

1.1.5 Revisions to OSC Staff Notice 21-703 – Transparency of the Operations of Stock Exchanges and Alternative Trading Systems

**REVISIONS TO OSC STAFF NOTICE 21-703 –
TRANSPARENCY OF THE OPERATIONS OF
STOCK EXCHANGES AND ALTERNATIVE TRADING SYSTEMS**

OSC Staff Notice 21-703 (Notice) published on October 9, 2009 outlines a process whereby both stock exchanges recognized by the Ontario Securities Commission (Commission) and alternative trading systems (ATSs) submit proposed changes to certain operations for review by Commission staff and for public comment.

The Notice has been revised to apply to the process and filing of certain aspects relating to the initial operations of an ATS seeking to carry on business in Ontario.

OSC Staff Notice 21-703 – Transparency of the Operations of Stock Exchanges and Alternative Trading Systems (Revised – Previously published October 9, 2009)

I. Introduction

Staff of the Ontario Securities Commission (Staff) have been examining the regulatory requirements for stock exchanges recognized by the Commission (Exchanges) and alternative trading systems (ATSs) set out in National Instrument 21-101 *Marketplace Operation* (NI 21-101) and National Instrument 23-101 *Trading Rules* (together, the Marketplace Rules) and the practices set out around those requirements in various recognition orders, rule protocols and staff practices. The purpose of this examination is to consider ways to align the processes for Exchanges and ATSs where appropriate. This notice applies to both equity and debt marketplaces.

The first phase of this review has been focused on initiatives that can be taken in the short-term and on the transparency of filings by Exchanges and ATSs in areas where their operations are similar (including new order types and other issues regarding trading). The next phase will be a review of the requirements set out in NI 21-101 and its Forms to ensure that the Marketplace Rules are able to provide for flexibility in a competitive environment while providing regulators with the information they need to meet their mandate.

This notice sets out Staff's process for reviewing the initial filings for Exchanges and ATSs and changes to certain of the operations of Exchanges and ATSs, after they have started operating. The objective of this process is to foster fair and efficient capital markets. To do so, we expect an appropriate degree of transparency for certain aspects of the operations of Exchanges and ATSs, so that investors and market participants may be better informed as to how securities trade on these marketplaces. At the same time, this process seeks to treat similar information and changes to the operations of Exchanges and ATSs in a similar fashion.

II. Characteristics of Exchanges and ATSs

A fundamental characteristic of stock and derivatives exchanges globally, even those that are structured as for-profit entities, is their regulation function. This is also the case in Canada. Under NI 21-101, only an exchange or quotation and trade reporting system can set requirements (i.e. rules) governing the conduct of marketplace participants and discipline marketplace participants. Even where an Exchange has outsourced this function, the ultimate responsibility for the regulation of the trading on the Exchange remains with the Exchange. Unlike Exchanges, ATSs are not permitted to have a regulatory function or set rules or requirements. They are required to retain a regulation services provider that sets rules to regulate trading on their marketplace.

Despite this, ATSs have trading activities that are similar to Exchanges. We recognize that in the competitive landscape of the Canadian capital markets, it is important to align processes for initial filings and ongoing changes in those areas where the marketplaces compete.

III. Review of Initial Operations

(a) Exchanges

An Exchange that seeks to carry on business in Ontario must apply for recognition under section 21 of the *Securities Act* (Ontario) (Act) (Application). An Application includes a description of the operations of the Exchange and how the Exchange meets criteria that deal with a number of significant operational areas, for example, fees, access, regulation of the 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 market design. As part of the process, an applicant for recognition as an Exchange also files Form 21-101F1 (F1)¹. The F1 contains detailed information about many of the aspects described in the Application. However, because the F1 contains intimate financial, commercial and technical information, the F1 is kept confidential.²

The Application along with the Exchange's rules, policies and a draft recognition order are published for a 30 day comment period in the OSC bulletin and on the OSC website. Once all issues raised during the comment process are resolved, the Commission may, in its discretion, recognize the Exchange.

¹ The F1 includes information about the Exchange that describes, among other things, the governance of the Exchange, the manner of operation of its trading system, including a detailed description of the market, procedures governing entry of orders, the means of access and the Exchange's listing criteria, fees, and regulation.

² See subsection 6.1(2) of Companion Policy 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 organization. An ATS must file Form 21-101F2 (F2)³ at least 30 days before an ATS begins to carry on business.⁴ The information in the F2 is similar to that provided in an Exchange's F1 and in the Application and is also kept confidential.

Unlike the process for dealing with an Application filed by an Exchange, information about ATS operations is not published for comment. Staff review the F2 and, in coordination with the registration of the ATS as an investment dealer, seek to resolve any regulatory issues that arise in connection with the information contained in the F2. Depending on the issues that arise, this process may take longer than 30 days.

IV. Review of Changes to Operations

(a) Exchanges

In addition to being subject to the Marketplace Rules, Exchanges are subject to the terms and conditions of their recognition order. Some of the terms and conditions relate to the types of rules that an Exchange must have and the requirement that it comply with its rule protocol. Section 5.5 of NI 21-101 requires an Exchange to file with the Commission all rules, policies, and other similar instruments, and any amendments to these instruments, while the rule protocol sets out the process for making and changing rules.⁵ As previously noted, the rules of Exchanges are publicly available on their websites.

Under their rule protocols, Exchanges must file all proposed rule changes with the Commission and categorize them as either (i): "public interest", or as (ii): "non-public interest" or "housekeeping". Public interest rule changes are published in the OSC Bulletin for a 30-day comment period and are reviewed by Staff prior to being submitted for Commission approval. In contrast, non-public interest or housekeeping rule changes are effective on filing with the Commission and are not published for comment.

In addition to the rule protocol, Exchanges are subject to subsection 3.2(1) of NI 21-101, which requires an Exchange to file an amendment to its F1 at least 45 days before implementing a significant change. Other changes are required to be filed quarterly. Subsection 6.1(3) of Companion Policy 21-101CP provides guidance about what the securities regulatory authorities consider to be a "significant change". Currently, the policy states that a significant change includes a change to the information contained in certain exhibits to the F1.⁶ Changes to an F1 are not published for comment unless they are contained in an Exchange rule that is subject to the public comment process described above.

(b) ATs

As stated above, the operational details of an ATS are outlined in its F2 and the process governing changes to the information in the F2 is set out in subsection 6.4(2) of NI 21-101. If making a significant change to the information in the F2, an ATS must file an amendment to the F2 at least 45 days before implementing the significant change. As with Exchanges, subsection 6.1(6) of Companion Policy 21-101CP provides that a significant change includes a change to the information in certain exhibits to the F2.⁷

Staff review all changes filed and, depending on the issues that arise due to the change, this review may take longer than 45 days. However, unlike public interest rule changes for Exchanges, there is no requirement for the publication for comment of significant changes to ATS operations and no requirement for Commission approval of such changes. We note, however, that the current practice is that an ATS will not implement a change until Staff have indicated that they have no further comments and that all issues raised have been addressed.

³ The F2 includes information about the ATS that describes, among other things, the classes of subscribers, the types of securities traded, a detailed description of the market structure of the ATS, and the manner of operations of the ATS, including procedures governing entry of orders, the means of access, fees charged by the ATS, and procedures governing executing, reporting, and clearing transactions.

⁴ See section 6.4 of NI 21-101.

⁵ Changes to the rules of the Toronto Stock Exchange (TSX) are governed by the Protocol for Commission Oversight of Toronto Stock Exchange Rule Proposals. Changes to the rules of the Canadian National Stock Exchange (CNSX) are governed by the Rule Review Process at Appendix B to the Commission order recognizing CNSX as an exchange.

⁶ The Companion Policy to NI 21-101 provides that a significant change includes a change to the information contained in Exhibits A, B, G, I, J, K, M, N, P and Q of Form 21-101F1.

⁷ The Companion Policy to NI 21-101 provides that a significant change includes a change to the information contained in Exhibits A, B, C, F, G, I, and J of Form 21-101F2.

V. Notice and Filing Process for Initial Operations and Changes to Operations

Staff's view is that an appropriate degree of transparency for certain aspects of the operations of Exchanges and ATSS contributes to the fairness and efficiency of capital markets. While the fact that Exchanges have regulatory responsibilities that ATSS do not have justifies some differences in regulatory treatment and oversight, Staff also believe that Exchanges and ATSS should be subject to a similar degree of transparency when proposing to carry on business and when making changes to their operations.

With this Notice, we are implementing a process applicable to all marketplaces that would make public summary information about initial operations and proposed changes to their operations. The process provided for in this Notice does not change the current process by which marketplaces file changes to their F1 and F2 filings. It does, however, provide for a new process by which certain information initially filed and subsequent changes would be transparent. We also note that we expect both Exchanges and ATSS to publicly display on their websites a detailed description of how their market or facility operates and the order types available and order features or characteristics. Pursuant to section 12.3 of NI 21-101, all marketplaces are also currently required to make publically available all technology requirements regarding interfacing with and accessing the marketplace.

(a) Initial Operations

As noted above, when proposing to carry on business as an ATS in Ontario, an ATS is required to file an F2 at least 30 days before the planned implementation date. Accompanying the F2 filing, we expect the ATS to also file a notice containing the information that describes the operations of the ATS including:

- access requirements;
- a description of the securities to be traded;
- the order types to be offered or features/characteristics of orders;
- how orders are entered, displayed (if applicable), executed and how they interact; and
- the special facilities or sessions of the marketplace (for example, pre-opening and market-on-close facilities)

The ATS' notice would be accompanied by a notice published by Staff that would provide market participants with an opportunity to provide feedback within 30 days.

The review process by Staff continues to be similar to the review process for an Exchange Application. Once all issues are resolved, the registration as an investment dealer would be issued. Where an existing investment dealer is proposing to operate an ATS, Staff would perform a full review of the F2.

Exchanges seeking to carry on business in Ontario would continue to be subject to the current Application process requiring public comment.

(b) Changes to Operations

The publication process described below would not apply to all changes filed by marketplaces. We expect that this process would apply to:

- order types (i.e. new or existing order types) or features/characteristics of orders;
- procedures governing how orders are entered, displayed (if applicable), executed and how they interact; and
- changes to the procedures relating to special facilities or sessions of the marketplace (for example, pre-opening and market-on-close facilities)

OSC staff may request that other changes be published if they raise regulatory concerns.

In the case of ATSS, these matters would generally be filed as amendments to Exhibits C and G, paragraphs 1, 2, and 5 to the F2. In the case of Exchanges, these matters are set out in Exhibit G, paragraphs 1, 3 and 4 to the F1. If the change requires a rule amendment, then the publication of the proposed rule change would suffice and no additional marketplace notice would be necessary.

If a marketplace is unsure as to whether a notice should go out, we expect the marketplace to contact OSC staff to request clarification.

On proposing a change to the Exhibits described above and at least 45 days prior to implementation, we expect Exchanges and ATSS to file the proposed change (a clean and blacklined version) with the Commission and publish a notice of the proposed change in the OSC Bulletin. The marketplace's notice should describe the proposed change, the rationale for the change, the expected impact of the change, any consultations the marketplace undertook in formulating the change, discussion of any alternatives considered by the marketplace and, if applicable, whether the proposed change currently exists in the market.

The marketplace's notice would be accompanied by a notice published by Staff that would:

- provide market participants with an opportunity to provide feedback within 30 days of the date of publication of the notice; and
- indicate that if the proposal does not raise any regulatory concerns, the proposed change would be implemented within 45 days from the date of publication of the notice.

Staff would review and evaluate the proposed change for the purpose of identifying any regulatory concerns with the proposal. Staff may also request any additional information from the marketplace to facilitate its review. Following this review, and in the absence of any regulatory concerns identified by Staff, the proposed change would take effect 45 days after the date of publication. The marketplace would then send out a notice confirming the original implementation date.

If regulatory concerns are identified, implementation of the proposed change may be delayed. Staff would discuss the concerns with the marketplace and attempt to resolve them. We would then issue a further notice identifying the concerns, the marketplace's response, and Staff's position. If the issues are resolved, the notice would also provide the implementation date. In the event that Staff's concerns and discussions with the marketplace result in material amendments to the proposed change, the publication of a second notice by the marketplace may be necessary.

There is presently no requirement that ATSS obtain approval by the Commission for changes to their operations but, under the rule review protocols, Exchange rule changes need to be approved. Rule amendments relating to the changes identified in this notice will be presented to the Commission for approval within 45 days if no comments are received or objections raised. If the change relates only to an F1 change and there is no accompanying rule change, no Commission approval is required.

Staff expect that proposed rule changes that affect an Exchange's regulatory responsibilities, such as changes to listing requirements, would continue to be subject to the current process requiring public comment and Commission approval. Similarly, non-public interest or housekeeping changes to Exchange rules would continue to be effective on filing.

VI. Conclusion

Staff are of the view that, from an operational and trading perspective, proposals filed by Exchanges and ATSS should be subject to an appropriate degree of transparency so that investors and market participants may be adequately informed of the nature and effect of such proposals. We believe that this process will achieve this goal while at the same time aligning the process by which Exchanges and ATSS begin operating in Ontario and subsequently make changes to certain of their operations.

VII. Questions

Questions may be referred to any of:

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