticipate from participating in both protected and unprotected visible marketplaces, including costs and effort; and**
- (e) the provision and use of consolidated data.**

Question 3: A key objective of OPR is to recognize and support the role of retail participation in the market. If the Proposed Amendments are finalized, what changes if any, do you expect will be required for dealers handling retail order flow? What changes if any, do you expect in terms of outcomes for retail clients?

(b) Implications of the Proposed Amendments

The result of this interpretation is that there will be some marketplaces that display orders that would not be protected from trade-through under OPR. This result raises complexities similar to

⁵ For purposes of this Notice, a “protected” marketplace is considered to be a marketplace which displays protected orders as defined in OPR, while an “unprotected” marketplace is one which does not display protected orders.

those articulated both in the 2014 Proposal, as well as the comments received in response to that proposal. The specific complexities include:

- Implications for “best bid price” and “best ask price” under the Universal Market Integrity Rules (UMIR)
- Implications related to locked and crossed markets⁶
- Best execution obligations and disclosure
- Implications related to consolidated data

(i) *Best Bid Price and Best Ask Price*

On May 15, 2014, IIROC published for comment proposed amendments to UMIR⁷ that would align UMIR with the CSA 2014 Proposal. Among other aspects, the proposed amendments would amend the definitions of “best bid price” and “best ask price” to reference orders displayed on a “protected marketplace”⁸. IIROC is re-proposing these amendments to ensure consistency with the approach taken by the CSA and provide flexibility going forward.

(ii) *Locked and Crossed Markets*

Given that there will be some marketplaces displaying orders which would be unprotected and could be traded-through, it is also necessary to consider the implications related to provisions which prohibit the intentional locking or crossing of markets. As indicated in the 2014 Proposal, we continue to be of the view that the provisions preventing intentional locks and crosses of markets are appropriate to foster investor confidence and market efficiency. However, without changing the locked and crossed markets provisions, marketplace participants would be forced to access marketplaces that introduce order processing delays, solely to prevent locked and crossed markets, despite not being required to for OPR purposes.

Consequently, if the Proposed Amendments are adopted, we intend to also recommend the implementation of the amendment to section 6.5 of NI 23-101 contained in the 2014 Proposal, which would limit the prohibition on intentionally locking and crossing markets to protected orders. For reference, we proposed⁹ that the section read:

- 6.5 Locked or Crossed Orders** - A marketplace participant or a marketplace that routes or reprices orders must not intentionally enter a displayed order on a marketplace that is subject to section 7.1 of NI 21-101, at a price that
- (a) in the case of an order to purchase, is the same as or higher than the best protected offer; or
 - (b) in the case of an order to sell, is the same as or lower than the best protected bid.

⁶ Section 6.5 of NI 23-101 prohibits the intentional entry of an order which would either lock or cross a protected order.

⁷ Published at: http://www.iiroc.ca/Documents/2014/3f942064-7077-4e57-963b-41ec79373cd0_en.pdf

⁸ As defined in NI 23-101

⁹ See the amending instrument that was published as part of the 2014 Proposal.

This change would not preclude marketplace participants from entering orders on marketplaces displaying protected orders that would lock or cross unprotected orders displayed on other marketplaces. Although this would result in an increase in the instances of locked and crossed markets, we think that the outcome represents a reasonable balance between important policy objectives of the prohibition and the goal of addressing issues associated with order processing delays imposed by marketplaces.

(iii) Best Execution and Markets with Order Processing Delays

In the context of best execution relating to orders on marketplaces imposing order processing delays, dealers should consider information from all appropriate marketplaces in developing their policies and procedures (including marketplaces with order processing delays). In accordance with existing best execution requirements, dealers should consider whether to access visible marketplaces that impose an order processing delay, and evaluate whether taking steps to access such marketplaces is appropriate. We would expect that the policies and procedures of marketplace participants will describe how decisions are made regarding whether to route to, or avoid such marketplaces, and these decisions should be regularly and vigorously reviewed. No specific changes to the rules or policies are being proposed in relation to this issue at this time.

(iv) The Information Processor and Consolidated Data

We recognize that the Proposed Amendments would result in certain marketplaces displaying orders which are not protected. This would require a change in the information that is disseminated by the information processor. We will work with the information processor to ensure that, if the Proposed Amendments are adopted, the information processor would produce replicated feeds for the Canadian Best Bid and Best Offer (CBBO), Consolidated Depth of Book (CDB) and Consolidated Last Sale (CLS) products. One feed would consolidate all of the marketplaces displaying protected orders and one would consolidate the information from all marketplaces that display orders, including those that impose order processing delays. Marketplace participants could choose to use either but would be expected to document that choice for any compliance requests or regulatory requirements.

Question 4: Are there implications that have not been addressed above that should be considered? How do you suggest they be addressed?

ANNEX B

This Annex shows, by way of blackline, changes to Companion Policy 23-101 *CP Trading Rules*, that are being published for comment.

Companion Policy 23-101 CP to National Instrument 23-101 Trading Rules

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**Companion Policy 23-101 CP
to National Instrument 23-101
Trading Rules**

PART 1.1 DEFINITIONS

1.1.2.1 Application to marketplaces implementing intentional systematic order processing delays - With respect to the application of sections 6.1 and 6.4, it is our view that where a marketplace has implemented an intentional systematic delay in order processing, whether for all orders or certain orders only, that results in the inability of an order entered on that marketplace to immediately execute against displayed volume, that marketplace does not provide “automated functionality” as defined in the Instrument. As a result, none of the orders on that marketplace are considered to be “protected orders”.

If a marketplace operates more than one market or facility and it implements an intentional systematic delay in order processing one or more of them, only the market or facility with a processing delay is considered not to provide automated functionality.

For greater certainty, an order processing delay that is imposed solely to comply with securities legislation is not considered a “systematic” delay.